

HOME AND AWAY



THE TREASURER ASKS **SAMER JANO** OF THE BAUMAX-SCHOEMER GROUP HOW EU ENLARGEMENT WILL AFFECT THE FIRM'S RETAIL BUSINESS IN AUSTRIA AND THE CENTRAL EUROPEAN ACCESSION COUNTRIES.

COMMERCIAL IMPACTS

THE TREASURER (TT) FROM ITS BASE IN AUSTRIA, YOUR GROUP'S BAUMAX-X-BRANDED DIY RETAIL BUSINESS HAS ALREADY ESTABLISHED A SOLID PRESENCE IN CENTRAL EUROPE, PARTICULARLY IN THE CZECH REPUBLIC, HUNGARY AND SLOVAKIA. WHEN THESE COUNTRIES JOIN THE EU, WHAT IMPACT DO YOU ANTICIPATE THAT ACCESSION WILL HAVE ON DISPOSABLE INCOME AND CONSUMER DEMAND IN THESE LOCATIONS?

SAMER JANO (SJ) The bauMax-x group is also present in Slovenia and Croatia, in which we are now expanding aggressively. The accession of these countries into the EU will accelerate the increase in disposable income and consumer demand. Even now, before accession, the growth rates these countries have experienced in the last decade support this trend.

Some 45% of our sales are in these central European countries and we expect their contribution to the group sales to increase continuously over the coming years. Accession will provide more opportunities for doing business in these countries. We still have a situation in Austria where a considerable number of companies, mostly small- to medium-sized enterprises (SMEs) have not yet considered expanding eastward (in the sense of real investment through local acquisition or the development of greenfield sites or joint ventures rather than through merely exporting), although they have the necessary capacities to do it. For example bauMax-x Slovakia has a market share of almost 97%. This hesitation is a result of a lack of trust in the business and legal framework in these countries. Many firms are waiting until they are sure the regulations will conform with the EU. We experienced something like this on the accession of Austria to the EU. Foreign investment in Austria has since increased. The experiences of Ireland and Spain are also evidence for this trend.

The comparative advantages of accession countries (for example, a highly educated and relatively cheap workforce or low energy prices, plus total free movement of goods and capital) will boost business activities in these countries. Therefore, a continued increase in disposable income is a near certainty and will inevitably result in increased consumer demand. However, there will be a gradual shift in the patterns of demand from elementary and basic goods and services toward more luxury and recreational goods and services.

TT WHAT IMPACT MIGHT THERE BE ON COMPETITION FROM OTHER EU OPERATORS WITHIN THE HOME IMPROVEMENTS SECTOR IN THE ACCESSION COUNTRIES OF CENTRAL EUROPE?

SJ The home improvements and DIY retail sectors in the EU are dominated by larger companies. Most of them already have retail stores in the accession countries. I believe there will be no place for new entrants. Those who have considered expansion are already there, and those who have not never will. The markets in the Czech Republic, Slovakia and Hungary are already saturated. Slovenia and Croatia could still provide some opportunities, but their markets are too small to be attractive. Once market growth slows and comes into line with that of Western Europe in years to come, competition will intensify between existing players. As in the EU, competition for market share will be carried out at the profit margin level. This will, in turn, increase the pressure on suppliers to deliver better wholesale prices and terms. Procurement is a key factor in this business. Nevertheless, other factors such as brand name, value-added services, customer orientation and store design will also be influential. Market consolidation should be expected, but this will be on a pan-EU basis.

TT HOW WILL YOUR COST BASE IN THESE COUNTRIES BE AFFECTED (IF AT ALL)? FOR EXAMPLE, DO YOU EXPECT INCREASES IN STAFF COSTS OR THE COSTS OF ACQUIRING NEW RETAIL SITES?

SJ In the long run, there will be a general increase in costs (up to cost levels prevailing in the EU). I expect this to come mainly from an increase in staff, energy and environmental protection costs as these countries move to comply with EU regulations.

Another factor is the intention of these countries to join the European Economic and Monetary Union (Emu) in some years' time. This will impose budget discipline and fiscal restrictions on the governments there. Unless these economic targets can be managed through cost containment in the public sector, this will result in increased taxes and duties. I am sceptical of government being able to deliver on public spending cuts – the current situation in Hungary is not encouraging.

The impact on real estate prices will be minimal because prices are already at such a high level. In some regions, property prices are already on a par with those in some EU countries.



ADMINISTRATIVE ASPECTS

TT WILL THERE BE ANY ADDITIONAL REGULATORY REQUIREMENTS TO BE MET IN THESE COUNTRIES ONCE THEY FALL UNDER EU JURISDICTION, FOR EXAMPLE, REGARDING WORKING CONDITIONS, PRODUCT SAFETY REQUIREMENTS AND INSURANCE? FROM WHAT DATE WILL THESE MEASURES NEED TO BE IMPLEMENTED?

SJ Absolutely, but there will not be a sudden shift. These countries have been upgrading with a view to meeting regulatory requirements of the EU since the fall of the iron curtain. There is still a lot to do, but I believe that, during the coming years, standards will reach EU levels.

