S&P Global
Ratings

RatingsDirect®

Research Update:

Danish Fine Jewelry Retailer Pandora A/S Assigned 'BBB' Rating; Outlook Stable; Proposed €500 Million Notes Rated 'BBB'

February 28, 2023

PRIMARY CREDIT ANALYST

Valentina Guerra
Paris
+ 33 1 4075 2565
valentina.guerra@spglobal.com

SECONDARY CONTACT

Abigail Klimovich, CFA
London
+ 44 20 7176 3554
abigail.klimovich@spglobal.com

Rating Action Overview

- Danish jewelry retailer Pandora A/S plans to issue €500 million senior unsecured notes under a new €1.5 billion Euro Medium-Term Note (EMTN) program. Proceeds will repay the Danish krone (DKK) 3 billion term loan maturing in December 2023, repay the drawings outstanding on the credit lines, and fund general corporate purposes.
- We think Pandora will continue growing 4% on average annually over the next two-to-three years thanks to its loyal customer base, and its versatile and low-budget wristwear design concept, which is likely to continue appealing to customers despite the weakening economic climate and squeeze on discretionary spending.
- We think Pandora's consistently conservative financial policy, geographic diversity, and relatively flexible cost structure will support free operating cash flow (FOCF) over the next two-to-three years, translating into S&P Global Ratings-adjusted debt to EBITDA of less than 1.5x.
- We assigned our 'BBB' long-term credit ratings to Pandora and our 'BBB' issue rating to the company's proposed €500 million senior unsecured notes.
- The stable outlook reflects our expectations that, over the next 24 months, Pandora will continue expanding its earnings, while preserving its adjusted EBITDA margins of above 30% and a solid level of annual positive FOCF after leases exceeding DKK2.6 billion, such that adjusted debt to EBITDA remains stable at about 1.3x and FOCF to debt is above 40%.

Rating Action Rationale

Our rating reflects Pandora's conservative financial policy, which underpins its financial flexibility. Pandora has a conservative financial policy commitment to a leverage ratio of below 1.5x, including its lease liabilities, and a long track record of operating within this framework while distributing dividends to its shareholders. The company preserved its FOCF and adhered to its commitment throughout the pandemic, even when it had to intermittently close stores in various regions over the past three years. We expect Pandora will continue pursuing this financial policy and respect its leverage target, and we forecast stable S&P Global Ratings-adjusted debt to EBITDA at about 1.3x over the next two-to-three years. Despite revamping the share buyback program in 2023, we believe the company's financial framework supports preserving a solid cash position, and we believe that Pandora has the flexibility to pause its share buyback program to preserve its liquidity, should the economy deteriorate further.

Gift-giving and greater recurring revenue sustain the business model's resilience. The jewelry market has demonstrated its relative resilience through the economic cycle thanks to the recurrent nature of purchases linked to celebrations, such as Christmas, Valentine's Day, birthdays, and anniversaries. According to Euromonitor, the fine jewelry market grew 3% from 2008-2010 and 5.8% from 2019-2022 year on year. Although it relies on a more concentrated product offering compared with rated competitors Goldstory or Signet Jewelers, Pandora has greater revenue recurrency than these peers thanks to its charm bracelets offered under the company's flagship product line, the Moments & Collabs platform, which accounted for about 70% of the 103 million pieces of jewelry sold in 2022. Strong brand awareness, affordable prices, and personalization opportunities afforded with a broad selection of charms have created a solid consumer franchise and loyal customer base. Therefore, we expect the company's revenue to increase about 1.5% in 2023 and 5.0% in 2024, supported by new stores opening, sustained volume, and modest price increases.

