

## **President and CEO Matti Halmesmäki's answers to questions at Kesko's Q2/2009 media and analyst briefing on 24 July 2009**

**Hanna-Maria Heikkinen of Nordea Markets:** You said that the Q2 result of the food trade was burdened by new store site openings. Are you satisfied with the achieved level in the present situation?

**MH:** Compared with last year, the performance has been slightly better, although this past quarter was a little weaker. Our margins are very small if we talk about Kesko's share of retail prices which is a little more than 2%. Even minor surprises in campaigns or product groups will reflect heavily on the bottom line, in addition to store network projects. We're prepared for sudden needs to boost sales. But now we're satisfied with Kesko Food's figures.

**Jenni Kimpimäki of Turun Sanomat and Väli-Suomen Media:** What does it mean in practice that adjustments will be continued? What kind of measures are you going to implement during the rest of the year and will there be further staff reductions?

**MH:** The starting point of our Work and Productivity Programme was that the share of staff cost of the gross margin must not grow. The K-Group seeks competitiveness by doing business with smaller margins while generating profits in bigger volumes and lower costs. Of course, if sales fall by 50% in some product lines or units, or by 90% as in the Baltic machinery trade, it puts pressure on staff cost too. But there are big differences between our different product lines, if we compare, for example, foods with boats or motorcycles. And big changes in the markets may also take place, for example, Yamaha motorcycles used to hold the number two position in the markets, and now they're clearly number one. This is because long-established and reliable companies are better able to maintain their trustworthy business images and customer relationships, and therefore also sell new products.

**Maria Wikström of Handelsbanken:** Kesko Food's performance was weaker than the market expected. This was the first time in nine years that the Q2 result was smaller than the Q1 result. Was there something special about the past Q2?

**MH:** I've talked a lot about the food trade, because it's such an important division for us. We've analysed the segment very carefully in the division board meetings but have not noticed any trends that would require any serious conclusions to be made. It may be that the first part of last year was relatively weaker compared with the previous year and the second quarter was very strong. But our food trade volumes are very big, and already when I was Vice President of Finance and Accounting, I told the organisation never to use the weather or calendar as an excuse for poor performance and I'm not going to do so now myself. If we look at very short periods, they contain various incidental factors. Today retail operations control systems are very tight and include various incentives. When a retailer succeeds in increasing sales and achieves good results in quality programmes, he/she gets better business terms. Often Kesko's short-term results do not show good performance in customer satisfaction or sales growth etc. And, for example, K-citymarket's sales performance also means that customers have been offered

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affordable goods, based on marketing plan drawn up for the whole chain. According to the chain control system, Kesko makes the decisions but price and marketing tools are discussed in planning groups. With respect to food prices, we've discussed them a lot and expect them to play an increasingly important part.

**MW:** Your business result for the first half increased. Do you expect the same for the second half of the year, although your Q2 operating profit dropped year on year?

**MH:** We are very serious about our business and operate in large volumes.

**Kalle Karppinen of Danske Markets:** I have two questions: about the food trade and the nature of new store openings. Is the cost level stable, or do some quarters have more openings than others, which reflects on the results? And my second question is about Rautakesko which has achieved cost savings: are there more savings to be expected?

**MH:** Rautakesko's result is especially good with view of the fact that the recession hit Lithuania much later than Latvia and Estonia. But this year, sales have come a halt falling by as much as 40%. Senukai has always performed strongly, but now its result has decreased markedly, although it's still clearly positive. Senukai has already taken corrective steps, but there are also various country-specific factors involved. What we're not at all happy about is our own retail trade in Norway, where we've also opened new stores. It seems that wealthier countries recover more quickly from the recession. For example, the building and home improvement trade in Sweden has already shown positive signs. But in Norway, where most of our stores are retailer run, we have a lot of work to do.

