# Annual Report 1998

VALIO

VALIOJÄÄTELÖ

NAMI NAMI

VALIO

Voimariini®

Voilevi®

Pinguiini®

HIENO SUOMALAINEN KERMAJUUSTO

Turunmaa®

PARHAISTA KERMOISTA KIRNUTTU

VALIO Meijerivoi

Aamupala®

GUARANTEED BY VALIO

Super™

VALIO Aamupala KEVYT

VALIO EMMENTAL sinileima

VOILLA LEIVOTTU®

FINLANDIA

AURA® VALIO

VALIO RAEJUUSTO

VALIO Maitojauhe

PUNAPOSKI

POLAR15

grandi®

VALIO MAITO

CLASSIC®

EMMENTAL punaleima

HOVI®

HYLA DIET

JADE™

# Contents

# Five-year Group Statistics

| | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| Net sales, FIM m | 7,604.9 | 8,055.5 | 7,837.6 | 8,181.9 | 8,785.9 |
| Change % | -5.6 | +2.8 | -4.2 | -6.9 | -0.7 |
| - Domestic, FIM m | 5,293.2 | 5,570.7 | 5,866.5 | 6,583.4 | 6,575.6 |
| Change % | -5.0 | -5.0 | -10.9 | +0.1 | -2.0 |
| - International operations, FIM m | 2,311.7 | 2,484.8 | 1,971.1 | 1,598.5 | 2,210.3 |
| Change % | -7.0 | +26.1 | +23.3 | -27.7 | +3.5 |
| Balance sheet total, FIM m | 4,097.9 | 4,501.6 | 4,457.8 | 4,575.1 | 5,364.3 |
| Liabilities as a percentage of balance sheet | 51.1 | 54.1 | 53.2 | 53.6 | 61.3 |
| Equity + provisions as a percentage of balance sheet | 48.9 | 45.9 | 46.8 | 46.4 | 38.7 |
| Personnel expenditure, FIM m | 902.1 | 916.4 | 872.6 | 945.2 | 752.5 |
| Number of personnel | 4,517 | 4,537 | 4,801 | 5,101 | 4,265 |
| Inventories, FIM m | 733.0 | 739.8 | 771.5 | 749.8 | 874.1 |
| Capital expenditure, FIM m | 329.0 | 248.5 | 211.9 | 279.1 | 194.2 |
| Planned depreciation, FIM m | 282.4 | 290.3 | 310.4 | 299.5 | 258.4 |

