Pandora A/S

Transcript: Interim Report for the first quarter of 2019

Date & time: 07 May 2019 at 11.00

Operator

Welcome to the Pandora Interim Report for the first quarter of 2019. For the first part of this call, all participants will be in listen-only mode and afterwards, there will be a question and answer session.

Today, I am pleased to present Vice President of Investor Relation, Michael Bjergby. Speakers, please begin.

0.00.21

Michael Bjergby

Yes, good morning everyone and welcome to the conference call for Pandora's Q1 2019 results. My name is Michael Bjergby from the Investor Relations team and with me here today at the Pandora head office in Copenhagen, I have our very new Alexander Lacik, new CEO Alexander Lacik, sorry, I have our CFO, Anders Boyer as well as my IR colleagues Brian and Christian. We will have a Q&A session at the end of the presentation. Please limit your questions only two at a time and get back into the queue if you have additional questions.

First of all, please pay attention to the disclaimer on slide 2 where we have also outlined the agenda of the call. Anders will obviously be the main presenter today considering that it is actually Alexander's 11th working day into the job. Now Alexander, we are looking forward to having you here. A warm welcome to you and please go ahead and introduce yourself to start with.

0.01.15

Alexander Lacik

Thank you Michael and good morning to everybody on the call. This is an important time, not just for myself but even more so for Pandora. I have spent most of my professional career in large complex and successful multinational companies. There are at least two things they have in common. First, they are consumer-centric so their journey starts from the outside and in. Secondly, they deliver on the consumer insights through brands. My experience has been that these two factors paired with an obsession for excellence and execution is what sets companies apart. I am confident that my experiences will be instrumental in helping Pandora. The company has some solid foundations on which we will build the future. We have a world class supply chain. Charms are a strong product concept and consumers also give us a clear licence to expand into adjacent jewellery segments. Finally, we have a deep-reaching distribution network that gives consumers all around the world physical as well as virtual access to Pandora. While there is a strong foundation in place, let me be the first to recognise that the company faces some serious challenges. Importantly, the characteristics of these challenges also offer great potential. Pandora is a clear turn-around case, a situation which I have faced previously and feel very excited to deal with.

On a more personal note, I am married and have four children in the ages of 10 to 21. I grew up in Sweden but as you can see from my bio, I have spent most of my professional career on the international circuit. Now, my family and I have moved back to Sweden and we refer to Stockholm as home.

Moving on to page 4, let me just give you a few observations from my first 10 or 11 days depending on how you count with the company. As you can imagine, I have been on the sidelines for a while, which has given me the opportunity to familiarise myself with the company. I step into a situation where a transformation agenda has been formulated and is wrapped under the programme named NOW.

The analysis, in my opinion, is honest and thorough with some clear work streams attached to it, ranging from demand generation, winning in China, digital capability enhancements as well as a strong cost squeeze. I fully support the transformation effort. The programme is in full swing and I am looking forward to drive this hard to ensure we structurally change the trajectory of Pandora.

Based on my experience, this transformation will not happen overnight so we need to stay patient as we deliver on the various aspects of the programme. I think I will leave it with these thoughts for now. In the coming days, I am looking forward to meet some of you and I am eager to understand your perspectives of Pandora. I will now hand over to Anders, our CFO, to take you through Q1 and the progress on Programme NOW. Please, the stage is yours.

0.03.59

Anders Boyer

Thank you Alexander and let us move to slide no. 5 and on slide 5, we have a quick summary of the development in the first quarter and in fact, it can be said in three key short messages. First of all, the first quarter was weak and it was partly weak due to our deliberate commercial re-set which has a temporary negative impact on the top line and the bottom line. But having said that, the main reason that Q1 was weak continues to be decreasing traffic in our physical stores. The weak performance was not a surprise for us and we had anticipated that when we made the guidance and so, therefore the financial guidance for the year remains unchanged.

Secondly, we are still of the opinion that Programme NOW will turn around our like-for-like performance but it is a two-year journey and we will not have any material revenue effect from NOW before late 2019.

Last, I would like to say that we continue to take prompt and tough actions as we are progressing on Programme NOW and today, we are announcing closing of an additional 50 concept stores and further significant reduction of staff in Thailand on the back of an increase in productivity.

Please turn to slide 6 for an overview of the financial performance in the first quarter and I will just touch upon a few of the points here. When we made the guidance, we said that like-for-like during 2019 would be worse before it gets better and it did get worse with like-for-like of minus 10 in the first quarter. However, like-for-like is also impacted by our deliberate decision to reduce promotions. Organic revenue growth was well below the full-year guidance, also as expected, and the reduction of inventories and sell-in packs impacted organic growth negatively in the quarter. And we expect organic growth in Q1 to be the lowest in 2019 as especially the negative revenue impact from the reduced sell-in packs and the inventory changes will be less of a drag in the quarters to come. The cost reduction programme progressed well both on cost of goods sold and on OPEX and on the cost of goods sold, the progress is visible with the highest gross margin in fact in the history of Pandora in the first quarter of 2019.

And cash flow also continues to be quite strong, enabling us to pay out around 15-16% of our market cap to investors in 2019.

We move to slide 7. Before we go into the details of the Programme NOW, I think it deserves or needs to be highlighted again how large a transformation Programme NOW is across the business on culture, on how we operate the business on the organisation and Programme NOW is not a quick fix, but it is a two-year transformational journey.

Then please move on to slide 8 where you can see the sort of four main work streams or steps of Programme NOW. In general, Programme NOW is progressing well and this is, these four work streams is what we communicated back in February when we made the full-year announcements and on top of these four work streams, we also had the network strategy where we are taking another large step today and we will get back to that in just a second. So in general, on Programme NOW I can say that the commercial reset has been initiated. Commercial pilots are showing early and promising results. The cost reduction is progressing as planned and finally, we are laying the foundation for working as a truly global and professional company.

Then please turn on to the next slide, no. 9, in order to dig a bit more into the details on the network strategy. As you probably recall, we took the first step on the network strategy back in November last year where we significantly reduced the number of concept store openings and we practically stopped buying back distributors and franchise stores for now.

