

Q&A with President and CEO Mikko Helander on 24 October 2019 at Kesko's media and analyst briefing for the Q3 interim report

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Maria Wikström, Danske Bank: A question about profitability in the building and home improvement trade. A 'housekeeping' question to start with, am I interpreting the figures correctly: you state that the comparable operating profit for the building and technical trade totalled €34.5 million in Q3, and you then say that acquisitions accounted for €9.7 million of the comparable operating profit. Minus the acquisitions, the underlying figure is €24.8 million versus the comparison figure of €29.5 million – does this mean that without the acquisitions, the operating profit would have decreased by 16%, or am I interpreting the figures wrong?

Mikko Helander: Jukka has the exact figures.

Jukka Erlund, CFO: The figure also includes Onninen's divestment of the HEPAC business in Sweden, so not all of it is related to the building and home improvement trade, though the most of it is. As we state in the report, our operating profit in the Baltics decreased somewhat and that had an impact. And we also state where we saw growth, namely in Finland and also in Sweden and Norway mainly through acquisitions. But the Baltics fell somewhat short.

Maria Wikström, Danske Bank: Can you help me understand the situation in the Baltics: net sales in the Baltics grew by 22.6% in Q3 yet operating profit decreased – why is that?

Mikko Helander: I'll start and Jorma can elaborate. Competition in the Baltics is tight, especially in Latvia and also in Lithuania. We have a good competitor who is challenging our position as the market leader. Our people have, in my opinion, reacted to the situation with various appropriate measures. Jorma, maybe you can elaborate further?

Jorma Rauhala, President, building and technical trade: Yes, this is especially true for Latvia and Lithuania. In Latvia, our market share fell fairly low at one point. We have now consciously and forcefully sought sales there, which is reflected in the sales figures. The same applies to Lithuania, and this has had some impact on the margins. But it's all according to our plans, and we are seeking growth strategically.

Jukka Erlund, CFO: I'll add that cost inflation in the Baltics is somewhat higher than in the Nordics, that also has had an impact.

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Maria Wikström, Danske Bank: I also have a question about the machinery trade. You've now divested the Finnish machinery trade – how do you see the future of the remaining machinery business?

Mikko Helander: We have already made agreements concerning the business, but the process has taken a surprisingly long time due to the approval procedures of the European Commission and competition authorities. Jukka perhaps is the most familiar with the process.

Jukka Erlund, CFO: We are completing the deal as soon as it is made possible by the competition authorities. The process is still underway and we will see how long it takes. We still own 55% of the machinery trade business in the Baltics, but our intention is to divest the remaining stake.

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Maria Wikström, Danske Bank: Finally, a question about investments, specifically in store sites. You seem to currently have a very competitive store site network. Do you see your store site capex coming down in upcoming years? Can you tell us what the capex levels will be in upcoming years?

Mikko Helander: I think it will come down somewhat. The biggest investments in our store site network and, for example, in redesigning the stores, are now almost completed. But of course you must remember that competition is tight and one reason we are performing better than in decades is that we have been extensively and successfully redesigning our stores. I'm sure we need to keep doing that also going forward. Jukka, do you want to comment? Of course, we have not given any outlook guidance regarding capex.

Jukka Erlund, CFO: Our surface area investments are not very significant. The growth comes mostly from organic development. Growth in terms of store sites comes mostly from K-Supermarkets and K-Markets, maybe some units from K-Citymarkets. But no major increase is to be expected.

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Pirkko Tammilehto, Kauppalehti: A question about the speciality goods trade: Intersport has performed well. Of course, it is a minor part of your business. How do you see the future, the sports trade is a very heavily competed business. How have your two chains fared?

Mikko Helander: They've fared well. Intersport has performed well in terms of market share, sales and profitability, both for Kesko and the Intersport retailers. Budget Sport has also seen progress. We are very happy with the performance of our sports trade. As you said, and as we both know, competition in the sports trade is also very tight, and it is unlikely to ease up.

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Pirkko Tammilehto, Kauppalehti: In the food trade, your prices are of course higher than those of your competitor. Now that the economy is likely to stagnate, what do you expect the impact to be? You state that you expect growth to continue, but is that likely, seeing as your prices are higher?

Mikko Helander: Are our prices "of course" higher?

