Pandora A/S

Transcript: Investor Presentation, Q2 2018

Date & time: 09 August 2018 at 11.00

Operator

Welcome to the Pandora A/S interim report for the second quarter, the first six months of 2018. 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. I will now hand over to Magnus Jensen, Head of Investor Relations. Please begin.

0.00.19

Magnus Jensen

Good morning and welcome to the conference call for Pandora's results for the second quarter of 2018 which we released this morning. My name is Magnus Jensen from Pandora's Investor Relations team and with me I have our CEO Anders Colding Friis, our new CFO Anders Boyer as well as the chairman of the Board, Peder Tuborgh. Before I hand over to Mr. Friis and Mr. Boyer, Peder Tuborgh will share a couple of words on the release sent out this morning regarding management changes.

0.00.48

Peder Tuborgh

Thank you, Magnus, and good morning to everyone. I have asked for the word this morning to shed some light on the fact that we have decided to change our top management. Anders Colding Friis has been with the company for 3½ years now and he has been instrumental in building the strong organisation we have today. Furthermore, Anders has been an important part of developing our new strategy assuring the future success of Pandora. That said we have today decided that it is time for a new set of eyes on the business and to strengthen the execution capability on the strategy. The development in the first six months following the Capital Markets Day has been disappointing and has of course been one of the reasons for the change. Anders Colding Friis will leave the company on 31 August at which point we will appoint Jeremy Schwartz in a new COO role. Jeremy and CFO Anders Boyer will jointly serve as interim CEO until we have made a new appointment at the CEO level. Jeremy has a strong retail background including several years as CEO of the Body Shop. Before handing the word back to Magnus, allow me to welcome Anders Boyer to the management team of Pandora. I know Anders very well from his time at our board and I am confident that he will be a strong addition to the daily management of Pandora. Thank you very to everybody. I will be handing back to Magnus now.

0.02.21

Magnus Jensen

Thank you, Peder. I now hand the word to Anders Colding Friis but before I do I would like to point your attention to the disclaimer on page 2. Now please turn to slide 3. Anders, please.

0.02.34

Anders Colding Friis

Good morning everyone and thank you for joining the call this morning. The second quarter came in below our expectations. Revenue growth was 4% in local currency and 8% adjusted for the one-off last year of DKK 200 million related to the change in return policy in the US. Growth was supported by our new launches. However, for both new and older collections, the charms category is not increasing to the level we had expected. I will come back to that later in this presentation.

Our eSTORE continued the strong development from the first quarter while revenue from Wholesale declined due to reduction of inventory, acquisition of stores and the one-off in the US.

We will show later that the impact of the inventory reduction is significant. Looking across the regions, we saw good improvement in our Chinese business as a result of our targeted initiatives. Italy, on the contrary, had a weak quarter on the back of a strong performance through many years. The drop in Italy was caused by negative like-for-like figures as well as inventory reductions in the wholesale network. Finally, the US had a strong underlying performance for the quarter. The EBITDA margin was 31.1% and was impacted by the lower than anticipated growth in the quarter.

Please turn to slide no. 4. As you saw Monday, we have decided to adjust our full-year guidance for 2018. We adjusted the expected revenue growth for 2018 to 4-7% in local currency from previously 7-10%. This mainly reflects a weaker than anticipated development in charms which we expect to continue. We also expect further impact from changes in inventory levels across our wholesale channel and we have seen a weaker than anticipated development in July. We have also our guidance for EBITDA. This is a consequence of the lower growth, a higher share of revenue from PANDORA Rose and PANDORA Shine and longer production time for our new more advanced products. We now expect the EBITDA margin to be approximately 32% instead of the previously guided approximately 35%. CAPEX is still expected to represent approximately 5% of revenue. The number of store openings is now expected to be around 250 and we anticipate a tailwind from acquisition of around DKK 1.4 billion.

Looking at the second half of the year, we expect Q3 to be the weaker of the two quarters. Growth for the third quarter is expected to be below the guided range for the year. The main reason is that the tailwind from acquisitions will be heavily skewed towards Q4 and that we expect an impact from changes in inventory levels across our wholesale channel which we also saw in the second quarter. Finally, the EBITDA margin in the third quarter is expected to be below the full-year expectations. This is due to the lower revenue and because Q3 will be impacted by one-off costs of around DKK 50 million related to the organisational changes we announced earlier this week.

Now please turn to slide no. 5. One of the reasons for the change in guidance is that we have been too optimistic about the impact of our new products in our charms revenue. Although the new collections have been well received, we do not see a change in the momentum for our charms category. Charms launched as part of our new collections are performing on par with our base collection of charms. Additionally, we are seeing a change in consumer demand pattern for our original charm concept, PANDORA Moments.

Bracelets continue to be in high demand and developing well but we are seeing a graduate shift where consumers prefer a simpler look with fewer charms on the bracelets. Where they used to wear 6 or 7 charms on the bracelet, they now typically wear 5. This is reflected in our result for the first half of 2018 where we see a continued strong development for bracelets but a slowdown in charms.

Now please turn to slide no. 6. At the Capital Markets Day in January, we talked about the development of a broader range of charms and bracelet platforms to support the development of the category and attract new consumers to our brand. Further, we also highlighted the importance of developing the new jewellery categories. In October we will launch the first new platform. We have named it PANDORA Reflections. The new concept will initially consist of around 20 design variations, and we will add around 40 more during the rest of year. Reflections will be launched in all regions in all concept stores and the eSTORE.

We are growing rings, earrings and necklaces and we will continue to strengthen the development of these categories with more products and marketing support. It is worth noting that we have increased the share of revenue from these three categories from 21% in Q2 of 2016 to 23% last year and now 27% in this quarter. This is as testimony to our ability to expand our business outside of charms and bracelets. Leveraging the brand and our infrastructure. In the second half of the year, we will launch around 100 new products in these categories. That is up from 75 last year.

Now please turn to slide no. 7. Due to the more advanced and innovative nature of our new collection, production of new designs is expected to be more time consuming than planned. To put this into context, the new products have an average production time of around 50% more. This will have a negative impact on our gross margin when we look ahead.