Since then, we have been investigating and analysing the store network from a brand, revenue and profitability point of view and generally, we have a very strong and very profitable network but as like-for-like was negative in 2018 and we also expected to be down to negative high single digit this year, the profitability of some of the stores is not surprisingly coming under pressure. It is not many but it is still some so in 2018, less than 20% of our stores were directly loss-making while most stores are on a store by store basis actually margin accretive to the group and that is a very remarkable and very strong starting point. Sorry less than 20 of our stores. Thank you Michael, that is very different. It is, let's say, 1.5% of our stores. Thank you for that correction. That is important not to get that wrong.

But we want to de-risk the financial profile of the company and we want to protect our margins and with that starting point, we have decided to close three buckets of stores and these closures are over and above what was included already in the guidance back in February so first of all, we want to close the few loss-making stores we have and that is a given. That is a no-brainer, I am almost tempted to say, but secondly, we will also be closing stores with a margin diluting and where we don't see a near-term prospect to improve the margins. And lastly, we will close stores in catchment areas with more than one store and where there are reasonable expectations to regain enough revenue in other stores or online for that matter.

But we are still developing and refining our catchment area framework and methodology but there are, not surprising, a significant number of store with overlapping catchment areas and given the high gross margin that we have, you do not need to recapture a lot of revenue for it to be EBIT accretive when you close a store and as an example, if you have a 20% EBIT margin owner-operated store, it only requires that we recapture around 25% of the lost revenue for it to be neutral on absolute EBIT and that is something that we need to look further into in the future. So we have identified around 50 concept stores to be closed when the rental agreements with the landlords run out. Or earlier if that proves to be a better business case. The financial implications for this year, 2019, will be limited but going into 2020, the closings will have a slightly accreting impact on the EBIT margin.

So then let us move on to page 10. In the Annual Report for 2018, we said that we would reduce the non-value adding discount periods while still maintaining the promotions during the key gifting events. And this is exactly what we have done in the first quarter. In the first quarter, we reduced the number of promotional days by 30% on average across the bigger markets. The largest impact on revenue in Q1 is seen in the eSTORE where we are now only using the online sales tab periodically or with fewer products or with a lower average discount. So all in all, we are tracking in line with the plan on the commercial reset on reducing promotions and we still expect the one-off impact on sales and like-for-like to the tune of 2-4% in 2019.

Then please move on to slide 11. Back in February, we highlighted five key areas that we believe will help Pandora get back to positive like-for-like and reignite a passion for Pandora and that is the five areas that you can see on this slide. And the sum of the parts of this slide is what we are calling a brand re-launch and these five areas are still the central building blocks and we are making great progress across all of them ahead of our brand re-launch later in 2019.

Today, I will just elaborate on a few of them and share some of the pilots and activities that we have done and are planning to do. So please move on to slide 12. We believe that Pandora has been underinvesting in marketing and actually quite significantly so. And as you know, that was part of the diagnosis ahead of Programme NOW. Our modelling and external benchmarking shows that there is a good return for every additional krone or dollar that we spend on marketing and that is a good return both in terms of like-for-like growth and in terms of absolute EBIT and in terms of EBIT margin.

And there is also an important data point in our internal benchmarking supporting the marketing model and that is in the US. The US has been performing relatively better than the rest of Pandora for some time and the same goes for the performance here in the first quarter of 2019. And in the US, we also spend more on marketing than in the rest of Pandora and that is both in per cent of revenue and in absolute terms.

So therefore, we have decided to initiate a number of new marketing pilots and the ambition is to confirm that by investing in marketing, we will be able to change or improve the momentum and drive profitable growth. And as part of these pilots, we are investing between 50 and 100 million kroner in Q2 and then again in the third quarter in three selected markets being the UK, Italy and China.

During the first quarter, we also initiated a collaboration with the Columbian singer Shakira, and we made a couple of influencer – several influencer collaborations in Canada and Brazil and in early Q2, sorry, in April, we launched a dedicated China collection, the one that we call the Peach Blossom and that is the first time that Pandora is launching a collection specifically for one country. It is early results, but we are excited by the early results that we see and the test and the lease initiatives and we also plan to spend more on digital and celebrity collaborations going forward.

Then please move on to the next slide, 13. We are doubling our spending and investments in our online presence in 2019. So we are taking a significant part of the cost reductions that we are doing as part of Programme NOW and reinvesting that online. Initially, we continue to improve the product landing pages with more inspirational storytelling but there will be more material changes during the year including a brand new eSTORE which has been developed and tested with roll-out in the third quarter. And we have already initiated some new omni-channel features in the US and we strive to soon finalise the business model with our partners in the US.

And then please turn to slide 14 where we have an update on the cost reduction initiative. As you know, the cost reduction opportunities are quite big and we target a run rate saving of DKK 1.2 billion by the end of next year, by the end of 2020. And for 2019 specifically, we expect to realise cost reductions of around DKK 600 million and that comes, as you know, on top of the DKK 350 million cost reductions that were announced back in August last year in connection with the Q2 announcement and the progress has been strong and in line with plan. And in the quarter, we have realised about DKK 100 million in cost reductions on the Programme NOW initiatives and about DKK 75 million from the other Q2 2018 initiatives as we have called them.

The way that you should read this slide, the Harvey Balls to the right of the slide, the savings indicator, is that it reflects how much run rate saving that has actually been realised in the quarter and therefore, as an example, even though there is no reported progress on IT, it does not mean that we are not progressing on IT because we are indeed. And it is simply that the effects of all the preparations and analyses that we are doing right now have not led to realised cost reductions yet, but they will come.

A few other highlights are on admin. costs, administrative costs. We are progressing quite fast but this is also where the low hanging fruits are. The tightened travel policy has an immediate effect, basically, and the same goes for training cost and a number of other employee benefits that we have been looking into.