# Valio - Milk for All Tastes

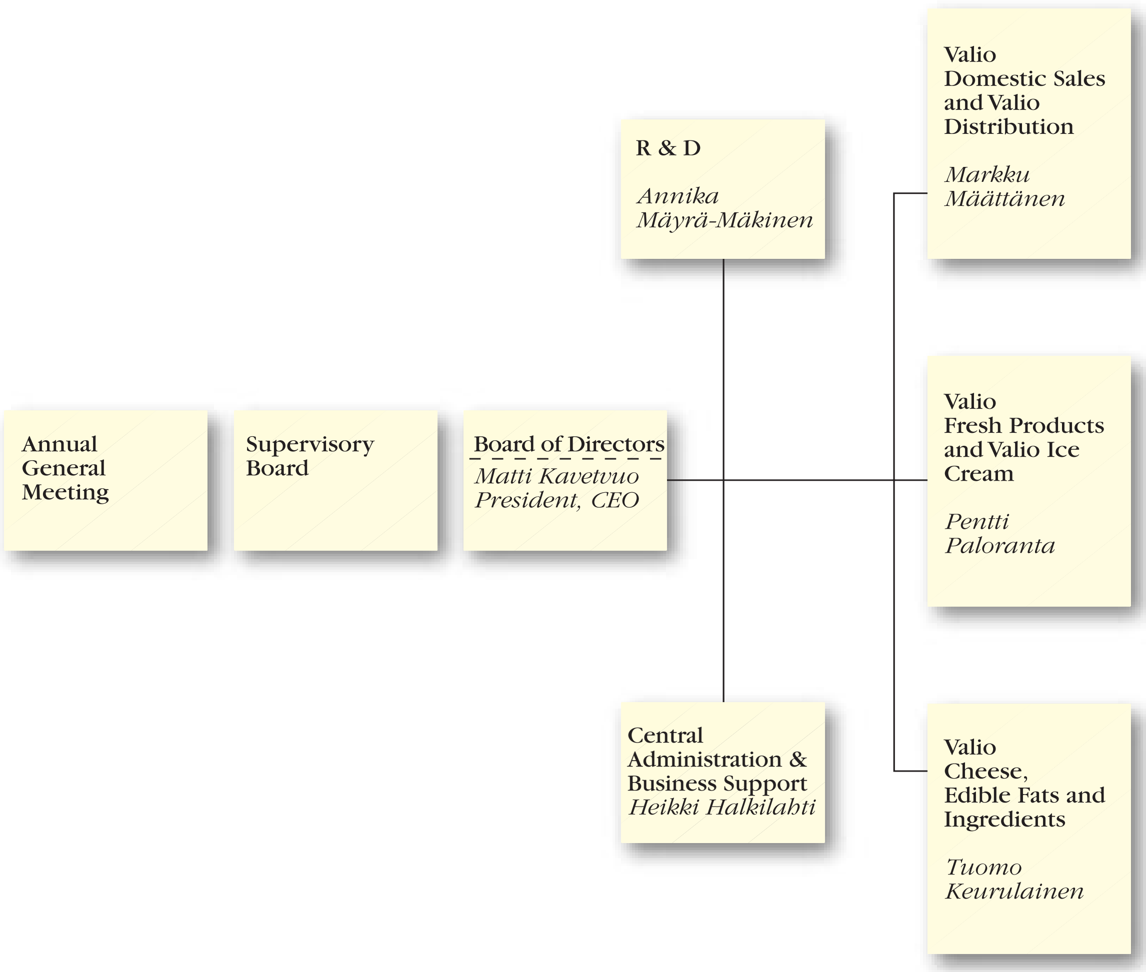
Valio is the leading Finnish dairy business. The company processes and markets milk in Finland and abroad so that its owners, some 17,500 dairy farmers, can carry on their business. The farmers are organized in 38 dairy co-operatives that together own all the shares of Valio Ltd.

Finnish retail chains and consumers see Valio as a partner that consistently improves its products and operations. The top-quality milk produced by Finnish dairy farmers is processed in twenty-three production facilities. Valio then markets, sells and distributes a variety of milk products to wholesale and retail outlets, restaurants and schools.

Valio is one of the best known brands in Finland with a product range of some 800 packaged items. Package sizes, lactose and fat content and other features vary according to customer needs.

Valio makes tasty, natural and versatile foods. Fresh every day!

## Valio, Group Organization Jan. 1st, 1999



# Annual Review by the CEO

A year ago I warned that the Finnish dairy industry would encounter serious trading difficulties in 1998, leading to lower expectations in market prospects and financial development for the Valio Group. Sadly, this proved to be the case. After three years of solid progress and growth in sales, Valio profitability decreased during the year under review. A number of factors were responsible for this:

- After long cooperation and full negotiations, Valio was reluctantly obliged to end business with Osuuskunta Maito-Pirkka and Hämeen Osuusmeijeri, resulting in a clear fall in the quantity of milk processed and taken in;
- Tighter domestic competition in liquid milks cut further into profit;
- The wet summer in Finland lowered ice cream sales;
- The economic crisis in Russia that began in August paralyzed our export program there, and froze it at a level well below the volumes achieved earlier last year;
- At the very end of the review year, knock-on effects from the Russian crisis spread to the European internal market as demand decreased and price levels dropped.

In addition, milk prices continued to hold at a high level, corresponding to or exceeding the Finnish dairy industry's target price, agreed during European Union membership negotiations. Valio paid its owner cooperatives FIM 2.24 a liter for their milk - FIM 0.03 less than in 1997, but still the second highest price since Finland joined the EU.

The decisions made five years ago by Valio's owner dairies concerning the Group's structure and business relationships have now, in the main, been acted upon. After making different lease and marketing contracts for the transitional period, Valio's take-in share of total Finnish dairy production through its owner dairies has fallen continuously, from 86 per cent in 1993 to 69 per cent last year. This enforced drop in Valio's operating volume has, of course, compelled the Group to adapt from a near monopoly position to one of more diverse competition. And that process of adaptation has led to a still continuing rationalization of extant excess capacity. Between 1992 and last year, some 20 dairy production plants were shut down, leaving Valio 23 plants in 19 locations at the end of 1998.

While dairy imports to Finland have increased considerably, and with competition narrowing Valio's share of the domestic market, our business development has demanded increased attention to exports. We have also substantially rationalized sales and distribution operations in Finland, to help us attain our objective of cutting unit costs to a satisfactory level.

In a radically changing operating environment, Valio has, naturally, examined a number of different operating strategies. There was for instance a plan to co-operate with Swedish dairy company, Arla. Despite considerable effort and keen interest on both sides, the negotiation teams were unable to formulate a satisfactory solution due to lower than expected profit potential. On the plus side, the Group has invested substantial new resources in marketing expertise, product development and information technology systems. The encouraging results of this initiative have already strengthened the company's competitiveness.

In the year ahead, highly demanding challenges will face both the owners and staff of Valio Group. During the final months of last year our operations were making a loss. Clearly we have to adapt to the tougher operating environment as swiftly and realistically as possible. To this end, Valio will tighten its rationalization program even beyond the level of recent years. Our goal is to strengthen the producer price in this transitional phase of insecurity for milk producers. EU agriculture policy is also undergoing significant reform in the Agenda 2000 program, and this has the effect of reducing security and thus raising the pressure to adapt for the whole Finnish dairy industry.

As far as I can see, it appears inevitable that the stringent rationalization process affecting our dairy industry must continue into the future. These have been difficult decisions to take, but embarking on this program is undoubtedly helping us to build a solid base, from which the future of Valio and the dairy industry in Finland can be developed competitively.

In conclusion, I should like to thank all Valio milk producers and our own staff for their splendid work over the past year. I wish you all the courage, energy and cooperative skills that are essential as we continue working for the benefit of this country's dairy industry.

*Matti Kavetvuo*

# Valio Ltd

SUPERVISORY BOARD

| | Term began | Term ends |
|---|---|---|
| Seppo Hakola<br>Dairy farmer, Kuortane<br>Chairman | 1994 | 1999 |
| Markku Heikkinen<br>Dairy farmer, Tohmajärvi<br>Vice Chairman | 1991 | 2000 |
| Pertti Hahl<br>Dairy farmer, Mikkeli | 1995 | 2001 |
| Kari Harsia<br>Personnel Representative, Seinäjoki | 1996 | 2001 |
| Toivo Heikkilä<br>Dairy farmer, Haapajärvi | 1996 | 2000 |
| Pertti Heinonen<br>Dairy farmer, Oripää | 1992 | 1999 |
| Eero Hiironen<br>Dairy farmer, Saarijärvi | 1991 | 2001 |
| Eero Jukkara<br>Dairy farmer, Savitaipale<br>member to April 21st, 1998 | 1989 | |
| Hannu Kainu<br>Dairy farmer, Kyyjärvi | 1997 | 1999 |
| Matti Karvo<br>Dairy farmer, Rovaniemi | 1994 | 2001 |
| Anneli Koponen<br>Personnel Representative, Vantaa<br>(to December 31st, 1998) | 1996 | |
| Pekka Lestinen<br>Dairy farmer, Sysmä<br>member as of April 21st, 1998 | 1998 | 2001 |
| Eino Lumiaho<br>Dairy farmer, Vihanti<br>member as of April 21st, 1998 | 1998 | 2001 |
| Tapio Malmiharju<br>Dairy farmer, Artjärvi | 1996 | 2000 |
| Martti Nevalainen<br>Dairy farmer, Valtimo | 1994 | 1999 |
| Paavo Niskanen<br>Dairy farmer, Iisalmi<br>member to April 21st, 1998 | 1995 | |
| Heikki Olkkonen<br>Dairy farmer, Alavus | 1988 | 1999 |
| Riku Ollikainen<br>Dairy farmer, Lapinlahti | 1981 | 2000 |
| Esko Pohjala<br>Dairy farmer, Orivesi<br>member to April 21st, 1998 | 1992 | |
| Antti Rauhamaa<br>Dairy farmer, Kärkölä<br>member as of April 21st, 1998 | 1998 | 2000 |
| Airi Raussi<br>Dairy farmer, Anjalankoski | 1996 | 1999 |
| Terttu Repo<br>Personnel Representative, Haapavesi<br>(as of January 1st, 1999) | 1999 | 2001 |
| Pentti Santala<br>Dairy farmer, Kauhajoki | 1997 | 2000 |
| Matti Siitonen<br>Dairy farmer, Parikkala<br>member as of April 21st, 1998 | 1998 | 2001 |
| Osmo Sikanen<br>Dairy farmer, Joroinen | 1991 | 1999 |
| Reino Tapani<br>Managing Director, Turku | 1992 | 2000 |
| Juhani Väänänen<br>Dairy farmer, Maaninka | 1995 | 2001 |

BOARD OF DIRECTORS

| | Term began | Term ends |
|---|---|---|
| Kari Inkinen<br>Dairy farmer, Ruokolahti<br>Chairman | 1997 | 1999 |
| Tauno Uitto<br>Dairy farmer, Tyrnävä<br>Vice Chairman | 1996 | 2001 |
| Matti Kavetvuo<br>President, CEO, Helsinki | 1992 | |
| Juhani Hörkkö<br>Dairy farmer, Koski Tl | 1998 | 2000 |
| Esa Juntunen<br>Dairy farmer, Vieremä | 1998 | 2000 |

AUDITORS

SVH Pricewaterhouse Coopers Oy,
Authorized Public Accountants, Helsinki
Tauno Haataja, MBA,
Authorized Public Accountant

# *Board of Directors Report*
# *January 1st, 1998 – December 31st, 1998*

## GENERAL

Valio Group financial performance for 1998 before extraordinary items and taxes stood at FIM 25 million, FIM 159 million lower than the previous year. The largest factor in this drop in performance was the cessation of business with Osuuskunta Maito-Pirkka and Hämeen Osuusmeijeri, resulting in still tighter price competition in the domestic liquid milk market. Performance development was also significantly affected by an unfavorable summer for ice cream consumption and by the Russian economic crisis arising in August. The latter reduced Valio's normal exports to Russia to a fraction of early 1998 volumes. At the very end of the year, the crisis was reflected in lower prices and weakened demand in other markets, too, as manufacturers aimed to compensate for lost Russian trade.

In Finland, Valio took in 1,587 million liters of milk or some 3.4 per cent less than the previous year. Valio milk procurement co-operatives' share of Finnish dairy milk volumes decreased by two percentage points to stand at 69 per cent. Valio Group took in total deliveries of 1,728 million liters of raw milk, which includes milk procurement for Valio dairies in the United States and Estonia.

Domestic net sales were down five per cent. Sales of cheeses, baby foods and frozen products were however better than expected and up on the previous year. Liquid milk product sales also exceeded their targets. Valio's market share of edible fats grew, while that of fresh productsales, cheeses and ice creams fell somewhat.

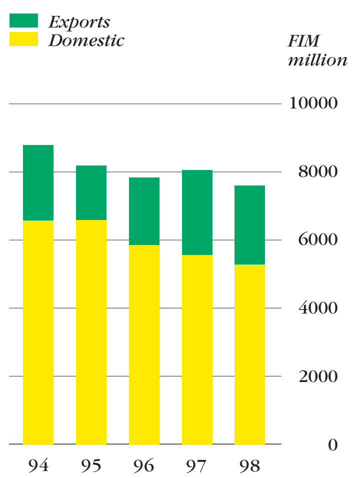
Net sales from international operations declined by seven per cent. Exports of liquid milk products and powders nevertheless grew, although those of other product groups fell.

Divisional profitability improved in Valio Edible Fats and Ingredients and declined in all other divisions.

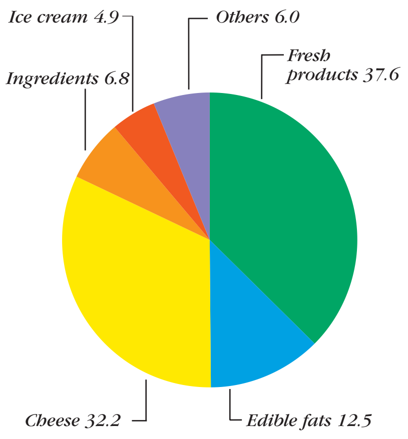
The owner co-operatives were paid FIM 2.24 per liter of milk taken in. This was FIM 0.03 less than the previous year. Thus, if a comparable raw material price were used, the Group's net income before extraordinary items would have been FIM 48 million weaker than the income statement now shows.

In November 1998, the Finnish Supreme Administrative Court rejected Valio's appeal on the decision concerning misuse of its dominant market position.

