Kingfisher plc 2019-20 half year results Q&A transcript - 18 September 2019

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6 months ended 31 July 2019

Speakers:

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John Wartig (JW), Interim CFO

Graham Bell (GB), B&Q CEO

James Grzinic, Jefferies

Andy Hughes, UBS

Anne Critchlow, SG

Kate Calvert, Investec

Simon Irwin, Credit Suisse

Geoff Ruddell, Morgan Stanley_

Geoff Lowery, Redburn

Tushar Jain, Goldman Sachs

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Tony Shiret, Whitman Howard

JAMES GRZINIC: Thank you, good morning; it's James Grzinic from Jefferies. I appreciate the added transparency on Castorama France, and in the spirit of that I'm wondering if you can give us more details in terms of, when were you able to exactly articulate what was going on, and at what point did you start putting remedial action to work?

AC: I think we started to become aware – the early signs started about this time last year, in terms of starting to believe that there were tensions in the team, which is usually the leading indicator that there are deep problems. I think the actual supply-chain issues didn't really manifest themselves until the spring, and since the spring and John's arrival, we've been able to increase the line of sight that we've had on those issues rapidly, and in that discovery process we found a lot more going on.

So we've been making our fixes since then, and John's been highly engaged in that; we're working with, obviously our teams in France, and because it's a combination of IT and supply chain working together, it's a complex but highly important set of things we've got in place now and task workstreams. That's really been the issue; I think that was the first time, back at the end of last year, but really in terms of the manifestation, probably in the spring.

JAMES GRZINIC: Thank you.

ANDY HUGHES: Thank you; it's Andy Hughes from UBS. I've got a few related questions here. Just kicking off with the £68 million exceptional charge; it seems a pretty hefty sum. There's, what, 11 big stores and I guess 19 tiddlers in Screwfix – it seems quite a big charge; is there any stock-clearance within that, is the stock within the stores being cleared?

JW: [Indiscernible]…consultation related to the actual programme itself, primarily because it's in France. *[Kingfisher Investor Relations: The majority of the £68 million exceptional charge is redundancy provisions in relation to the 11 planned store closures in France]*

ANDY HUGHES: Okay, so nothing on stock.

JW: Nothing on stock.

ANDY HUGHES: And just moving on to stock, obviously you're sitting on £2.8 billion of stock, so your stock's been going up whilst your sales have been going down; can you give us any feel for what the right level is? Presumably you're carrying a bit of new products – or not new products, often old products – can you give us a split: 59% of sales are in new categories, is that mirrored in your stock, or is there more or less in terms of…?

JW: As you can see, it's a combination of that. What we have got, is that part of the build-up has been bringing the new ranges; we need to actually have a peak at building the inventory for the sell-through – that should graduate over time; but also we've got a growing amount, particularly in France, of stock that's actually now ready for clearance, so that's got to work through as well.

So I think there's been a build-up in both: new ranges coming through, and then we've also had the deleted items, if you like, that we've got to work through as well. In terms of a number where that should get to, I'd hesitate to give a number at the moment, but I think we do need to reduce this in both areas. One will happen naturally, as new ranges come in, but the other, the non-unified ranges, or those that have been deleted, they will have to reduce over the next 6 to 12 months.

ANDY HUGHES: So old lines of stock which is going to be discontinued; what sort of rough percentage of inventory is that?

JW: To give you a number, it'd be 5%.

ANDY HUGHES: Right, okay, that's quite low. What I'm trying to get at is, when's the magic year going to be when you get your supply-chain gains coming through and you don't have the clearance to offset it?

JW: Yeah, I see where you're coming from. Why don't you say it: what's our baseline clearance when everything goes through? I think we're going to need another year and a half at a minimum – it definitely won't happen this year; we still have new ranges coming in, particularly in kitchens in France next year, and then there'll be some range extensions of the existing ranges we'll put through, so I think it's another year, year and a half before we get down to a normalised level – but we don't have a total fix on that at the moment.

ANDY HUGHES: Great.