And I would also like to highlight that the redundancy of the craftsmen in Thailand is a part of the cost mindset that we are instilling across the company. We have secured quite significant productivity improvements and we are able to reduce the workforce in Thailand with around 1,200 additional employees on top of the changes that we made – the 700 that were laid off back in February of this year. And to further reduce production cost and deal with annual sales out and production seasonality, we will also be introducing additional shutdown periods in the months to come. So this basically concludes the update on Programme NOW as such and I will just again reiterate that we are on the right track. That is what we firmly believe but we are still at the bottom of a huge mountain to climb.

Let us quickly go through some of the financials. You can skip slide 15 and go to slide 16 where we have the revenue growth bridge and as already mentioned, the weak like-for-like development is the largest building block in this waterfall and you can see that as the second purple building block in the chart here. And I will just come back in a second, speak a little bit more about the drivers behind the like-for-like development. Organic growth was -12% in the quarter and in addition to being obviously impacted by the negative like-for-like, it was also impacted by destocking, lower sizes of sell-in packs and finally, we have also seen a quite significant decline of our sales to the multi-branded customers. And I want to highlight that a number of the organic growth drivers are non-recurring in nature and not least the sell-in packs and Q1 is expected to be the only quarter for the year where organic growth is actually lower than like-for-like.

Then please move on to slide 17 where we are showing you a breakdown of the drivers behind the like-for-like development and our underlying challenge is to get traffic into the physical stores and that is the red arrow to the lower left part of this slide pointing downwards. That is the main challenge. And traffic into the physical stores is significantly down while the other KPIs that are driving like-for-like are broadly speaking relatively stable. At the core of Programme NOW is, as you know, exactly to address the traffic challenge through, among other things, significant marketing investments and the upcoming brand re-launch.

And please turn on to the next slide, slide 18. The EBIT margin was 22.5% excluding restructuring costs in Q1 and that is the black bar to the right being the third last column in the waterfall and as you can see on the waterfall, the main reason for the lower margin compared to last year is deleverage and it is deleverage from the negative like-for-like combined with lower sell-in packages and lower inventories with our wholesale partners. And the latter is partly non-recurring in nature. And the cost reduction supported the margin by 4 percentage points as planned and in line with prior years, the EBIT margin is going to be skewed towards the fourth quarter and we also expect that both the second quarter and the third quarter EBIT margin will be below our full-year guidance.

Then please move to slide 19. We improved the cash conversion in the quarter, mainly due to better working capital. But I should say that the development that you can see in the numbers here, the reported cash conversion, is better than it is because the reported number shows that we went from a cash conversion of 30% last year to 70% this year and that is what you can see in the upper left part of the slide but obviously, the new accounting regulation, IFRS 16, technically improved the cash conversion with around 27 percentage points so the underlying and comparable number to the 30% last year is a cash conversion of 43% this year so it is still a decent improvement even taking out the accounting noise. And just as with the cash conversion, the leverage ratio is also impacted by IFRS 16 so the net debt to EBITDA ratio roughly increases by half, 0.5, due to the new accounting regulation so the underlying leverage ratio is still up versus last year but only around 0.2 or so and that is impacted by the lower profitability but also the fact that we have made significant cash returns to shareholders during the last year over and above the free cash flow generation.

And thereby, we are getting to the final point on the prepared part of the agenda and we can go directly to slide no. 21 with the financial guidance. So in short, the guidance is unchanged. We continue to expect between -3 and -7% organic growth for the year and 26-28% EBIT margin, excluding restructuring costs. So we still believe that total like-for-like can be down to negative high single digit for the full year and the guidance still assumes a material and positive effect on like-for-like from the initiatives in Programme NOW in late 2019.

There will of course be some impact on the 75 net concept store openings this year due to the additional store closings that we just talked about but we don't expect the number to be significant already in 2019. And finally, I will just say that the cash return to our shareholders is also on plan and looking at the full year 2019, we will pay out around 7% of the market cap in dividends and we will be buying back shares equivalent to around 9% of the company so that is a total return to the shareholders of around 15-16% of market cap in 2019. And with that, that concludes the prepared part of the presentation and I think we can go to Q&A.

0.26.00

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question, please press 01 on your telephone keypad, and if you wish to withdraw your question, you may do so by pressing 02 to cancel. There will be a brief pause while questions are being registered.

0.26.30

Okay, and our first question comes from the line of Thomas Chauvet from Citi. Please go ahead. Your line is now open.

0.26.39

Thomas Chauvet

Good morning, Alexander and Anders. Thanks for taking my questions, I have two. The first one on the selling distribution marketing expenses that were up 10% in the quarter. It was well above expectations, I think. How do you expect both items S&D and marketing to develop in the coming quarters? The press release suggests marketing costs will be stepped up in Q2 in Italy, UK and China. Could you comment on that in relation to your profit guidance for the full year? Secondly on the press release, there is quite a few incremental items announced today 1,200 additional headcount reduction in Thailand, the implementation of part-time work in May and June in Thailand, the closure of an additional 50 unprofitable concept stores. However, you reconfirm the 1.5 billion restructuring charges and the 1.2 billion cost savings by 2020, could you elaborate on that so are these incremental announcement where they are already in the pipeline when you struck your guidance or are they just in aggregate relatively materials? Thank you.

0.28.02

Anders Boyer

Thank you, Thomas. I can start out here. On the sales and distribution and marketing expenses, it is true that the sales and distribution expenses are up Y/Y despite all the efforts that we are doing on the cost programme. You should recall that we are, if I just remember rightly, we have 342 more owned and operated stores in our network in Q1 of 2019 compared to last year and they obviously come with a cost of beneath that number. That is actually a like-for-like if we can call it that decline in the sales and distribution expenses but going forward, we are not guiding specifically on cost lines, but just to give you some insight, the Y/Y growth will, when we move into Q2, 3 and 4 of 2019, will be impacted by a couple of different factors. One is that the Y/Y increase in new stores will decline as we progress through the year. We had a 6% revenue uplift from what you call concept store openings network in Q1 and for the full year, we have guided about 4% so that in itself will decrease the Y/Y growth as we move through the year, but it does not mean that the numbers will be.. spending will be lower than in Q1 but that is one, I think, important building block. Then in Q1, as you can see, in our EBIT margin bridge, we have not invested, reinvested a lot yet in Programme NOW but that building block in the diagram is basically zero and as we move into the later part of the year, we will start increasing our marketing spending especially significantly. We are starting now and testing out basically as we speak in a couple of selected markets and that will, everything else being equal, increase our marketing spending going into the latter part of the year. So there are some offsetting forces when we look at those cost lines going into the later part of the year.