Furthermore, we see a high demand for our plated products Shine and Rose. This supports our top line and earnings in kroner but also has a consequence for our gross margin as these collections are less profitable percentage-wise.

To keep our industry-leading profitability, we are implementing a number of cost initiatives.

Please turn to slide 8. The 300 million procurement programme which we announced in connection with the Capital Markets Day is progressing well. We now aim to realise additional savings around DKK 200 million with effect from 2019.

Some of the areas where we have identified cost savings are travel, IT and packaging. We are also taking steps to make our organisation more efficient by optimising global processes and freeing of resources. This will include around 400 redundancies which we announced Tuesday. All of the positions are white collar. This will provide cost savings of around DKK 150 million from 2019 and onwards. The associated severance costs will be booked in the third quarter with an estimated impact of around DKK 50 million.

Now please turn to slide no. 9. Before we move on to the quarter, let me just emphasise that our long-term strategy presented in January remains intact as are the ambitions presented at the Capital Markets Day. We maintain a strong focus on innovating the product portfolio, strengthening the brand, gaining control of the retail channel and improving our manufacturing capabilities. This is providing a strong foundation for the future.

Please turn to slide 10. Before we start commenting on the financials for the quarter, let me highlight an addition to our financial reporting. To increase the transparency in our reporting and to meet a strong wish from investors, we have decided to include more like-for-like numbers. Starting today, we disclose total like-for-like sales-out growth for the

Group and for our 7 largest markets. The total like-for-like includes PANDORA owned concept stores, eSTORE as well as Franchise and 3rd party distributor concept stores. We will continue to report a retail like-for-like number for the PANDORA owned concept stores plus the eSTORE, but we will stop reporting like-for-like for the US as we now report a total number for the US. We hope that you will find this information valuable. The total like-for-like number covers approximately 75% of our reported revenue.

Now please turn to slide no. 11. Revenue from the second quarter was DKK 4.8 billion and increased 4% in local currency compared to the second quarter of last year. Adjusting for the one-off last year related to returns in the US, group revenue increased 8% in local currency.

As mentioned in the introduction, revenue growth in the quarter was also impacted by a reduction of inventories in the wholesale channel. As you can probably triangulate by looking at our numbers the reduction is around DKK 200 million in franchise stores. This is a healthy thing for the business although it obviously impacts growth negatively in the quarter when it happens. Growth was mainly driven by the eSTORE, concept store openings and acquisitions leading to an increase in revenue from PANDORA owned retail of 43%. Revenue from Wholesale was down 27%. Total like-for-like improved sequentially to -1% compared to -5% in the first quarter. Retail like-for-like was 3% flat compared to the first quarter. The EBITDA margin was 31.1% and was impacted by lower than expected growth in the quarter. The free cash flow improved to DKK 1.1 billion and we returned a similar amount to our shareholders in the quarter through our ongoing share buy-back programme.

Please turn to slide 12. Across most categories, our new product collections performed well. This supports our view that a renewed and more innovative product assortment remains a cornerstone for the development of our business. However, as mentioned earlier, the new charms have not been sufficient to change the momentum in that category. Bracelets and products in other categories are performing very well with like-for-like of 30 and 17% respectively compared to the same collections last year. Charms like-for-like was -10 and total like-for-like growth for the new collections was 2%.

As mentioned earlier, the PANDORA Shine and the PANDORA Rose collections are strong drivers of the growth. Together, they now represent around 20% of sales out. PANDORA Shine is already 5% of sales out while Rose continues its strong growth and now represents 15% of sales out.

Please turn to slide 13. Revenue from charms was DKK 2.6 billion, a decrease of 7% in local currency. Adjusted for the one-off last year, charms decreased 3%. The category was impacted by the earlier mentioned challenges we see with charms. Revenue from bracelets increased 10% in local currency supported by the launch of several new bracelets. And growth in bracelets has in fact been in double-digit figures the last several quarters. The other product categories all delivered solid performance in the quarter and increased to 27% of revenue, up 4 percentage points since last year. Rings have improved. A demand for earrings and neckwear remains strong. The three categories delivered local currency growth of 14, 21 and 56%, respectively.

Now please turn to slide no. 14. Looking at the strong development in the eSTORE, we find it meaningful to increase our ambitions for the eSTORE and we now see revenue from online representing more than 15% of revenue in 2022 compared to 10-15% as represented at the Capital Markets Day.

Even though we see better than expected performance in the eSTORE, we still also see many opportunities to improve and expand our physical store network. As mentioned, we now expect to open 250 concept stores in 2018. Looking at the period from 2018 to 2022, we see a potential of up 1,000 store openings. As illustrated on the slide, around 550 of the 1,000 stores are planned to be opened in white space areas with no or very few current Pandora stores. This includes stores in for example China, Mexico and Turkey. Around 250 stores are planned to be opened in semi-penetrated areas where we see pockets of white space. Spain, Italy and France are good examples of countries in this category. Finally, around 200 stores are planned to be opened in penetrated areas like the US and Germany. We will always monitor and reassess closely as we progress to ensure that demand is not already covered by eSTORE or some other concept stores. The same goes for acquisitions of stores where we continuously evaluate if any given acquisition makes financial sense.

Now please turn to slide no. 15. Looking across the different channels, we increased revenue in PANDORA owned retail by 43% in local currency. Retail now represents 57% of our total revenue compared to 42% in the same quarter of last year. Growth was driven by network expansion of 23% and the acquisition of stores which added another 18%. Retail like-for-like for the quarter was 3%, up from 0 in Q1.

Revenue from franchise concept stores decreased 30% in local currency. Adjusting for the one-off last year related to sales returned and the acquisition of stores, revenue through concept stores decreased 16%. The negative development was driven by a reduction of inventory in the channel and negative like-for-like. Revenue from other points of sale in the wholesale channel decreased 23% in local currency. This was caused by a negative development in the US and Italy where we have seen some destocking in the quarter. This channel only represented 16% of sales in the quarter.

