

## President and CEO Matti Halmesmäki's answers to questions at Kesko's Q3/2009 media and analyst briefing on 22 October 2009

**Hanna-Maria Heikkinen of Nordea Markets:** Congratulations for your food trade's good Q3 results. What has changed from Q2? At least for me, the Q2 margin was somewhat disappointing.

**MH:** In our opinion, the machine has been running smoothly and normally all the time. If we talk about two percent numbers, the coefficient is so big that even minor changes become visible. But our work and productivity programme is being intensively implemented also in Kesko Food. The basic idea of the programme is doing things in more efficient ways. We have, for example, developed logistics automation whereby we've been able to centralise all warehouse operations in Hakkila. This means a better control which translates into shorter storage times, lower labour costs, reduced wastage and saving in space. Another important factor is the location of the Vuosaari Harbour. But of course, new investments always take some time before they operate on a full scale. We have systematically pursued our quality-driven policy without compromising the right prices. By quality, we refer to product quality, but also to selection quality and service, the accessibility of stores and availability of products.

**H-M H:** A question about your future outlook. Am I right in saying that your results improve as the comparative figures become lower towards the year end, or are there some actual improvements in sight?

**MH:** We're saying that there will be as concrete improvements as in the Q3 results compared with the second quarter results. And the results are not expected to deteriorate further.

**H-M H:** How about the business acquisition possibilities, especially in Russia? Carrefour announced their withdrawal from Russia last Friday, saying that they saw very few acquisition possibilities there in the short and medium term. Do you disagree with them on this?

**MH:** No, I don't. Carrefour is a well managed major operator with enormous stores. But I don't know what kind of domestic pressures they may have. It's not a matter of opinion to say that Russia is a huge market consisting of different areas. The opportunities for business acquisitions have improved because companies are suffering from the financial crisis which is difficult to overcome. Therefore good store sites are now available at low prices and overheating is over. But the recovery is not very easy to predict, largely because of certain unhealthy phenomena involved in difficult financial situations. We'll look into these issues again in the next strategy meeting next month. Kesko Food's international expansion is included in the agenda. Kesko Food is our principal division and we're looking for healthy growth opportunities for it.

**Elina Pennala of Öhman:** Could you please specify the guidance a little. Does it mean that you don't expect the quarterly operating profit to deteriorate further, or are you talking about the cumulative operating profit?

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**MH:** The outlook is for the rolling 12 months. On a quarterly level, we'll be able to show growth rather than fall.

**EP:** About your building and home improvement trade: are B-to-B sales a more important trigger than sales to consumer customers with regard to recovery?

**MH:** It naturally affects the sales levels. The margins are different in these customer groups. In big building projects, we are in a subcontractor role, because goods are delivered from factory directly to the building sites. Private consumption demand plays a crucial role. The outlook for, for example, the yard & garden business is very good. All K-rauta stores already offer those products and most of the Rautia stores will have a yard & garden department added to their offer.

**Martin Sundman of Sofia Bank:** I'd like to ask about the impact of the lowered VAT on food prices: retail operators have been under a magnifying glass in the media about the subject and they will be closely monitored also in the upcoming months. Are you going to have difficulties in adjusting the lowered prices to increasing costs?

**MH:** Actually it's been surprising to see that people don't trust retail operators and think that we could have artificially raised prices in order to be able to lower them when the VAT rate was dropped. Our systems use tax-free prices and we don't play games with a thing like this. Our operations are always market driven and transparent. The K-Group made a major effort in changing food prices throughout the K-store network. We are aware that this issue will continue to arise.

**MS:** Is it possible to make any further cost adjustments in a situation where price increases would be difficult to make? If there is cost inflation, are there any cutting possibilities?

**MH:** These things can always be developed further. But we must consider the service levels involved. We carefully monitor costs by product group and by product from the store level to the supplier. There are, of course, differences in profitability resulting from the competitive situation etc. But all products must meet the profitability criteria. Campaigns involve large numbers of customers and big flows of goods and it's very important that campaigns succeed.

**Pirkko Tammilehto of Kauppalehti:** About food prices: you said that you haven't been able to meet consumers' expectations. How could food prices be reduced further? Can you cut retailer margins or be even tougher with product manufacturers?

**MH:** I don't think we've been tough with industry because so many manufacturing companies have given positive profit warnings. For example, the wholesale price of milk much talked about has not decreased although producer prices have. Centralised trade operators negotiate with strong operators in production. We've also developed cooperation with retailers, given their high motivation as entrepreneurs which we see as a competitive advantage. Retailers adapt their operations

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to the prevailing local situation on a daily basis and either gain immediate profits or not. This is where we've been losing, but now we have improved the system. But we do not intend to become a single-owned chain operator, because then we would lose the benefit generated by retailer enterprise. Information management and system developments enable us to establish a better operating environment for retailers and Kesko Food. The same development holds true of our home and speciality goods trade. We must take care that K-stores have the widest product selections in the market and that the retailer is the face of the store. But as we develop these processes for higher efficiency, we must follow the rules of our cooperation.