Pandora's vertical integration and low inventory depreciation risk underpin its robust profitability and alleviate inflationary stress. The company is a vertically integrated operator: It owns the entire product value chain, from manufacturing to direct-to-consumer stores and online platform. The vertical integration gives Pandora greater flexibility in managing its collection design and product availability, control over its commercial strategy, and cost structure. The company's focus on wristwear, while posing a higher concentration risk of falling out of favor with consumers, enhances profitability by streamlining processes and tools. Moreover, more than 80% of Pandora's products are made from silver, whose price has increased moderately over the past year compared with precious metals such as gold or palladium. Pandora faces lower inventory risk compared with rated fast fashion retailers such as H&M and Next, since it can mitigate fashion risk by melting and reusing silver to create new products rather than selling at a material discount. Pandora is also less exposed to inflationary pressure on transportation costs. Thanks to the average item size and weight, their products can be shipped via air freight, which is not experiencing the same inflationary pressure or disruption as ocean shipping. We expect the company to mitigate cost inflation via price increases, economies of scale, and cost savings, maintaining an adjusted EBITDA margin at 33%-35% in 2023 and 2024, in line with the 33.3% in 2022.

Pandora's geographic diversity and increasing footprint in new markets cushions the effect of economic downturns. The group operates in more than 30 countries, with about 30% of revenue generated in the U.S., 14% in the U.K., 10% in Italy, 5% in Germany and France, and the rest spread across Western Europe, the Middle East, Africa, Australia, and the Americas. As part of its Phoenix strategy, Pandora intends to expand its operations in the U.S. and China, doubling and tripling their current size, respectively; and in Latin America, where it should capitalize on relatively low brand penetration and appeal to more affluent customers. We view favorably the company's geographic diversity, because it offers some protection against economic downturns. Indeed, while we expect U.S. and eurozone real GDP growth to stall in 2023, we expect China's real

GDP to grow by about 4.8%, while Latin American GDP will expand by about 1.1%. Moreover, we think the average Pandora customer in emerging markets is more affluent compared with those in Western Europe, supporting earnings resilience during recessions.

Despite the revamped capital expenditure (capex) program and normalization of working capital pattern, we forecast solid FOCF. After two years of halted capex due to the pandemic, Pandora is resuming investment in its manufacturing capacity, store expansion, refurbishment, and strategic projects, spending DKK1.8 billion in 2023 and DKK1.5 billion in 2024, compared with DKK1.2 billion in 2022 and DKK586 million in 2021. Moreover, we expect working capital to weigh on the company's cash generation in 2023 due a heightened level of inventory, as the group expands activity and integrate franchise partners. Nevertheless, we expect Pandora to generate a solid DKK2.6 billion of FOCF in 2023 and DKK4.8 billion in 2024, which will allow the company to finance shareholders distributions.

The Phoenix strategic program and related investment incorporate some execution risks. The company launched Phoenix in May 2021, aiming to fuel its core operations, the Moments platform, by increasing brand desirability and efficiency of operations through omnichannel and digital investment, marketing, and new product development. Moreover, in its efforts to diversify the product offering with new collections, Pandora revamped its Style & Upstream Innovation platform by adding new collections of classical jewelry, a new collection targeting Gen Z, and an innovative collection of lab-created diamonds. Since the launch of Phoenix, total revenue increased 13% in 2022, supporting our forecast. However, we cannot exclude execution risk related to the program's ambitious scope, since investment in the associated strategic initiatives could fail to deliver expected results amid economic uncertainty and pressure on discretionary consumer spending.

Our rating on Pandora considers the lack of product diversity. The group derives more than 70% of its revenue from the Moments & Collabs platform, which entails bracelets with charms. Although the company intends to diversify its reliance on one product line through investments in its Style & Upstream Innovation platform, we expect the flagship product line to continue to account for a similar share of revenue over our forecast horizon, highlighting the reliance of the business model on a consistently strong customer appeal of charms and bracelets. Although these offer greater recurring revenue compared with traditional jewelry, the socioeconomic characteristics of the average Pandora customer in developed economies makes them more sensitive to fluctuations in disposable income compared to luxury customers. Moreover, demand for Pandora products depends on customer preferences and the company needs to rely on significant marketing investment to avoid customer disengagement.

Pandora's manufacturing facilities concentration in Asia-Pacific exposes the company to elevated event risk. The group's manufacturing facilities are in Thailand, which we deem exposed to social disruption, anti-government protests, and weather conditions, thereby increasing its susceptibility to supply disruptions. Although the company's advancement in building a manufacturing plant in Vietnam will address some of the key-asset risk, Pandora's production will remain exposed to disruptions in these countries, which are both susceptible to social and political unrest and natural catastrophes.