ANNE CRITCHLOW: Thanks, Anne Critchlow from SG; two questions from me, please. When do you think you will be able to drop the legacy supply-chain systems in France? And then secondly, what percentage of product is now relating to the product unique to Kingfisher?

JW: That's a good question on the legacy. Most definitely, I think that has been an issue as we've been transitioning; we're now actually completing the IT platform rollout in Brico Dépôt during the course of this year. Working it through with the team, we're really looking through to next year, the second half of next year, dropping the core legacy systems, and that will actually release the duplication in some of the costs we've got in the IT area.

Part of that's obviously going to be dependent on how quickly we can move through these ways of working and the process-engineering that's required, because as Andy said and I've said, both of these models have been decentralised models that we actually have to centralise and actually get the process and ways of working, but I'm aiming for the second half of next year.

AC: And if you need a number – I'll be corrected if it's wrong – 6? 6-7%. So it's still relatively low. As you saw if you were there in May *[Kingfisher Investor Relations: Kingfisher's Innovation Day on 15 May 2019]* it's an area where we think there is a lot of mileage, and the opportunity to more be innovative, and we have invested quite heavily in the last few years in product design capability that we've never had before, so we do actually now have teams of people coming up with our own customer-focused innovative products which we're now getting our new supply-base to make for us.

So, again, it's a journey, but we are confident that's going to rise, but again, one of the questions for Thierry is exactly how far does that go, what's the return on investment of that, and how does that stack up against international brands and local brands, which is all part of that customer proposition piece that we were talking about.

ANNE CRITCHLOW: Thank you.

KATE CALVERT: Morning, Kate Calvert from Investec; can you explain why Brico Dépôt didn't have the same supply-chain issues as Casto, and what's been different in the implementation?

JW: Three things. First of all, Brico Dépôt is not fully on the template yet, it hasn't been fully transitioned – that'll happen in the second half of this year – and secondly, I think a major component there is they have significantly less SKUs. And if you take Castorama, it has close to 60,000 SKUs, but currently Brico Dépôt only has 13,000. And also it has less unification, so the complexity there has been less. But also I'd like to think we've learnt some of the lessons from what exactly transpired recently with Castorama. There's a lot of the same people that are working on that.

And I think the last point to add that's not a small point, is that the master data which is critical to this was actually in a much better shape in Brico Dépôt, because of the legacy of how it ran its business.

AC: I think that's really important – sorry, just to add to his really important point; all our different opcos started in a different place; you know, we were never in a roll-out situation that some companies have. We were in a situation where we have legacy businesses that all were running differently, and we've had to migrate them all to this new future.

What that's meant is that those who've had the longest journey to travel on the centralised curve – which is Castorama – have found it most challenging. Brico Dépôt's always had a fair amount of centralisation within their culture and their management structures and frameworks. It's always been much more of a centralised model.

So I think that really helps psychologically, and in the stores people are more prepared to follow and understand central instructions much more rapidly. So it's a combination of all those things.

Sorry, do you have a follow-up?

KATE CALVERT: No I don't; thank you very much.

SIMON IRWIN: Simon Irwin from Credit Suisse. A few random questions: can you talk a bit about footfall of Castorama? I'm intrigued by your comments around NPS going up; what's happening, are people not coming to the store and finding poor availability – in which case it's quite surprising that the Net Promoter Score is improving – can you just talk a little more about that dynamic? Second is, how has GoodHome gone down as a brand within the business? It's clearly a very important initiative for the group. And can you just talk a bit about clearance guidance? My impression was that clearance this year was going to be a bit more first-half-weighted, and now you're talking about it being second-half-weighted.

AC: Thanks – I'll take the first bit if I may, and then John can talk about clearance. So, footfall is down, obviously; I don't know by how much, but it's probably about a quarter in the last thereabouts. *[Kingfisher Investor Relations: Footfall at Castorama France is down by approximately 7% over the last 2.5 years.]* But we've definitely lost footfall over the last 2-3 years. Part of that's been the reaction to the EDLP strategy which we've implemented. We've brought the overall price index of Castorama down substantially, by about 5-6 points over the last two and a half years – but in doing that we've also taken away the price-point spikes that you get in promotional activity, and we know that a fair portion of people we had coming into the stores were coming in on promotion deals, which is the same in Brico Dépôt. So the strategy was around trying to make sure we had a more widely-understood universal message of everyday low price which people would respond to.