Revenue from 3rd party distributors increased 1% in local currency. If we exclude Spain, Belgium and South Africa, where we have taken over distribution, revenue from 3rd party distributors actually increased by 22%. This was mainly thanks to an improvement in some of our Southeast Asian markets as well as in Russia.

Now please turn to the next slide where I will talk you through the geographic performance starting with Italy and China. Following a strong development in Italy, revenue decreased 7% in the quarter. Our brand remains strong in Italy but a couple of factors impacted our business. Revenue from our concept store network increased 26% but underlying we saw a 7% decline in total like-for-like numbers due to the development in charms. The growth in the concept store network was offset by a weak development in our other points of sale where revenue declined 39%. This was mainly due to a reduction of wholesale inventory, lower sales out and store closings. 33 other points of sale have been closed in the last 12 months. To support the development in Italy, we are opening stores in the territories with limited Pandora presence while also strengthening our growing online channel. However, short-term we expect like-for-like to remain negative due to the negative charm development. This is also the trend so far in the third quarter.

Now please turn to slide 17. Following a weak start to the year in China, we improved our Chinese business in the second quarter. Revenue increased 29% in local currency for the quarter with total like-for-like improving sequentially from -14 to +1%. The improved performance comes from a combination of an improved physical network and a strong online performance. We have done a number of things to restore growth in China. We have increased our marketing spend with a focus on building awareness. We have improved our in-store execution with more training, better staff incentives and more product activations. And finally, we are working to reduce the grey market trading. The most important step was taken in July where we reduced our prices in China to align them with the prices in the near region and reduce the gap to other regions. We are not through the woods in China, but we are encouraged by the progress we have seen throughout the quarter. So far in the third quarter, we have seen a mixed development. However, most of the sales in China will be generated in August and September with Chinese Valentine's and the launch of the autumn collection coming up.

Please turn to slide no. 18. Looking at the three regions, revenue from America decreased 6% in local currency to DKK 1.5 billion, primarily due to the US which was impacted by the one-off that we mentioned earlier. Adjusted for that, America was up 6% in local currency. The US remains a challenging market, but we are generally happy with the development and the progress we are making. Revenue in the US decreased 12% in local currency corresponding to an increase of 4% adjusted for the one-off last year. The positive underlying development was driven by our branded network. The total like-for-like growth in the US was 3%. The improved performance was a result of an increase in-store, traffic driven by relevant in-store activities and new products. All the points of sale in the US continue to be challenged.

Our business in Latin America continues to be a priority area and in the quarter we opened our first store in Argentina. Revenue from the region increased 31% and it is now representing 80% of revenue from the Americas. EMEA generated revenue of DKK 2.2 billion corresponding to an increase of 8% in local currency. The increase was mainly driven by store acquisitions which added DKK 210 million to revenue in EMEA of which DKK 100 million was related to Spain. Revenue in Asia-Pacific was DKK 1.1 billion, an increase of 11% in local currency. This was driven by improved development in China as revenue from Australia declined 15% in local currency for the quarter. Australia was impacted by declining revenue from charms and a continued decline in revenue from Chinese consumers and tourists in general.

With this, I hand over Anders Boyer who will take you through the P&L and the balance sheet.

0.23.29

Anders Boyer

Thank you Anders but just before we go on to the next slide, I would like to say that this is obviously a very difficult quarter for Pandora and a much more turbulent start as a CFO than I had envisaged. But I just want to say two things before going into a couple of more details on the second quarter. I said yes to become the CFO of Pandora because I do see great opportunities for the company to generate value. And I don't say that as a complete outsider because, as you know, I have been on the board of Pandora since 2012. But actually it has been a difficult period for our investors and this quarter is no exception but for whatever it is worth in a turbulent week like this, I want to say that Pandora is here to stay. Pandora is not a fad. I know it is a strong statement, but we don't or I don't see anything to the contrary when we look into the numbers. Absolutely, yes, we have our share of struggles and we need to execute faster and execute more effectively on our strategy, but when we look behind all the numbers our total like-for-like was -1% in the second quarter and -3% in the first half. That is a negative number but things are not falling apart. We have a strong brand. We have strong manufacturing capabilities. We have strong innovation capabilities and we have a strong global network. And that is a strong platform to come back on a track where we create shareholder value including increasing the revenue that we have in the other categories.

And secondly and much more concretely, I hope that you appreciate that today we also give you the total like-for-like numbers, not just at group level, but also on the 7 major markets and we hope, as Anders said, that this will help you better understand the development in our business but you also see that we will give you some additional insight into the DSO development and hopefully that also mitigates or explains some of the concerns that you have understandably had on that KBI.

If you then go to slide 19 on the EBITDA margin, we are building an EBITDA margin bridge in a different way that in the prior quarters because we are trying to reflect the impact of the actions that we actually take rather than just summarising what happens in the P&L line by line. And again, we hope this gives you better insights into the dynamics of the transformation that we are going through, the dynamics of our business. I think the bridge is pretty self-explanatory and several of the components you already know from what we talked about at the Capital Markets Day and what we talked about at the last quarter such as the metal mix and the higher O&O share, but as you can see, and obviously I would like to say, the DKK 200 million one-off in the second quarter last year obviously not just impacts the top line but also the EBITDA margin Y/Y.

We also saw some impact in the quarter from the longer production time on the new products, but it is in the quarter as such. It is not a large number. The impact will be higher and more visible as we get into the gross margin in the second half of the year. I would also just like to highlight that the second quarter EBITDA margin includes a negative impact of close to 1 percentage point related to the ongoing acquisitions and the inventory that we have taken over at wholesale prices and the size of that impact is obviously directly linked to the level of forward integration that we are doing in any given year and therefore it will be a relatively high number in 2018.