We adjust Pandora's lease liabilities included in our debt calculation to enhance comparability with those of rated specialty retailers. Under our criteria, we view the reported lease liabilities as artificially short relative to the time the company expects to use the leased stores. Our adjusted debt as of Dec. 31, 2022, includes DKK4.5 billion of lease obligations, compared with DKK3.0 billion reported. In our forecast, we include an additional lease adjustment of DKK2.2 and DKK2.3 billion in 2023 and 2024, respectively.

Outlook

The stable outlook reflects our expectations that Pandora will continue expanding its revenue and EBITDA and maintain its adjusted EBITDA margin steady at above 30% and annual FOCF after leases of above DKK2.6 billion over the next 24 months. We also expect the company to maintain a conservative financial policy, translating into an adjusted debt to EBITDA ratio of less than 1.5x at all times.

Downside scenario

We could lower our rating if:

- The company significantly underperforms our forecast such that its organic revenue declines, its EBITDA margin falls from its historically stable level, or cash generation weakens. This could happen if worsening economic conditions weigh on consumers discretionary spending and overall performance of the gifts and jewelry segment, or if the group flagship product line starts losing appeal among customers; or
- The company shifts to a less conservative financial policy through higher-than-expected dividends or acquisitions, leading to adjusted debt to EBITDA of more than 1.5x or FOCF to debt of below 40%.

Upside scenario

A higher rating would depend on the company broadening the cohort of its end customers and meaningfully expanding its product lines, while maintaining its profitability margins. In addition, we would expect the group to diversify its manufacturing footprint and maintain a conservative financial policy with consistently robust credit metrics and ample level of earnings conversion to cash flows.

Company Description

Pandora is a global affordable fine jewelry retailer. The company operates two global business units: the Moments & Collabs platform, encompassing the company's flagship product, charms bracelet, accounting for 70% of total revenue; and the Style & Upstream Innovation platform, offering a diverse line of products targeting classic jewelry collections, younger customers, and an innovative collection of lab-created diamonds.

In 2022, Pandora reported DKK26.4 billion of revenue and DKK8.7 billion of EBITDA. The company derives about 30% of its revenue in the U.S., 15% in the U.K., and 10% in Italy, with the rest from across Western Europe, the Middle East, Africa, Australia, and the Americas. The company has a well-diversified omnichannel model: about 51% of revenue stemmed from concept stores, 27% from wholesale and third-party distributors, and 22% from its proprietary online platform.

Our Base-Case Scenario

Assumptions

- U.S. and eurozone real GDP to stall at 0% in 2023, before rising modestly by 1.4% in 2024. We expect Latin America's economies to be more resilient, with real GDP growth of 1.1% and 2.4% in 2023 and 2024, respectively. We also expect China's real GDP to increase 4.7% in 2023 and 2024, thanks to the lifting of pandemic-related restrictions and the consequent economic recovery. In our opinion, jewelry market conditions are linked to economic conditions, given they are discretionary products, but somewhat protected by the recurring nature of celebrations such as birthdays and anniversaries.
- Total revenue growth of about 1.5% in 2023 and 5% in 2024, driven by a store expansion strategy in the U.S., China, and Latin America; and positive like-for-like growth in other areas.
- Adjusted EBITDA margin of 33%-34% in 2023 and 2024, in line with 2022, thanks the company's ability to pass through to customers higher costs for raw materials, energy, and transportation.
- Working capital outflow of about DKK1.5 billion in 2023 due to inventory buildup to support the growth and the acquisition of franchised partners. We expect the working capital profile to normalize and have a mildly negative contribution to FOCF from 2024 onward.
- Total capex of about DKK1.8 billion in 2023 and DKK1.5 billion in 2024 as the company continues investing in the expansion of production capacity and store openings.
- Acquisitions of franchised partners of about DKK210 million in 2023 and DKK110 million in 2024.
- Dividends and share buybacks of about DKK4.9 in 2023 and DKK6.0 billion in 2024.

