Q&A with President and CEO Mikko Helander on 23 July 2020 at Kesko's media and analyst briefing for the Q2 interim report

**

Maria Wikström, Danske Bank: I have a question about the outlook for construction. The coronavirus has clearly had a positive impact on demand in the building and home improvement trade, while we've seen new construction starts in Finland decline for some time. How do you see things moving forward in H2 in building segments? And how do you see the outlook for construction in Finland in 2021?

Mikko Helander: This is a difficult question. As we've said before and as indicated by the wide range of our profit guidance, visibility remains very limited, especially for building and technical trade. Firstly, there's the epidemic and the question of a potential second wave and its impact on the society and construction. Secondly, there is uncertainty regarding the global economy and Finnish economy. These are the big issues. What we can say is that we are in an excellent condition and, as noted today, we are taking over market share. The situation in building and technical trade has continued to develop positively, but we cannot ignore the fact that there is quite a lot of uncertainty regarding H2, especially in the building and technical trade.

**

Svante Krokfors, Nordea: What made your cash flow so very strong in Q2?

Mikko Helander: First and foremost, our two big divisions – grocery trade and building and technical trade – developed very well, sales have been good. However, we have also improved capital efficiency, significantly also in the car trade. In addition to having good sales, we have managed to improve inventory turnover and to reduce inventories across the board. We have been able to improve cash flow also via terms of payment. There has been a wide range of successful measures in many areas in all our three divisions. Jukka, would you care to elaborate?

Jukka Erlund, CFO: When the coronavirus began affecting our operations from mid-March onwards, we made cash flow development a key indicator to monitor, and have focused on it heavily in many areas. Our sales have been very good, which of course has had a positive impact on cash flow, but we also focused heavily on cost control, and that was visible in Q2, as our cost efficiency developed very well.

We also carried out special measures in working capital management, which have been very effective. Our inventory levels have been well under control, we've carried out sometimes quite significant inventory adjustments in some of our businesses, such as the car trade. So inventories as well under control. We've also been successful in securing and managing trade receivables. We have not seen any significant credit losses despite the epidemic and there has not been a material change in trade receivables.

Trade payables have also been a part of our working capital management. We have been able to improve working capital efficiency via measures related to trade payables, and the situation is good. These actions had a positive impact on cash flow from operating activities, while total cash flow has been impacted by our capex adjustments. We carefully prioritised projects, and adjusted certain investments, and as a result our cash flow from investing activities is also well under control. Our capex for the year is likely to stand at some €200 million, excluding acquisitions, i.e. clearly below last year's level.

Mikko Helander: So successes across the board.

Jukka Erlund, CFO: Yes, extensive positive development in cash flow.

**

Svante Krokfors, Nordea: As a follow-up: you clearly cut your capex targets for the year – have you thought about raising the level again, as your cash flow is strong?

Mikko Helander: We do still invest heavily. Our capex for the year is likely to amount to some €200 million. Adding to that acquisitions – the most important being Carlsen Fritzøe – the figure will be close to €350 million, based on investments decided so far. But it is a valid question: as our sales and profitability development have been so strong, we are currently reviewing options with the divisions, especially in grocery trade and building and technical trade. It is possible we will allocate more to store sites in particular, as the investments we have made in redesigning stores have brought us significant sales growth and profitability improvement, combined with store-specific business ideas and their implementation. These are issues we are currently reviewing and it is possible we will allocate more money towards them this year.

**

Svante Krokfors, Nordea: How have grocery store sales been affected by restaurants opening up again?

Mikko Helander: As we noted, Kespro's situation and sales have recovered clearly faster than anticipated in June, and also, it seems, in July. That's great. Yet despite this, maybe somewhat surprisingly, the sales of our grocery trade chains have not decreased notably, sales seem strong regardless.

