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Transcription

Nokian Tyres Q&A Conference Call

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PRESENTATION

Operator

Hello and welcome to the Nokian Tyres Q&A conference call. Throughout the call, all participants will be in a listen only mode and afterwards there will be a question answer session. And just to remind you, this conference call is being recorded.

Today I'm pleased to present Päivi Antola, SVP Communications and IR. Please go ahead with your meeting.

Päivi Antola

Good afternoon and welcome to Nokian Tyres CEOs 100-day update call. My name is Päivi Antola and I'm the Head of Investor Relations at Nokian Tyres and in this call I have with me, well, obviously Jukka Moisio, the President and CEO of Nokian Tyres, as well as the company CFO, Teemu Kangas-Kärki. So, Jukka and Teemu, welcome.

Jukka, the first 100 days are now behind you. So, what are your key observation so far?

Jukka Moisio

Thank you, Päivi. First of all, welcome on my behalf and indeed my first 100 days observations are very favourable. But if I start with some personal notes first. When I was a young man I worked at a gas station and learnt a lot about tyres and especially in 1970s learned about the practical view, how to change tyres and how they perform and how the consumers think about those products.

And then latest last week I actually have a new car and our testing team and R&D team did some detective work and they found out that I have a competitor tyres in my car so they took the liberty and opportunity to change into Nokian Hakka Black 2 and I tested them on the highway from Nokian to Helsinki and I have to say that of course the car performed beautifully and there was a clear difference between the competitor tyres and our own tyres. So, many ways, I'm very, very pleased that our products perform well and my new car feels like a completely different car with the new tyres.

But some of the strength of Nokian Tyres, I find that our products are good, so they perform well. I also see that we have a good pipeline of innovation, new products coming not only in passenger tyres but also in heavy tyres. We have a strong manufacturing know-how. So, in terms of modern manufacturing and the capability what we have for example in Russia in [? 00:02:41] is really, really strong.

Our brand is well known in the market and in the segments where we have a historical traditional strong position. And finally, and most importantly, we have good and strong team and I think that one place where that was visible was our reactions and how we dealt with the COVID-19 situation because the impact could have been really significant. However, our team reacted well. We did quite significant cost reductions. We made good focus on cash flow and also we did very quick decisions to stop manufacturing so that we didn't produce tyres into inventory, we shut down our factories and that maybe reacted not only short term which helps the immediate situation the company into cash flow but also long-term impact in a sense that when we go into the third quarter, fourth quarter and 2021, inventories are well managed and that allows then a good recovery of manufacturing going forward.

This assumes of course that the recovery that was visible in the early part of the third quarter and also that a part of second quarter continues and that no new impact on COVID in terms of shutdowns and so on will come. However, if they do come, we are not prepared and we have shown that our team reacts well. So going forward, our inventories are clean, our operation is in a good position to run well.

It's also clear that in 2020 we have a short-term tactical focus and that means that the cash flow and cost control is very important, and that is something that the company needs to do in 2020. However, the longer-term strategy; we are comfortable with it right now, but clearly, we need to review that once the market has stabilised. After stabilisation we will need to see when that happens, maybe it's ‘21, maybe ‘22 depending how the COVID impact will continue. My personal guess is that in 2021 already there will be an improvement and a clear recovery and that allows also the revisit of the strategy and precising of the strategic targets.

Right now, top line is key. Selling more tyres is important. We have a strong focus on new products and innovation. There are new products in the pipeline. And as I mentioned both in the passenger car tyres and also in heavy tyres. And then we looked at the historical trend and the current situation. We can say that we have all-time high number of new product launches that have taken place during the course of this year and also will continue in the remainder of this year and early 2021.

So, in that sense we are in a good position that new products come and then they bring opportunities to increase the top line and also the customer satisfaction in terms of serving various segments where those products are being targeted.

More work has to be done. It's clear in distribution, especially in continental Europe and in North America. Commercial marketing actions, promotion actions, et cetera will have to be improved and also convincing customers will have to continue at higher level. And that means that we need to have an intelligent use of commercial tools, promotional tools, and also the product positioning in the marketplace.

In terms of investment situation, the key investments are about to be behind us. Some of the investments will take place, some capital outlay, still minor parts towards the end of this year, but the US investment, Spain test track, heavy tyres programme, most of that is now behind us and in fact it started to generate cash flow and it's really important that we get the benefit from these investments.

And I am convinced and confident that our capability and our installed base now is very strong in manufacturing and then that the most of the work will have to be done in the innovation, new products, targeting products and new segments, and also in the commercial activities so that we actually mobilise our commercial team, our distribution dealers, to sell our products and make sure that the customers and consumers get them in the appropriate places and point of sales in the coming months and quarters.