So I don't think they're in conflict; I think the fact that we've got lower footfall is a reality which we are trying to address through all the things we've talked about. But the fact that the NPS scores – because you do NPS scores with the people who shop with you – I think we're actually providing a better service and product and experience for the people who actually use the store, in the way we would like them to use it, which is as the place to come as their first-choice home-improvement centre. The promotional people have gone for now, and it's our job to convert them into loyal customers, not just deal-seekers. So I think that's what's happened.

SIMON IRWIN: GoodHome?

AC: GoodHome is very new; we've spent a lot of time building that brand and just putting it together; it's our first multi-regional, multi-category entry. And I think it is important, as you say, not just because it is our first one that's like that and is therefore a really interesting brand departure for us – but also because it ticks some boxes which some of our other brands aren't quite as forceful on. Such as the sustainability platform and the profile of the brand – which we know are going to be really important for customers going forward. It's landing well, but it's just rolling out, it's just beginning.

We've got flooring in stores – maybe Graham, you'd like to make a comment, very early days, customers have to get used to new brands, but do you have a comment about ups and downs of the introductions Graham?

GB: I think as ever with a new brand there is a timing issue, and I think the earliest ones we've had in it's been GoodHome paint; obviously paint is one of those brands where some customers have a lot of loyalty and getting the change-over. But what we have found, especially from the staff and customers who are using the new GoodHome paint, they are delighted with the quality and the price of the product, so that's landed really well.

GoodHome flooring, which has kind of been the next one, we're getting a lot of great feedback, and starting to see the sales lift with that. And I think the next big one for us is probably going to be GoodHome kitchens, which we're obviously just kicking off at the moment. So I think it's a timing issue, but some great feedback from the customers and the staff, which I always think is a great measurement. And listening to our customers, it's about the quality of the brand as well as about some of those sustainable issues which really are coming to the fore, and predominantly we've been asked a lot from customers about, not just the sustainability of that paint, but also, is it suitable for children? Which are questions which our older generation never used to ask.

SIMON IRWIN Clearance guidance?

JW: Yes, Simon; we always said we thought that clearance would be half-one weighted, primarily associating implementation of services and décor; we've had increases, as I said earlier, from 25 to 30-35, but we're also expect incremental clearance now in half associated new B&Q kitchen range. And just to note, the half-one clearance was about 40 basis points on sales for about six billion, so that calculates to around £20 million, so we're just building in the incremental for B&Q.

GEOFF RUDDELL: Geoff Ruddell here from Morgan Stanley; can I just take you back to slide 16 of the presentation, which is the gross margin bridge, where you have a 30 basis-point improvement from price repositioning mainly at Brico Dépôt, France. Could you just explain to us exactly what you've done in terms of price repositioning at Brico Dépôt, France?

AC: I'll take it, I'll try – you'll no doubt correct me if I get this wrong – one of the main features of Brico Dépôt, France, is we used to run about 16-17% of our sales were on "Arrivages", which is an imported product which is sold at a deal as one-off lots. That has gone down significantly; we're probably at the 4-5% level.

That whole strategy – how much, where is it – we're just testing the markets to see where's the right... it's that, it's the reduction – because that was typically, if we made anything from it, it wasn't much. So it was about taking that away from our sales line and converting that into more profitable sales, even though we got an impact on the top line.

GEOFF RUDDELL: If I could just have one more – obviously we don't know where we're going with Brexit at the moment, but if we do end up with the UK having a different trade policy to the rest of the EU, are you still going to be able to get the group-scale buying benefits do you think, going forwards? Because obviously if the UK has a different tariff imports relative to the EU tariff imports from China or wherever else you may be sourcing product from, could that obviate the whole strategy of buying jointly?

AC: We don't think so, because we'd still be better off than we otherwise would be. Unless we were buying most of our things locally, which I don't think we ever really do.