On the announcements that we made this morning on concept stores and further cost reductions, they have been on our agenda for a while but obviously, with things like this, you cannot announce it until you actually know that you are doing it. You have to be ready and I think on the changes that we have been making in Thailand and announced in Thailand early this morning Bangkok time, we had to see the productivity increases being there for some months. As you recall, last year we had a dip in the gross margin in Q3 and Q4 Y/Y of around 200 basis points because we saw a significant increase in the average production time per product and we are dealing with that and actually have had a very decent improvement in productivity during the last couple of months and that led us to conclude that we could make the changes in Thailand this morning so we are keeping the 1.5 billion or up to 1.5 billion in restructuring costs unchanged for that same reason and yeah. I hope that answers this question.

0.32.05

Thomas Chauvet

Thank you. Thank you, Anders.

Operator

Thank you. And our next question comes from the line of Michael Rasmussen from ABG Sundal Collier. Please go ahead. Your line is now open.

0.32.18

Michael Rasmussen

Thank you and first a question for Alexander and then a question for Anders. So Alexander, I appreciate it is obviously early days for you at Pandora but could you add a little bit more details about some of the turnarounds that you have been part of in the past, for example have they mainly been a cost reduction exercise or have this been cases of fixing a brand or fixing any kind of top line issues? So any details on your past would be appreciated. And then secondly for Anders, I hear what you are saying on the inventory reduction potential. Can you first comment a bit on the timing of that and also on the magnitude of this potential because obviously, you know, we would not risk you moving into any out-of-stock issues when or if like-for-like starts to improve. Thank you very much.

0.33.17

Alexander Lacik

Okay, so I have a couple of experiences which are, I think, relevant for this situation, but I think what is kind of common across all of them is that cost squeeze, wherever it may come from, has always been there to underpin so that you can invest the forward drive of the business, which I think is very much similar to the case we are discussing on Pandora so you would have things like when I first took over, Greece was a very sub-par performing country in the Reckitt Benckiser portfolio. Three years on, 50% growth and was the strongest growing entity in the RB portfolio. Moving from there, I went to the US which was also a kind of sub-par performer was growing to 2-3 points a year, pretty much in line with market growth. A few years on, I think we were between 2 to 3x market growth performance and again this came from finding pockets of costs which we could reinvest back into growing the business and then a very specific one was on Head & Shoulders which is a specific brand. Again, in a 3-year period, I doubled that top line and that came more from profound inside work, communication work, slightly repositioning the brand and again fuelled by, you know, pretty healthy structural P&L so we allowed that growth to come along so you have both small markets and big markets, specific brands that we turned around. There are a few more in the bag, if we have time. In another setting we can talk about them, but I think the important thing, it has always started with a profound understanding of where we went wrong with the consumer and that we have underpinned those efforts with spend that we have squeezed out of the business from different aspects of the portfolio or companies that I have worked for. I hope that answers your question.

0.35.30

Anders Boyer

Anders here. There are two angles to the question and I heard your question being about the own and operated, our own inventories, so that is where I am starting out. I fully agree that we have to be cautious with the gross margin like we have in Pandora. It is very expensive to be out of stock so we are doing it cautiously. So there is of course a reason that we write why we see some further potential in reducing inventories and I think we can say that should be an opportunity to reduce it by more than 10% compared to where we are but it is not a structural change where the net working capital will be at an entirely different level than where we are today. That is not where we are heading, but it is a decent upside that we have to pursue. There will be, I think that we will see some already in 2019 and then more to come in 2020 and it goes hand in hand with the merchandising process, getting a strong global merchandising process in place and we have talked about that at the last couple of quarterly releases and that takes some time to get in place.

0.36.51

Michael Rasmussen

Great, looking forward to following that. Thank you so much.

Operator

Thank you. Our next question comes from the line of Chiara Battistini from J.P. Morgan. Please go ahead. Your line is now open.

0.37.04

Chiara Battistini

Good morning. Thank you for taking my questions. I also have two, please. The first one is on products more generally and the charms/bracelets both remain under pressure in Q1 so I was wondering, can you please talk about a little bit more about the initiatives you are thinking about and implementing on the product side and how you are seeing those two categories, the charms and bracelets, accelerating through the year. And around that also I was wondering, all these marketing activities are being stepped up at the moment those are still on a product offering that has not been refreshed. Is that correct? And then on the promotional activity, can you please quantify the current percentage of sales on a discount or a full price and also do you see the need to go further in terms of cleaning up your discounting activities in the coming quarters, please? Thank you.

0.38.01

Anders Boyer

Chiara, I will just see whether I caught all of the questions. On the charms and bracelets, it is correct that the Q1 numbers are an extension of the prior quarters with the charms category being the one where we have the biggest challenge and that is exactly down the alley of our diagnosis and the structure of Programme NOW to deal with that in general of course across our product categories but not least the charms and bracelet category so we are – some of the things that we have put out to address exactly this is both how our marketing campaigns, how we run them and structure them. We have talked about a loyalty programme at a later point in time. There is also an element of how we structure or design our stores, actually how you navigate as a consumer in our stores. So all feeding into the charms category is the one where we are challenged the most, but I would say – I will repeat what we have said both in the Q4 announcement and Q3 of 2018 is that there is nothing in what we see that points in any way towards that we are facing something that is a structural issue. We are facing issues that are within our own control and that we can deal with. It does not mean that it is easy to fix. This is Q1 of a 2-year journey but there is nothing that tells us or shows us that we can't get back to a positive like-for-like on the other side of Programme NOW. But on top of this, I think you should look at.. when you look at the performance of the charms and bracelet category, you should also look at all the other elements of Programme NOW including our collaborations with celebrities, use of influencers, a significant increase in our marketing spend and also the new charms and bracelet concept that we are launching in the second half of 2019.

