

## **President and CEO Matti Halmesmäki's answers to questions at Kesko's Q1/2011 media and analyst briefing on 28 April 2011**

**Mika Karppinen, Evli:** You have slightly amended your guidance. Is it due to higher sales, better cost management or development projects having got off to a better start than expected? And what kind of capital expenditures on infrastructure and logistics are needed in Russia for your food trade expansion?

**Matti Halmesmäki:** In recent years, we have not had any significant problems and a steady performance has been our strength. An explicit management requirement for every division is to achieve their objectives. Our compensation plans are also designed only to reward for results. The aim in all operations is high customer satisfaction in every store, chain and division. It generates healthy sales. Development situations vary between divisions but, as a whole, performance has been steady. The building and home improvement trade has the biggest profit potential, and before the recession, its performance matched the level of the food trade. Now it is lagging behind even in terms of annual figures, and we also have some minor operations which are not yet as good as they should be. But sales and profit growth is steady overall.

Yesterday, Kesko's Board made a decision concerning a €30.5 million capital expenditure in the building and home improvement trade in the Moscow area, the store site included. We see it as a substantial benefit that we have opened all our stores in Russia according to schedule and cost estimate. We have ourselves obtained permissions for zoning alterations and the like. As a result, we'll be able to leverage efficiency in the expensive store sites in Moscow and also in St. Petersburg by locating both food stores and building and home improvement stores on the same sites.

As for logistics, the businesses we have considered for acquisition are only developing their logistics operations, and in many cases, manufacturers deliver products direct to retail stores. Congested local traffic must also be taken into consideration, although a large-scale store can receive large quantities of goods at a time. In other words, there are many sides to the logistics question, which is why it is important to establish sufficient local volumes soonest possible.

**Tiina Taipale of Maaseudun Tulevaisuus:** What will the contribution of Russian operations to net sales? And could you please elaborate on the trading sector's role in the retail pricing of food, which has been discussed a lot in public recently?

**MH:** When I presented Kesko Food's sales margins at a supplier event, it could be seen that they have remained constant. In my opinion, Finnish consumers pay the highest prices for milk compared to other European countries. As for meat, the prices of production inputs have risen and the question is how soon it is reflected in consumer prices. I'm worried about a development towards regulation which can be seen also within the EU. Resulting cartels would mean higher prices. An equally big problem would then be that consumers would not buy those expensive products. In other words, although Finnish origin of especially meat is valued by Finnish customers, there is a limit to what it can cost. And in such a situation, customers opt for cheaper alternatives and the trading sector is blamed for importing them. But I'm

sure we all agree that income per farm is low. I wonder what would be the solution, because land prices have risen so high as a result of subsidies allocated without any correlation to productivity. But in any case, customers decide and instead of blaming each other, we should aim at cooperation. There are different operators in the food chain and competition must be efficient. And long-term efforts are required starting from new product launches, development of logistics models etc. I see that we should think about ways in which to maintain Finnish products competitive, even if a good product selection in a store also includes imported alternatives, since we are an EU member state.

In Russia, we want to have store sites which stand time and are profitable as property investments too. Proof of which were the real estate we sold to ICA in the Baltics some years ago at double the price we had paid for them. Kesko Food's objective is to achieve €500 million in net sales in Russia by 2015, and if the sales of K-food stores in Finland total €5 billion, you see the contribution. In the building and home improvement trade, foreign operations already contribute more than 50% to total net sales and growth is expected from operations in Russia mainly because of the size of the market. But we also have growth potential in Sweden, the Baltics and also Norway where we are planning to open new stores. And the performance of our only store in Belarus has been excellent.

**Petri Karhunkoski of Swedbank:** What are the reasons for changes in the operating margin of the food trade from Q2 and Q3 in 2010 at over 4%, to a weaker Q4 and back to above 4% again for Q1 in 2011?

**MH:** When a new store opens, it takes some time until a normal profitability level is achieved. But we have succeeded very well in the food trade, as new stores have started to generate profits very quickly. And we have no stores in profitability problems and very few support operations are needed today. We incur costs from making operations and processes more efficient, for example, we have increasingly centralised warehousing. Selections and operations control have been increased while costs have decreased. Although retailers make direct goods purchases, Kesko gets chain, store site, marketing and information system fees for them. Control systems have also changed, so that only a minor percentage of the profit of a successful store site is generated by goods trade, compared to the percentage from our cooperation with retailers. Payment systems correlate with costs, coupled with the chain fee system. We encourage retailers to generate sales and profit, because they reflect on Kesko's figures too.

Thank you!