Key metrics

Pandora A/S – Key Metrics

	--Fiscal year ending Dec. 31--				
Mil. DKK	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Revenue	23,394	26,463	26,000-27,000	28,000-29,000	29,000-30,000
EBITDA	8,004	8,804	8,700-8,800	9,400-9,700	9,900-10,900
Total net debt	4,296	8,416	11,300-11,700	12,900-13,250	13,200-13,800
of which, leases	3,900	4,500	5,300	5,470	5,655
EBITDA margin (%)	34.2	33.3	32.5-33.0	33.5-34.5	33.5-36.0
Debt to EBITDA (x)	0.5	1	~1.3	~1.3	~1.3
FOCF after leases	4,644	2,175	2,460-2,560	4,645-4,945	5,210-6,210

DKK--Danish krone. FOCF--Free operating cash flow. f--Forecast.

Liquidity

We assess Pandora's liquidity as adequate. We estimate that cash sources will cover liquidity uses by more than 1.4x over the next 12 months starting Jan. 1, 2023, and remain above 1.4x over the subsequent 12 months even if EBITDA declines by 30%.

We expect principal liquidity sources over the 12 months from Jan. 1, 2023, will include:

- Cash on the balance sheet of about DKK794 billion;
- DKK6.7 billion available of its DKK7.1 billion revolving credit facility;
- Forecast cash funds from operations of DKK5.5 billion-DKK5.9 billion; and
- Debt issuance of DKK3.5 billion from the proposed € 500 million senior unsecured notes.

We expect principal liquidity uses over the same period will include:

- Maintenance, refurbishment, and growth capex of DKK600 million-DKK650 million;
- About DKK2.5 billion of intra-year working capital swings;
- Approximately DKK3.8 billion of debt maturities; and
- About DKK4.9 billion of dividends and share buybacks.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

Environmental, social, and governance (ESG) factors have no material influence on our credit rating analysis of Pandora. We think the company's exposure to ESG risk is similar to that of the broader retailing industry.

The company intends to use only recycled gold and silver in its jewelry by 2025. In 2022, 61% of silver and gold came from recycled products and we think it is well positioned compared with other rated specialty retailers to meet this target, thanks to its vertical integration.

The group has historically benefited from good labor relations and is committed to offering equal rights and opportunities to its workforce, while prioritizing the health and safety of its staff. As a vertically integrated operator, Pandora is exposed to human rights risks. The company ensures a constant dialogue with employee representatives in Thailand facilities meet quarterly and relies on third-party social audits to ensure its Human Rights Policy complies with the UN Guiding Principles on Business and Human Rights (UNGPs). It also manages its social capital carefully, by ensuring controls are in place to ensure compatibility with their Responsible Marketing Standards. It intends to allocate about 30% of communication and branding budgets to content created by underrepresented groups by 2025.

Pandora's governance structure reflects its status as a public company listed on the Copenhagen Stock Exchange. Except for Christian Frigast, deputy chair of the board of directors, board members are independent from management to provide effective oversight and there are no significant controlling shareholders that could negatively influence decision-making to promote their own interests above those of other stakeholders.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2022, the capital structure comprised senior unsecured credit lines, of which DKK372 million was drawn; a DKK 744 million amortizing bank loan; about DKK 410 uncommitted money market line; and DKK3 billion bilateral term loan, all issued by Pandora and ranking pari passu. The proposed €500 million senior unsecured notes the group will issue form part of the new €1.5 billion EMTN program and will repay the DKK3 billion term loan, reduce RCF and other credit line draws, and fund general corporate purposes. The notes benefit from a negative pledge, rank pari passu with Pandora's other senior unsecured debt, and are not subject to material subordination to other instruments.

Analytical conclusions

We rate the proposed senior unsecured notes with expected maturity in 2028 'BBB', in line with the long-term issuer credit rating on Pandora. We have not identified significant elements of subordination risk in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating	**BBB/Stable/--**
Business risk:	Fair
Country risk	Low
Industry risk	Intermediate
Competitive position	Fair
Financial risk:	Minimal
Cash flow/leverage	Minimal
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

-
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Top Trends 2023: Retail and Restaurants, Jan. 23, 2023

Ratings List

New Rating	
Pandora A/S	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB