Questions and President and CEO Mikko Helander’s answers at Kesko's Q4/2016 media and analyst briefing on 2 February 2017

Olli Kuivaniemi of STT: **Competition in food trade has been quite intense over the last year or two. How do you expect the competition to develop and do you have some new initiatives in mind?**

Mikko Helander: Talking about food prices, the last couple of years have been quite exceptional and not only in Finland but also elsewhere in the sense that food prices have fallen. We estimate that it is more of a passing phenomenon than a permanent situation, simply because the world’s population is growing and in the long term, the availability of good, high-quality food will be a critical issue for the survival of the human race. As for Finland, we see very clearly that intense competition in the Finnish grocery trade will continue and Kesko and the K-Group will succeed in it especially by systematically implementing our strategy, which means that we are an emphatically different operator in the Finnish grocery trade. In other words, when consumers shop with our K-Market, K-Supermarket or K-Citymarket chains, their experience is different compared to our competitors’ stores. I’m sure this is the case already today, but even more clearly in the future. Another thing is that we are making major capital expenditures. As I mentioned, our total capital expenditure over the last two years is more than one billion euros and most of it is allocated to Finland, which is naturally a great thing. It is also proof of the fact that we have a very strong confidence in the Finnish society.

Kimmo Lunden of Maaseudun tulevaisuus: **Population is growing across the globe but in Finland, population growth is more modest. How do you expect grocery prices to develop in Finland?**

Mikko Helander: This is also a global issue, because it is related to harvests and harvest expectations in different parts of the world, which after a delay will also have a direct impact on food retail prices and naturally production costs. I don’t see that Finland is very different in this respect. Strong Finnish agriculture with the ability to produce good, high-quality, safe Finnish food also in the future is not self-evident. We all should be concerned about it and take responsibility for it, and I can assure you that Kesko and the K-Group have and will continue to do so. I’d like this issue to be discussed more. We would be very pleased to see all related parties – agriculture, industry as well as other trading sector companies and also the government and politicians, who make the decisions about taxation – to take a more active part in this discussion. As I said, this is a very important social issue, and I’m again surprised at politicians’ reluctance to discuss it. In Finland, food is very highly taxed; taxes account for over 40% of food prices, compared to the European average of around 20%. In many countries with which Finland is so often compared as regards food prices, tax accounts for 10%-15% of food prices. These are points that should also be discussed publicly.

Arto Jaakkola of Kehittyvä kauppa: **Now that there is so much talk about food prices, what is the situation today when consumers choose their shopping place; where is price in terms of preference?**

Mikko Helander: An extended trend is that price is not among the most important criteria. Year after year, the most important criterion seems to be the experience of the store and of shopping in it, as well as shopping ease. These are among the things we are investing in. But of course, price is and will be one of the important issues.

Thirdly, I want to stress is that it's very dangerous to talk about these things as if consumers were a single homogenous mass. They are not. The polarisation of consumers is an ongoing development in Finland too. Customer needs and wishes are more clearly very different in different groups. Price is very important and will be important, but not the decisive factor. Jorma, would you perhaps like to elaborate more on this?

Jorma Rauhala: If my memory serves me right, the results of the Taloustutkimus' survey conducted last autumn showed that on weekdays price ranked as the second most important criterion and on weekends, as the sixth most important criterion. On weekends, the other criteria, such as taste and store location, come first.

Olli Kuivaniemi of STT: If the intense price competition continues, what is your preference: are you prepared to sacrifice operating profit levels at the expense of market share in the grocery trade?

