Pandora A/S

Transcript: Investor Presentation, Annual report 2017

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Operator

Welcome to the Pandora A/S Annual Report 2017. Today, I am pleased to present Magnus Jensen. 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. Magnus, please begin.

0.00.16

Magnus Jensen

Good morning everyone and welcome to the conference call related to Pandora's full-year results released this morning. My name is Magnus Thorstholm Jensen from the Pandora Investor Relations team and with me I have our CEO, Anders Colding Friis, and CFO, Peter Vekslund. I will now hand over to Anders who will give you an overview of the overall performance for 2017 before Peter shares some highlights from the fourth quarter. Finally, Anders will conclude the presentation and then we will be happy to take your questions. Before I hand over to Anders, I would like to point your attention to the disclaimer on page 2. Anders, please.

0.00.53

Anders Colding Friis

Good morning everyone and thank you for joining the call this morning. 2017 has been an eventful but also a challenging year for Pandora. We continued the strong performance in several of our key markets. However, we were also impacted by a weaker performance in some of our more developed markets. Looking ahead, our focus is to deliver on our 2022 strategy that we presented at our Capital Markets Day. In short, the strategy is about capitalising on our strong position as the world's largest manufacturer with the most recognised brand. We will leverage our fully integrated value chain and capture the ample growth opportunities in the global jewellery market through four core strategic focus areas. We are going to innovate affordable jewellery, lead in agile manufacturing, we are going to digitalise the brand experience and win in omni-channel retail. With this strategy, we are confident that we delivery continued growth and strong profitability in 2018 and in the years to come. With that said, let me go through the highlights for 2017.

Please turn to slide no. 3. Revenue for 2017 was DKK 22.8 billion and increased 12% compared to 2016 or 15% in local currency. The Asia-Pacific region was the main driver of growth increasing 25%, whereas revenue from the EMEA region increased 13%. The US continued to be affected by a challenging retail environment and consequently revenue from the Americas region increased 4%. On the product side, the performance in our more established markets has been impacted by a lack of new concept as well as too much repetition in our collection. Nevertheless, all product categories delivered double-digit growth in local currency for the year.

We opened 308 new concept stores in 2017 and continued to increase the control of our network. Half of the concept stores opened were owned and operated and on top of this we acquired 200 concept stores during the year. Acquisitions had a positive impact on revenue of around DKK 750 million.

Moving on to our profitability, EBITDA for the year was DKK 8.5 billion corresponding to an EBITDA margin of 37.3%. The effective tax rate was 24.8% and the higher than anticipated level was due to the new US tax reform as well as the repatriation of dividend related to Pandora production in Thailand. Excluding the two one-off items, the effective tax rate was approximately 21%.

Finally, free cash flow for the year was DKK 5.3 billion, on a par with 2016. Peter will come back later in the presentation with how we plan to distribute cash to our shareholders in 2018.

Please turn to slide no. 4. Now, let me sum up some of the key strategic accomplishments in 2017. First, our crafting facilities in Thailand. We started the year by opening a brand-new state-of-the-art crafting facility in Lamphun. The facility is part of a larger expansion programme which also includes a new facility in Bangkok which was opened this January. With the two new sites, we secured capacity for the future and we have a much more agile and efficient production set-up. We have already reduced our lead time from 8 to 6 weeks with plans in place to deliver in four weeks or less from 2019. We are very pleased with the progress we have made in 2017 towards becoming a full jewellery brand. In the last couple of years, we have successfully penetrated the rings market and since 2016, we have improved our focus on the earrings category and also introduced new innovative products in the neckwear category. In 2017, we increased revenue from these three product categories by 28%. The three categories now represent 26% of revenue. We also launched the Pandora Rose collection in EMEA and Asia Pacific in the second half of 2016 as well as the Disney collection in EMEA in October of 2017.

As we have discussed throughout the year, 2017 has been impacted from too much repetition in our product collection, but as showcased at the Capital Markets Day, we have solid plans in place to deliver more relevant and innovative products to our consumers in the future. On this note, I am happy to say that the new Valentine's collection has been very well received. This collection includes several designs from our new design team and it is great to see that it works with the end consumer. Even though it is a small collection, we are happy to see that the products so far are making up around 8% of sales out in the weeks since launch compared to 4% last year.

Our efforts to optimise our global store network continued in 2017 and during the year we added 308 new concept stores while closing around 650 other points of sales. Furthermore, to increase the control of our network, we added 376 Pandora-owned stores of which 200 were acquired from franchisees and distributors. This included successful integration of the distribution in Spain, Belgium and South Africa. We will continue this journey in our strategy period from 2018 to 2022, and in 2018 two thirds of all concept stores opened will be Pandora-owned.

