

## Questions and President and CEO Mikko Helander's answers at Kesko's Q1/2017 media and analyst briefing on 27 April 2017

**Pirkko Tammilehto, Kauppalehti:** How much will it cost you to handle those stores of Suomen Lähikauppa which you failed to sell contrary to the Finnish Competition and Consumer Authority's condition? A number of stores are going to be closed down and employees made redundant.

**Mikko Helander:** There will be costs, and we have announced the actions which will be taken. So no surprises there. And Jorma, am I right in saying that the actions will, in fact, take place quite soon?

**Jorma Rauhala:** The last Siwas will close on Saturday

**Mikko Helander:** In other words, the entire network change will be completed by the end of this month, when a total of 407 Siwas and Valintatalos will have become part of the K-Market chain. And they will be gradually transferred to retailer entrepreneurs; by now 57 of them are already run by retailers and the rest will be transferred this year and the next.

**Pirkko Tammilehto:** About the outlook, the latest figures for small stores show a falling trend as a result of the liberalised opening hours. Do you expect this trend to even out at some stage, or will small stores become a burden for you and difficult for the retailers?

**Mikko Helander:** No, they won't. I must say that when we acquired Suomen Lähikauppa, we estimated the number of stores integrated into the K-Market chain to be significantly smaller than what it turned out to be. And another thing is that the sales performance of the converted stores have exceeded our expectations, and in fact, the trend continues to rise. Retailer entrepreneurs have also contributed to the good sales performance. This is actually the best answer; clearly more stores than planned have been converted into K-Markets, because they are in greater demand. Does Jorma want to elaborate on this?

**Jorma Rauhala:** I assume that the question also refers to the grocery trade figures in today's report by The Finnish Grocery Trade Association (PTY). Store numbers in the less than 400 sqm market have fallen significantly, especially as a result of the Siwas which have been closed down. And in consequence, development in that category has been weaker than in the rest of the market. But the impact of the liberalised opening hours has clearly evened out.

If we think about the existing network, the difference in the development between large and small stores is very small. We definitely see that this difference will even out significantly this year already and in the future, the demand for small stores will be high.

**Mikko Helander:** Indeed, it will.

**Pirkko Tammilehto:** What is the situation with the new health and wellbeing store chain? You've said that you're waiting for licenses. Yesterday's news about the government's mid-term negotiations did not, however, show a green light to your pharmacy license.

**Mikko Helander:** No, that's true. But I don't think anyone – at least among ourselves - has expected the Finnish pharmacy legislation to change overnight. We've all the time expected it to be a process of its own, and quite a big political issue that will take its time. But the situation is as we then announced some weeks ago, that we have signed an agreement with Oriola, both parties are strongly committed to the new chain and its development. We'll start with health and wellbeing products and as soon as we receive the appropriate permits, we'll be able to launch the business by the end of this year. In other words, the situation has not changed from what we have announced.

**Rauli Juva, Nordea:** About the store conversion costs and the transfer of Lähikauppa's logistics; how has the operational profitability been affected in Q1?

**Mikko Helander:** For my part, I can say - and Jukka and Jorma can continue, if they wish – that for one thing, for the neighbourhood market – and I'm not referring only to Suomen Lähikauppa's stores – but to smaller stores in general, Q1 is by far weakest. And as you know, it's typical of the grocery trade that after the holidays, Q1 starts always a little slower. The fact that we now have the relatively biggest number of neighbourhood stores highlights the seasonality of Q1, perhaps more than is understood outside.

Another thing is that when the acquisition was closed and completed, we also announced that we had decided to implement the conversions in a faster time frame than we had originally planned. In consequence, the efforts made in the first quarter of this year have been great indeed. They have made me time and again marvel and admire the work of our personnel in the huge number of conversions in such a short period of time. If we compare the whole amount of costs we expected to arise with the costs we have incurred, they are perfectly in line, as are the costs in Q1. Perhaps all of the business professionals have not necessarily realised the change.

**Jukka Erlund:** We have recorded certain one-off costs on the conversions. But when we have such a massive process of store closures and re-openings in progress, it's obvious that sales and margins are affected by the periods of time when stores are not in operation. The whole conversion process, now reaching its conclusion on Saturday, has been huge.

**Mikko Helander:** The final separation of logistics from Tuko Logistics and transfer to Hakkila has been extremely important in terms of synergies. All of this is now done and in May, all of the logistics operations will start running there.

**Rauli Juva:** Could you say something about the operational impact in figure; are we talking about a profit impact of millions or perhaps less?

**Jukka Erlund:** What can be said is that we reported last year's pro forma figures, and seasonality affected the figures for Q1. But millions of costs arise from the massive change

programme we have implemented in Q1. The figures will improve as a result of the seasonality element and the fact that store closures and re-openings will no longer take place.

**Rauli Juva:** Now that the process is over, will you be able to start realising the €30 million synergies in full as from May?

**Mikko Helander:** Not in full, but we've already gained some of those synergies, which can be seen, for example, in the profit of the grocery trade. Synergies will be realised gradually, and they are important, but we must not forget that the work is not done yet; transferring the converted store to retailers is very important and it has had an immediate impact on, for example, the reduction of wastage, selections will improve as retailer entrepreneurs start running the stores and listen to the needs of their customers. Many things remain to be finalised in the coming months and in full in 2018, when the entire process will be completed.

**Rauli Juva:** Onninen's Q1 sales and profit were good. What is behind the good performance and were there some particularly weak elements last year, or was it because the calendar effect, or some other significant factor?