Another thing I would like to mention while we are on this slide is that we obviously between the board and the management regularly look at the KBIs that we used to drive the business and of the key KBIs is obviously the EBITDA margin. And we are looking into whether that is the right metrics to use to measure profitability. We are considering whether EBIT might be a better metric as it better captures value creation, not least considering that we do have quite some CAPEX levels in the business. And EBIT, when we come to 2019 going onwards we will also be subject to less accounting noise if you like because next year, as you know, IFRS 16 comes into force. We have not concluded anything yet but I just want to say this so it does not come as too much of a surprise if we decide to use EBIT as the key profitability measure next year.

If you then go to slide 20, you can see the free cash flow in the corner was around DKK 1.1 billion up from DKK 0.6 billion in the second quarter of last year and the increase was mainly due to more favourable movements in our working capital compared to last year and that gives us a cash conversion in the quarter of 91% and 59 year to date. As you can see, the trade receivables were around or roughly unchanged at 5.9% of revenue but if you look at the Days Sales Outstanding instead we do see an increase from 39 days last year to 59 days this year. I think it is worth spending just a minute on that development on the next slide, slide 21.

As you can see here on this bridge there are a number of building blocks in understanding the 20-day increase from last year. DSO did increase – a decrease from 66 days in Q1 of this year down to 59, but that does not change the fact that Y/Y we have a 20-day increase. First of all, if we look at the DSO calculation. A DSO calculation the way we do it is supposed to show the DSO development in the wholesale channel but the fact is that some of our retail revenue actually carries some receivables, not least related to the eSTORE, and this overstates the DSO as the retail receivables are included in the numerator in the KBI but not in the revenue in the denominator. And when you look at it Y/Y that is 3 days of increase. When you look at the 59 days as such 7 of those days are due to this anomaly in the way the KBI is calculated. Secondly, and I think you know that already, the acquisition of our Spanish distributor had an impact of around 4 days. Thirdly, we did see an increase in our overdue trade receivables and that amounts to around 8 days Y/Y. It is not an issue from a bad debt perspective, we don't see a risk, but it is surely an issue from an operational point of view and we will increase our focus on reducing overdue receivables. And I would say the 8 days increase Y/Y that does include an impact from the US where we – some of you probably know that we implemented a new IAP system over the summer and a couple of days – 3-4 days of those 8 days impact is related to that transition to a new IAP platform. And with that I will hand it over to Anders for some closing remarks.

0.32.30

Anders Colding Friis

Thank you very much, Anders, and please turn to slide 22. So if we summarise the quarter, revenue grew by 4% in local currency and delivered an EBITDA margin of 31.1%. We see improvement in the business in China and the US. However, we have seen Italy slowing down in the quarter. And looking ahead, we will launch a new charms/bracelet concept in the second half with PANDORA Reflections while we increase the focus on rings, earrings and necklaces. At the same time, we do maintain our focus on cost to protect our profitability. So thank you very much for listening. And we will now take questions. Operator please.

0.33.16

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question, please dial 01 on your telephone keypad now to enter the queue. Once your name is announced you can ask your question. If you find it is answered before it is your turn to speak, you can dial 02 to cancel. So once again that is 01 to ask a question or 02 if you need to cancel. And our first question comes from the line of Michael Rasmussen of ABG. Please go ahead your line is open.

0.33.44

Michael Rasmussen

Thank you. Thank you very much. So my first question goes on your charms. What makes you so certain that this category will recover growth-wise? I mean, looking beyond the launch of Reflection are you considering also maybe changing the prices or do you need to go back and look at some of designs potentially? Then my second question goes to Anders Boyer directly. Anders, welcome on board. And now you have had a deep dive into the business. What surprised you more or most both from a positive and a negative side? And potentially what do you think working capital as a percentage of revenue should be longer-term in Pandora, please? Thank you.

0.34.41

Anders Colding Friis

Thank you very much for your questions, Michael, I will do the first one and most obviously Anders will do the second one. If we look at charms, I think that the pre-request to see a positive development in charms is that we see a development in the sales of bracelets. So bracelets are the carrier and then we add charms. I actually think it is encouraging to see the development in the bracelets and clearly we have seen this, you have also seen this that over the years we have seen a slow decrease if you look at the ratio of charms per bracelet. We have actually done some work over the past few months to understand this development better. And what we see is that where consumers used to have a preference to have more charms – let us just take some numbers and say 6 or 7 charms on a bracelet it is probably more around 5 now so simplicity is something that consumers are looking for so the reason why we feel comfortable and confident on our development in charms is that we a positive development in bracelets which is a pre-request for the charms, but we just have to accept and adapt to a point where we see less charms on a bracelet.

When we look at the new products that we are launching, the new PANDORA Reflection concept that we are putting into market in October, it is also about broadening our span. We talked about that at the Capital Markets Day but we see an opportunity of also capturing new consumers into the brand and that is something that we expect to do through that. And Anders.

0.36.21

Ander Boyer

Yes, thank you for the questions, Michael, if I start off sort of at the end about the working capital, I think that is – it is a day, working day 6 in the company and I think it is too early for me to comment specifically on the net working capital target. I think the 15% target that we laid out at the Capital Markets Day – a long time ago – is a good yardstick to think about when we look ahead. I think another angle to – if you think about cash – I think we obviously have to all the time re-visit and think about how we use cash in the company both to open new concept stores and forward integration and that we will do very carefully and we already do that and we will continue obviously to do that whether that spend of cash makes sense. On the pluses and minuses I would say in general of course I have been on the board since 2012 so obviously I had some insight into the business already so I wouldn't say I have been neither very positively surprised nor very negatively surprised because I actually did listen and sit here – I was on the board if that answer kind of makes sense to you.

0.37.58

Michael Rasmussen.

And how many charms should one expect or do you expect consumers to put on each Reflection bracelet, please?

0.38.05

Anders Colding Friis

Yeah, that is a very good question and the obvious answer is as many as possible but I think that what we look at is something which would be similar to what we see in this study we did so it can be down to two for some consumers, others more. We also still see consumers who are buying a full bracelet of charms so it is not like we are seeing everything moving in one direction but we see the trend going in the direction of less charms per bracelet.

0.38.36

Michael Rasmussen

Thank you so much and all of the best forward, Anders.

0.38.39

Thank you very much, Michael.