Finally, we continued our development towards a balanced global business. We increased the share of total revenue from Asia to 13% from 11% in 2016, mainly driven by expansion in China where we added 58 new concept stores. Furthermore, we established a hub in Panama in January to increase our focus on Latin America and during the year we opened 34 new concept stores in the region. Looking ahead, these newer markets will be an important part of our growth, and in 2018 more than 40 concept stores are planned to be opened in China and around 40 in Latin America. With this, I hand over to Peter for a more detailed review of the Q4 numbers.

0.08.03

Peter Vekslund

Thank you, Anders and now please turn to slide 5. Total revenue for Q4 2017 was DKK 7.6 billion, an increase of 15% or 20% in local currency. Organic growth was 12% in local currency while acquisitions added around DKK 520 million for the quarter, including around DKK 170 million from Spain. Revenue from Pandora-owned retail increased 51% and represented also 51% of total value compared to 38% in Q4, 2016. Growth was supported by a like-for-like increase of 15% as well as the expansion of the store network. Additionally, acquisitions added around 27% growth. The main driver of the like-for-like growth was the eStore which increased by 62% in local currency and represented 11% of total revenue for the quarter. Revenue from franchise concept stores decreased 11% in local currency. This included a negative effect of around DKK 200 million from the acquisition of franchise stores. The underlying decrease was mainly due to the challenging retail environment in some of our larger markets as well as the lack of newness in the product assortment. Revenue from other points of sales in the wholesale channel increased 36% in local currency. This was mainly driven by Spain, as other points of sale in Spain are booked as wholesale following the takeover of distribution. Furthermore, Q4 2016 was negatively impacted by around DKK 200 million from product returns in North America. Revenue from third-party distributors decreased 40%, mainly due to our acquisition of distributors. Excluding Spain, Belgium and South Africa where we have taken over distribution, revenue from third-party distributors was slightly down.

Now please turn to the next slide where I will talk through the performance in each of the three regions. Starting with EMEA, the region generated revenue of DKK 4 billion, corresponding to an increase of 20% in local currency. The UK increased revenue by 8% for the quarter, mainly driven by a strong performance of the eStore expansion of the network as well as the acquisition of stores. Italy and France generated growth of 45 and 20% respectively, both as a result of strong performance in the concept stores while revenue from other points of sales was flat. Revenue in Germany increased 9% for the quarter driven by the positive performance of our strong German concept store network. Americas reported revenue of DKK 2.2 billion, an increase of 27% in local currency, mainly driven by the US. Revenue in the US increased 31% in local currency, supported by the acquisition of franchise stores with around DKK 190 million and a negative one-off related to the product returns in Q4 2016 of around DKK 200 million. Excluding the two technical tailwinds, growth in the US was around 2% in local currency. This was driven by network expansion as well as a strong performance in the eStore resulting in like-for-like growth in the US of 27%. US retail conditions continued to be challenging and this resulted in negative performance in the physical network. Revenue in Asia Pacific was DKK 1.4 billion and increased 13% in local currency. We continued to see a strong performance in China where revenue increased 62% in local currency. This was mainly driven by our store expansion as well as a strong performance in our Chinese online business. Revenue in Australia decreased 3% in local currency, mainly due to a slowdown in traffic from Chinese consumers.

Now please turn to slide 7 which is an overview of our five product categories. Revenue from charms was DKK 4.2 billion, an increase of 19% in local currency. Growth was mainly driven by the continued success of the Pandora Rose collection as well as the launch of the Disney collection in EMEA. Revenue from bracelets increased 13% in local currency, supported by the launch of several new bracelets, including the fast-track Open Bangle and the Silver Mesh bracelet. Demand for rings, earrings and neckwear remains strong and they deliver double-digit growth in local currency of 24, 33 and 40%, respectively. All categories have been well supported by successful marketing campaigns and a greater in-store focus.

Now please turn to slide 8. Gross margin for the quarter was 75.8% compared to 75.2% last year. The increase was driven mainly by an increase in the share of revenue from Pandora-owned retail which had a positive impact of around 3 percentage points. This was partially offset by metal mix, mainly related to a higher share of revenue from Pandora Rose as well as 1 percentage point impact from higher realised raw material prices. The EBITDA margin was 40.1% and decreased 1 percentage point compared to last year. The development was driven by an increase in sales and distribution costs due to the increasing share of revenue from Pandora-owned retail. Administrative expenses decreased to 6.8% of revenue, mainly due to increased leverage on cost.

As mentioned with the Q3 results, we decided to increase the promotional level in the fourth quarter of the year. This had an insignificant impact on margins for the quarter. In regard to promotions going forward, we currently plan to do slightly less in 2018 on average compared to last year, mainly driven by a planned reduction in Q4.