Then let me see if I am missing something here, but there was a question on promotions and whether we see a need to further dial back on promotions compared to what we have done already. Of course, there is a bit of testing and trying in what we are doing, that is clear, but I think we have seen that we are pretty much on track with what we have been doing in the first quarter. And then, did I miss something?

0.40.54

Chiara Battistini

No, that is great so you don't see any need to further push on the cleanup of discounting? You are happy with the current levels posted at the end of March, I guess?

0.41.06

Anders Boyer

I think with what we have done during Q1 with a pretty significant reduction of the number of promotion days by 30%, that is with what we have seen and the impact that we have seen and speaking to our organisations around the world, that is probably a reasonably good starting point. But of course, there will be a Y/Y impact throughout 2019 so that like-for-like impact and organic growth impact will be felt throughout the year until we analyse it next year.

0.41.39

Chiara Battistini

But not sequentially Q/Q?

Anders Boyer

I don’t think you should expect that.

Chiara Battistini

Yeah, okay great, thank you very much.

0.41.50

Operator

Thank you. Our next question comes from the line of Lars Topholm from Carnegie. Please go ahead, your line is now open.

Lars Topholm

Thank you very much, Alexander, welcome to Pandora. Two questions on my side also which is about store closure, so on the 50 of your own stores you are now announcing you are going to close, can you give a little bit of flavour on which markets you are talking about? And then the second question is on the franchise store network because clearly, franchise operated stores everything else equal have lower margins than your own stores so I wonder if you have some insight into the general health of that franchise store network given the pressure on your like-for-likes and also on the risk of multi-brand jewellers cutting back on selling Pandora going forward, is that a risk we should factor in when we look at your numbers? Thank you.

0.43.00

Anders Boyer

It's Anders here. On the store closures, I can't speak about the markets yet, we have not announced it internally market by market yet but obviously there will be some that are more hit than others but it is not just one place, it is spread across the globe but for now, I will have to keep it internally until we announce it. And then on the franchise stores, it is clear, if we are hit then our partners are hit as well, that goes without saying and we have different starting points on average with the profitability in the stores so obviously on average, the earnings among our partners have come down as well during the last number of quarters or couple of years, that is pretty clear. And I think one way to look at it, if we continued like what we are doing then of course we would at some point in time hit into a serious problem across the network if like-for-like was negative to this tune for a couple of years then that goes without saying. But that is not the plan. That is also clear. But we are, I think it is also important to recall that even though one of our franchise partners, just as an example, might come in a situation where there are no or little earnings left, it doesn't mean that the total profit pool with partner and Pandora together is not attractive. I think that is important to keep in mind. Then on the multi-branded part of our business, other points of sale, they are clearly hit harder than the rest of our business in the first quarter and I think without being too detailed that there are some of our larger partners that have been particularly hard hit and that it is visible in the numbers.

0.45.25

Lars Topholm

Sorry I interrupted before but I simply didn't understand, you said even if the franchise stores are not making money, the total profit pool is still attractive but would that mean you would then go in and sponsor the franchise store if he doesn't make money and also, to be specific, do you in your plans expect any franchise concept stores to close in 2019 and have you embedded in your guidance any of your larger multi-brand franchisees abandoning Pandora during the year? Just to be perfectly clear.

0.46.07

Anders Boyer

Taking the first question first on the situation where franchisees are not earning money and the total profit pool is still attractive then obviously, it will be just to say plainly stupid not to continue operating that store and then you will have to figure out how do you then do it and then there is obviously a range of different options how you run that store. I will have to stress, this is not where we are but of course, having 2,700+ concept stores, there will always be someone who is struggling including our own stores but in that example, Lars, then obviously we will have to look and say well, do we then continue running the store or do we split the profit pool in a different way? That could be some of the solutions to look into. And yes, we have in the, when we announced in February that we are opening up net 75 stores for 2019, in that number is also included a number of closings of franchise stores. And the last question was on the multi-branded business. Yeah, in our guidance, we had assumed that the multi-branded business would be declining more in revenue than Pandora in general.

0.47.40

Lars Topholm

Okay. Thank you. I have some more questions but I will jump back into the queue. Thank you very much for answering these ones. Thanks.

0.48.00

Operator

Apologies for the delay. Our next question comes from the line of Fredrik Ivarsson of Kepler Cheuvreux. Please go ahead, your line is open.

Fredrik Ivarsson

Hey guys, thanks for taking the questions, a couple of ones from me as well. First one is on the store network going forward. Obviously, the share of retail revenue, sorry, retail stores is up more than 20 percentage points and my question is would you ever consider increasing the share of wholesale stores again? I guess are you divesting some Pandora owned stores to franchisees? That is my first question. And the second one is on the gross margin. I assume that you have quite significant tailwind from FX and raw materials in the quarter as well. Could you confirm that and maybe quantify that a little bit? Thanks.

0.48.49

Anders Boyer

Thank you, Fredrik for the questions here and I will just start out apologising for the two minute blackout, we just had some technical issues. On the store network, I think as a responsible company and a responsible management, you always have to look at all options and always question status quo and that would include across markets and across our network whether should this market be operated and which type of stores, should they be owned by us or be owned by someone else so we will always be reflecting on how we are structured. Having said that, repeating this morning that we will be reviewing our general network strategy during the second half or at a later point in time. We said that also in the Q4 announcement in February this year. It is on the agenda but we have deliberately put it a couple of quarters out to focus on, so the most important issues first. So, we will revert to you and talk more about that at a later point in time. And then on the gross margin. Yes, on the commodity, you are absolutely right, we have around 40 basis points of tailwind or plus on the gross margin from commodity prices in the first quarter but on the FX piece, it is pretty limited, the type has been going up a bit but in the quarter as such it is quite limited impact on the gross margin. And then I think you asked about also whether there is a channel mix impact and that is clear that there is an impact on the gross margin from having a higher retail share revenue in Q1 compared to prior quarters and compared to prior years but I think the most important is that if you look at the Y/Y gross margin development during the last number of quarters then if I just remember right off the top of my head then in Q3, 2018, we were down 190 basis points. In Q4, we were down 200 basis points and now we have turned that around to have a 10 – not a lot but still a 10 basis point uplift compared to Q1 of last year.