**

Maria Wikström, Danske Bank: A follow-up question on grocery trade, where your margin improved despite the weakness in wholesale. It seems the really good underlying profitability development in food retailers' business has continued. How do you see the future, is it possible to improve the margin further? What are the main reasons and successes behind such positive underlying margin development?

Mikko Helander: There have been many successes, and it is important to note that this has been a long-term trend. It's difficult to specify individual reasons here. I would again stress our strategy established in 2015, which emphasises strong growth and considers K-retailer entrepreneurship as a competitive advantage for us – we manage and develop our business based on these. Today, retailers have an obligation to create their own store-specific business idea, and be agile in developing their operations based on that idea. This has been a success factor also under the current conditions. Yet I must also point out that we have 1,200 K-food retailers in Finland, and maybe half of them are currently fully implementing this strategy. That means Ari, I and we all still have a lot of work to do in pushing all K-food stores to utilise this operating model that has proven so successful. This is an important question in terms of Kesko's future success – Ari, maybe you can elaborate further?

Ari Akseli, President, grocery trade: I would add that our work towards selection differentiation continues. We offer sushi, Naughty BRGR products, we are increasing the share of own brand products. In campaigns, we have improved optimisation via data utilisation, improving input-output ratio so we don't waste margin but focus it where it has the biggest impact. Overall, we have been successful in adjusting our sales mix – it has clearly improved in terms of store profitability. The pull factors in store-specific business ideas work so well that we get very good payoffs from our transformation efforts and sales rise to new levels.

Mikko Helander: Compared to 2015, our sales in grocery trade are up by €1.1-1.2 billion, yet we manage the increase in sales with pretty much the same sales network and logistical systems, which means our unit costs have decreased very significantly, while we have also constantly improved operational efficiency.

Ari Akseli, President, grocery trade: Yes, we have simultaneously been able to improve margins with a better sales mix while reducing relative costs. There has been a significant increase in euro sales margin per square metre or euro sales per square meter in the stores. This means our growth is very profitable.

Mikko Helander: Yes, and we can grow sales further still. Our understanding is that our systems can handle additional sales. There's great incentive to further bring down unit costs.

Ari Akseli, President, grocery trade: We have great successes, and I'm leaving here to go support some who could do even better. We see plenty of potential.

**

Maria Wikström, Danske Bank: Many new retailers joined your online grocery sales service. It seems that, at least in your case, the situation in Finland is very different from Sweden, where online growth seems threaten margins. Your margin continues to grow while the number of stores offering online sales increases. How do you view profitability online, and how will the increasing number of stores offering online sales affect it?

Mikko Helander: It has had and will continue to have a positive impact only. Despite the strong growth, online sales are a very profitable business for Kesko and many retailers. For individual retailers who only launched online sales this spring and are still learning everything related to that business, there are issues with profitability. Kesko is supporting them with its systems and strong advice. I want to stress that online grocery sales are a very profitable business for Kesko, and growing online sales further is an important part of our growth strategy. Like we said, increasing sales and thus further reducing unit costs is one of the key strategic objectives in K Group.

**

Hanna Jaakkola, VP, Investor relations: A few questions online from Jutta Rahikainen at SEB. The first one on capex was already covered. The second one concerns Kespro's EBIT – how low did it drop in Q2 and did it have a significant impact on profit for the grocery trade division?

Mikko Helander: If we think about how badly sales plummeted in the foodservice business, of course profitability dropped too. Nonetheless, I'm happy to say Kespro managed a slightly positive result in Q2, that's a great achievement. It shows that Kespro was again able to significantly increase its market share, as Kespro's sales declined clearly less than those of its competitors.

**

Hanna Jaakkola, VP, Investor relations: And finally: where has Senukai's profitability stood?

Mikko Helander: Like I said in the presentation, Kesko Senukai recovered quite quickly, especially in June. The epidemic hit hard, especially in Lithuania where stores were closed. But at the moment, Kesko Senukai is at the same good, stable level it has been on for several years.