Please turn to slide 9. The operating working capital for the quarter was 13.1% of revenue, a decrease of 0.6 percentage points compared to last year. The decrease was mainly related to optimisation of our inventories. In terms of receivables, days sales outstanding were 47 days, up 10 days compared to the same quarter last year. The increase in days sales outstanding was mainly due to revenue in the fourth quarter being skewed towards the end of the quarter as well as the acquisition of our Spanish distributor.

CAPEX investments were DKK 502 million compared to DKK 249 million last year. CAPEX for the full year was 6% of revenue and slightly higher than expected, mainly due to faster progression in our expansion programme in Thailand as well as more own and operated store openings than anticipated. In terms of franchise and distributor acquisitions in 2017, we took over Spain, Belgium and South Africa as well as 200 franchise concept stores. The total purchase price was DKK 1.4 billion plus around DKK 500 million in inventories.

Please turn to slide 10. Before I hand back to Anders, let me share a couple of words on our capital structure and proposed cash return. Our capital structure remains unchanged and we continue to target a net interest bearing debt to EBITDA ratio of between 0 and 1. Based on this, we propose to increase the return to our shareholders in 2018 to DKK 6 billion compared to DKK 5.8 billion in 2017.

In terms of the split between dividend and share buyback, the board of Pandora has carefully considered this. We are aware that any change or no change will not satisfy all shareholders, but on balance the board has decided to increase our share buyback to DKK 4 billion from DKK 1.8 billion last year and we will reduce the total dividend paid out for 2018 to DKK 2 billion. The dividend will be distributed through an ordinary dividend of DKK 9 per share supplemented by an interim dividend of also DKK 9 per share paid out in connection with our half-year results in August.

With that, I will hand over to Anders who will give some more colour on our financial guidance for 2018.

0.17.36

Anders Colding Friis

Thank you very much, Peter. Now please turn to slide no. 11. The guidance for 2018 is within the framework of our long-term strategic targets outlined at our Capital Markets Day. For 2018, we expect to increase revenue by 7-10% in local currency. This will be supported by around 200 concept store openings, of which two thirds will be own and operated, as well as an expected tailwind from acquisitions of roughly DKK 1 billion. Assuming current exchange rates versus the Danish krone, we expect a currency headwind of around 3 percentage points. As in 2017, we expect the year to start slow, mainly due to the gradual introduction of new product designs throughout the year, which is one of the key drivers of growth for Pandora. Therefore, we expect the first quarter to be slightly below the guided range. For 2018, we expect an EBITDA margin of around 35% compared to 37.3% in 2017. This is mainly due to our efforts to increase the Pandora-owned part of the retail network as well as product innovation. As last year, the EBITDA margin is expected to be significantly lower in the first half of 2018 compared to the second half. CAPEX for the year is expected to be around 5% of revenue and this mainly includes investments in owned and operated stores and IT as well as a continued optimisation of our manufacturing facilities in Thailand.

Please turn to slide 12. To summarise the year, we increased revenue in 2017 with 15% in local currency, generating an EBITDA margin of 37.3%. We will return DKK 6 billion to our shareholders, a slight increase compared to 2017 and with more weight towards share buyback. Looking ahead, we expect 2018 to deliver according to our 5-year plan which includes 7-10% local currency growth and 35% margin. We have a strong foundation and detailed plans on how to deliver towards 2022 and look forward to updating you on this journey in the quarters to come. Thank you very much for listening. And we will now take questions. Operator, please.

Q&A

0.20.14

Operator

Thank you very much. Ladies and gentlemen, if you have a question for the speakers, please press 01 on your telephone keypad. And our first question comes from Michael Rasmussen of ABG Sundal Collier. Please go ahead, your line is open.

0.20.31

Michael Rasmussen

Thank you so much. I would like to start up by asking about the Australian market. So now when we see this rather rapid slowdown in growth, what are you planning in order to restore that growth slowdown and can you maybe give a little bit more insight into some details on why is it exactly now that you see the Chinese tourists coming less to Australia? My second question is on the US market. Could you maybe give us a little bit more insight into what your assumptions are for 2018? Are they in terms of traffic ASP and how you see the promotions from competition outlining here in 2018? Thank you very much.

0.21.16

Anders Colding Friis

Thank you, Michael, for your questions. If I start with the Australian market, I think one of the things that we have mentioned on numerous occasions is the fact that we have seen a lot of Chinese consumers in our stores. Now, we can see that some of those Chinese consumers they have chosen to buy products in China instead. So, I think what we should expect is, this is a move. Remember, Australia is one of our absolutely strongest markets and with a penetration which is stronger than anywhere else in the world. I don't think that we should expect this consumer move to be something that we can capture in a plan. I think it is fine and it is driven, to some extent, by the fact that we see a bit more and we have done a bit more promotion activity in China, which has supported people to buy in China rather than Australia. If I look at the US market, we would expect, it is known fact that the retail market in the US is difficult. We expect that to continue so that the traffic will probably also in the future be weak. If we look at where we see our opportunities for growth in the US market in the years to come, it is very much on getting more product newness into the market. We know that the American consumers are very keen on newness and the other thing is, as we have also talked about previously, we do see that our share on the eStore even though it has grown quite a bit from last year, is below the level of the market, which is around 21%.