0.51.37

Fredrik Ivarsson

That is very clear. Thanks.

Operator

Thank you. And our next question comes from the line of Hans Gregersen of Nordea. Please go ahead, your line is open.

0.51.46

Hans Gregersen

Good morning. I would like to ask a question to you, you mentioned a little bit about your experience in what could deem there is a need to have products like shampoo. One could argue that jewellery is more a more nice-to-have product. Could you really argue that there is a direct comparison in the turn-around actions you are looking at between those two categories? That is the first question. And then to Anders, we have now had a strategy plan last year that was being revoked by the announcement of Project NOW, you have previously argued or indicated that there was quite weak data visibility into the previous strategy plan. In the whole analysis you have done, what new data have you discovered and where have the changes been? And then just if you could clarify, with the new staff reductions in Thailand, is that incremental cost savings or part of the original target? Thank you.

0.52.48

Alexander Lacik

Well, I mean, they are quite different categories, you are right. However, I mean you can see, jewellery is a discretionary category for sure. You could also argue, shampoo in general is obviously for most people that have hair is not discretionary but a particular brand can be seen as a discretionary. So then you go back into okay, what are we actually trying to do here? We are looking at the positioning of Pandora, we are going through proper insights work, we are trying to sharpen who actually we want to target and that all leads into kind of understanding better what type of products we should be serving them with, what type of communication will work with them and finally, how you merchandise this at the point of sale. So I think all those things are very similar even though your point, shampoo and jewellery obviously are a little bit different in nature.

0.53.39

Anders Boyer

And then I can take your two and a half other questions I think I counted, Hans, but that's okay. On the data visibility, a couple of angles to it. First of all, I will also say that the data visibility and transparency also go for basic financial data, just having one set of data and one way to look at pure basic financial numbers, how do we look at a store P&L as an example so one set of numbers across and there we have gotten, I think, quite far pretty fast because we had a good ERP IT infrastructure in place. But then on more the consumer facing data, we are, I think we are building much better and much deeper consumer insights. We are having focus groups with hundreds of consumers with quantitative analysis and surveys and we are also getting digital data from social media and structuring and building that in a different way, a more detailed way than what we have done in the past. And then we have also broadened our approach to data and from focusing mainly on products to also think about data in terms of brand and consumer experience. And then you could also say we are simply just becoming, we are one year further down the road compared to when we announced the strategy at the Capital Markets Day in January last year and we are one year wiser in terms of what works and what doesn't work. And then on the cost saving in Thailand, that is part of the plan. That is part of the DKK 3-400 million in total cost of sales reductions that we announced as part of the DKK 1.2 billion cost reductions and it flows directly into that.

0.55.55

Hans Gregersen

Thank you

Operator

Thank you. Our next question comes from the line of Piral Dadhania of Royal Bank of Canada. Please go ahead, your line is open.

Piral Dadhania

Hi, good morning. If I could just come back to the charms category which is -17% in Q1, could you just give us an indication of what that growth rate would have been if we strip out the effects of wholesale inventory destocking and lower NPI sell-in? And just coming back to a previous question, is the strategy still to double down on the charm category going forward or should we expect to see a change in the merchandise mix towards some of the other categories if you expect charms to remain negative in the mid-term? I am just thinking in terms of the Q1 performance, there were some new product launches which have clearly not had the impact that you are expecting them to have. So just really want to understand how important charms are to your mid-term strategy? And then secondly just in terms of the store network. I appreciate there is a more detailed analysis due to take place later in the year but if we take the like-for-like to remain negative for the next few years, what proportions of your stores would end up being dilutive to group EBIT margins or potentially even turn loss-making? I am just curious as to why there isn't more of a focus on store closures at this point if we extrapolate these types of like-for-like declines which would be detrimental to your margin in the mid-term? Thank you.

0.57.27

Anders Boyer

Thank you, Piral, for those questions. Just starting out with the charms revenue. It is right that the charms total local currency growth was -17% in the first quarter and thereby, more down than what you saw in the quarters in 2018 and we don't disclose like-for-like on product category, at least we don't put them in the announcements but the like-for-like on charms is actually not that very different between Q4 of last year and Q1 of 2019 but what I would say is that there is nothing in the Q1 data that changes what we announced as part of Programme NOW a couple of months back with more focus back on the charms category. I think the numbers, if anything, they just confirm what we said as part of Programme NOW that there is a potential to re-grow in the charms category again. Then you asked about the future store closings. You can make a lot of scenarios of what the profit level on store by store would be in different like-for-like scenarios and it is clear, if we had -10% like-for-like for the next 8 quarters, yeah, then that is very different situation but again, that is not the plan and with what we have announced today, we have addressed both closing own stores that are loss-making and then we have taken all stores that are diluting to our margin over and above a certain level and where we don't see that we can cut cost in that store or do other things to improve revenue in that store in the very short term. So we are taking with what we see and with the situation that we are in and with the guidance that we have put out, then that addresses the margin diluting stores that we have across the network. Having said that, there are some choices in some markets where margins are below group average. We have a couple of markets, as an example, in Latin America, Brazil, where margins are lower in general, there is a decision that we want to keep operating in Brazil even though margins there are and probably are likely to remain below group average. But of course, if we sat in a year's time and like-for-like remained where it was and prospects for 2020 were the same, then it is a very different situation. But again, that is not the plan.

1.00.37

Piral Dadhania

Okay, thanks Anders. So, if I just come back to the charms point, is that to suggest that the like-for-like in charms was around the negative low to mid single digit level in Q1?

1.00.51

Anders Boyer

No, that is actually not the case. The like-for-like on charms specifically in Q1 was actually the same as the reported local currency growth around -17%.

Piral Dadhania

Oh, sorry, I thought you said it was in line with the fourth quarter of 2018. Sorry, okay.

Anders Boyer

It's good to get that clarified

Piral Dadhania

Thank you

1.01.14

Operator

Thank you. Our next question comes from the line of Klaus Kehl of Nykredit Markets. Please go ahead, your line is open.