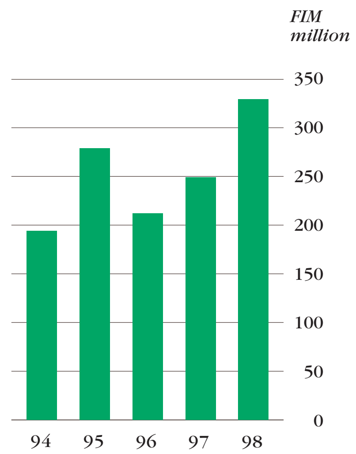
GROUP NET SALES




GROUP NET SALES BY DIVISION (%), 1998




GROUP CAPITAL EXPENDITURE



## SHAREHOLDERS AND SHARE CAPITAL

The number of shareholders fell by 6 to 38 by the end of the financial year due to merger activities.

The total paid-up capital of Valio Ltd is FIM 586,340,000.

## CHANGES IN GROUP STRUCTURE

Kiinteistö Oy Kuivamaito's merger into Valio was listed in the Finnish Trade Register in August. Valio sold its share of VBF Trading S.A. during the financial year.

Valio International Belgium-Nordic Foods, Marco Casodost, Nordic Immo and Vache Bleue merged to become Valio - Vache Bleue S.A. in December. Business operations for cheese exported from Finland were separated away from Valio subsidiary McCadam Cheese Co., Inc. during the financial year, and a new subsidiary, Finlandia Cheese Co., Inc., was established.

## CONSOLIDATED NET SALES

Consolidated net sales totalled FIM 7,605 million (FIM 8,056 million). Domestic net sales stood at FIM 5,293 million (FIM 5,571 million). Net sales from international operations (exports from Finland and foreign subsidiaries) totalled FIM 2,312 million (FIM 2,485 million).

## PARENT COMPANY NET SALES

Valio Ltd net sales totalled FIM 6,925 million (FIM 7,303 million). Domestic net sales stood at FIM 5,291 million (FIM 5,569 million) and net sales from exports at FIM 1,634 million (FIM 1,734 million).

## CAPITAL EXPENDITURE

Consolidated gross capital expenditure totalled FIM 329 million (FIM 249 million) or 4.3 per cent (3.1 per cent) of net sales. Investments of FIM 61 million were made in buildings and land and FIM 224 million in machinery and equipment.

Investments in stocks and shares totalled FIM 5 million, and in other capitalized expenditure, FIM 39 million. Consolidated net capital expenditure stood at FIM 301 million (FIM 229 million).

## PERSONNEL

The Group employed an average number of 4,517 people during the financial year, compared to 4,537 the year before. The numbers employed at the end of the financial year were 4,270 and 4,331 respectively.

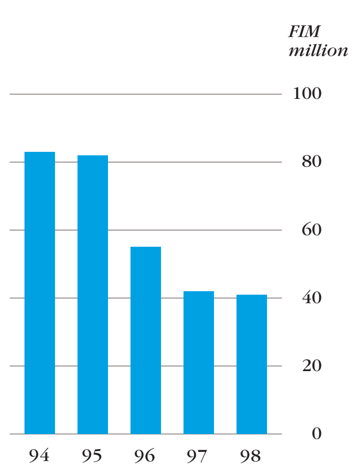
The parent company employed an average of 4,073 during the financial year, compared to 4,063 the year before. The numbers employed at the end of the financial year were 3,831 and 3,868 respectively.

## WAGES AND SALARIES

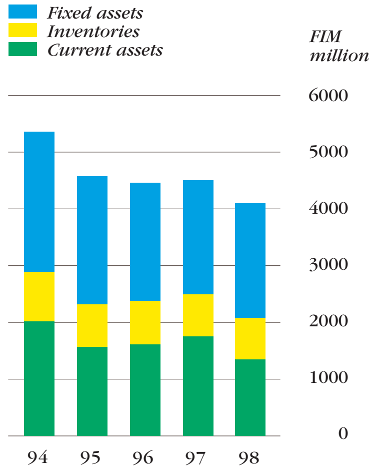
Accrual-based salaries paid to Group Boards, Supervisory Boards and Managing Directors totalled FIM 5 million (FIM 7 million). Other wages and salaries amounted to FIM 671 million (FIM 670 million).