0.23.06

Michael Rasmussen

So, the comments that Peter made regarding the promotions, that is both for the group and also what you expect to see in the US?

0.23.14

Anders Colding Friis

Yeah, in the US we are going to, we had a bit more promotions in the fourth quarter, we are going to trail that back a bit. Maybe a number, which could be interesting, we have shared before, is the gross to net number, if you look at that in the US, the last time we shared the number I think was in Q3 when we had an around 85% gross to net number, the gross to net number for the fourth quarter is around 83% so it is not a big effect but still we want to scale back a little bit on promotions.

0.23.47

Michael Rasmussen

Thank you very much, Anders.

0.23.48

Anders Colding Friis

You are very welcome.

0.23.50

Operator

Thank you. Our next question comes from the line of Chiara Battistini of JP Morgan. Please go ahead, your line is open.

0.23.59

Chiara Battistini

Good morning, hello, thank you for taking my questions. The first question will be on your guidance for the quarter one saying that you are expecting lower growth than in your early guidance. Can you just tell us more on why this is and given that the counts are easier and you say Valentine's has been very well received so why should we be expecting lower growth for the rest of the year? And also, when you gave us the 7-10% guidance at the Capital Markets Day and the week before with the 2022 targets, were you already expecting this Q1 to be slower for this cadence of the quarters? And the second question would be on your inventories that franchisee levels because I think you have been doing the pre.. earlier shipments in Q3 and also earlier shipments in Q4 so finalising then Q1 2018 so wondering whether you could comment on the level of inventories at the franchisees' levels, please. Thank you.

0.24.58

Anders Colding Friis

Thank you very much for your question, Chiara. If I look at the guidance for Q1, what you have to remember is that the reason why we had a weaker quarter one last year is that we launched our Valentine's collection already in the end of 2016. That is exactly the same this year so the two quarters are comparable. We are a product brand and Pandora is very much a product brand so one of the things that we need to do is add more newness to the assortment. We have started doing that, we are very encouraged by the fact that our Valentine's collection is doing very well, as I said before, it is actually for the first few weeks here 8% of sales out compared to 4% in the same quarter of last year. So that is encouraging but we have to remember that it is only around 44 DVs that we have launched so there is a limit to how much impact we will see from that. Further, if we look at the other launches we are going to have, we have talked about Pandora Shine but also Drop One, it is going to be in the market from 15 March and thereby have a relatively small impact on the first quarter. Peter will answer the second question.

0.26.15

Peter Vekslund

Yes, Chiara, in terms of your question on inventories at the franchise level, that is at a normal level and we have not seen any significant change to that even though we do not have full insight into all franchise inventories.

0.26.31

Chiara Battistini

So you would say you are happy with the levels you are aware of at least?

0.26.34

Peter Vekslund

Overall happy on the level while we are of course continuously focusing on inventory levels and getting a turn in that in our stores.

0.26.47

Chiara Battistini

Perfect, thank you, and maybe just a follow-up on the SHINE, as you mention and there is a.. can you comment on early receptions from the franchisees on this SHINE collection, please?

0.26.57

Anders Colding Friis

I certainly can, I was actually, just after the Capital Markets Day I went to Miami where we presented the new Shine Collection to our American franchisees and that was a very, very, very nice event, there were a lot of positive reactions to the Shine assortment and I think that it is important to say that we launch Shine in connection to our Drop One but the whole drop has a lot of newness in it so we expect to see positive development across but clearly it helped us get a little bit enthusiastic around Pandora SHINE.

0.27.36

Chiara Battistini

Great, thank you.

0.27.37

Anders Colding Friis

… so much.

0.27.39

Operator

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

0.27.47

Hans Gregersen

Good morning. You have mentioned before that promotions will be slight less in 2018, mainly due to lower activity in Q4. Can you confirm whether this is in specific geographies or across all over? Secondly, in terms of turn-in of the SHINE collection, how much should we assume that will carry in value for the franchise operators? And then finally, the depreciation of around 230 in Q4, is that sort of a good running rate for 2018? Thank you.

0.28.21

Anders Colding Friis

I think, when you look at promotion, thank you very much for your question, Hans, promotions, you should expect that to be across markets. So we are taking the level a little bit down, especially, as we have said, in the fourth quarter. When it comes to Pandora SHINE, we do not give any numbers on that, we have talked about Rose and also Disney previously, and we see it as something like that. If you take the Disney, the essence, and the Rose collection and put them together, they would be in terms of total revenue share in Pandora 15-20%.