So, that's in a summary where we are and I believe that in many ways this is a favourable situation. We clearly see that the COVID in the early part of the year is a temporary setback. Most companies experience that. When the recovery comes, and if it continues then we are in a great position to enjoy the benefits in terms of not having too heavy inventories and also being prepared to run our manufacturing in an efficient way.

Päivi Antola

Great, and then how would you summarise what will change in Nokian Tyres now with you as the company CEO?

Jukka Moisio

I think that we need to put that into perspective of the company also that in the past years we've had a number of important initiatives to improve our capacity, capability, and also expand our geographic reach. Now, when these programmes are coming to an end, then clearly the focus will move into external. So, we need to look at the commercial opportunities, new product launches, because that's the starting point of the revenue plan that we have the right kind of products, we target the right segments, we have a good distribution, good commercial tools and promotional programmes. So, that is very important.

The investments we will seek to benefit so rather than initiating a lot of new programmes immediately. Now, I think that we will focus on the cash flow generation and make sure that the system we have put in place, of course, we keep on improving it and we keep on gaining efficiency, productivity and all that. But the system we have put in place, it's time for that to deliver. So, in terms of revenue plan, new products, and so on, cost efficiency that is something, but then in terms of capital outlay, we've done the major part of that, and so therefore, we now look to benefit from the actions taken.

So, that, of course, is the big thing that changes with the new CEO, but that's mostly dependent on the company timing also. In terms of how I look at the situation is that I'm relatively straight forward, so we focus on selling more tyres, operations, and then we also make sure that the company operates in a world-class way in terms of achieving the results so that we have good commercial programmes, good innovation and marketing, and also strong administration that supports the team.

But the important thing is to make sure that the system that is in place delivers.

Päivi Antola

Thank you and now before we open the line for questions from the audience, I will take couple of questions which have been frequently asked by investors. And even though you said that this is not the time to review the longer-term growth strategy or the financial targets, let's still start with the financial targets. So, how do you see Nokian Tyres' financial targets from 2018: above 5% annual growth and EBIT at the level of 22? Are these realistic?

Jukka Moisio

I think that first of all 2018 is a different time compared to 2020. We hope that when we go to '21 then we start going back to a more normal level. But in terms of having the capability and investments mostly behind us, I think that growth targets are 5%. So, if I say that in 2021, 5% growth is something that we aim to have, I think that everybody will say that you were far higher in top line in 2019 and ‘18, so that is not the relevant target and I fully agree. We need to get back to that 1.6 billion type of net sales and then setting a target to about 5% after that means about 1 million tyres per year more so we have that kind of capacity and capability invested in Dayton and also additionally we have added capability in heavy tyres. So, I would say that 5% or higher growth after achieving the level that we had in 2018/2019 is something that is a good target to aim for.

Profitability-wise; so again 2018/19 was a different time compared to where we are right now and really you saw that our second quarter segment, the operating profit was about 9%. Still higher than our competition. I think that our first and most important aim is to be better than competition. When we look at 20/22% target level, I think that when we go back to normalised level it's a good ambition to aim for.

Can I say exactly 22%? We need to see how to world will look like after the COVID and the post COVID period. But we surely want to be the most profitable tyre company and therefore we aim high.

Päivi Antola

And can you comment a bit on the tools how to support margin rebound in 2021 and beyond?

Jukka Moisio

I think that one of the most important things to establish is that the system is now in place, so we have investments behind us. We surely again want to continue the productivity case and efficiencies and all those and make sure that every day, every quarter the productivity improves.

But then besides that, I think the new products is something that we start the margin improvement and revenue plan. So, that is one of the key focus areas because new products always allow also to have a new price point. You try to sell the same and old all the time so you probably face declining prices and so on. But if you have a good pipeline of new products tailored to market segments, to specific car models or car model categories, so that way that allows to have a good price point and good product margin.

Equally important is the strong industrial plan, even though we have the investment behind us. So, it doesn't mean that we cannot specialise our factories so that we load the most productive factory first, which is Russia. Then we continue to make sure that our North American factory is in a good momentum and good position and therefore we see that that is also very cost competitive.

So, first Russia, then North America, and finally we have a Nokian factory where we have R&D specialty tyres and also all kinds of development activities. But also, it's the oldest factory. So, in terms of productivity for passenger car tyres, there we have the highest cost. And so therefore Nokian needs to benefit from the heavy tyres direction, so adding the investments and volume increase in heavy tyres that will keep the competitiveness of Nokian, but of course Nokian will have to be more and more heavy tyres, so bigger volume that way, and then more specialised products in terms of testing R&D technology development, while the big volumes will have to be elsewhere.

Sales and commercial excellence is something that we need to put more emphasis on. So, promotional tools, new point of sales, distribution, dealer support, and similar things and that will then help us to move the product. And finally, of course the cost discipline so that the cost discipline never goes away. So, it's important to pay attention to that.