Mikko Helander: Firstly, it is not a matter of **if**, it is a matter of **as** the intense competition continues. We are quite sure that the price competition trade will continue to be very tight in the Finnish grocery, but it is the same in the rest of Europe, and that's good. We will succeed in the competition, first of all, with our own work and efforts, enhanced operations, by improving the customer experience and by providing better services, because like we've said, price is not the decisive factor. And we have done well in the competition. Our price competitiveness is good, and I'd say that price differences between us and the competitors are marginal when the comparisons are made appropriately, and when we remember that customers' experience of our stores and their services have been proven to be at a clearly better level compared to competitors. On that basis, we are able to show good development and our profitability is at the top European level. That requires incredible amounts of work also in the future: we will have to operate even more efficiently, improve the customer experience, introduce more digital services, we've just launched a next generation online food store. Jorma told me today that currently the biggest problem is that customer flows are much bigger than we expected which is why we have difficulties with capacity, we are recruiting more people to the pilot stores so that the goods ordered by the growing number of customers are delivered. I can assure you that the service will very soon be expanded to other areas in Finland. These all are ways in which I'm sure the K-Group will succeed even better than before in the Finnish grocery trade market. But as I said, we will be emphatically and increasingly a different operator compared to the other operators in this sector. Finnish consumers will also appreciate the difference, because it would be quite sad if all stores were alike and only differentiated themselves with price.

And I'm saying this without understating the importance of price. I emphasize the fact that already today, the K-Group's prices are very close to the level of our competitors' prices when comparisons are made professionally and appropriately.

Pirkko Tammilehto of Kauppalehti: Could tell us more about your food online store?

Mikko Helander: I'll let Jorma answer, because food is especially his business.

Jorma Rauhala: We've been doing food online business since the 1990s and the level and volume have been reasonably good in the last five or six years. This week, we launched a completely new food online store application. Deliveries are made from K-Citymarket Iso Omena in Espoo and K-Citymarket Itäkeskus in Helsinki. These two stores are piloting the app with a completely new platform, a new system for order picking and transportation. As the first experiences have been very encouraging, the system will be expanded rapidly.

Pirkko Tammilehto: Can you specify the number of customers?

Jorma Rauhala: In the first two or three days, there have been so many orders that we haven't been able to deliver all of them.

Mikko Helander: I was told that yesterday at Iso Omena, they had to close the online store by around 2pm, because no more orders could be registered. More resources are being added, because the demand has clearly taken us by surprise. Another important thing to mention is that in the new system service has a charge. An appropriate price is charged for home delivery, because it is the customer's benefit that by nature, ecommerce is also a form of healthy business. If business isn't healthy, it will be short-lived, because nobody wants to develop such business. We want our ecommerce to be rational for us and retailers, which will help us develop and increase the ecommerce services, all of which will eventually benefit the customers.

Pirkko Tammilehto: How about your capital expenditure; will there be no more new K-Citymarkets, because it seems that Finland is full of hypermarkets?

Mikko Helander: We are in the process of renewing all K-Citymarkets, and the results from those which have already undergone the reform are very encouraging. For example, the sales performances in our home and speciality goods trade for 2016 are very promising, especially in the case of the renewed K-Citymarkets. Likewise, the profitability of the home and speciality goods business is very good, as is the sales performance of the food business of the renewed K-Citymarkets. The reforms will continue and in many cases, they also include construction. In eastern Helsinki, a totally new K-Citymarket will be completed this year. If we think about the number of K-Citymarkets, the total number will be 81 this spring as the new K-Citymarket in Sastamala opens in April. I won't guess on their future number; there may be some new ones or some may cease to exist. We should also keep in mind the extensive social change taking place in Finland as people move to growth centres and Greater Helsinki, which will inevitably become manifest in the development of the store network. On this basis, I repeat what I said earlier that the total number is not very likely to grow, but there may be some individual new stores.

Pirkko Tammilehto: A question to Jorma Rauhala about the Lähikauppa stores to be divested: how has their divestment progressed and has there been other than M retailers

Jorma Rauhala: The process is being led by an independent expert and progressing according to plan. One store has been sold and several are under negotiation. Some of them will undoubtedly be divested, and like it's been in the media, both the S Group and M stores have been interested in them. In a few weeks, no more than some months, the process will be completed: some stores have been sold and the rest will be included in our normal network development to see whether they become K-stores or are closed down.

Kimmo Lunden: About the liberalization of store opening hours that took effect last year: what kind of net impact do your estimate it has had on the K-Group and what was its cost impact on wages and salaries, etc.?