0.29.10

Peter Vekslund

With respect to your last question, can you please repeat that, Hans?

0.29.14

Hans Gregersen

The depreciation level in Q4, is that sort of the running rate going into 2018?

0.29.21

Peter Vekslund

So overall, the increase in depreciation is due to our increased investments in IT projects as well as own and operated stores, so expect around that level.

0.29.35

Hans Gregersen

Thank you.

0.29.36

Anders Colding Friis

Thank you very much.

0.29.39

Operator

Thank you. Our next question comes from the line of Kristian Godiksen of SEB. Please go ahead, your line is now open.

0.29.47

Kristian Godiksen

Thank you. I was wondering if you could add some flavour to what expected revenue impact you have from the net 200 concept store openings but also the closing of the multi-branded retailers and then secondly, I was wondering if you could comment a bit more on your like-for-like performance in the US in Q4, both for the physical stores but also combined with the e-commerce and then I guess with the strong traction you mention now both for Valentine's and also the SHINE and an easy company in the US when you invested??? 0.30.19 in Q1 2017 both with the promotions and lack of newness, I guess. Is it impossible to think that like-for-like for physical stores could be positive in Q1 in the US? Thank you.

0.30.34

Anders Colding Friis

I think Peter will do the first one and I will get back to the second one.

0.30.36

Peter Vekslund

Yes, in terms of your question on revenue for the 200 store openings then at the Capital Markets Day we had a couple of slides explaining the dynamics of the store openings. So overall, expect that new store openings will have a lower productivity, so lower revenue per store at around index 75 and also the 200 openings will be around two thirds being owned and operated and one third being distributor and franchise openings. And finally, the split is around 50% in EMEA and 25% in Americas and 25% in Asia Pacific. So a lot of building blocks we need to put together to transfer the 200 openings into a revenue number.

0.31.26

Anders Colding Friis

If we look at the like-for-like numbers in Q4 in the US, we can see that the eStores did very well and actually we got to the point where it is more than 10% of our revenue so we are catching up in an area where we have also previously said we needed to catch up. It also means that when we look at our physical stores, owned and operated but very much the same for the franchise stores, it is slightly negative and that is something that we… or slightly negative but a little bit better than in Q3, so we saw an improvement during that. Let's talk about what happens in Q1 when we finish the quarter in terms of the US but of course it is, as I said before, encouraging to see that our franchisees have received the Valentine's collection but also the news on the SHINE launch positively.

0.32.30

Kristian Godiksen

Okay, thank you, just one quick follow-up for Peter, so you mention a lot of building blocks for the 200 concept store openings but what are your plans for closing of the multi-branded retailers?

0.32.41

Peter Vekslund

Again, as we explained at the Capital Markets Day, we will continue our journey of upgrading our branded network and therefore also closing the other points of sales but that would be gradually over the period with a couple of hundred per year.

0.33.01

Kristian Godiksen

Okay, thank you.

0.33.03

Anders Colding Friis

Thank you very much for your question.

0.33.04

Operator

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

0.33.13

Anne-Laure Bismuth

Yes, hi this is Anne-Laure Bismuth from HSBC. I just wanted to come back on your comment regarding the margin in H1, especially the significantly lower ??? issue??? 0.33.23 Is it linked to the finishing of store acquisition that.. and product complexity which will weight more in H1 than in H2? And my second question is about the performance in the UK, which slowed down in Q4 from 22% at constant affection??? 0.33.41 in Q3 to 8% in Q4? Thank you.

0.33.48

Anders Colding Friis

Peter will take the first question, I will get back to the second one.

0.33.52

Peter Vekslund

Yes, so in terms of the phasing of the margin between first half and second half, in past years we have had around 4 percentage points in difference between EBITDA in first half and second half with second half being significantly higher so around 4 percentage points. That is also to be expected in 2018 and that is because we do see leverage in the second half as we get more revenue from our conversion into being owned and operated retail.

0.34.23

Anders Colding Friis

And if we look at the UK market, remember that when we go back to Q3, we actually launched the Disney collection in the market and that had a positive impact and if you look at the.. actually maybe adding to this, I think we talked to some of you, at least, about the fact that we expected Disney to be more well-received in the Southern part of Europe than in the UK but it has actually been doing very well in the UK. If you look at the underlying performance between Q3 and Q4, it is more or less unchanged in the UK market.

0.35.02

Anne-Laure Bismuth

Thank you.

Anders Colding Friis

You are welcome.

0.35.05

Operator

Thank you. Our next question comes from the line of Elena Mariani of Morgan Stanley. Please go ahead, your line is open.