JW: It's roughly a third, a third, a third *[Kingfisher Investor Relations: i.e. approximate split of products sourced from the UK, Europe and Asia by UK Opcos]*. In terms of sourcing, part of the strategy has been, on the unified product particularly, is to source from the Far East. We actually have hedging there, and also then there's sourcing locally.

But to your point, in terms of the tariffs, particularly from Europe, if the government guidelines which they've put out, which they've still to reaffirm, come through – because we're not actually selling food or pharmaceuticals, etcetera – the products on that list, the ones that we sell, actually have zero tariffs. So that falls into place depending on how it lands.

AC: Yeah, I don't think so, no.

GEOFF LOWERY: Hi, Geoff Lowery at Redburn; can we talk a bit about Screwfix? I think price and Screwfix were co-joined four or five times through the presentation; should we take out of this that you've been a bit greedy on price in recent years? How far do you need to go? Can you help quantify in that group gross margin bridge, what the Screwfix price component is in half-one, half-two?

JW: I think we are sensitive to the competition; we have actually put some price-realignment in the first half, we do have some up-weighted in the second half. I wouldn't use the term "greedy", I think it's just recognising the competitive situation. Our price-index now is actually in some categories quite close – 101, 102%. But we're continuing to assess that.

GEOFF LOWERY: And can we talk about transformation costs? You're obviously taking away one of your PBT definitions, which is totally fine and logical; should we be adding back this £60 million next year to the adjusted number for the non-recurrence of transformation costs – or, given all that you've got to do, is this just going to be a permanent feature now?

JW: I think part of the logic there is that the transformation costs … we think within P&L transformation; we were trying to extract those costs that were actually part of the initial establishment – for example, the unified offering. As that's now come into play and that continues to work, that is actually generating profitability for the business, so it would be incorrect for us to extract that and sell it as a separate P&L item. So any associated costs, with any ongoing, is actually absorbed within the margin generation of the costs – so I wouldn't be adding £60 million to the underlying costs as a consequence.

TUSHAR JAIN: Tushar Jain from Goldman Sachs; let's start with B&Q, it seems the like for like has been underperforming, some of the listed peers – is there anything apart from range changes and installations issues in B&Q that might be impacting the performance there?

AC: In B&Q in particular?

TUSHAR JAIN: Yeah.

AC: Well we'll ask Graham; I think those are the three we've called out, Brexit, installation disruption, and the kitchens – is there anything you'd like to add?

TUSHAR JAIN: I'm kind of sad on the digital part as well, it only improved 10%.

AC: Yeah, we put a new platform in.

GB: Yes, I think obviously the economy is something we're aware of, but what we have been doing is really getting our house in order and really getting fit. The installations were a decision we took; I think it was the right decision at the time, we were not technically set up, we didn't have a product range, we were not giving our customers a good service, and we weren't making money out of it. So I think it was the right decision for B&Q, and what we've got to do is get our new kitchen range in, get supply and logistics properly set up, and then maybe look at where we go on installations in the future, but I'd rather get the base elements in first to get ourselves really fit and ready. Be famous for doing a great service, a great product, and then building that.

I think on digital, as you probably know having come from Screwfix, I've got a great passion, and I think the work that I'm doing with John Mewett at Screwfix is where we really have a great opportunity to push forward. As you know, it's all about getting the base elements in, the technical fulfilment, and we've got a great opportunity there, I think, in the future, and we're making great strides forward in that.

We have had a lot of disruption this year; we have changed probably over a third of the store, which has led to a lot of disruption, we're just coming through that apart from kitchens; we've worked hard at clearing the stock as well as getting the new range in, and really trying to minimise the impact on the customers, and the thing we're looking forward to now is really being able to sweat that new product, and drive forward a better performance in the future.

TUSHAR JAIN: One question on unified ranges – thanks for that – it does look like the growth has slowed down in unique and unified ranges, it was going close to 2% last year, broadly flat in the first half of this year; is it all linked to the Castorama issues, or how these ranges are being accepted?

AC: Sorry, I missed the question?