Mikko Helander: The liberalisation of opening hours has not increased people's need to eat. Instead, it's the Finnish consumers' shopping habits that have changed amazingly fast. But in afterthought, it's not so surprising, as many people now want to do their grocery shopping on Sundays, which makes managing their weekday schedules easier. In consequence, when we see that Sunday sales have grown significantly, we also see that it reflect in lower sales on the first days of the week, Monday in particular. Am I right Jorma?

Jorma Rauhala: Yes, Monday and Friday. The most significant impact is in the bigger role of Sunday and the peaks are balanced on national holidays, Easter for example, when Maundy Thursday sales transfer to Good Friday.

Mikko Helander: I see that this is good from the consumer's perspective, because it helps take the stress out of holiday shopping, And from the store's perspective, the liberalised opening hours have increased costs. Therefore I think that the opening hours will gradually settle at a reasonable level in each individual case. I don't think having a store, especially a large hypermarket, open 24/7 is a sustainable basis. And in our calculations, extra-long opening hours until 11pm or 12pm are commercially very poor. However, each store makes its own decisions. But because we operate in a business oriented manner, and in addition to providing good customer service, it's important to us to make good profit. This follows that we consider these things from with a somewhat different view than other operators in this sector.

Jorma Rauhala: I'd like to add that the decision on store-specific solutions we took a year ago was exactly right. The need for extended opening hours varies greatly from one store to the next and each retailer knows the local demand and amount of footfall in their stores.

Kimmo Lunden: Can you specify the increase in costs due to liberalized opening hours?

Mikko Helander: We don't have any exact estimates, because as Jorma said, in our system, it's the retailers who decide when they keep their stores open. But their costs have increased and Kesko's costs have also increased at stores it operates itself, not so many grocery stores but in other product lines. On the other hand, as we have retailer entrepreneurs, liberalised opening hours have meant that in many cases the retailer couple works longer hours, especially in smaller stores.

Arto Jaakkola: Our government will have their mid-term review in the next few months. Which are the issues to which attention should be paid especially from the trading sector's point of view? Could the retail sector change this situation in some way?

Mikko Helander: Thank you for the question; I very much like to answer it. I would begin from regulation and deregulation. When we look at the Finnish society, Finland is verifiably one of the most regulated countries. Deregulation, which the government has begun, is absolutely important and should be promoted. It adds to the dynamics and employment of our country and its people. Especially when we remember the positive experiences of the liberalisation of store opening hours. The government should adopt an even more serious approach to deregulation of, for example, pharmacies, alcohol sales, movement and traffic and many other things, where we continue to operate in a very old-fashioned way, proof of which is the fact that the state itself takes care of many things that have been proven in Finland and other countries to be more efficiently managed by businesses. Another issue is taxation, which is important not only for the trading sector but society as a whole. We are a country in which tax rates are extremely high, and it's sad to see that, nevertheless, we don't have enough money when we have to take out massive loans year after year. Making the public sector operations more efficient and thereby lower tax rates which would create more dynamics to the Finnish society, business and industry and more jobs which is yet another matter. In my opinion, the government has got off to a good start, but bolder and faster and even more systematic actions are needed. Perhaps these two are the most obvious ways in which to change the situation.

Kimmo Lunden: In November, you closed the divestment of your Russian food trade operations. Is it possible that Kesko returns to the Russian grocery trade sometime in the future?

Mikko Helander: I don't see that happening at least in any near future. But I've learnt that you should never say never. Especially in a job and position like mine, you should not promise anything in the name of the company which would oblige your successors in any way. But thinking about it here and now and about us and our strategy, returning to the Russian grocery trade is not in sight.

Kimmo Lunden: How about your other businesses in Russia, is something going on in them?

Mikko Helander: All the time: our building and home improvement stores are doing well in the Russian market with a strong organisation, good management coupled with strong local personnel. We systematically increase and develop the operations of our Russian building and home improvement stores. And I emphasize that we particularly increase the sales of our local business units.

Olli Kuivaniemi of STT: As regards Lähikauppa, at what stage are the two cooperation negotiation processes that started in early January now? When will the store closures be decided and the store network cleared?

Mikko Helander: Jorma has a very clear picture about this.

Jorma Rauhala: It's difficult to give any exact dates for individual stores, but no later than this spring. And at the same time, we have started to transfer stores to retailers, which is planned to be completed during the latter half of 2018.

Jorma Rauhala: We have estimated that more than 400 stores will remain in operation.

Mikko Helander: Do you remember how many stores we got altogether?

Jorma Rauhala: The number varies a lot depending on whether we look at market shares or some other indicators, and in 2015, for example, the store network changed a lot in Suomen Lähikauppa's ownership and the number of stores decreased. In 2016 before we acquired it, the number had decreased further as some stores had been acquired by the S Group etc. And after we acquired Suomen Lähikauppa, the number of stores was around 600, part of which had been decided by Suomen Lähikauppa to be closed down. We have examined the remaining stores one by one and estimate that around 400 stores will remain in operation. As such we are satisfied with the number, and it should not be forgotten that the company was unprofitable and that there was the risk of the entire network closing down. And now over 400 stores will continue in addition to the rest of our neighbourhood store network, which means that we will have nearly 1,000 in the neighbourhood market.

Mikko Helander: I'm very pleased that in the end, we decided to implement the integration of Suomen Lähikauppa in much tighter schedule than what we first planned. The further it has progressed we have been able to see that it was a very good decision and the right one. We have been happily surprised at the good sales performance of the converted stores. And yet another delightful thing is to see that even if the first stores that transferred to retailer entrepreneurs showed good sales growth before the transfer, growth figures have gone further up as soon as a retailer has taken over. This is again proof that our business model of good retailer entrepreneurs managing the stores on an entrepreneurial basis with a good knowledge of their local customers and their needs generates clear added value also to our business operations.

Pirkko Tammilehto: Have you got enough retailers for the stores, or does it seem that you will get as many as you have planned? These days, entrepreneurs are not necessarily very hopeful.

Mikko Helander: This is one of the key questions. First of all, it should be kept in mind that in connection with preparing our new strategy, we made a number of significant policy definitions that are historic for the K-Group. One of them was that in the grocery trade, good retailers can run more than one stores. This possibility has been very attractive to potential new K-retailers. It is very important in this situation that our retailer entrepreneurs are willing to invest and make capital expenditure in several stores. Another piece of good news is that last year, we received, wasn't it Jorma, three of four times more retailer applications compared to a long-term average.

Jorma Rauhala: At least that many.

Mikko Helander: Yes, at least that many, if not more. Today in the Finnish society there are very many people interested in a K-retailer career. Contrary to previous years, a lot of young, highly educated people have contacted us wanting to become K-retailers and we a number of them have already started the K-retailer training programme. This year, reformed neighbourhood stores will be transferred to these new K-retailers. This is very invigorating for the entire K-Group.

Pirkko Tammilehto: Were there any members of the personnel, for example, Siwa store managers, among the applicants?

Mikko Helander: Yes, but Jorma knows more about this,

Jorma Rauhala: Yes, there have a few, perhaps not as many as we first thought. And some of them have already been trained. All in all, the number of retailer applicants and the number of applicants being trained is very adequate.

Mikko Helander: There has also been a lot of discussion with good store managers encouraging them towards entrepreneurship. Some of them have welcomed the idea, but others have said that it does not suit their situations in life. Indeed, entrepreneurship as such does not suit everybody, and some people prefer to work as paid employees, but we very much promote entrepreneurship and encourage people towards it.

Kimmo Lunden: When did you decide that a retailer could run several stores?

Mikko Helander: In May 2015, when the K-Group's new strategy was announced. All of the major policy definitions including this have been implemented very successfully. And this, among others, has added momentum to our system.

Mikko Helander: There seems to be no more questions. Thank you and see you again in a couple of months!