0.38.42

Operator

Thank you. Our next question comes from Zuzanna Pusz, Berenberg. Please go ahead. Your line is open.

0.38.47

Zuzanna Pusz

Good morning. I have two questions, please. First of all, on the comments regarding the inventory level in Wholesale, I was just wondering what has changed since Q1 when it comes to the inventory levels because I think I remember in Q1 when we were discussing the wholesale channel and potentially the fact that maybe the inventories were too high, which is why some of the products were ending up in the grey market in China. If I remember correctly, we were reassured that there were no issues with the inventory so I am just wondering what has changed? I mean and also what is the situation by region, I mean is there one specific region where the inventory level is the highest? And also what kind of measures you may take to address it? I mean shall we expect an inventory buyback or any colour would be really helpful. Also secondly on the mid-term targets that were announced at the Capital Markets Day so there was a 35% EBITDA target which if I remember correctly was meant to be the kind of average profitability we could see over the next 5 years so how shall we think of it right now? Is it the target you will try to return to in the next 5 years or, I mean, is it even still a sustainable level of profitability? Any additional comments on that would be also really helpful. Thank you.

0.40.17

Anders Colding Friis

Thank you, Zuzanna, very much for you question. If we look at the development of inventory you can say we have seen a reduction. I think you can also now with the like-for-like numbers triangulate that and see this is just a reflection on where we are. If you look at why we see this, I think there are a couple of things that is driving it. One is clearly the fact we had a negative like-for-like number in the channel and you would understand that. The other thing which is important is that as we have also stated in the announcement today, we have actually cut our lead time from the manufacturing facilities already now down to the 4 weeks that we actually expected to reach at a later stage. So that of course gives our partners confidence that they can get inventory when they need it and you can say we want our partners to have as much inventory as they need to make sure that they don't have out-of-stock situations but not more than that. What we have seen we just say that with the guidance change we have made on Monday of this week behind that is also an expectation that this will continue during this year.

And then the EBITDA, maybe Mr. Boyer would take that?

0.41.42

Anders Boyer

Thank you for the question, Zuzanna. I think the future profitability looking at 2019 onwards this is supported by a number of factors and we do see a way back to an EBITDA margin of around 35% but of course it goes hand in hand with returning to 7-10% growth and not least getting to a positive like-for-like but let me just take you through some of our thinking on the margin from 2019 onwards and how we get from 32% this year versus the 35% and I apologise for a maybe little bit long explanation but there is no single bit movers in this but a number of smaller components. So no. 1, as you saw in the announcement earlier on this week of reducing the number of open positions like positions in the company with 400 people and that give DKK 150 million or 60 basis points, also margin support getting into next year, the procurement programme that Anders talked about just earlier on, that is another point – 8 percentage points or so as a runway when we get into 2019. Then no. 3 obviously the destocking, the inventory impact hits quite hard on the margin in 2018 because it just flows through with the gross margin directly to the bottom line so that will have a kind of a one-off impact – I don't know if that is the right terminology but it hits the margin and it won't hit the margin next year. Then you should expect that we will have less headwind maybe to the tune of 50 basis points from less inventory impact following acquisitions of franchisees going into 2019. The DKK 1.4 billion broad integration impact is quite a high number and I think we should expect that that number will be lower next year. Then we will obviously have a negative run rate impact from the higher production time and the new drops in 2019 given a bigger impact in the second half of 2018 and that obviously has a run rate negative impact Y/Y getting into 2019. But we do have a number of actions in place to offset that run rate impact getting into next year. So that was 5 of the components already but then number 6 obviously is leverage and leverage is an important thing and we do see that we have the infrastructure in place to grow and the way to think about it is at full leverage then a 1 percentage point of top line growth gives us 0.4 percentage point or so on the EBITDA margin. And then I again apologise for the long explanation but this is – I think this is important to all of us. We do see a few other opportunities that we look at, not least on the cost side and it is nothing dramatic and single bit buckets on the cost side, but we do see a number of things that could help us support the margin onwards and that could also include further opportunities on the IT side. That is a rather long explanation but again we have to underline that obviously the risk in the long-term guidance has increased but when you look at all the things that we are doing we do see a way back on the margin to the territory that we have guided back at the Capital Markets Day.

0.45.50

Zuzanna Pusz

Okay that is very helpful so just to clarify one thing because I am not sure I understood it correctly so can we expect, do you expect to return to a 35% EBITDA margin next year? Or is this something that we should see as a target out in 5 years? I just want to clarify it because I thought that the initial plan was to keep on average at the profitability at 35 so I want to make sure whether right now it's.. could it turn to 35 in the 5 years basically?

0.46.21

Anders Boysen

Yes, 2019. That is the answer. That we see a way back to that to that around 35% EBITDA margin in 2019.

0.46.34

Zuzanna Pusz

Okay perfect. Thank you very much.

0.46.37

Operator

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

0.46.44

Lars Topholm

Yes, a couple of questions on my side so you mention in your report that you have seen a weak July. I just wonder if you can put any additional colour on that along the same trends you have observed for Q2 or are there any specific markers that have changed the direction or how do you see that? And a second question goes to the increased production complexity because our impression is that a number of the best selling SKUs are in order backlog so I wonder if you can comment on that situation, I mean, not only the margin impact which obviously is from products taking a longer time to produce but also the whole supply chain, to what extent you believe a lack of being able to supply these products has hurt your top line and what the supply situation is today? Thank you.

0.47.51

Anders Colding Friis

Thank you very much for your questions, Lars. When we say July it is of course the reason why we do that is because that is also part of what we have evaluated when we looked at the full year here so when we say that it is a slightly slower than what we saw in the first half of the year. At the same time we also have to say July is one of the smaller months in the year for Pandora and we came into more activities and also a bigger month in August and September so it is just telling you also that is what we see but also that has been taken into account when we have looked at our expectations for the full year. And when we then look at our.. it is correct that we always had a bit of backlog issues in Pandora but we have had some extraordinary issues and we had some of – which you also say which is correct – a couple of the bestsellers which have been out of stock for a period of time. I think, it is important to say when we look at now but are actually from the middle of June we got to a point where we have solved that. We are in a very, very good state when it comes to supplying and securing the orders so that has been – that is a lot stronger than it was there. If we take one of the products which has been doing very well – the dream catcher – personally I must say I had big hopes for that and so did a lot of people. There were some of the regions that actually ordered too little in the beginning so that has been part of the challenge we have seen.