Päivi Antola

Then one question we get is the North American strategy. What is the target and the plan to get there? And of course, there is always the question what will be the margin impact?

Jukka Moisio

Yes, so we are in the ramp-up phase in the Dayton factory right now and we are about to hire the second shift so we are able to move into all the continuous production and that's part of the ramp-up. So, we have two shifts, three shifts, and then we add capacity and expand the capacity and ultimately the capability at this point of time with relatively modest investment is about 4 million tyres, so it takes a while to get there, but our plan is clear that we ramp up and we achieve those targets.

How do we make it so clearly? The important thing is, again, the product innovation and the product launches so that we have the right kind of products and right kind of services to the car categories that are important in North America. In order to achieve that, then we need to have a good distribution. So, one of the key things what we do right now is that we find more distribution point of sales. So, we are approaching about 5,000 this year, and we've added the double-digit percentage growth in terms of point of sales during the course of 2020.

In order to make all of them hungry and successful, it's clear that we need to have the right products and it's equally clear that we need to have the production coming from our North American factory, because if we long term continue to supply significant volumes out of Europe or Russia to North America, then obviously the profitability is not optimised that way.

So, these are some of the things we do in North America. Most importantly, of course, is to have a relevant product and product offer and equally to have it available to consumers and so therefore all these steps need to take place at the same time.

Päivi Antola

Let's then shift topics a little bit then and talk about capital allocation. What are Nokian Tyres' capital allocation priorities going forward?

Jukka Moisio

I think that we basically, first of all, the capital allocation is such that a lot of these investments are ready, and so therefore the capital will go with the smaller pieces into improving efficiency, de-bottlenecking lines, complementing the existing. So that means organic growth, but not a significant piece of capital. So, this is more step-by-step improvements and making sure that we get the most out of our installed base and existing system. But there are always things to do, de-bottlenecking improvements and clearly moulds for new products is an important part of investment plan going forward.

Then we look at the M&A opportunities and to the extent we can find value adding and good return opportunities we will pursue those and finally then dividends and share buybacks. We will not want to build overliquidity on our balance sheet so that whatever it is, overliquidity, then we will find a way to return that to shareholders.

But it's also important to keep in mind that as we operate in Russia in significant ways, so it's important that our balance sheet is strong enough to tolerate the uncertainty and potential risks that relate to operations in Russia. And historically, we have always had a strong balance sheet. I think that that will continue, but there's no need to build overliquidity.

So, to the extent we cannot find good organic growth, investment opportunities or M&A opportunities, we will look at how we can return that overliquidity to shareholders. But please be prepared that we want to keep a strong balance sheet for the reasons explained.

Päivi Antola

Do you want to comment on CapEx this year or next year?

Jukka Moisio

Yes, we have basically the guidance in the early part of the year already that we will reduce from 200 million to about 170 million in 2020. We believe that we might be below that 170 million and then when we go to 2021, we will be below what we invest in 2020. So, there will be a declining expectation of the capital outlay. As I said, the important part is to make sure that we have the moulds for new products.

At the same time, we want to debottleneck our current operations and so on. But by and large the system we have in place is very invested, and so therefore we don't foresee significant capacity increases to the tune of tens of millions in the immediate future. But keeping in mind that longer term, of course we want to make sure that we ramp up the North American operation to a level that is competitive and appropriate for the marketplace in North America.

Päivi Antola

You already mentioned dividend. Can you comment on the possible additional dividend payment for which the Board has the authorisation from the AGM?

Jukka Moisio

I think that from the management point of view, the important focus as mentioned earlier is on cash flow, working capital, cost efficiency, and so on, and so we will do that part. And we also make sure that we enjoy whatever the recovery there is and make sure that that comes to our top line.

But those actions together will allow the Board to make a decision about the dividend already this fall, at least at the latest by the next AGM. I expect that they make a decision, but most likely before the year end. What that decision will be, I don't want to speculate, but clearly the Board also understands that there’s a good generation of cash flow and good momentum in the company. Then there's also recent reward [ph 00:22:07] to shareholders.

But what that report will be, I cannot speculate. I don't want to speculate at this point. Our job is to make that possible.

Päivi Antola

Thank you. And now operator, we would be ready for questions from the audience please.

Q&A

Operator

Thank you. If you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw your question, you may do so by pressing 02 to cancel. Our first question comes from the line of Akshat Kacker from JP Morgan. Please go ahead.

Akshat Kacker

Thank you for taking my questions and thank you for the prepared remarks as well. Three from my side. The first one on your distribution strategy and the sales network. You did mention a few things that you want to do in North America. Can you comment on what are your initial observations for Europe and what would you like to change in that region? That's the first one.

The second one is around your passenger car production capacity. You mentioned that all three factories will play a very important role in your growth story. Can you give us an update on the planned ramp up of capacity at Dayton over the next few years? How much of the current fixed-cost structure support in terms of annual output right now in Dayton? That's the first one on passenger car production capacity.