The respective figures for Valio Ltd were FIM 2 million (FIM 2 million) and FIM 601 million (FIM 596 million). The retirement age of the parent company CEO is set at 62, or earlier on a partial pension.

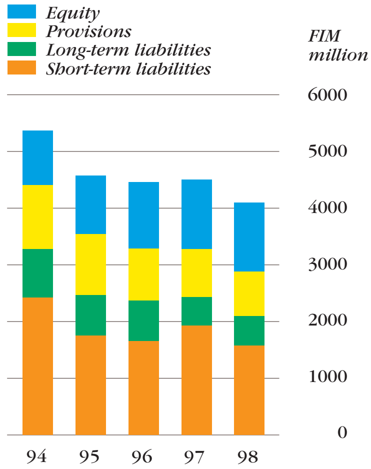
GROUP NET INTEREST EXPENSES




GROUP BALANCE SHEET, ASSETS




GROUP BALANCE SHEET, EQUITY AND LIABILITIES



## FINANCE

Both Group and parent company liquidity remained satisfactory throughout the financial year. Cash plus bank and short-term deposits totalled FIM 639 million at the end of the year, compared to FIM 958 million at the beginning. Inventories stood at FIM 733 million at the end of the financial year and FIM 740 million at the beginning.

Interest-bearing liabilities totalled FIM 683 million at the end and FIM 772 million at the beginning. These included liabilities denominated in foreign currencies amounting to FIM 143 million at the end of the financial year and FIM 264 million at the beginning. Net financing expenses amounted to FIM 42 million (FIM 33 million) or 0.6 per cent (0.4 per cent) of consolidated net sales. Net interest expenses amounted to FIM 41 million (FIM 42 million).

## FINANCIAL PERFORMANCE

Consolidated net income before extraordinary items was FIM 25 million (FIM 184 million). Extraordinary items primarily comprised gains on sales of fixed assets and on value adjustments. The difference between planned depreciation and book depreciation amounted to FIM 51 million (FIM -56 million). Book depreciation was within the maximum permitted under Finland's Business Taxation Act. Taxes for the financial year totalled FIM 22 million (FIM 54 million). Net income for the financial year was FIM 59 million (FIM 95 million).

Parent company net income before extraordinary items was FIM 43 million (FIM 200 million). The difference between planned depreciation and book depreciation amounted to FIM 51 million (FIM -56 million). Taxes for the financial year totalled FIM 21 million (FIM 53 million). Net income for the financial year was FIM 66 million (FIM 117 million).

## YEAR 2000

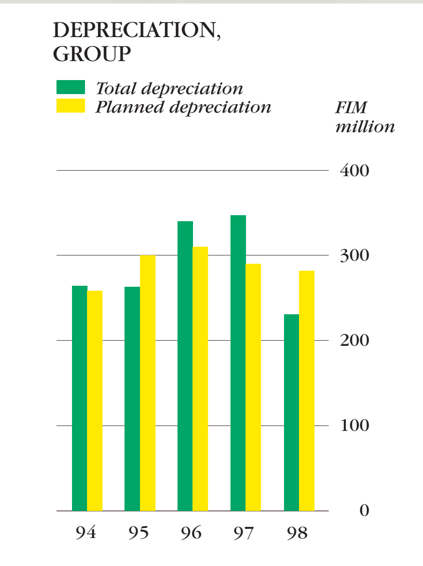
Valio Group information systems have been examined and any Y2K trouble spots identified. System checking and some modification work are still in progress, to be completed well before the turn of the millennium.

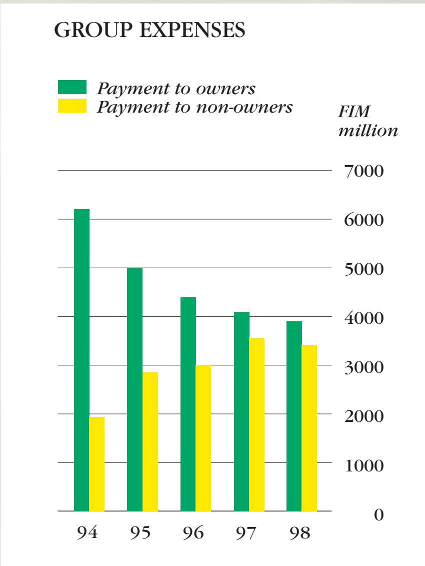
## EURO

Valio will trade consistently in the Euro with customers and dairy producers from the start of 2002. Appropriate IS modifications have been taken into account.