0.49.39

Lars Topholm

Thank you very much I have some more questions but I should jump back into the line and Anders good luck going forward.

0.49.46

Anders Colding Friis

Thank you Lars.

0.49.49

Operator

Thank you. Our next question comes from the line of Henry Yew of Morgan Stanley. Please go ahead. Your line is open.

0.50.00

Henry Yu

Yes hi. Good morning everyone. This is Henry. A couple of questions from me as well. First of all on the increased production time. We understand that it has increased quite a bit because of your new products but do you expect the production time for these new products to come down over time? And if so what is the time horizon for that? And just a second question on your eSTORE as well. So yet another very strong quarter for the eSTORE but in some of the markets where you recently launched the eSTORE, could you give us an indication of what kind of impact that has had on your performance with your physical store network?

0.50.39

Anders Colding Friis

We will try to do that. If you look at the increased production time what is behind it to give you a little bit of flavour is look at the dream catcher. If you follow our assortment that is a good example of a product where there are more parts so it is not more complicated. There are just more parts which need to be assembled. And honestly we have underestimated how much time that would take. There is a learning curve and that is also why it has taken us a while to find out what is the exact production time of those products. In the assumptions that also – Anders Boyer – now there are a lot of Anderses in the room – Anders Boyer alluded to, we have taken the assumption that also in the coming years we expect to have a higher production time on the new products. We need to stay relevant for the consumers and we believe this is one of the ways to do that and then we have our efficiency programmes which are to offset that and Anders also talked about that. If we look at the eSTORE actually what we see in general is that the eSTORE and the physical stores work very well together so in markets where we open a new eSTORE we see a good – it is very different for markets – we have markets with high double-digit eSTORE rates and we have markets as we talked about before like Italy where it is relatively low so there is a very big difference depending on how big the penetration in eSTORE generally is. What we see, and I think that is important, and we have seen that in the US, we have also seen that in China – when we have areas where we don't have stores and we open a physical store we actually increase our eSTORE revenue so I think the important thing for me to say is that eSTORE and physical stores work very well together.

0.52.32

Henry Yu

Okay that is all, Anders, and all the best going forward.

0.52.33

Anders Colding Friis

Thank you very much

0.52.37

Operator

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

0.52.43

Hans Gregersen

Good morning. If you look at charms it is a little bit difficult to gauge this from your report but is it fair to assume that the new charms are actually underperforming like-for-like with the existing platform? And what sort of changes or expectations can we have to or when the charm trend can be stabilised? That is the first question. The second question goes, related to the first one, financial engineering in terms of buying out stores, to what degree can that compensate for let's say revenue pressure in the charms category? Thank you.

0.53.21

Anders Colding Friis

Thank you, Hans, for your questions. When we look at our charms and how it has developed the assumption in our strategy or not in the strategy because that is actions but in the objectives we have set for our study was that we should see an uplift in charms based on the launch of new products and we have not seen that so if you look at the numbers it is actually the same development we have on the new charms as existing and we had expected more. And then if we look at the acquisitions – when we look at acquisitions what we do is that we look at them one by one and that is something that we do Anders and I together to evaluate whether we think that that is a good – for us if it becomes bigger acquisitions – we always have the board on board on that so I think we won't accelerate anything. We will look at the opportunities which are there and do the ones which are really supporting of our financial development.

0.54.24

Hans Gregersen

So Anders, just going back to your first answer. My question was rather than what the strategy plan was saying what do you see now and going back to my second question is: understand your process or how you evaluate the acquisitions. But do you think that that.. how much revenue decline is a likely scenario in charms and to what degree can you compensate that by financial engineering? That is essentially the question.

0.54.55

Anders Colding Friis

Financial engineering is not something we do. We run a business and the important thing is that everything we do to run the business is supporting it. What I said about the charms is that the development we have seen on the new charms is the same as the existing so we have not seen the new charms do better. They are just doing as much as the existing charms so that is the answer, at least, I try to convey. And we continue looking at franchise acquisitions but only do the ones which are the right ones so we are not going to accelerate that to compensate for something. We look at this and we can see we have a lot of interest from franchisees and we take the best ones but we will also get to a point where it will probably slow down because we have taken the best ones. So that would be my answer to that. I hope it helps.

0.55.48

Hans Gregersen

I will quickly follow up on that Anders. Do you see the prices you are paying for stores coming down giving the – let us say – the weakened market outlook?

0.55.56

Anders Colding Friis

The answer is yes, clearly any acquisition is based on the expected like-for-like development in the country and in the store and when you see a downturn, clearly that has an influence on the price.

0.56.12

Hans Gregersen

Thank you.

0.56.13

Operator

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

0.56.21

Chiara Battistini

Yes, hi. Thank you for taking my questions. I have a couple, please. The first question on the medium-term guidance and you mention to reach the 35% EBITDA margin you need also the top line to go back to 7-10% and now you are saying actually that the new charms are now showing a profit in reflection versus the existing portfolio so what is giving you confidence that you can accelerate your top line next year to 7-10%? Also in the context of lower contributions from store openings and also lower contributions from acquisitions. The second question is on your marketing spend and I was wondering how come with marketing done in Q2 given that you are through the big work for the launch of Shine and how should we be thinking about marketing spend for this year and next year, please? Thank you.