Klaus Kehl

Yes, hello, two questions from my side as well. First of all, you had negative like-for-like growth of 10% here in Q1 and that is obviously a pretty tough start so could you give us any insight into the beginning of Q2 and April? And also in this context, you have mentioned these new commercial initiatives with Shakira etc. but were they in full speed here in Q1? And then finally, just to get back to these store closures, and obviously you need to dig further into it, but could we end up in a situation where network expansion will be zero or even negative on a net number in 2020? That would be my questions.

1.02.14

Anders Boyer

Thank you Klaus. It is Anders here. On Q1 and the start of April, we are still seeing a like-for-like in April being below what we have guided for the full year so in line with what we saw in the first quarter, but again, yes, little impact still of all the top line initiatives that we are taking as part of Programme NOW. Then on the commercial testing and initiatives that we are doing, no they are in no way near a full speed in Q1. It is selected testing in a number of markets that we have been doing on celebrities and influencer collaborations so it has no, there is no impact really in the market yet. And on the marketing initiatives, that hasn't even started in Q1, that is basically starting this week plus or minus. In the three countries, China, Italy – sorry, Italy and UK, China only being a bit later in the quarter but Italy and UK starting as we speak. So we are basically just scratching the surface in the first quarter. On the store closures, obviously that would depend on exactly what does like-for-like look like when we get into and guiding for 2020. I think, what we can say is that it is likely that there will still be room for profitable and attractive store openings in China and Latin America also in 2020 but exactly how that plays out net-net, I think that is too early to say. But I think one thing we can say, we will not be getting back to the 2-300 store openings net that we saw in 2017 and 2018. That is maybe the yard stick we can put out there.

1.04.46

Operator

Thank you. Our next question comes from the line of Patti Wong in Hudson. Please go ahead, your line is open.

1.04.50

Patti Wong

Thank you. Could you please talk about the market expansion plan in China so for example the digital channels like Tmall and Taobao. Thank you.

1.05.05

Anders Boyer

Sorry, we didn't catch that. Can you please repeat?

Patti Wong

Yeah, so I asked about the market expansion plan in China. So you know the online platform I mean the Tmall and Taobao. Do you try to sell any products on such platforms to increase the sales?

1.05.25

Anders Boyer

We remain exclusively on Tmall in China but obviously, China is very much on our agenda as part of Programme NOW but we are actually already doing more on WeChat and we have done that in connection with the launch of the Peach Blossom just a month ago or four weeks ago and then obviously, we are looking into whether there will be other channels that will be interesting for us in China such as JD but for now, we are exclusively on Tmall.

1.06.18

Operator

Thank you. Our next question comes from the line of Anne-Laure Bismuth of HSBC. Please go ahead, your line is open.

Anne-Laure Bismuth

Yes, hi, Anne-Laure Bismuth from HSBC so two questions on my side as well. So really I just wanted to come back on these additional marketing investments that you are flagging in the press release of this morning. Can you give us a bit more colour of what are these initiatives? And the second question is about what it means when it comes to marketing ratio for full year 2019. It was a 10% at the end of Q1 but what should we expect for the full year? And I assume that it was embedded in the commercial plan reset. Thank you very much.

1.07.02

Anders Boyer

The marketing initiatives that we are launching here as we speak in UK, Italy and again a little bit later in the quarter also in China are to the tune of DKK 50-100 million in additional marketing spending per quarter. Then we have also I think somewhere said that we have seen a decent return on those investments and if you do a little bit of math and say well, DKK 50 to 100 million in investments per quarter times a decent multiple and then look at the revenue that we have in those three markets, you can also see that it is, if it has the intended impact, it will be visible in the like-for-like in Q2 and going into Q3. There is nothing magical specifically in what we are doing, we are coming from a very low level, especially in Italy, from a very, very low level of marketing spending so we are using sort of the usual tools and focused on traffic generating activities. This is not branding, it is a working marketing that we are focusing on and the main handles or tools that we are using are TV commercials, it is paid search, it is paid social, but we believe that we can generate good traffic and we are doing also that based on the learnings that we have seen in the US where we are spending, as I mentioned, more money on marketing than in the rest of the world and where traffic and like-for-like is clearly better than in the rest of the organisation. Then on the marketing ratio. I would be hesitant to guide that specifically on a line in the P&L by quarter but it is clear, it is part of the Programme NOW diagnosis that we should spend more and we are doing that and with these initiatives, it is likely that the marketing spending as a percent of revenue will be higher going forward.

1.09.37

Anne-Laure Bismuth

Thank you

Operator

Thank you. Our next question comes from the line of Thomas Chauvet of Citi. Please go ahead, your line is open.

1.09.48

Thomas Chauvet

Morning. I have two additional questions. One is on… related to the... hello, sorry, can you hear me? I was on mute, I think. Just a follow-up on the crafting facilities in Thailand. You are one of the largest private employers in the country, nearly 2,000 people have left the company this year I mean that is about 15% of your workforce in Thailand. Two quick questions one that. One, have you had discussions with local authorities or the government on these measures and reiterated your commitment to Thailand? I think you have still a tax exemption status in the country. Could you remind us where you stand on that tax exemption status? And two, could you try and explain the nature of these layoffs between what is a risk of work capacity that literally the order book is weak and you have too many people in the factory, craftsmen, and two, the introduction of more technology related production methods like Triple A and how this impacts longer term the need for big labour intensive workforce in Thailand? Thank you.