## PROSPECTS FOR 1999

Price competition in the Finnish liquid milk market has further lowered price levels at the beginning of 1999. With the problems in the Russian export market and their knock-on effects persisting, the outlook for profits and dividends during the current year is weaker than for the previous year. Valio has therefore initiated a number of special measures to secure profitability. These rationalization projects aimed at adapting cost structures will be actioned during 1999, but their effects will mainly not be felt until the year 2000.



# *CONSOLIDATED STATEMENT OF INCOME*

| | 1998 | 1997 |
|---|---|---|
| Net sales | 7,604,947 | 8,055,544 |
| Increase (+) / decrease (-) in finished goods | -5,507 | -47,496 |
| Other income from operations | 147,161 | 132,312 |
| | | |
| Variable expenses | | |
| Materials and supplies | | |
| Purchases | 5,197,928 | 5,465,257 |
| Increase (-) / decrease (+) in inventories | -10,366 | -149 |
| Outside services | 123,727 | 112,683 |
| Personnel expenses | 535,209 | 538,601 |
| Other variable expenses | 616,652 | 621,901 |
| | -6,463,150 | -6,738,293 |
| | | |
| Gross profit | 1,283,451 | 1,402,067 |
| | | |
| Fixed expenses | | |
| Personnel expenses | 366,855 | 377,773 |
| Rents | 62,054 | 66,687 |
| Other fixed expenses | 505,183 | 450,497 |
| | -934,092 | -894,957 |
| | | |
| Net income before depreciation | 349,359 | 507,110 |
| | | |
| Depreciation on fixed assets and other capitalized expenditure | 266,905 | 276,849 |
| Amortization of goodwill | 15,484 | 13,419 |
| | -282,389 | -290,268 |
| | | |
| Net income from operations | 66,970 | 216,842 |
| | | |
| Financing income and expenses | | |
| Dividend income | 3,706 | 2,744 |
| Interest income | 24,537 | 31,755 |
| Other financing income | 8,610 | 12,389 |
| Net income from affiliated companies | -808 | 869 |
| Interest expense | -65,447 | -73,974 |
| Other financing expenses | -12,741 | -6,756 |
| | -42,143 | -32,973 |
| | | |
| Net income before extraordinary items, allocations and taxes | 24,827 | 183,869 |
| | | |
| Extraordinary items | | |
| Income | 21,190 | 8,226 |
| Expenses | -12,633 | -94,609 |
| | 8,557 | -86,383 |
| | | |
| Net income before allocations and taxes | 33,384 | 97,486 |
| | | |
| Increase (-) / decrease (+) in accumulated difference between planned and book depreciation | 51,149 | -56,370 |
| Allocation to (-) / from (+) optional provisions | -2,837 | 124,122 |
| Taxes | | |
| Current period | -22,070 | -54,047 |
| Previous periods | -391 | -16,035 |
| | | |
| Net income before minority interest | 59,235 | 95,156 |
| Minority interest | -215 | -155 |
| | | |
| Net income | 59,450 | 95,311 |

All figures in FIM ’000s

# *CONSOLIDATED BALANCE SHEET*

| ASSETS | Dec. 31, 1998 | Dec. 31, 1997 |
|---|---|---|
| FIXED ASSETS AND INVESTMENTS | | |
| Intangible assets | | |
| Immaterial rights | 6,582 | 6,127 |
| Goodwill | 34,303 | 52,873 |
| Other capitalized expenditure | 82,898 | 62,193 |
| | 123,783 | 121,193 |
| Tangible assets | | |
| Land and water areas | 75,915 | 76,366 |
| Buildings and constructions | 791,131 | 827,273 |
| Machinery and equipment | 845,005 | 812,541 |
| Other tangible assets | 16,716 | 19,927 |
| Advance payments and construction in progress | 65,077 | 61,097 |
| | 1,793,844 | 1,797,204 |
| Investments and non-current assets | | |
| Investments in affiliated companies | 7,078 | 5,959 |
| Stocks and shares | 90,091 | 80,671 |
| Loans receivable | 1,474 | 1,544 |
| | 98,643 | 88,174 |
| CURRENT ASSETS | | |
| Inventories | | |
| Materials and supplies | 139,744 | 129,752 |
| Semi-finished goods | 88,059 | 83,996 |
| Finished goods | 501,310 | 518,682 |
| Other inventories | 3,851 | 7,330 |
| | 732,964 | 739,760 |
| Receivables | | |
| Accounts receivable | 551,342 | 637,604 |
| Accrued income and prepaid expenses | 123,146 | 124,225 |
| Other receivables | 34,854 | 35,075 |
| | 709,342 | 796,904 |
| Current investments | 560,889 | 770,491 |
| Cash and bank | 78,443 | 187,921 |
| | 4,097,908 | 4,501,647 |