And a second one, if you could, can you quantify the rough amount that you will save in your logistics and import duties once you transfer the 2 million units for the North American market from Russia to the Dayton factory. Those are my three please. Thank you.

Jukka Moisio

Okay, thank you for the questions. So first of all, about the distribution strategy in Europe. So, clearly we've been present in Europe for a longer time compared to North America. And also, if you then compare to Russia or Northern Europe, Scandinavia, so we have a relatively mature [ph 00:24:08] distribution network.

So, there's more work to be done in Europe in order to expand our distribution and support our distributors and dealers in order to make our products available. But to the extent that we will expand that at the same rate as we do in North America, not needed, but clearly we are looking to expand our distribution in Europe as well.

I don't have specific numbers here how much of new point of sales and so on we are adding, but as I said in North America, double digit, in Europe, a single digit type.

In PCT [ph 00:24:44], ramp-up of the Dayton factory, so we basically go to two shifts now. We expect that when we go to three shifts and before we make an investment, we are about 2 million tyres and then we make some additional small investments and then we go up to 4 million. That's essentially our immediate plan. So, one shift, two shifts, three shifts, and a little bit of additional investments, and then we are at about 4 million, which is then the minimum efficient scale of the factory. Then we have space to add more when that time comes, but this is the immediate one and we talk about – in the immediate one – we talk about the strategy type per period, so three to four years.

And logistics and the cost savings in terms of shifting from Europe to North America. I don't have a specific number here. I'm sorry about that and we can look at that later on. But at this point in time I don't have that number to give.

Akshat Kacker

Thank you for that. Can I confirm you said some additional investments to expand to the 4 million capacity? Can we have a rough amount that you're thinking about?

Jukka Moisio

Yeah, we talk about in three to four years. We talk about double digit million numbers which are not close to 100 and which are not close to 10. So, you can pick maybe the average point.

Akshat Kacker

Thank you.

Operator

And the next question comes from the line of Pasi Vaisanen from Nordea. Please go ahead.

Pasi Vaisanen

Great thanks, this is Pasi from Nordea Bank. Well, indeed if I hear right, you actually said that you will increase the amount of partners and/or increase the point of sales and occupiers. So, if this actually going to lead to increased marketing expenses and is there a chance that you actually are going to face a declining price point by trying to take market share from competitors?

And secondly what is actually the price point? Could you actually highlight something from the US factory or from Dayton in terms of kind of sales volumes you are currently making?

And lastly, I mean, of course the Russian situation. What's the most recent inventory situation in Russian sales channels as you have actually seen it in August/September? Thanks.

Jukka Moisio

Okay. Why don't we start with Russian comments? So, we said already in connection with quarter two that we had a plan in 2020 to go back to [? 00:27:26] level at the end of the year and we're basically pressing that plan so that we expect that by the end of this year our Russians are almost at the level of 2021 [? 00:27:39] sell in at expected [inaudible 00:27:49]. Obviously the sell-out continues normally at this time, but our [? 00:27:44] is lower. And we compare those [inaudible 00:27:57] in the pipeline.

In terms of North America, yes we are expanding our network. We are hiring, recruiting more distribution and dealers. I think the more important thing rather than pulling into price is the launch of new products because a big part of this that we actually get into bigger distribution and more dealers in North America is that we have new products, so actually this is one of the things that we need to do internally is to develop and make sure that we have the appropriate product offer as we haven't historically. We have historical been in North America, mostly in the winter tyres, studded winter tyre and often New England and Canada states now when we have other products and segments then the important thing is to have new products and innovations in that sense.

So, how that plays out in terms of what commercial tools, what marketing programmes, promotional programmes, e-commerce, et cetera, what tools will be used, we have to then step by step. It's normal in North America that you have this cross [? 00:29:17] and in between you have various commercial tools also and if we use those in an intelligent way, we believe also that in combination with new products and localised manufacturing that in terms of taking money, that total picture is still attractive to us.

Then about the net sales prices in North America right now. We don't really have any specific comments on those.

Teemu Kangas-Kärki

Just to remind all of you, our capital markets day presentation from 2018 where you can see the relative PCT [ph 00:29:57] level compared to the PCT average.

Pasi Vaisanen

Thanks, that's clear, but just to confirm, to crosscheck, could you actually repeat what is the most recent breakeven date assumption for the Dayton plant currently?

Jukka Moisio

Breakeven assumption.

Pasi Vaisanen

In terms of a month or a year.

Jukka Moisio

Okay, when we start seeing the profitability that is attractive and so on, we need to go above 3 million tyres. We believe that that 3 million tyres can be achieved. What do you think, Teemu, 2.5/3 years? Something like that. Then we see a profitability that is not hampering or hindering the company performance in any shape or form.