TUSHAR JAIN: So unique and unified ranges' growth was close to 2% last year, and it's close to broadly flat 40 basis points up for the first half of this year; is there something specific happening in the growth in the unique and unified ranges?

AC: Not that I'm aware of.

JW: No, there's no issues; if anything the growth, as we've seen across both unified and non-unified, some of the disruption that we've had in France been due to the supply chain, some of the competitive and some of the disruption issues we've had across the business – but it's not something specific to unified ranges that's changed. And at the end of the day unified is still growing versus non-unified.

TUSHAR JAIN: Thank you.

RICHARD CHAMBERLAIN: Good morning; Richard Chamberlain, RBC. Can we just touch on Eastern Europe; I think it looks like the growth in Poland has slowed in the second quarter; can you just give the reasons for that, and also in Romania how much has the Praktiker integration contributed to the losses we saw there?

JW: I think in the second quarter there was more some comparatives … it was more the comparatives quarter on quarter. We're not seeing it as a slowing; we actually have new store openings and a couple of events taking place in the quarter, which are more standalone, but it's not a slowing of the overall business. In terms of Praktiker, it has proved challenging; the businesses aren't integrated, they've got a lot better, as I said in my presentation, there's a lot of transitional work still taking place, and that'll go into next year as well. It's taking longer and taking more time.

Once they've integrated the two businesses, and they can actually manage their inventory and everything better, I think their execution will improve, but the stores are still in transition over the next 6-12 months. It has been a drag on earnings in the short term.

RICHARD CHAMBERLAIN: Can I just ask a follow-up on Castorama France, the digital offer, where you think you are on that journey to improve the customer experience in terms of functionality and search optimisation and so on, and when do you expect a sales uplift from that?

AC: Our digital upgrades have come out in a series of releases, so Graham has just been in the latest one, that gave us some clunky moments when that was going in in the spring. But that's now working a lot better, and if you look at the NPS – because we also measure the NPS for our digital customer reaction – and that's rising. But I'd say it's rising from a low start in both B&Q and Castorama. I think yes, it's better, sales have been rising in all our business units, including Castorama, but it starts from a long way back, and there's still a lot we can do. And I think the next release, the B&Q release that we've done this spring, that I think is scheduled for…next spring, in Casto?

So it's coming, but probably six months; now we have to line everything up with all the other questions we've asked today about how do we sequence the change programme – because there's no doubt that the compound effect of the changes in France have been what's really hurt us – so if you just track the individual activities you don't actually see the compounding effect until it's late in the game. So I think what we need to do is go back, as we've said, and look at how we're sequencing these change programmes, so we're not submerging our people continually with more change, so it's just how we do it. I think the current forecast is for that, but we'll review that. Hopefully it'll be there, it'll be fairly discrete work, so it should improve from now. But a long way to improve. Big opportunity.

ADAM COCHRANE: Adam Cochrane at Citi; can you explain the moving parts of the gross margin guidance being flat for the full year versus up for the first half if you can? And secondly, I'm trying to wrack my brains, you've talked about dual running costs, clearance … what is the underlying profitability of the business? How much dual running costs are sitting in there, how much of your gross margin is being negatively impacted – I can't quite get a feel for what it should look like at the end?

JW: First on the margins there, I think the primary drivers there are the ongoing clearance, as we've said – we've actually upweighted our guidance in terms of clearance – and the second part is the ongoing disruption, particularly around Castorama France. We don't expect that to change materially over the short to medium term, as we're working through a number of the issues we're talking about – and then there's a third element to that too, as we don't expect to get the same level before clearance in disruption costs, because we've got the annualisation of both the installation removal in B&Q and also the price repositioning in France, that annualises the end of Q3.

ADAM COCHRANE: There's less positives coming through.

JW: Less positives and too many negatives coming through.

AC: And underlying profitability, we don't have a calculation on that at this point. It's large. Does that help?

JW: I think it would be fair to say that there's significant unlocked potential in value, once we remove a number of these impediments – clearance being normalised, removing the supply chain and logistics issues, getting our fulfilment in place and getting digital in place. We're currently working through a three-year plan analysis at the moment, which we'll be going through with Thierry, and I'm sure that Thierry will actually have a number of inputs into that, so the business going forward is something we'll be working through in the next 3-6 months.