0.35.12

Elena Mariani

Hi, good morning. A couple of questions from me as well. The first one again on your growth phasing through the year with regards to the top line because I was also surprised by the guidance on Q1 so perhaps putting together your expectations on the underlying pickup on the back of the new collections but also the store openings and forward integration initiatives, how should we expect the fourth quarter is to look like? Is it incrementally growing, the outlook you have, or how should we expect, for example, Q2 versus Q3 versus Q4, given that the comp base is not helping us to figure out the trend. And then the second question is again on Pandora SHINE, you said that you are going to launch it in mid-March but I guess that is going to be in your retail stores so haven't you seen the benefits yet of the sell-in or are you not expecting to see benefit in Q1 from the sell-in into the franchisees' network and sell-in into the Pandora SHINE, could you remind us of the gross margin differential versus the rest of the product? Is it lower, similar to Rose, or is it more in line with the rest of your products? Thank you very much.

0.36.37

Anders Colding Friis

Thank you very much for your questions. If we start with the phasing of the growth during the year, what we can see, and that has been foreseen as we move into new products, yes, you should expect a positive development as we move through the year and introduce more products. Remember, we expect to launch 650 new DVs during the course of 2018 and that is to make sure that we accomplish more newness in the market. That is one thing. The other thing you should be aware of is that as we become more an owned and operated retailer, we will be slightly more skewed towards the fourth quarter of the year. We will have the sell-in to concept stores of Pandora SHINE and clearly also to the franchise concept stories, we have taken that into account and we will get the benefit from that. I think that that will be probably as much as you would have at any launch because what you need to do is to have the initial products in the store and then on top of that, clearly we expect to have replenishment orders when and if, what we hope, that the products will be well-received by the consumers. I think on the last point, Peter has a point.

0.37.55

Peter Vekslund

Yes, in terms of the gross margin on the Pandora SHINE collection, let me remind you that the SHINE products are priced one price point above Pandora Rose, so around index 130 compared to our ordinary or normal Silver assortment so that the gross margin is comparable to Pandora Rose so there is a diluting impact on the gross margin from Pandora SHINE.

0.38.25

Elena Mariani

Thank you. Maybe just one brief follow-up. With regards to the store openings and forward integration, how do you plan to phase them through the quarters? Thank you.

0.38.35

Peter Vekslund

Yes, in terms of the forward integration, that is equally split over the quarters. First three quarters, of course, are being impacted by Spain, but overall forward integration equally phased over the four quarters.

0.38.53

Elena Mariani

And the store openings as well?

0.38.57

Peter Vekslund

The store openings, we will see how the year progresses. Usually, we have quite some store openings in the back half in Q4.

0.39.06

Elena Mariani

Okay, thank you very much.

0.39.08

Anders Colding Friis

Thank you very much

0.39.10

Operator

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

0.39.19

Klaus Kehl

Yes, hello, Klaus Kehl from Nykredit Markets. Two questions. Also a question related to SHINE, how difficult is it for you guys to produce these new products? That will be my first question. And secondly, returning also to this forward integration, you say that you expect a tailwind of 1 billion for 2018 and I believe that Spain must be a very large part of that but the remaining, let's say 3-400 million, are they already in the books or do you need to make further acquisitions during 2018 in order to reach this 1 billion in sales? Those would be my questions.

0.40.03

Anders Colding Friis

Thank you very much, Klaus. SHINE first, we.. it is difficult to produce, we can produce and we have the capacity to produce SHINE. Clearly, there is also, as in any other thing, a limitation to how much you can do of that but we have enough to do it and we have actually done quite a lot of preparation on SHINE to make sure that, as we also stated at the Capital Markets Day, that we have a very, very, very strong quality concept around that. Maybe adding one thing on this, as you know, historically we have done any plated products outside of Pandora, we are presently preparing ourselves to bring that in-house and we will do that in the later part of 2018. And then Peter will take the second question.

0.40.54

Peter Vekslund

Yes, in terms of the forward integration expected to be around 1 billion, then Spain is around 300 of that and in total, we have around two thirds of the one billion on the books already so a placeholder for acquisitions to come is also included.

0.41.16

Klaus Kehl

Okay. Thank you very much.

0.41.18

Anders Colding Friis

Thank you very much.

0.41.20

Operator

Thank you. Our next question comes from the line of Frans Høyer of Jyske Bank. Please go ahead, your line is open.

0.41.29

Frans Høyer

Hi, it is Frans Høyer. Two things. The novelty, the design variation 600 of them in 2018, how does that compare to 2017 and it sounds like it is going to be not so much in Q1 and then successively more later in the year. And the second question is on the innovation centre that you mentioned at the Capital Markets Day. How much of that a step-up in costs is that innovation centre going to give you, when did it actually start to kick in or when does it start to kick in, please?