As regards store openings, the starting point is the chain agreement signed by each retailer. When a retailer starts a business in a new store site, he/she pays a lowered store site fee. Practically in all our store chains, the fee is tied to the gross margin, which means that the cheaper the retailer sells the smaller fee he/she pays. And for the first three years, the percentage remains smaller than normal. In other words, as soon as the store site gets off to a good start, the retailer starts paying the normal percentage, and as the gross margin settles to the normal level, Kesko's share increases. In connection with a store opening plan there's always a separate marketing plan for the opening which specifies the marketing costs, special offers plus various other costs. The store staff is employed a long time before the store opens. In addition, there are certain costs for temporary arrangements during the construction. In other words, the cost lines are many, and every new store opening is a major effort for the chain, no matter how well according to plan everything goes.

**Tia Lehto of Carnegie:** Do I remember right that you plan to open another K-citymarket by the end of the year?

**MH:** The rest of the year will see three more new K-citymarkets opened, one of which in Kirkkonummi and another in Kaukajärvi, Tampere.

**TL:** When are the openings scheduled?

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**MH:** The dates are fixed so that the stores open in good time before Christmas, which is important for the home and speciality goods trade. In these days building projects are completed ahead of schedule instead of being late, which is a good thing.

**TL:** Stroymaster's operating profit was up 3.8% over the previous year. How much did price increases contribute to that?

**MH:** Rautakesko Board's directions were that gross margins must be raised to compensate for the euro-denominated rents while maintaining the profit level. This has not quite been achieved, because the local market has weakened, especially in the B-to-B trade. I cannot give any exact figures, but the gross margins have not changed significantly.

**TL:** How about the volumes?

**MH:** Price increases have been implemented by suppliers. And in the building and home improvement trade, there's a difference between warehouse sales effected in the store, and sales with 3<sup>rd</sup> party invoicing. CFO Arja Talma sits in the Stroymaster Board. Can you elaborate on this? I've understood that interior decoration products and tools are selling reasonably well.

**AT:** I can't give you exact volume figures, but in Russia like elsewhere, it's the building materials trade that's in difficulty, while the retail sales to consumers have continued reasonably well.

**Question through the net:** Could you comment on the impact of new store site openings on the operating profit? And what was the corresponding figure for Q1? And does any other factor than the new store openings explain the Q1 margin fall?

**MH:** I think I already answered these questions by explaining about the volume in relation to the control margin, and that short periods may include incidental factors, such as store openings. We've also opened new building and home improvement stores, and have had to consider whether to open a new store in Latvia at all, or to postpone it and wait for rents to come down. However, we've seen that the expansion of the store site network is important. Weak operators will go bankrupt, making room for those who remain. This is already happening in the Baltics, where small and even bigger operators run out of goods because they are not supplied anymore, and then they can't pay their staffs. In a cyclical business, such as the building and home improvement trade, opening a new store is even more challenging. Although the recession can't be seen on the streets of St. Petersburg and Moscow, demand has declined there too. The implementation of a store site opening varies according to the product line and the locality. But every opening relies on customer flow calculations, store network plan and continuous monitoring.

**Question through the net:** About the operating profit of the building and home improvement trade for Q1: which countries recorded the biggest improvements?

**MH:** A profit decrease from €38 million to €5.6 million does not show very much improvement in any operating country, except for Belarus. Perhaps we could learn something from their social system.

**Question through the net:** What plans do you have for Musta Pörssi and Konebox engaging in the home and speciality goods trade?

**MH:** After the digital boom was over, all operators have had more or less difficulties. In all retailing, customers have begun to prefer large product selections, affordable prices, and therefore large stores. The problem with home electronics is that the product selection is enormous, it changes rapidly and prices go down. This means that carrying large stocks is unprofitable and naturally ties up a lot of capital, which is why this is a typical product line in which online trading will capture an increasing role; the products are well-known, customers are used to comparing the offer online. Konebox, which is Musta Pörssi's sister company, attracts those customers, as well as the Budget Sport online store. The product line is big and it's undergoing a major transitional stage. As regards our divisions in general, focus is better than expansion into new areas. We have no plans to that effect, because the market demand is different from what it was some time ago. Capital investors and banks are careful about new targets and concentrate on ensuring the settlement of existing obligations.

Thank you!