0.57.11

Anders Colding Friis

If we start with your first question on the long-term guidance and what are the drivers behind that? You can say there are three main drivers of our top line in Pandora. One is the network expansions, the other one is acquisitions and then of course as I think also Anders alluded to before a pre-request for us meeting the long-term guidance or the medium-term, whatever you want to call it, is clearly that we see an improvement in the total like-for-like numbers. I actually find it even though we did not get to the number we had hoped for it is encouraging to see the development we have had from Q1 to Q2 where we have seen an improvement and that is clearly driven also by the fact that we have launched the new products but we do need to see a stronger development in charms. Now, of course we have so far innovated very much on the Moments platform but in October we launch a new platform, the PANDORA Reflections, and that is also part of driving forward the development on charms. When we look at marketing, we have spent the money behind the launch of Shine and a lot of that was actually already in the first quarter of this year so if you remember we had a slightly higher spend in the first quarter. We are still keeping the same level of marketing spend – 9-10% - as we have said before. As you know, over the next 5 years according to our strategy plan we expect that number to come down a little bit but that is because we transform from wholesale to retail revenue so the absolute number will still increase.

0.58.57

Chiara Battistini

Thanks a lot and maybe just just one follow-up on marketing spend, you see a 9-10% for 2018 but on a top line that is much lower than what we were planning at the beginning of year, so there is no change there in terms of percentage?

0.59.12

Anders Colding Friis

Actually, I can say that we have been running as part of our procurement programme and I think we have that in one of slides for today, we have had a consolidation of our media agencies and that means that we have become more efficient in the marketing spend so it means that we will get more activities for the same money and thereby we will also or even a little bit less money so that means that we will keep ourselves within that framework.

0.59.38

Chiara Battistini

Perfect. Thank you very much.

0.59.40

Anders Colding Friis

Thank you, Chiara

0.59.42

Operator

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

If your phone is on mute, it is mute you want to use to un-mute.

0.59.59

Anne-Laure Bismuth

Yes hi it is Anne-Laure Bismuth from HSBC. I have two questions, please. Just coming back on the marketing expenditure so given the weakness in the charm category and the focus of silver on your other product categories. Do you think that your metric requires more investment to reach the awareness on the other product categories? That you need to invest more money in marketing in order to raise the awareness on the sort of product categories given the weakness of the charm category? And my other question is about the gross margin. What was the split between the positive impact from channel mix and the negative impact from metal and product mix in Q2? And how should we think about the gross margin evolution for the full year? Thank you.

1.00.51

Anders Colding Friis

I will do the first one and I think, Anders, you will do the second one. If we look at our marketing expenses you are actually touching upon a very important part which is of course we look at how we deploy our marketing. I think that at least our evaluation is that we have the right funds and as I mentioned before we are also becoming more efficient so in that way we actually can see we can increase the level of marketing without increasing the spend and we are deploying more on the new categories. I think what is important to also understand is that we are driving the brand PANDORA. The awareness of charms and bracelets for Pandora is super high. We actually are known for those categories so we do deploy, relatively to earlier, a larger part of our marketing spend towards the new categories to drive that also in the future. And then I will leave the other question for Anders.

1.01.53

Anders Boyer

Yes thank you for the question and Laure on the gross margin I think the first part of the question was related to specifically the second quarter and the bridge that we had in the investor presentation and in the – I know we have lumped it together in the bridge, but the bigger part specifically in Q2 was related to the metal mix and product mix and the smaller part on the production time as such specifically in the second quarter, I think you should expect to see gross margin declining a bit compared to the first half in the second half of the year due to the higher production time but obviously O&O on the other hand fills up more in the second half given the nature of the seasonality of O&O, but still you should expect gross margin to go down a bit in the second half.

1.02.51

Anders Colding Friis

If we maybe look at the metal mix and the difference between the Rose and the PANDORA Shine we had anticipated with the launch of PANDORA Shine where we are very happy with the results that we would see a little bit of trail off in PANDORA Rose. It is actually very encouraging to see that that has not happened. So we have actually seen that strengthen so the fact that we have now more metals and more colour in the stores seems to support each other.

1.03.18

Anne-Laure Bismuth

Thank you

1.03.21

Operator

Thank you. Our next question comes from Poul Jessen of Danske Bank. Please go ahead. Your line is open.

1.03.29

Poul Jessen

Yes, thank you. Just the first question is if Peder Tuborgh is still around?

1.03.35

Anders Colding Friis

He is.

1.03.37

Poul Jessen

Okay, then a question about a search for a new CEO but also new board members about the strategy which was announced in January is that written in rock or will that given new board members and a new COO and a new CEO will that then be up for revision within the next year? Or should we look at the current strategy as the one which will also be present 2 or 3 from now? Yes, that is more or less the question.

1.04.12

Peder Tuborgh

And the short answer to that is that we, as a board, believe strongly in the strategy and the direction that we have set out as I also explained at the Capital Markets Day what we need to see is probably in some areas a different approach or balancing of some of the strategic components and then it is very much about execution and understanding the transition period that the strategy actually is imposing on us but the strategy.. we are behind the strategy and we can see also that underlying you can see that even in the Q2 report that underlying the strategy is working we just need to have more speed on it and probably have slight adjustments in how we execute some of the components.

1.05.10

Poul Jessen

Okay, thank you and then the second question. That is more on the operation so the guidance for the second half you said that the forward integration would be skewed towards the fourth quarter. Is that distributors that will come in or is it more forward integration of buying franchisees?

1.05.29

Anders Colding Friis

Well, the short answer is it is forward integration buying franchisees. And then clearly when it comes to distributors that is bigger chunks and that is a little bit difficult for us to predict as closely time-wise but we see when it runs out but this is forward integration of franchise stores.

1.05.48

Poul Jessen

Okay, thank you.

1.05.50

Anders Colding Friis

You are welcome.

1.05.52

Operator

Thank you. Our next question comes from the line of Mimosa Spencer from WWD. Please go ahead. Your line is open.

1.05.57

Mimosa Spencer

Yeah hi there. I had a quick question about the effort that you are making to reduce the problems with the grey market in China, if you could just give us a little more colour on that. You mentioned lowering prices and increasing marketing. Also, I was wondering if you are present on any multi-brand e-commerce platform in that country? And very quickly on the decrease in the number of charms in a bracelet. You mentioned that you conducted a study. Did your study turn up any information like perhaps that other brands are selling charms that people are adding to your bracelet? Thank you very much.