0.42.08

Anders Colding Friis

If you look at novelty and the 650 products that we expect to launch, it is about 200 products more than we did last year and actually a step-up compared to what we have done before. So it is a substantially higher number and the reason being that we feel that there is a need to replenish the assortment with the newness. And yeah, the innovation centre Peter will…

0.42.37

Peter Vekslund

In terms of the innovation centre, it is in Thailand, it is a separate building housing around 3-400 employees and it is included, of course, in our guidance and the CAPEX was included in our capacity expansion programme that we did in Thailand. So, there will be in the P&L limited impact but of course all that is included in our guidance for the year.

0.43.06

Frans Høyer

Okay, thanks.

0.43.10

Operator

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

0.43.16

Lars Topholm

Yes, two questions on my side. Just first in connection with what Klaus from Nykredit asked on store acquisitions. What cash flow effect should we assume from acquiring stores in 2018? And then a second question goes to what you, Anders, said about contraction in Australia being a function of revenue moving back to China, so if I look at the decline in Australian revenue, it is of 63 million compared to Q4 the previous year. China grows 135 million but in Australia you lose wholesale revenue and in China you gain retail revenue, i.e. revenue at a higher level, so wouldn't that mean that if, let's say that the 63 million loss in Australia all gained in China that at least 63 of the 135 million you grow in China is coming from Australia? And if it is so, wouldn't it imply that underlying your growth in China is decelerating quite rapidly or how should we look at this? Thanks.

0.44.37

Peter Vekslund

I will start there with the store acquisition question and as guided at the Capital Markets Day, we said that we would spend up to or around a billion buying back stores and that is still the case. Of course, that number varies, depending on the progress over the year and the individual stores taken over.

0.45.02

Anders Colding Friis

And maybe just clarifying on China and Australia. What you see in Australia is that you have Chinese residents in Australia living there who buy Pandora products and then sell them online in China. We, of course, monitor that and see that declining a bit but that would not go into our numbers, if you understand what I mean, so it is actually a change which is outside so I am not sure I can follow your calculations, Lars. Probably it is…

0.45.40

Lars Topholm

No, but my point is, Anders, if they buy in Australia and sell online in China, your book it as revenue in Australia. If they now stop buying in Australia because you discount more in China, then presumably people buy directly in China and then it goes into your numbers in China. So you are basically shifting revenue from Australia to China, isn't that what is going on?

0.46.08

Anders Colding Friis

Overall, Lars, you are correct in this, we have the same conversation when we close multi-branded accounts in various markets. So measuring and capturing the flow of consumers from closed accounts into neighbouring concept stores is very difficult to measure, same is going for Australia.

0.46.32

Lars Topholm

That I understand, but shouldn't we assume that if Australia contracts because of this, then your growth in China should accelerate, which it doesn't? I mean, shouldn't there be concern, if I shouldn't be concerned, then why shouldn't I?

0.46.49

Anders Colding Friis

Well, I think, we are not concerned, we saw a small decline in Australia in the quarter and we still are very, very happy with the development in China so I think if there is any other questions and actually if you look at the growth in China, it is 62% so a pretty healthy development. I don't think we can get into more of the details of this here.

0.47.16

Lars Topholm

That is fair enough. Thank you very much for answering my questions.

0.47.19

Anders Colding Friis

Thank you very much, Lars.

0.47.22

Operator

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

0.47.30

Kristian Godiksen

Yeah, just a couple of follow-ups here. First of all, I was wondering, loosely you said that if you are in the high-end level of your fall integration which you are now you are guiding for the 1 billion, you may end up the high end of the local currency revenue growth guidance. Is that also the case for 2018? And then secondly, I guess what are your thoughts on taking on more debt now as I see you with your new share buyback programme and also dividends for 2018, is it still that you are aiming for the lower end of your capital structure range? And then I was just wondering if you had any updates since the Capital Markets Day on progress on implementation of some of the omni-channel initiatives you laid out in connection with the CMD? Thank you.

0.48.19

Anders Colding Friis

I think what we can say is that we build our plans for 2018 and with that we guide for between 7-10% growth, that is what we expect.

0.48.31

Peter Vekslund

And in terms of the debt, then our capital structure policy still between 0-1 net interest bearing debt to EBITDA and that we are not aiming for the lower end, so it will be in the range 0-1.

0.48.48

Kristian Godiksen

Okay. On the omni-channel process?

0.48.53

Anders Colding Friis

Can you repeat that question, what was that?

0.48.54

Kristian Godiksen

Yeah, on the CMD you mentioned that one of your must-win battles for the US is to implement these, to have a better omni-channel approach, which you would also implement here and speak to the franchisees regarding both H1 and H2 of year 2018. I was just wondering if you had any updates on that since the CMD?