1.11.07

Anders Boyer

Thank you for those questions, Thomas. We are fully committed to our setup in Thailand and it works really well and we are very happy with our setup and the corporation that we have with the Thai authorities. And we are giving our size as you also indicate, Thomas, we are in a very frequent dialogue with the authorities in Thailand and we should be obviously, so we have, as you say, a tax exempt agreement with the Thai authorities and it runs for a number of more years and obviously, when we get to the expiry of that in a number of years with the Thai authorities, we will have to sit down and discuss what does that then, what next. But again, we are very happy with our setup in Thailand and we are doing all these changes in close co-operation with the local authorities. Then on the other question on the going forward. If I understood the question correctly, then I would say that if we – we shouldn't have too many people at the factory in Thailand, that is why we are offering voluntary resignation to the 1,200 people today and that is also why we are introducing a few more days and weeks in the months to come where we are closing down production because otherwise, we would risk producing to inventory and that obviously also comes with a risk. And behind all of this is an increase in simply how many pieces of jewellery do we produce per hour and that is the number that is improving quite nicely despite the fact that our products, our standard time as you will call it in engineering language is up compared to prior years, as you recall, back in – was it Q1 last year or Q2 last year we talked about that the average production time on some of the new collections was 50% up compared to the old days but despite that fact, we are actually producing more units per hour per manhour and that is a pretty strong result and for that same reason, we are adjusting capacity in Thailand this morning and to the extent that we need to flex further, we also always have the opportunity to do overtime and at the same time, we have good co-operations with a couple of external OEMs that also can serve as a flex, at a cost, obviously, but that is a handle that we have as well.

1.14.41

Thomas Chauvet

Thank you

Operator

Thank you. Our next question comes from the line of Hans Gregersen of Nordea. Please go ahead, your line is open.

1.14.50

Hans Gregersen

Thank you. In terms of the outlook for second half, you have sent quite confident signals on growth improving due to, I would assume, new product launches and your route to market initiatives. ….

1.15.10

Operator

And it seems that his line has disconnected. I will move to our next question which is from the line of Lars Topholm of Carnegie. Please go ahead, your line is open. Lars from Carnegie, if you have your phone on mute, you need to unmute. Okay, as there is no response from this line, I will move to the line of Fredrik Ivarsson of Kepler Cheuvreux. Please go ahead, your line is open.

1.15.54

Fredrik Ivarsson

Thanks. Short follow-up on the 75 net openings. I think you said there was going to be a split between owned and operated and franchise stores. Can you give a ballpark figure on that?

Anders Boyer

For the 75 openings this year? Yeah, I think we said two thirds, roughly two thirds is our own stores and the remaining being franchise stores.

Fredrik Ivarsson

Thanks

1.16.30

Operator

Thank you. Our next question comes from the line of Magnus Jensen of SEB. Please go ahead, your line is open.

Magnus Jensen

Hey guys, thank you for taking my question. I guess most of them have been answered already but I just have one little follow-up in terms of promotions. You say that you did a reduction of 30% for the first quarter but you also started the year by saying that you will reduce it by 50% for the year. Could you give some flavour to the reduction you expect to see in the remaining quarters of the year? Thank you.

1.17.01

Anders Boyer

I think the way that we have approached it is that we are looking at it market by market and seeing what are the promotions that are non-value adding, it doesn't drive enough of revenue and the 30% reduction that we have seen or implemented in Q1 is in line with the plan that we made as part of the budget and Programme NOW but in general, the first quarter is actually a small quarter on promotions with more of a focus on the Clearance sale in January so going down with roughly 50% is still the plan but there is, to be honest, Magnus, some testing and learning in this but again, Q1 generally lower on average on promotions.

1.18.03

Magnus Jensen

Thank you. And one final question from me, so you haven't talked very much about Reflexions which I guess have been in the market now for 6 months or so. Could you give some flavour on how this concept is performing?

1.18.20

Michael Bjergby

So I think, this is Michael speaking, we don't disclose numbers exactly for Reflexions and that is why we haven't provided any information for this. I would say that what we have seen in Q1 is that we have seen that there have been sold more charms per bracelet in Q1 than we saw in Q4, so this seems to be that it is a carrier and that it does help charms sales so that is positive. But obviously, we can all see that what is important is not what product category that we drive but really the total like-for-like and obviously, we still have some improvement through the year. But generally, we are happy with the performance of Reflexions even though it could not turn around the like-for-like as we already diagnosed with NOW.

1.19.01

Anders Boyer

Yeah, and I think, Michael, that is the important point. I think on an isolated basis we are okay with the performance but I think it is very clear that it hasn't been enough to turn around the overall like-for-like trajectory.

Magnus Jensen

Thank you

1.19.23

Operator

Thank you. We are going to try again with Lars Topholm from Carnegie. Please go ahead, your line is open.

Lars Topholm

Yes, I think that was an example of fat finger before, I was trying to unmute. Anyway, my question is part of Programme NOW is to take back channel inventory, I just wonder if you have an update there as to how much channel inventory you expect to buy back and when you expect to implement this part of the programme. Thanks.

1.19.56

Anders Boyer

Yeah, maybe I should have touched upon that, Lars, in the prepared remarks. We are having a lot of preparatory work internally so far on this topic so we have not started implementing the programme yet. I think we will start actually executing on it later in the second quarter but the majority of the impact will be probably in the third quarter would be my best guess. I have been all the way afraid of taking a one size fits all-approach to this and therefore, we are doing it case by case, channel by channel, market by market, partner by partner. That takes a bit of time but I think it gives a better end result. I think it is still up the DKK 500 million, the number that we have put out there hasn't changed.

1.20.52

Lars Topholm

And just remind me, Anders, are you going to offset this against revenue or will it be offset against provisions or how will you treat it accounting wise?

Anders Boyer

I think one model can simply be that we buy back inventory from a partner at a discount and then when the product comes back on our distribution centre, then it will likely be fully or partly written down net of the silver value, obviously, and then that net cost would go into cost of goods sold in the reported numbers and there, we would call it out as a restructuring cost and include it in the up to DKK 1.5 billion restructuring cost. And then I think, as you maybe indicated, then there has to be something in it, there has to be a revenue impact at some point in time and that is the idea but the two won't be linked but obviously, we are doing this hoping that we can clean up the inventories among our partners so they can start selling out better than what they have been doing in the past.

1.22.09

Lars Topholm

Thanks, Anders, excellent answer. Thank you.

Operator

Thank you. And as there are no further questions, I will hand back to our speakers for the closing comments.

Michael Bjergby

Alright. Thank you very much for this time and I am looking forward to seeing you all on the roadshow in the coming days. Thank you.