Pasi Vaisanen

Okay, thanks. That’s clear. All from my side. Thanks.

Operator

And the next question comes from the line of Henning Cosman from HSBC. Please go ahead.

Henning Cosman

Yeah, thank you very much for taking my question. Just on that last point actually, can I just clarify that you're saying in three years when you reach 3 million tyres that the US will not be dilutive to what you then want margin level for the company to be 18 to 20%? Is that what you're saying?

Jukka Moisio

What I'm saying is that when we get to a point that we actually focus the production because the whole production system now it's not only one factory, so we need to start from the point of view that first of all we – first reload the Russian factory, then we load to the maximum capability, North American factory. We will have a swing in passenger tyres in Nokian and then we drive a higher volume of heavy tyres in Nokian so that the mixing department obviously sells more volume through heavy tyres and less for passenger tyres.

And this whole system allows us to get to a level that as we earlier commented that is 20% EBIT. A reasonable target going forward, yes. When we go beyond the next – after this COVID time – and then we start looking at the targets and 20% is a relative target, but it's not only one factory. It's a whole system because we have a system-wide plan for the manufacturing and the industrial plan, and this is important that the industrial plan is strong and supports then making the company-wide margins good.

Henning Cosman

Yeah, that's understood. Teemu?

Teemu Kangas-Kärki

And building on this roughly 3 million level in Dayton, that is the level where we see that we are then finishing these [? 00:32:47] extrusions from the Dayton factory. So, we will be then more on a normal level at the Dayton factory.

Henning Cosman

Yeah, exactly because it's sort of leads me to my actual question, which was when Pasi asked you about the tools for the profitability improvement, you said that it's mainly the investments being behind you, but doesn't that also mean that the DNA [ph 00:33:12] is now starting to kick in as far as P&L profitability is concerned for the US, and so on?

And I imagine it's still true that US is in tendency rather dilutive compared to the Russian factory. It's helpful that you're talking about that 20% ambition in three years' time, let's say. But if you could just put that in context again with the DNA [ph 00:33:37] and the structurally dilutive character of the US vis-à-vis Russia.

Jukka Moisio

Yeah, and therefore it is important that we get the full utilisation or as high utilisation as possible in North America with new products and so on. But you are right of course the DNA [ph 00:33:56] will kick in. At the same time if you go into a situation now that the capital outlay this year, next year, and the year after will be relatively modest. So, we also win some of that DNA [ph 00:34:08] back because the investment plans in the immediate two to three years will be relatively, let's say, subdued because we are quite well set for the volume growth and quite well set for the immediate future.

Henning Cosman

Sure, and the other question was about your review to the strategy once you see a market normalisation. Can I just ask you along what dimensions you would want to review the strategy because I would imagine it's relatively simple? You just basically try and resell the existing capacity as quickly as possible, and beyond that, you add step-by-step capacity for organic growth. So, maybe you can just share with us a little bit what sort of dimensions you're thinking of when you're thinking about a mid-term review of the strategy.

Jukka Moisio

Maybe it's simply that. I mean you hit the nail; it is exactly that. We will look into situation that how the recovery comes, what kind of market segments are evolving, where can we play our know-how best and then direct the company accordingly. And I'm not saying that the fundamental strategy of being pro-company, selling the capacity, and targeting the attractive markets is not going to change, but what's in it then will have to be detailed, but maybe that's enough.

Henning Cosman

Yeah, and very lastly, if you don't mind on the dividend again. Pasi, again, asked that in a way, but is it fair to say that – you commented that you basically see the momentum and the liquidity level are going in the right direction and it is therefore also fair to reward the shareholders, but maybe more for next year and beyond that, you're not really thinking of a lower absolute dividend level than what we've seen in say 2018/19. It's rather that level or above. Is that fair to think about?

Jukka Moisio

I think that this is something that I cannot speculate on behalf of the Board, so we need to see how the momentum continues and what's the comfort level of the decision makers in the company. Obviously for the management the important thing is to deliver the cash flow and deliver the turnaround and the momentum in top line.

Henning Cosman

Understood. Thank you very much.

Operator

And the next question comes from the line of Thomas Besson from Kepler Cheuvreux. Please go ahead.

Thomas Besson

Thank you. Hi, it's Thomas Besson. Thanks for the comments. I have a few additional ones please. Can you help us assessing where is currently your minimum CapEx levels? So, you say you're going to drop probably below 150, go lower next year. Before Dayton, I think the maintenance CapEx level was close to 100 million. Should we assume that with Dayton and the additional 50 million investment coming, the maintenance CapEx is somewhere between 120 and 150 and that's something where we should be – the direction we should be thinking about for possibly '21 and then '22?

Jukka Moisio

So, if you look back at the CapEx levels, the normal CapEx levels have been on the level of 100 and 120. And now when we have then a new factory in place and additional NPD [ph 00:37:51] pipeline. So, you could assume couple of tens of millions on top of that.