**PT:** Could you elaborate on that?

**MH:** For about twenty years, the Finnish Competition Authority has required that retailers must be free to purchase the goods they sell from anywhere they want. Therefore we must make sure that by combining our buying power we get the products at lower prices than single retailers. And to ensure that we must be able to promise the manufacturers that their products are made available in all K-stores at agreed prices. Suppliers are naturally interested in the visibility and the prices of their products in K-stores. Therefore we must have the authority to promise them to our suppliers. It also requires well managed systems for a controlled process which we have been developing to establish a model which is spontaneous and local on one hand, but at the same time predictable and shared by all. Because competitive situations are different in different parts of Finland, there are different cost elements in play, if we think about, for example, transport distances, we cannot operate a nationwide product selection and single prices. This chain operation system has been used for ten years now, and Kesko Food has developed it furthest and perhaps best enjoys the benefits. This is largely because the customers of building and home improvement stores are more difficult to conceptualise because the projects for which they buy products are so different from each other. There we need situation management and the services of the local entrepreneur and his/her staff.

**PT:** One more question about prices: it is widely argued that there is no real competition in Finland's grocery trade because the K-Group and the S-Group have same level food prices. Does this tell us that there is no competition? Should your prices be more different from each other?

**MH:** This situation is a result from competition and market shares keep changing due to competition. I think both the S-Group and the K-Group will increase their market shares this year. And it would be a big surprise if the same thing did not happen next year too. This is not due to the lack of competition but the keenness of competition. Our strength has relied on best retailers and we have not gained system benefits offered by large units. But now we're gradually fine-tuning the system to deliver its full competitiveness to the stores, so that we don't need so much to rely on the top retailers. We still have the best food stores in Finland. Now we need to fine-tune the system so that also the average K-retailer outperforms the local S-store manager.

But my answer to your question is that the food manufacturing industry is so centralised that all stores sell the same products, and the stores are the same size with more or less the same cost structure, as well as the same level purchase prices from industry. I think that so far, we've been in a somewhat weaker position due to our less centralised purchasing. We are improving on that and have been able to compensate it by retailer operations. As we know, a retailer is efficient in managing his/her store. In all countries, smaller stores do and they should have higher price levels than hypermarkets. In times of recession, prices do not necessarily decide everything. Customers' experience of the store and its reliability also play an important role. We terminated our contract with Nielsen expressly because we didn't want all operators to share the same information in a situation where there was practically only one other hypermarket operator in Finland in addition to us. We feel that our K-retailer organisation consists of efficient local operators who do not need exact sales data from the competition. The basic idea of the system is good, aiming at higher efficiency through data from different types of stores etc. and the concept is used worldwide. In our opinion, however, it was no longer practicable in our situation in Finland.

**PT:** Are you going to continue investments in Finland, and have you changed your investment plans for the building and home improvement trade in Russia because of the outlook?

**MH:** We have made a decision in principle concerning Finland that in cases where a positive land use decision has been made we will carry out the K-citymarket building project. But we evaluate each case on profitability criteria. During the next 2-3 years, we plan to build some 20 new K-citymarkets. As for K-supermarket investments, Kesko's Board will shortly discuss them. I'd say that in the next 3-4 years, we'll open some 50 new K-supermarkets. We see that customers want wide selections and affordable prices. But we've also renovated all K-markets and extended the chain to the Teboil and Neste service stations.

As for Russia, building the store network continues, and any further decisions are made based on profitability criteria. We haven't made any decisions in principle to postpone investments. But profitability is the leading principle. We're not obsessed with having a given number of stores within a given time in Russia. The local demand is big and service offer is poor. Each time when a new K-rauta store has established itself, customers come from far and wide and are very satisfied with our stores.

**Hanna-Maria Heikkinen of Nordea Markets:** The Q3 tax rate was exceptionally high. What is to be expected for the rest of the year?

**CFO Arja Talma:** The cumulative 9-month tax rate corresponds to our view for the rest of the year.

**H-MH:** The profitability of your home and speciality goods trade in Q3 was surprisingly good. Is it due to same kind of logistics factors as in the food trade?

**MH:** The improvement is largely attributable to Citymarket Oy. People nowadays buy home and speciality goods from food

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stores too. Enhanced purchasing coupled with inventory management has generated healthier sales margins. And as in the previous recession, Intersport seems to be doing well now too. In the furniture trade, Asko and Sotka seem to be gaining on competitors' difficulties although the market is slack. In home electronics, the market has declined further especially now that the digital transition is over. And prices of especially TVs have dropped a lot.

**Arto Jaakkola of the Kehittyvä Kauppa magazine:** Has the chain agreement reform progressed as expected from Kesko's point of view?

**MH:** About ten years ago, we implemented a complete reform of the chain agreement model. The model's functionality and other aspects have been estimated, and it has been found to have stood the time very well. If only we had carried out the reform earlier, but it's only natural that difficult reforms are easily delayed. Now there's unanimity about the need for developing efficient tools for the retailers so that they get information about their customers, costs, wastage etc. The management and monitoring must be brought down to a more detailed level. By the end of next year, some 200 of the approximately 1,300 agreements are to be renewed. The situation will be completely new because 10 years ago, all of the agreements were renewed for a fixed term of 10 years. The contents are not going to change in any radical way. But one big question is electronification, and we must discuss system developments with the retailers. I see no problems in the agreement renewals next year. If a retailer so wishes, he/she can easily terminate the agreement with a short notice and without giving a reason, in which case Kesko will buy the store equipment. But we want to hold on to good retailers and hope that they renew their agreements. All in all, we have good cooperation with retailers.

Thank you!