1.06.41

Anders Colding Friis

Thank you very much for your questions. If we start with the grey market in China. Marketing is more an opportunity we saw in China to support the development in and we have actually seen that working well so it has not really anything to do with the grey market. It supports the brand overall. What we have done and we have done that methodically over a longer period of time but also in the quarter is that we have closed down and turned down on infringing online listings and closed thousands of those and that is something we will continue to do. I think the most important activity or action we have taken in terms of capping we will never remove it but capping the grey market in China is that we have lowered the prices. That is not seen in this quarter. That will be seen in Q3 because that was implemented in the month of July. And then we have when we look at multi-brand e-commerce we don't have any multi-brand e-commerce unless you see Tmall as multi-brand – and it is not, so we don't have that in China. If you say then: Are there multi-brand or any other sites? That is exactly the challenge we have with the grey market that Pandora is sold across a lot of different platforms. We only sell at this time on Tmall and through our own eSTORE in China. And then finally on the study where you asked whether there were competing platforms or competing charms which were ending up on Pandora jewellery and the answer is very simple. No, we haven't seen that.

1.08.29

Mimosa Spencer

Okay, thank you very much.

Anders Colding Friis

You are welcome.

Mimosa Spencer

Good luck.

1.08.35

Operator

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

1.08.42

Klaus Kehl

Yeah, hello, a question to the guidance for the full year. You say you expect the 4-7% growth in local currencies for 2018. But if I do the math, then at least forward integration will be around 6%, new stores ought to be around 3%, then we have an impact from the like-for-like growth at group level and then there ought to be some inventory – yeah reductions. So just to get a feeling for what your thinking is, would it be fair to say that the new guidance is based on a negative like-for-like or yeah what are your comments around that?

1.09.27

Anders Colding Friis

Yeah, we are looking at each other, but you are welcome to answer

1.09.30

Anders Boyer

Anders will answer it in any case, no matter who – I can, this is Anders Boyer and thank you for the question, Klaus. Yeah, it obviously depends on the answer whether you look at the high end or the low end of the guidance range, but if you look at 4% then in that scenario if we end up at 4% it is probably assumed that the forward integration will be a little bit less than the DKK 1.4 billion guided. Obviously, there is always uncertainty to that number as well, but then if you in that calculation also you build in the DKK 200 million one-off in this quarter that you know about and some destocking it is probably assumed that in the second half you would have low mid-single-digit negative like-for-like in that scenario. So we came out with, on average in the first half, -3% total like-for-like and then in that low-end scenario of the range that will probably be to the tune of -5%. And then if you do the same math on the 7% range you will probably get closer to that – that implicitly means a like-for-like in the second half total like-for-like in the second half to the tune of 0.

1.10.57

Klaus Kehl

Okay and then just a follow-up. This forward integration so it means that the DKK 1.4 billion, it is not a done deal. It's yeah you need to do more acquisitions in order to reach the DKK 1.4 billion. Is that correctly understood?

1.11.11

Anders Boyer

The bigger chunk is done. I think given that we are in month 8 the bigger part of the alternatives is also about exact timing. When do you actually do the closing? And take always that month, A, B or C. But the bigger part we are obviously in dialogue already etc. It is a question when do you sort of get to putting pen to paper and make the closing accounts.

1.11.37

Klaus Kehl

Okay, excellent, thank you very much.

1.11.42

Operator

Thank you and our last question comes from the line of Hans Gregersen of Nordea. Please go ahead. Your line is open.

1.11.47

Hans Gregersen

Yes, in terms of the trade overdues can you say those 8 days in terms of credit risk how big is the amount and then going back to the previous of out-of-stock. Do you have any out-of-stock issues in Q3 as of now? Thank you.

1.12.10

Anders Colding Friis

If we do the second one and then Anders can come back to the first. The answer is yes, we always have a bit of out-of-stock but what I said before was that actually when we look at our inventory situation and our ability to deliver we are in a very, very good state right now. I think I talked to Thomas Touborg who is head of that part of the operation the other day and he was very happy and he said that it is the best he has seen for quite a while but it doesn't mean that we don't have out-of-stock situations in individual stores and there can be one item which is a little bit delayed here and there but in total we are in a very good situation.

1.12.50

Hans Gregersen

So the example you gave about another product being out of stock, Green Cat or whatever you call it, those are general out-of-stock issues you don't see anymore.

1.13.00

Anders Colding Friis

No, you can say that specific issue has been solved but we had a little bit of a backlog and that is absolutely true. I think the market which was most affected by was the US where we have seen a number of reasons also a little bit low forecasting on some of the products because that is also part of it where we sad they have been affected more than anybody else. If you then ask how much has that affected the business, I would say not a lot because I think it is actually something that we are happy with in the quarter. We saw a 3% positive like-for-like number totally in the US market so we have generated a lot of traffic to our stores through the new product and the good thing is that our store staff have been able to convert people and convert them in other products and hopefully then they will come back when we get – as we now have the collection stock.

1.14.01

Anders Boyer

On the other question, Hans, from the credit risk perspective we don't see a risk on the overdues that is the short answer. So it is like historically also we have had as I understand it, I am looking at my Investor Relations colleagues here – very, very low bad debt expenses and that does not change.

1.14.23

Klaus Kehl

Yeah but the question was, I mean, you mentioned there were 8 days where you said 3-4 days were related to the new IT implementation so let us take 4. The simple question is: How big is the amount, those 4 days, how big is the amount equal to?

Anders Boyer

That's.. I am just doing the math on why we think that is 7% of the total days if you like and if I remember right we have DKK 1.1 billion in trade receivables in the balance sheet and I can look that up while I speak so that will translate into let's say DKK 75 million.

1.15.00

Klaus Kehl

Okay thank you

Thank you very much

Operator

Thank you and I will now hand back to our speakers for the closing comments.

Anders Colding Friis

Thank you very much operator and thank you to everybody for listening to the call today and for your questions. Have a great day.