Thomas Besson

So, 125-150 doesn't [? 00:38:01] then?

Teemu Kangas-Kärki

Yeah, you are pretty much on the range. Yes.

Thomas Besson

Okay. Great. Can you confirm, Jukka, whether the full investments on doubling the capacities for specialty are effectively going to spent or have been spent, or whether you eventually plan to limit the investment and not go as far as doubling the capacities in specialty or heavy tyres?

Jukka Moisio

In heavy tyres? Basically, the heavy tyre investments are in the – I think it's at the back end of the investment, because basically the mixing department is – two years, sorry, two years. Sorry, I didn't hear. So, basically what we have is that in this year we have the heavy tyre investments and then next year as well. But then after that we basically increase more than 50% output of the heavy tyres.

Most of the investment is not on the mixing department but it's on the heavy tyres forming [ph 00:39:03] department.

Thomas Besson

Okay, and my question was nothing has changed on that plan? You still plan to increase the capacity that much?

Jukka Moisio

Yes, we plan to increase and we also plan to direct Nokian volume and especially the mixing department volume more through heavy tyres and then that allows also that we can specialise more in the passenger car tyres in Nokian which then consequently allows then a fully loading of Russia and then calls for fully loading on Dayton as we go along.

Thomas Besson

Okay. It's also a way to protect the plant in Finland in the long term?

Jukka Moisio

The plant in Finland will be a dedicated to heavy tyres and will be quite profitable and successful in that then so it's not protecting anymore. I think it's more to open a new avenue for that.

Thomas Besson

Securing, maybe I should have said. Okay, very clear. Thank you very much. I have one last question, if I may. You're here, I hope for this decade, or for a large portion of the decade, I would assume? If you have the choice between having Nokian in 2030 as a 2 billion revenues company with a 15% margin or 1.5 billion company with a 25% margin and substantially higher returns, which one do you choose if that is something you can decide?

Jukka Moisio

Is it something that I can decide? Well, I would probably go with a higher top line and then I would work my ass off to achieve higher margins than 50%. I would accept that you give that it's 15%, I would say that but I don't believe that. I believe that it can be higher.

Thomas Besson

Great well if you can do 2 billion in '25, I sign immediately. Thank you very much.

Operator

And the next question comes from the line of Victoria Greer from Morgan Stanley. Please go ahead.

Victoria Greer

Hi there. Yes, just a couple please. You said that the sell-out volumes in general were quite strong at the moment. Could you talk a bit about how you were thinking about the longer-term impact of miles travelled being down in 2020, flowing through to replacement demand? Because obviously there has been at least in your Q2 quite a strong footfall in the dealerships as people had that seasonal shift back to summer tyres. So, how are you thinking about that?

And then secondly [inaudible 00:41:39] ask the question about why you haven't chosen to make bigger strategic changes right now. What are the uncertainties about the market development that are holding you back? Is it just not the right point from a macro perspective to be launching new products? Is it uncertainty about overall demand levels? Or is it really about segment mix and how those perform? Thanks.

Jukka Moisio

Okay. So, first of all about the demands. So clearly the demand is fluctuating a lot, so therefore ultimately of course our volumes is as good as the underlying demand, so there's a lot of fluctuations. So, obviously there are call-offs by our customers and there are delays by our customers about the volumes that they can sell to consumers, and so it is a little bit that.

So far, what we see is that obviously when the miles driven go up and traffic in the major cities and Western Europe, et cetera, increases then obviously we also see the demand recovering, but still that continuing is really dependent on what will happen with the lockdowns, and so on. And so, if there's a hard lockdown, you may remember that in the second quarter conference call we talked about that, that there may be a 70% required in miles driven and that has an impact on the tyre demand. We don't see that kind of thing happening right now so therefore, we expect recovery.

Then what will happen with the winter tyres market. So, still seeing – because obviously the season will come only in the quarter four, and so therefore we see what the demand there is.

Why not pick a strategic change at this point of time? I think that this is a time that many things in the company are coming to place in terms of investment and ideas that have been put in place. So, it's important to focus on the fact that we make them deliver. If you make major strategic changes or shifts at a time when you actually expect the system to deliver, then you risk that because the demand and the environment is quite fragile.

And if there's a more stronger momentum, then we can of course look at the potential changes that need to be made, but at this point of time, I'm quite confident that what we have in place, the new product pipeline, and the recovery, and the opportunity to make sell more and make more money, I think that that's within our reach. So we should really grab that because it's right there, right now.

Victoria Greer

Great, thank you.

Operator

And the next question comes from the line of Panu Laitinmäki from Danske Bank. Please go ahead.

Panu Laitinmäki

Yes, thank you. I have three questions. Two on the new products. You spoke a lot about need for new products to drive sales and you mentioned a good pipeline for new products. So, first question, can you tell a bit more what is coming and into which regions and what kind of impact do you expect that to have on the business?