All figures in FIM ’000s

| SHAREHOLDERS' EQUITY AND LIABILITIES | Dec. 31, 1998 | Dec. 31, 1997 |
|---|---|---|
| SHAREHOLDERS' EQUITY | | |
| Shareholders' equity | | |
| Share capital and legal reserves | | |
| Share capital | 586,340 | 586,340 |
| Legal reserves | 45,093 | 54,494 |
| | 631,433 | 640,834 |
| Distributable earnings | | |
| Retained earnings | 519,065 | 482,388 |
| Net income for the financial year | 59,450 | 95,311 |
| | 578,515 | 577,699 |
| MINORITY INTEREST | 138 | 823 |
| PROVISIONS | | |
| Consolidation difference | 3,704 | 7,108 |
| Accumulated difference between planned and book depreciation | 779,002 | 830,151 |
| Optional provisions | | |
| Other provisions | 3,016 | - |
| Obligatory provisions | 7,540 | 10,322 |
| | 793,262 | 847,581 |
| LIABILITIES | | |
| Long-term debt | | |
| Loans from financial institutions | 321,297 | 396,473 |
| Other long-term debt | 197,787 | 106,117 |
| | 519,084 | 502,590 |
| Current liabilities | | |
| Loans from financial institutions | 164,314 | 269,213 |
| Advance payments received | 4,735 | 17,486 |
| Accounts payable | 1,202,404 | 1,451,652 |
| Accrued expenses and prepaid income | 185,890 | 171,182 |
| Other current liabilities | 18,133 | 22,587 |
| | 1,575,476 | 1,932,120 |
| | 4,097,908 | 4,501,647 |

All figures in FIM '000s

# *CONSOLIDATED STATEMENT OF SOURCES AND APPLICATION OF FUNDS*

| | 1998 | 1997 |
|---|---|---|
| SOURCES OF FUNDS | | |
| Financing from operations | | |
| Net income before depreciation | 349,359 | 507,110 |
| Financing income | 36,853 | 47,757 |
| | 386,212 | 554,867 |
| Capital financing | | |
| Increase in long-term debt | 160,463 | 8,802 |
| Increase in shareholders' equity | - | 13,884 |
| | 160,463 | 22,686 |
| | 546,675 | 577,553 |
| APPLICATION OF FUNDS | | |
| Dividends | 58,634 | 57,780 |
| Financing and other expenses and taxes | | |
| Financing expenses | 78,996 | 80,730 |
| Extraordinary items, income (-) / expenses (+) | -4,436 | 86,383 |
| Taxes | 22,461 | 70,082 |
| | 155,655 | 294,975 |
| Capital expenditure | 328,995 | 248,522 |
| Other changes in fixed assets | -37,733 | -18,375 |
| Increase (+) / decrease (-) in loans receivable | -70 | -344 |
| Repayment of capital | | |
| Repayment of long-term debt | 143,969 | 205,652 |
| Decrease in equity | 9,401 | - |
| Decrease in minority interest | 470 | 9,145 |
| | 153,840 | 214,797 |
| Increase (-) /decrease (+) in obligatory provisions | 2,782 | -3,033 |
| Change in working capital | | |
| Increase (+) / decrease (-) in inventories | -6,796 | -31,722 |
| Increase (+) / decrease (-) in current receivables | -406,642 | +141,720 |
| Increase (-) /decrease (+) in current liabilities | +356,644 | -268,987 |
| | -56,794 | -158,989 |
| | 546,675 | 577,553 |

All figures in FIM '000s

# *PARENT COMPANY STATEMENT OF INCOME*

| | 1998 | 1997 |
|---|---|---|
| Net sales | 6,925,376 | 7,303,382 |
| