Lego Adjustment is a bump in strategy … Notes on the Interim Results 2017

Comment : "Lego adjustment is a bump in execution not strategy. An adjustment is needed as Lego awaits China and South East Asia to come on stream". JKA

The Golden Arch

Like all high growth companies, Lego faces the challenge of the Golden Arch.

The rate of growth in sales at a faster rate than the growth in total market sales cannot be sustainable in the medium term.

We call this the "Golden Arch of Growth" set to lose it's glister over time.

Lego Market Share

Lego market share had grown to over 6% by 2016. Lego had emerged as the number one brand in the market in $ dollar values.

[Largely at the expense of Mattel. The market valued at around $94 billion dollars in 2017, A highly fragmented market]

Growth in sales, margins and revenues per capita

The company had enjoyed strong growth in sales, margins and profits. A gross margin of over 70%, a return on sales of over 30% and sales per capital of over 2 million krona, would mean the options for further gains in profits would have to be derived from the top line sales growth.

Sales Growth in 2015

Revenues in 2015 soared by 25%. It was an illusion flattered by a 20% appreciation of the krona against the dollar. Underlying sales growth in dollar terms was a more modest 6%. The company reacted by setting out on a huge hiring scheme.

Employee Numbers

The number of employees, had grown from 12,852 in 2014, to 18,200 by the middle of 2017. A 42% increase in staff numbers was riding on a sales revenue increase of 32% in krona revenues over the prior two years.

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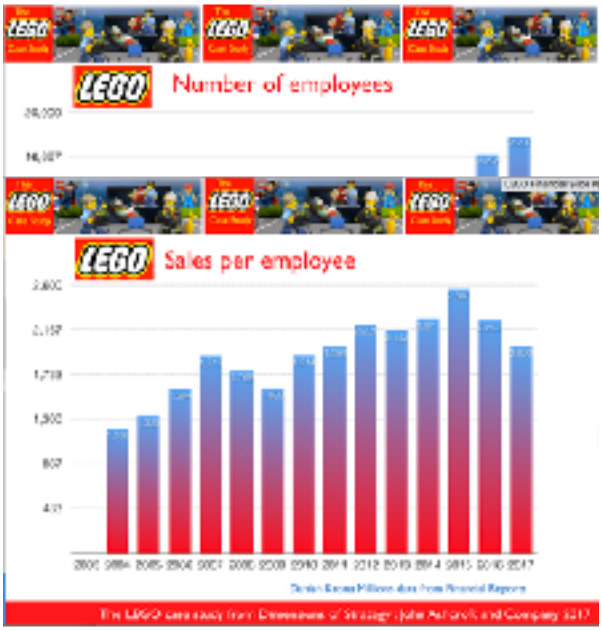

In dollar terms the sales growth was just over 10%.

Of itself this was an accident waiting to happen. The company had moved too "fast" in expanding the headcount and management infrastructure.

Revenues per capita would have fallen significantly in 2017 based on the first half results.

The plan cut in staff numbers of 1,400 would return the projected sales per capita to 2.15 million krona. Back towards the levels of the last few years. Knudstorp can do the maths!

Back to Basic - Profit from the core …

During the past five years, the LEGO Group has built an increasingly complex organisation to support global double-digit growth quoted from the Lego Interim Report

Knudstorp said: "In the process, we have added complexity into the organisation which now in turn makes it harder for us to grow further. As a result, we have now pressed the reset-button for the entire Group. This means we will build a smaller and less complex organisation than we have today, which will simplify our business model in order to reach more children.

Back to basics, profit from the core was very much the theme of the Lego turnaround identified in The Lego Case study 2014. Can Knudstorp repeat the trick?

Will it be so easy this time …

Slow growth in the established markets of Europe and North America is hitting top line sales. Outgoing CEO Bill Padda claimed he was unsure of why sales had been so poor in the U.S.A. Really? That is his job after all.

The bankruptcy of Toys R Us must have provided a clue but certainly will not have helped. Market maturity, online sales, new technologies in digital, drones and mobile will be a real challenge for Lego in the future.

Heavy investment in China is beginning to produce results. Knudstorp reported double digit growth in China albeit from a low base perhaps. In the future back to basics, profit from the core will help. "Conversations with kids" will be assisted by a slimmer management tree. For the moment, It is simple maths to get the sales per capital back in line. "Lego adjustment is a bump in execution not strategy. An adjustment is needed as Lego awaits China and South East Asia to come on stream".