Pirkko Tammilehto, Kauppalehti: All price comparisons say they are, K-stores fare poorly in those.

Mikko Helander: I expected you to say that! Those price comparisons only compare the prices of 30 or 50 products, while our K-Citymarkets may carry as many as 30,000 products, and a typical K-Supermarket has nearly 15,000 products. Without disparaging such comparisons, also made by the media, we all know that they are in no way mathematically reliable. I point this out because I can guarantee that we also have affordable alternatives. Our high market share and the growth in our market share show that consumers who place importance on price know that we also offer affordable options. If you take our affordable products such as the K-Menu and Pirkka products and compare those correctly to similar products by our competitors, I claim that our prices absolutely hold up in comparison. And luckily many consumers today know that. However, the fact that we offer such a variety of other products as well makes it complicated to conduct reliable price comparisons, especially based on 30 or 50 products. You can't draw extensive conclusions based on those.

Pirkko Tammilehto, Kauppalehti: Do you gather regional research data from lower income areas...

Mikko Helander: Yes.

Pirkko Tammilehto, Kauppalehti: ... and from more affluent areas such as Tapiola? What is the distribution there?

Mikko Helander: Yes, we research this all the time, thank you for asking this question, too. This goes to the core of what I previously said: today, we use data, and based on store-specific Kesko data, we determine a store-specific business idea as well as store-specific pricing that take into account the region and the needs of consumers in that region, including purchasing power. We see the utilisation of this data and store-specific business ideas as one key reason why our commercial success in Finland has clearly improved across the board. In stores where we see that customers place more importance on price, the selections look a bit different, and the pricing also reflects it. Ari, maybe you can elaborate?

Ari Akseli, President, grocery trade: In figures for the grocery trade division, we focus on improving comparable sales and maximising the profitability of sales space. As Mikko said, we do this by defining store-based business ideas based on data, and then optimising selection, pricing and space management relative to the needs of that store's customers. Our solutions are already world-class, not just from our point of view but also from the point of view of our external international suppliers. But as Mikko said, we have more things in the pipeline that will create even more potential, and the figures reflect that, how we improve further. We don't apply just one model everywhere, but models that are optimal for each market. That correlates with unprecedentedly high customer satisfaction and excellent sales development, we are constantly beating the market and competitors. And we are constantly coming up with new, even more developed solutions, which we implement and which affect the whole network.

Pirkko Tammilehto, Kauppalehti: Are there areas or store sites that are less interesting to retailers because they sell cheaper products and margins are lower?

Mikko Helander: No, they are all interesting in their own way once we come up with the right concept for each one. We have very good examples of this, we have seen many cases where a “less-desirable” store site has started to flourish as a result.

Ari Akseli, President, grocery trade: Exactly. I’ve worked in the grocery trade for all my life, but these are truly incredible cases. We had a K-Citymarket, which I won’t name, which had established its place on the market and sales levels. We revamped the operations, built new operating models with the retailer, and sales have doubled over the past 2-3 years. It’s incredible, the same business space.

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Pirkko Tammilehto, Kauppalehti: Have the sales of your car brands been weaker than those of competing brands? Has there been less interest towards Volkswagen’s brands or models?

Mikko Helander: Not Volkswagen so much, but Audi has maybe suffered the most in relative terms. Johan, you can elaborate. Like I said, we may have had more issues with availability than our competitors due to WLTP. There we’ve now seen an improvement. We’ve also had big changes in our range of models, but now that is also quite good. We expect to see a correction as a result. Johan, please elaborate.

Johan Friman, President, car trade: That was fairly exhaustive. You are partly right, Pirkko, that a year ago when they introduced the new WLTP testing, of our brands, Audi suffered the most, and partly Porsche as well. There were long breaks in production due to technical changes. In Finland, when you order a new car, you usually get it in 3 or 4, maybe even 5 months. Last autumn, we didn’t get as many orders for these two brands as we should have, and that was reflected in registrations earlier this year. Volkswagen and SEAT are selling at market pace, while Audi and Porsche are currently somewhat behind. But like we noted in the presentation, Audi is now bringing out plug-in hybrids to almost all models, and our order book for Porsche is currently higher than ever. The situation is correcting, but it has taken longer for our brands than for others.