Second question is that do you expect the need for new products to result in a need to increase the R&D expenses? And then third question is on Russia and basically on the factory capacity, utilisation. Would you consider going to the C segment in Russian to keep up the kind of capacity utilisation or are you confident that you can grow your market share in other regions to kind of fully load your factories? Thanks.

Jukka Moisio

Okay. Let's start with Russia again, because I think that’s something that is important. So, in Russia, no C segment. We will not manufacture C segment. We think that we can load the Russian factory with A and B and to the extent that we have capacity, then we supply that outside Russia. So, that is our most efficient factory and very important in terms of the company system. So, therefore it also needs to have the best product range in terms of making the best money.

Need to increase R&D. Yeah, I think that this is something that we will – in part of our investment plan we will invest in more moulds and so on and so even though the total investment [? 00:45:47] capex will go down, the mould investment will probably go up because we have new product launches and those will happen of course, in our Nordic regions. So, there will be new products coming.

I don't want to disclose what products and when, but they are. Also, we're doing continental European or Central European like season proof was launched on the 2nd of September and then we have a number of products for North America because obviously there are segments and targets and end users where we haven't been present in the past and so we use our know-how which is based on our traditional historical know-how of premium demand in tyres and we will apply that to supply and design categories for North America.

And again, all of those will have to go with the mould investment. So yes, there will be R&D increases and there will be investments dedicated. Rather than investing in hard capacity or walls [ph 00:47:02] and equipment, it’s investing in moulds and that way then investments move closer to customer consumer if you want that way.

Panu Laitinmäki

Okay, thanks. Can I have a follow up on the products? Where do you see the most need for new products? Do you see gaps in the portfolio? Or is it more like you just need to improve the existing products all around the regions?

Jukka Moisio

Well, some of our existing products are becoming dated, so we need to, and we want to, launch new versions of those. But the big opportunity is of course in the product portfolio. We have a gap in our line-up. And in North America we have a number of gaps. So therefore of course filling that line-up or filling those gaps is obviously important. But we don't want to remain anyway with our existing products in the Nordics or in Russia. We want to make sure that we remain competitive because new products really mean also a new price point and a new price point means that the margins can be maintained and restored and improved.

Panu Laitinmäki

All right, thank you.

Operator

And the next question comes from the line of Artem Beletski from SEB. Please go ahead.

Artem Beletski

Yes, hi, this is Artem Beletski from SEB. Thank you for taking my questions. So, I actually have three to be asked. Firstly, starting with discussing regarding financial targets and you have been indicating about EBIT margin of roughly 20%. Do you see these potential targets in a two- to three-year horizon? And maybe could you clarify whether you are talking about reported EBIT margin, given the fact that you had some one-offs historically and likely in future.

Second question is related to your distribution strategy and I have noted that you have sold some [? 00:49:03] stores in the US. So, how do you view the franchise business model compared to ownership on this front and what is the right way in terms of distribution what comes to your different brands what you have out there?

And lastly on current trading. So, you talked about inventory situation and being pretty comfortable about the current state. So, are you talking about inventory? Basically, what you have but also when it comes to inventories, for example, if your dealers in Europe and also North America.

Jukka Moisio

Okay, so first of all, we talk about the segment operating profit and we hope that we will not have too many one-offs in the future. Obviously, we want to make sure that our EBIT and segment operating profit are getting closer because longer term if you have those at very different levels, this is not healthy. So, we recognise that, and we understand that as a business people operating the company with non-IFRS [ph 00:50:07] exclusions only, it is not a healthy way. We've seen a number of companies in Finland doing that, and it's not healthy. So, we aim to make sure that segment and operating profit are very close to each other.

Current trading in terms of inventories, yes, we’ve reduced, and we’ve worked on our inventories. And indeed, in the second quarter we took quite significant downtime in our factories and that helped us to work on the inventories and now what is important to keep in mind is that in the third quarter we are building, of course, a little bit inventory for the winter season and so on, but that's normal and that's part of the way we operate. But in the macro picture of our inventories, we are quite compatible with inventory level and the working capital level at this point of time. Just paying attention to the fact that this is the time when we get prepared to a season which is in the latter part of the year.

[? 00:51:15], Teemu, can you comment on the [? 00:51:16] distribution, please?

Teemu Kangas-Kärki

Yeah. So, regarding your comment of our divestment in US, so we sold 10 stores in the area of North East US and we have felt that it's not a strategic asset for us, so we sold these stores to our current trade customers who continue to sell also Nokian tyres. So, in that sense, no dramatic change from our point of view.

Then going to the [? 00:51:50] in the Nordics. As you know it is a vital part of our business in the Nordics to secure a good market position.