**Mikko Helander:** I can start and Terho can then give the right answers. In my opinion, the single most important factor is that building and renovation are transferring to professionals on a large and rapid scale, a trend which seems to be strengthening. And now we play a much stronger role in that trend. The second important factor is that we have succeeded in making the combination of Kesko's B2B trade organisation and Onninen's organisation operate as a single entity in a surprisingly short time. The results prove that they are getting things done. And the economic trend helps too. The fact that we are able to leverage it for the reasons I said are the factors behind the good performance. And we are very pleased with the acquisition of Onninen, its financial performance and the way in which Onninen's personnel are working for K Group. But perhaps Terho would like to continue.

**Terho Kalliokoski:** We were able to take over Onninen and build the new Kesko building and technical trade entity within a shorter time frame than we originally expected. Now Onninen is not only part of B2B trade and customer relationship management, but also all background functions are part of the division and Kesko's organisation. As such, they are the requirements for improved sales performance, and of course, as Mikko said, the market has also helped in that. But we have also been able to improve efficiency and our profit making capacity. It should also be said that because Easter did not fall in Q1, it had a positive impact on selling days. But the view of Onninen and the whole building and technical trade is very positive and confident.

**Arto Jaakkola, Kehittyvä Kauppa:** The business operations of K-maatalous have just been sold, which again raised the issue of the future of Kesko's home and speciality goods trade. How can a listed company comment on the issue of those chains' future at this stage?

**Mikko Helander:** The same way as we've been saying since spring 2015: Kesko and K Group will develop the operations of all divisions, and that's what we've been doing in the home and speciality goods trade too; we've made capital expenditures in them, several renewal and development actions have been implemented thanks to which all of those units have been able to improve their sales and profitability. I've today also expressed my sincere thanks to these organisations. But once again, I repeat that at the same time when they are developed, we must consider the future of those businesses and the retailer entrepreneurs in the increasingly intense competition; we are not the most responsible trading sector company in the world for nothing. I see the K-maatalous arrangement as a very good example of this. Lantmännen with its partners is one of the largest operators in the European agricultural trade and has almost a tenfold purchasing power compared to Kesko. As part of such an entity, K-maatalous and the K-maatalous retailers have completely different conditions for success in competition in the coming years and decades. From this perspective, we also examine those other chains. We have made similar arrangements in the machinery trade and I'm convinced that considering the future of the divested operations, the solutions will prove very successful. And I'm very pleased with, for example, the positive attitude of K-maatalous retailers towards the arrangement. I expect that they too have realised its importance for their future.

**Arto Jaakkola:** From Kesko's point of view, was the selling price of the Siwas and Valintatalos too low; did you sell them at a discount, and could you have sold more of them?

**Mikko Helander:** We must not forget that we first tried to sell the stores which the Finnish Competition and Consumer Authority ordered us to sell. Then a trustee took over and the FCCA continued selling them through the trustee, but no more of them were sold. In other words, the FCCA was in charge of the selling and there is no point in speculating about the outcome. I'm sure the trustee did everything he could, if not more. The reason for why no more stores were sold is that some of the unsold stores had been loss-making and were in poor condition, the properties were in need of major capital expenditure and their financial performances until then and those to be expected in the future were not considered interesting.

But the big thing here is that 407 Siwas and Valintatalos have been converted into K-Markets, which I see as a good work; we have saved those stores and we have saved them in many localities for Finnish consumers. That's one of the good reasons to raise a glass on 1<sup>st</sup> May!

**Pirkko Tammilehto:** Speaking about your home and speciality goods stores, who would be interested in, for example, the Intersport stores, or the business models of the chain controlled Asko and Sotka stores? Would similar arrangements be possible with them as you made with the K-maatalous stores?

**Mikko Helander:** Certainly, but time will tell. We must not forget that they are very well run and managed businesses. They are either market leaders or one of the three largest operators in Finland in the sector, all of them have good ROCEs, good profitability and

very competent personnel. There's no doubt that on this basis, we can safeguard their success in the long run. But there's no hurry, as all of these businesses have increased their sales and profitability in the last two years. We will continue to develop also these businesses responsibly.

**Pirkko Tammilehto:** You've told that several K-Citymarket's have opened an online food store and had lots of orders. How are they doing now, are they as popular as in the beginning?

**Mikko Helander:** Jorma can continue, but I just want to say that it was great that we started piloting these 3rd generation online food stores at K-Citymarket Itäkeskus and K-Citymarket Iso Omena. In my opinion, the results are very encouraging, but Jorma can tell you about them in detail.

**Jorma Rauhala:** The most important thing about these pilots is their completely unique selection of around 20,000 grocery trade products plus store specific service counters etc. Now we are in a very intensive development phase, which means that on a daily basis, we are developing the ordering phase, the in-store picking phase, as well as transportation. The system is now so good, that it will be introduced extensively in dozens of other K-stores and transportation service will be widened in Greater Helsinki and elsewhere. Our online food trade is progressing precisely according to plan. We are fine-tuning the process in order to turn also e-commerce into a good business.

**Mikko Helander:** Just like Jorma said, it's very important that e-commerce is good business. It has to be profitable. In the long run, no online store is on a sound basis, if it's not profitable. We pilot, develop and fine-tune the systems to make the business profitable. Then we'll be able to provide good online food services on a wider scale to consumers in Finland.

**Mikko Helander:** That seems to be all this time. Thank you for your attention!