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Maria Wikström, Danske Bank: You’ve expanded the online sales of groceries to stores other than specific K-Citymarkets, and that creates certain logistical challenges. Before, you had maybe two or three units in the greater Helsinki area delivering items to most households. How does this affect Kesko’s figures, is the retailer in charge of transports? I understood that early on, Kesko took part in the delivery costs? Now with the expansion, what is the impact on Kesko’s figures?

Mikko Helander: There’s an easy answer to this: the expansion of online sales is reflected in Kesko’s figures as sales growth. The expansion of online sales is one reason behind our good sales development and our rising market share, as our online sales are also growing faster than those of our competitor.

As you said, we have many K-Citymarkets which act as hubs that operate online grocery sales on a large scale, and some of those use K Transport, which is the delivery system we have organised together and which has been very well received. However, an overwhelming majority of K Group's online stores use the same platform, but the K-retailers organise the transports themselves, often creatively and efficiently. This is a good model: it is already a good, profitable business for Kesko. Growth is a second important aspect. Thirdly, we can clearly see that the people who use our online stores also visit our physical stores more, the two support each other.

Maria Wikström, Danske Bank: Prices for the same product may differ in a K-Citymarket and a K-Market, do you see it as an opportunity or a threat that customers in certain regions may choose where to buy and compare prices? Will there be a price war between the retailers?

Mikko Helander: No. Another good, topical question that allows us to analyse why we are doing so well today both in terms of sales and profitability. This is another key factor. In the old system, the differences between K-Citymarkets, K-Supermarkets and K-Markets had become too minor. Not just in terms of prices, but in other aspects too. Today, each chain implements its own strategy and the stores their store-specific business ideas, and as a result our chains are much less similar than before, and complement each other. What I've understood from my colleagues is that this type of a situation, in which all the chains are successful and improving their profitability without cannibalising each other, is unique. I believe this is down to differentiation. It's obvious that K-Markets are competing on totally different things than K-Citymarkets. Today, consumers value very highly good, high-quality neighbourhood store services and do not expect all products to be as affordable as in our hypermarkets. That's a healthy change. Do you, Ari, want to say something?

Ari Akseli, President, grocery trade: The beauty of our model is that it is scalable depending on where the market is growing. In the K Transport model, when the delivery volumes of one store grow to a notable size, we can bring in another store nearby to share the volume. So we have a constantly optimal model in terms of logistical efficiency for Kesko in the K Transport stores. As more stores have started to offer online sales, our digital footprint and online visibility have grown.

As an anecdote, I can tell you a practical example. I rode along on an online grocery delivery van on a Saturday, and personally talked to 28 customers. Not one gave feedback on the prices, except to say they were good, and no one considered the delivery fee too high. Do you know what bothered them the most? In a typically Finnish fashion, they all wanted to point out that they were not lazy even though they had their shopping delivered. The same way people did early on with cleaning services.

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Joni Sandvall, Nordea: I have a question about the building and home improvement trade in Sweden. The comparable net sales in Sweden were down, while the comparable operating profit was up. What was the division between K-rauta Sweden and K-Bygg in the quarter?

Mikko Helander: Like I said, K-Bygg's development has been very good in terms of both sales and profitability. It was good before, and now as part of Kesko, the good progress has continued, proving that the integration has been very successful. Another significant issue in Sweden is that we have fixed the problems with Onninen. Development in the infra business, which we kept, is good, and we divested the very problematic business. We continue work on K-rauta, we still have homework to do there and we need to correct past mistakes. We have new management, who are also in charge of K-Bygg. It's an area where we saw some negative development, but we will absolutely carry out corrective measures.

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Pirkko Tammilehto, Kauppalehti: In the grocery trade, how many retailers now have two stores and what is your target? How has the multi-store model worked?

Mikko Helander: Some retailers have up to five stores. Again, thank you for the question, the model has worked extremely well. It's no secret that without the introduction of the multi-store model, we would never have been able to take over such a huge number of Siwa and Valintatalo stores and make them so successful within K Group. Today, the biggest number of stores for one retailer is five. Out of 1,200 food stores, nearly 600 operate under the multi-store model. That shows it has been a huge success, and has also energised the retailers, who have been eager to employ the model.

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