0.49.15

Anders Colding Friis

We don't have any update. We are talking to our franchisees and it is something where I am happy to say that there is an understanding on both sides that we need to service our consumers in the best possible way. So we are moving on it but we don't have an update at this time but we will get back to you when we have.

0.49.34

Kristian Godiksen

Okay, sounds good. Thank you.

0.49.37

Operator

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

0.49.44

Hans Gregersen

Yes, at the CMD you mentioned that the new option programme had not yet been approved by the board. Can you shed any light if it has been, I mean in the past, as far as I understand, it has been based on a very low strike price and a low number of shares. One could argue that if you have a far higher number of shares based at market price, you would be more aligned with shareholders. What is the status on this, please?

0.50.10

Anders Colding Friis

Thank you very much for your question. We actually have included that in our annual report on page number.. what is it, nine, on page number nine. What you can see in that is that our long-term incentive programme is totally aligned with the strategy that we presented on the Capital Markets Day so it is about the growth of the company, 7-10%, and also EBITDA margin. But you have a good overview of that programme on that page.

0.50.57

Operator

Thank you. Our next question comes from the line of Michael Rasmussen of ABG Sundal Collier. Please go ahead, your line is open.

0.51.06

Michael Rasmussen

I have two follow-up questions, please. First of all, on the forward integration, isn't it rightly understood that people ask about what cash flow impacts they should put into

2018? But isn't it so that the two thirds of the 1 billion, you already acquired that in 2017, or am I missing something here? Another follow-up question is on the lower than expected or the growth below 7-10% that you talk about in Q1, was this already the plan at the Capital Markets Day or is this something which you have seen since then? Thank you.

0.51.46

Anders Colding Friis

Thank you very much, I will do the last one. The easy answer to the second one and short is yes, that was expected, as it is related to the progression in our product newness. So we have expected that this will go and we will see this progression in growth during 2018. And Peter will do the other one.

0.52.10

Peter Vekslund

Yes, and on your question forward integration and the 1 billion, which overall you are correct on that, but also remember that in this year, we are buying stores that will be taken over in 2019, so overall on the cash flow impact over the next five years, expect around this billion, even though it is a ballpark number that we are giving to guide you.

0.52.36

Michael Rasmussen

Great, thank you for that clarification.

0.52.38

Anders Colding Friis

Thank you very much.

0.52.41

Operator

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

0.52.50

Poul Jessen

Yes, thank you. A question about the gross margin. Looking into the specs you gave about the composition of the COGS where we can see that the actual spend on silver, gold, raw materials and so on is more or less flattish and the volumes produced actually are down, that means that the whole increase is in the line of other which is up by some 700 million. Can you give some insight into what is actually driving that increase in the other line?

0.53.23

Peter Vekslund

Yeah, so included in the other line that is anything that is leather, that is gemstones and that is also other base materials not being gold and silver included in that. And also remember that part of our Pandora Rose collection is currently being produced outside and we are on track and planning to take that in-house in 2018.

0.53.57

Poul Jessen

Yeah, but if you take out, there are some other materials, but if you go down and take out materials and you take out wages, then there is a number left back which is increasing from about 1.7 billion to 2.4 billion and that is more or less the full increase in cost of goods sold?

0.54.21

Peter Vekslund

Yeah, and part of that, I am just getting the slide up here, you can say, on the other we have also opened our new facility in Chiang Mai where we do, of course, we have opened the facility up there and in 2017 there is to some degree a small overlap as we are transferring the production up there. On that, we will be happy, Poul, when we meet at the roadshow, to dive more into the details on this question.

0.55.02

Poul Jessen

Okay.

0.55.04

Anders Colding Friis

Thank you very much.

0.55.05

Operator

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

0.55.14

Lars Topholm

Yes, just a question on France because here it seems momentum improved quite a bit and I remember on the previous calls you mentioned you had some issues in France so I just wonder if you can give some comments on that improvement? Thanks.

0.55.32

Anders Colding Friis

Thank you for your question, Lars. We are very happy with the development that we saw in the fourth quarter in France, clearly a combination of opening stores and also seeing a positive development in the market, so we have a new GM, general manager, in France in place and we are addressing some of the issues we had. I think the way you should look at this going forward is we got in a good start with the new team in France and expect that we are not totally through the woods but it is encouraging to see the performance in the fourth quarter.

0.56.13

Lars Topholm

Thank you, Anders.

0.56.14

Anders Colding Friis

You are welcome.

0.56.16

Operator

Thank you. And we have no further questions on the line at this time. Please go ahead, speakers.

0.56.24

Anders Colding Friis

So thank you very much for joining us today and listening in in the call and for your questions and we wish you all a great day. Thank you very much.