TT DO YOU FORESEE ANY REDUCTION IN LOCAL FINANCIAL REPORTING OR TAX COMPLIANCE COSTS AS A RESULT OF THE ADOPTION OF IFRS IN THESE COUNTRIES AND FROM THEIR INCLUSION IN THE EU AREA FOR TAX PURPOSES, FOR EXAMPLE, IN RELATION TO VAT AND CUSTOMS DUTIES?

SJ During the transition period, there will be an increase, rather than a reduction. But once this has been concluded, there will be a reduction, especially for multinationals.

RISK MANAGEMENT

TT WHEN THE CENTRAL EUROPEAN COUNTRIES YOU DO BUSINESS WITH JOIN THE SINGLE CURRENCY, IN WHAT WAYS DO YOU THINK THIS WILL IMPACT YOUR BUSINESS? HOW WILL THESE COMPARE IN SIGNIFICANCE FOR YOUR PARTICULAR GROUP RELATIVE TO THE ORIGINAL CONVERSION FROM THE AUSTRIAN SCHILLING TO THE EURO?

SJ Joining the single currency provides firms with many advantages. With regards to risk management, there will be considerable cost reductions in foreign exchange (FX), as well as in interest rate risk management. Regarding inflation, there will be an advantageous new stability in relation to financial planning and results. Cross-border transactions will become cheaper and implementation of euro-pooling arrangements will be possible.

Joining the single currency entails giving up sovereignty over exchange and interest rates, which means that the accession countries will not be able to escape inconvenient developments in the EU business cycle. However, these countries have the EU as their main trading partner and they will have to meet the demands of the ERM II, two years before joining the Emu. Therefore, the current advantages they enjoy, in terms of independence, will diminish over the period between accession and joining the Emu. For this reason, our group will lose the natural hedge against adverse development in the EU's business cycle, from which we benefit today.

The benefits to risk management are similar to those experienced on conversion from the Austrian schilling to the euro, but they will be even larger in magnitude on accession because our business is largely with these central European countries and the Far East.

TT WHAT PROPORTION OF YOUR GROUP'S FX EXPOSURES ARE CURRENTLY ATTRIBUTABLE TO SALES IN NON-EURO CURRENCIES IN CENTRAL EUROPE (AS OPPOSED TO THOSE RELATING TO THE SOURCING OF PRODUCTS AND MATERIALS IN NON-EURO TERRITORIES)? WILL REDUCED FX RISK ON CENTRAL EUROPEAN SALES PROVIDE COST SAVINGS WITHIN YOUR TREASURY MANAGEMENT FUNCTION?

SJ As I mentioned above, 45% of our sales are in these countries. We have a negligible portion of goods that are sourced locally, with the remainder being sourced from Austria through our company bauMax Import & Logistik plc in euro. Therefore, the FX exposure on this element of our business is about 40% of our total exposure. Our offsetting FX exposure relating to sourcing in non-euro currency amounts is about 10%. Therefore, this reduction in FX exposure will provide cost savings in our treasury management function.

CASH MANAGEMENT AND BANKING

TT RETAIL BUSINESSES TRADITIONALLY ENTAIL A SIGNIFICANT PORTION OF SALES BEING REPRESENTED BY CASH RECEIPTS. CAN YOU BRIEFLY DESCRIBE TO US YOUR CURRENT PROCESS FOR COLLECTION AND BANKING OF CASH RECEIPTS IN CENTRAL EUROPE? WHAT CHANGES WOULD THE ADOPTION OF THE EURO IN THESE COUNTRIES HAVE ON THESE PROCESSES?

SJ In general, we collect cash in all countries in a similar manner, through a contracted security company. The firm transports the cash from our markets, counts it and sorts it in accordance with the requirements of either the national or the commercial bank with whom it works, and then transfers the money to our accounts. I do not expect any changes in this process as a result of the adoption of the euro.

TT HAS YOUR GROUP ESTABLISHED CASH CONCENTRATION ARRANGEMENTS EITHER DOMESTICALLY IN AUSTRIA OR CROSS-BORDER, INCORPORATING CENTRAL EUROPEAN OPERATIONS? IF SO, HOW MIGHT THESE ARRANGEMENTS BE EXPANDED OR ENHANCED ON ADOPTION OF THE EURO IN CENTRAL EUROPE?

SJ Yes, we have cash concentration arrangements with our key banks in Austria. In the accession countries, we do not need similar domestic arrangements because collected cash is concentrated in one account, with one bank. For the time being, it is not our strategy to put in place a cross-border arrangement, for legal and tax reasons. Upon adoption of the euro, I think we will consider the possibility of euro pooling.

TT WOULD THE ENTRY OF CENTRAL EUROPEAN COUNTRIES INTO THE EURO INFLUENCE YOUR CHOICE OF BANKING PARTNERS? FOR EXAMPLE, WOULD THERE BE A MOVE TO REDUCE RELIANCE ON LOCAL BANKS IN CENTRAL EUROPE IN FAVOUR OF A LARGE PAN-EUROPEAN BANKING PROVIDER?

SJ No, our bank relations in these countries are already mainly with banks whose headquarters are based in the EU.

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