

Looking towards all of Russia



THE BAKERY DIVISION OF THE FINNISH FAZER GROUP HAS BEEN DOING BUSINESS IN RUSSIA FOR 10 YEARS. IT IS NOW TIME FOR A REVIEW, IN PARTICULAR BECAUSE THE DIVISION – AFTER LIMITING ITSELF TO ST. PETERSBURG FOR NINE YEARS – IS NOW TAKING THE FIRST STEP TOWARDS MOSCOW. HILDEGARD M. KEIL, EDITOR-IN-CHIEF OF BAKING+BISCUIT INTERNATIONAL TALKED TO **MARKKU NUMMINEN**, MANAGING DIRECTOR OF FAZER BAKERIES.

+ bbi: Mr. Numminen, Russian bakeries have belonged to your group for 10 years now, but it was only in the past year that you acquired a business outside of St. Petersburg. What was the reason for this step?

+ Numminen: Our connection to Russia goes further back than just 10 years. Our company's roots were a French-Russian café, founded by Karl Fazer in Helsinki in 1891. We have also exported products to Russia for dozens of years.

+ bbi: A French-Russian café – where did this combination come from?

+ Numminen: Karl Fazer studied to become a confectioner in St. Petersburg, Paris and even in Berlin. But to answer your first question: In the 1990s, we took over Hlebny Dom in St. Petersburg, followed later by two smaller bakeries, but around the turn of the century we realized that the possibility for continuous growth in the St. Petersburg region would soon be exhausted. Therefore, we started in 2000 to search for new opportunities.

+ bbi: In the meantime the bread sector as well as the sales market in Moscow have undergone radical changes. National retail chains have emerged and international chains have discovered this market and pushed into Russia. Did all these factors affect your decision in favor of Moscow?

+ Numminen: Of course. The consolidation on the retail market in Russia is heading along at full speed. We know that in the medium-term we can only be a serious partner in this rapidly developing market if we act nationally. Most trade companies have their headquarters in Moscow. This was the reason why we turned to Moscow as well.

+ bbi: Zvezdny, the Moscow company you took over last year, is one of the largest producers of frozen pizza and frozen dough in Russia but not really a producer of fresh bread.

+ Numminen: With our acquisition we have introduced an investment program for Zvezdny focusing on fresh bread. By the end of 2007, we expect to have six lines in operation and this may not necessarily be the end of our involvement in the Moscow fresh bread market.

+ bbi: What is your standing with Zvezdny today and what are your next targets?

+ Numminen: To be considered a market leader, one will need a market share of at least 15%. When all lines are running at Zvezdny we will have a share of about 5% of the fresh bread market. It is our intention to belong to the market leaders in Moscow. However due to logistics and other reasons it is not possible to achieve this from one location alone due to the traffic volume in that city.

+ bbi: There were two large supplier groups at the Moscow bread market: Nasdjuscha and Tscheremuscki. Do they appear to be profitable acquisition objects for you?

+ Numminen: We have not yet decided whether we will buy a company, enter into a joint venture or erect a new factory in Moscow. But no doubt – there are still a number of interesting independent companies left which have developed with the market in terms of production capacity, product assortment, organization and management, but there are also a number of companies which will disappear from the market. Please keep in mind that we have already gained



ground on the market in Moscow from St. Petersburg. We deliver about 40–50 tons of baked products to Moscow daily.

+ bbi: Does that mean that Fazer will invest in Moscow only in the future and no longer in St. Petersburg?

+ Numminen: No, this is not a matter of either or. We are operating at our capacity limits in both locations and we will strengthen our position in both cities.

+ bbi: St. Petersburg has been a real success story for Fazer. It is no secret that Fazer Bakeries is achieving a better return there than in all other countries. What is the reason?

+ Numminen: When we took over Hlebny Dom in 1997, the company produced about 10 different types of bread. Today the product range comprises about 250 different items. Our sales in St. Petersburg in the year 2000 with one factory totaled 25m Euro. In 2003 it was 53m Euro with three companies. Last year we realized sales of 110m Euro in that city. However, we expanded in more than just the product range. Almost all bread produced by Hlebny Dom is packed. 70–80% of the bread is cut. We have very high quality and hygiene standards. Nevertheless, despite all these modifications, we have kept the production processes and taken the taste preferences of the Russian consumer into consideration with the new products as well. We have also launched adapted versions of Finnish and Swedish products like berry pies, dark portion bread and Swedish flat bread onto the Russian market. Added to that, we also master our logistics.



+ bbi: How does this work in practice? Do people from Finland take over the running at Hlebny Dom?

+ Numminen: This would have been a mistake. One of our principles is not to replace the culture of a country within the company. In Russia we have Russian management. Normally, we have close cooperation and provide all kinds of support from Finland. People who have grown up in the culture of a country move in their country like fish in water. When talking about culture we have of course the same values in Russia as we have in all other countries. As you can see, we are also disclosing our figures.

+ bbi: In your opinion, what is the reason for the higher profitability of your Russian companies?

+ Numminen: Russia is a hot market at the moment. It is a growth market in terms of consumption and expansion of our own activities. But on the other hand, it is a market that is in the middle of a consolidation phase for suppliers and trade. The food market in Russia is growing annually by 7%.