Artem Beletski

Okay, very clear, and if I maybe can have one follow-up when it comes to current trading. So, looking at your Russian factory, so after this kind of quite exceptional first half, are you currently operating close to full speed or could you provide some comments on this front?

Teemu Kangas-Kärki

Yeah, we operate at full speed right now.

Artem Beletski

All right, great, thank you. That's all from my side.

Operator

And the next question comes from the line of Sascha Gommel from Jefferies. Please go ahead.

Sascha Gommel

Yes, good afternoon. Thank you for taking my questions. I've two follow-ups. First, on the strategy and the strategy review, are you also considering going into direct or e-distribution, or is that something you could rule out already today? And then my second question would be on capital allocation again. Maybe firstly, you said you want to keep a healthy balance sheet. Can you quantify that in any way? And then secondly, you said M&A seems to be a higher priority than returning cash to shareholders. Maybe you can share some views on the M&A side. What's the strategy there or any indications would be appreciated?

Jukka Moisio

So, we cannot rule out e-distribution, so we need to look into that. What is really the world after the COVID time. So, all of those distribution elements that are important and relevant for us to sell our products to customers and consumers will have to be evaluated. And then of course the tools and the ways to be chosen accordingly.

So, we have what we have right now, and we improve it but there will be an opportunity to reinvent and improve the company going forward and the strategy is part of that to look at how do we sell more tyres because as correctly pointed out, we have invested in the capacity and capability and how do we move the product.

Capital Allocation and M&A. We will look for opportunities. Obviously, it's important to keep that focus, that organic growth, as well as M&A or acquired growth. We will have to bring the returns that are attractive and to the extent we cannot find and we are not able to develop those projects and so on, we will then return [? 00:54:28] but if we do have opportunities then we start with the organic. We know that we can deliver that, and we just have to identify the right projects and whether they are efficiency gains or complementary or even bigger investments, they have to meet the criteria of returns.

M&A, the same applies there, and then finally the overliquidity is something that if there is really excess money on the balance sheet that is not needed to grow the company or advance the company, then that's so-called overliquidity and then [? 00:55:04] seek ways to return to the shareholders. And I think that the Board and everybody will want to do the same because keeping overliquidity beyond having a strong balance sheet in the context of Russian operation is something that no one wants, and no one needs.

Sascha Gommel

And how would you quantify that in terms of healthy balance sheet or excess cash? What metric should we look at?

Jukka Moisio

Well, I would say that there are different times to assess that, and right now I think that we have a situation that we need quite a significant liquidity in order to navigate through this COVID period. When we get to the other side of this and then we will also define that more carefully. So, that's part of the setting the strategic targets and then quantifying that.

Right now, I would say that most companies would probably quantify that lots of liquidity is needed because there may be surprises around the corner and we will be prepared for those and we are keeping a very sound liquidity situation as we speak, but longer term, we will quantify that. I'm sorry that this may not be the right time to do it.

Sascha Gommel

Don’t worry. Thank you for the answers.

Operator

And the next question comes from the line of Mattias Holmberg from DNB. Please go ahead.

Mattias Holmberg

Thank you. Several years ago, I think there was some discussion if heavy tyres was big enough from a scale perspective. So, now given where heavy tyres stand today with the capacity expansion, I'm curious if first of all it even hypothetically, of course, would be possible to separate heavy tyres from the rest of the group from, say, your divestment. Or if it's sort of too integrated with the mixing or the passenger car tyres business.

And as a follow up for that, if you even would consider doing anything with the heavy tyres business, such as a sale or a spin-off, or if it's a too importantly strategic asset for you.

Jukka Moisio

I think that they are now in the middle of the investment programme. So right now, the important thing is that we implement that, and we achieve the results that we've set out to achieve. So, that will mean that the capacity and capability will increase. That also means that the Nokian factory, a significant part of Nokian factory is delegated to heavy tyres and so therefore, of course, it becomes a possibility to consider that asset as an operation with its own factory.

Will we then do that? Then it's something that we look at the margin profile and the opportunity and ambition beyond the immediate Nokian investment and then see if there are add-on acquisition type opportunities or market penetration or innovation opportunities then it would be considered to be an important part of the company and I think that this is the starting point.

So, at this point of time, we would want very much Nokian Tyres to keep heavy tyres while we, of course, develop that into a strong entity based on Nokian factory and the Nokian factory significantly is supporting heavy tyres and less significantly supporting the passenger car tyres, except for the innovation and R&D and the technology development.

Mattias Holmberg

Thank you.

Päivi Antola

And it's starting to be to be four o'clock here in Helsinki, so it's time to finish this conference call. Thank you everybody for participating. Thank you, Jukka, and thank you, Teemu, and we will be back on the line on the 27th of October with the Q3 results. Thank you all and have a good day.

Operator

This now conclude our conference call. Thank you all for attending. You may now disconnect your lines.