AC: But we agree it would help to have some visibility with that. Point taken.

ALASDAIR MCKINNON: Alasdair McKinnon, Scottish Investment Trust. Thanks for today's presentation, I get the fact that it's been several years of pain unifying everything; what I wondered though, was, with Thierry's arrival, is there an opportunity to step back a level, at the board level, and say 'is this the right way forward? Is this what the customer wants, or is there a way to look at the portfolio of assets and say perhaps different countries want different things – perhaps there's a different way of doing it?'

I know that one won't be popular, what with the journey we've been on, but I just wonder what your thoughts are, why you think a unified offering across different geographies will work. What can you point to, to say it works?

AC: It's a great question, and I said it at the start of the presentation: Thierry has no handcuffs on, and he can come and he can look. We're operating to a business that, is commonplace in any business, you make the best of your assets, however you define that to be. We definitely want to get a return on the investments we've made, and we think that some of the things we've done are certainly obvious ways to improve the efficiency of the business as it's composed.

I think Thierry will come and take a full view and a good look at everything; we need to have some priorities of resource allocation; we need to think through that; that's going to be part of the process we're going to be having on the board with Thierry's input over the next few months. I think there are evidence points that it's always a balance – this is not an act of faith, this is about finding the right pragmatic balance between what you know you can unify and get benefit from, where customers are happy with the innovation you bring, and the fact that it's unified is neither here nor there. It can be unified, and the advantages seen in better pricing and unique attributes of the product, you improve the product, you drop the price, and it's a product-category that is insensitive in terms of customer loyalty. Those exist: we have large amounts of our range that exist like that.

Finding the balance between those products and how much local product we have, and international, is back to this question, and we need to continually test and make sure that we are serving our customers – and I'm sure Thierry would agree with this – with what they want, and finding the places where we can get the efficiencies out with no detriment if not an improvement to the customer offer.

So it's a balance, and we'll see where we go. But I think Thierry's arrival is opportune, I think it's a good opportunity to get a completely fresh perspective, and we'll be back to talk to you about that. Thank you. Last question if we may?

TONY SHIRET: Thanks very much; Tony Shiret, Whitman Howard. Back to the business as it is: you mentioned availability, Castorama, and I wondered if you could give us some sort of quantification of how bad presumably the availability is, and where you think you can get it to, and what you measure with availability, and the second point: on the unique offer, where you've got the 150 basis points of gross margin benefit, is that a net figure? Have you retained all of the benefit, or I presume there's some pass-through in price as well as retention in the gross margin – can you give us some sense of that?

JW: On the 150 basis points, it is gross, and I think that stretching it out we haven't been able to retain all of that; there is some CPI and inflation coming through there which we're trying to offset, but not all of it gets retained; it's getting dissipated, some of it, through supply-chain. *[Kingfisher Investor Relations: 150 basis points of gross margin increase (year on year) in unified offer is stated <u>after</u> cost price inflation and price investment, but <u>before</u> clearance and logistics & stock inefficiencies.]*

As we've said, with our ways of working now, under the new operating model we're actually owning more of the supply chain, particularly from the Far East, so we're not sourcing from around the corner, so there are some additional costs which are actually offsetting that.

TONY SHIRET: So the 150 is before those costs?

JW: Correct *[Kingfisher Investor Relations: See correction noted above.]*

TONY SHIRET: Okay. And the availability?

JW: And the availability, in broad terms, if you're looking at what does good look like, we can look around the group, it's more like 98, 99% in terms of fulfilment. That's what we should be going for. In some cases, and some of it's because things have just fallen over in some of the DCs (Distribution Centres), it would be sub-95%. And that's the heart of the issue that we're addressing, and in some cases it's a disconnected process, the way we've had inventory in location, the way we've entered it into the system.

TONY SHIRET: Okay, thank you.

AC: Thank you very much. Well, thank you very much for your time this morning, ladies and gentlemen; we look forward to seeing you again soon. Thank you.