Our three factories in St. Petersburg have an annual output of 130m kg. In Finland we produce only 73 kg in eleven factories. This results in economies of scale. By the way, in Finland, we produce 400 different kinds of baked goods a day, in Russia there are 250 types.

+ bbi: Earlier you talked about the emergence of the national market in the context of the development of the trade. Do you believe that in the near future a somehow national market will develop in this huge country? ▶

Fazer Group

- + total sales 2006 about 1bn Euro
- + Fazer Amica: leading food service group in the Nordic countries, Estonia and Latvia, sales 2006 514m Euro
- + Fazer Bakeries: sales 2006 422m Euro
- + Fazer Candyking: confectionery manufacturer Scandinavia and UK, sales 2006 125m Euro

Fazer in Russia

- + Hlebny Dom, St. Petersburg (1997)
- + Murinsky, St. Petersburg (2002)
- + Vasileostrovsky, St. Petersburg (2002)
- + Zvezdny, Moscow (2005)

Fazer in the Baltic States

- + Fazer Eesti AS, Estonia (1993)
- + Ogres Maiznieks, Latvia (2001)
- + Gardēsis, Lithuania (2001) +++

Fazer

Russia & Baltic States

	Sales 2006 (in Euro)	Production quantity per year (in t)	Market share (in %)
St. Petersburg	109m	130.000	35%
Moscow	36m	34.000	6% (fresh bread including the products transported from St. Petersburg)
Baltic States	30m	36.000	14%

+ Numminen: If the consolidation of the trade is progressing at the same speed as up to now, I am positive that we will see this national market coming soon. The trade is trying to set up national networks and if this succeeds, the trade will need national suppliers.

+ bbi: You are focusing on the modern organized trade, but there are still many so-called independent traders in Moscow who, in the morning pick up bread from the bread factory for cash and then sell the products in a kiosk at train stations for example. Will they disappear?

+ Numminen: Sure, many of them will disappear. The Russian consumers have increasingly more money to spend and they are clearly changing their purchasing and consumption patterns. Just look at the consumption of bread. Previously the annual bread consumption, even in major cities was more than 100 kg per capita. Recently this consumption has dropped to the levels known in European countries and lies now somewhere between 60 and 70 kg per person per year. The consumers in Russia are very eager to test new things. We have introduced a number of new products in St. Petersburg such as different rolls, Krajushki bread, a rye bread with a prolonged shelf life in a serving size, and Lavash, a soft Swedish flat bread. All of them are very successful.

+ bbi: When consumption habits meet, what is the situation on the food service market? Fazer Amica, your sister company, is now also present in Russia. Will this be the beginning of another feather to your bow for Fazer Amica and Fazer Bakeries, probably in the form of a sandwich chain?

+ Numminen: Fazer Amica has just recently started to operate in St Petersburg, therefore the business is still quite small and there are no such plans right now. But the idea is tempting. In Finland we are of course an important supplier. Fazer Amica purchases about three thirds of its bread supply from us.

+ bbi: How about the bake-off market in Russia?

+ Numminen: We are not yet present in this market. But we believe that this market has some growth potential, in particular in the food service sector. Right now there are not very many suppliers and the ones operating in this market import their products.

+ bbi: If you want to become a national supplier, it might not be sufficient to produce in St. Petersburg and Moscow alone. Which city will be your next target?

+ Numminen: Let's take it step by step. When I talk about a national distribution, then I am talking first of all about the region west of the Ural mountain range. In the medium term, this will mean an involvement in the south of Russia. But we are not yet prepared for that step.



+ bbi: Zvezdny is one, if not the most important supplier of frozen pizza in Russia. Would you say you are a national supplier already in this field?

+ Numminen: Zvezdny is for sure the largest Russian producer of frozen pizza, but probably not the largest supplier. For example Dr. Oetker serves the Russian market from its factory in Poland. In fact, we have looked into this situation. Pizza from Zvezdny is present in the 19 largest cities in Russia and in about 60% of all supermarkets. One might call this a national distribution.

+ bbi: In the Baltic States Fazer Bakeries' market share has been around 10%. Do these markets have a lower growth potential?

+ Numminen: These countries have fewer inhabitants. Nevertheless I would say that our growth rates in these markets are good. Ten years ago, Hlebny Dom's market share was 12–13%, now it has almost tripled. In Latvia, where we have been present since 2001, the market share was 4%. In the past four months we have achieved 19%. In Lithuania, where we also entered the market in 2001, the market share at that time was around 2%. Today it is 10–11%. However, the competition in the Baltic countries is much stronger and more focused on price, just as in Western Europe. In conclusion, the Baltic countries are displaying an annual growth of 20%. We are rather satisfied with that.

+ bbi: Let's go back to the market in Russia. Where do you see key developments taking place in the next few years?

+ Numminen: We believe in a growing market in Russia. The market will open up and become more international and this will interest the trade as well as the producers. At the same time, the consolidation phase will continue, also on both sides. There will be two to four big players on the market and a number of small to medium sized enterprises doing either regional business or producing specialty products.

The largest obstacle in my opinion is the increasing traffic in the cities which will complicate the distribution of goods. Anyway, Russia will remain an exciting and hot market.

+ bbi: Mr. Numminen, thank you for the interview. +++



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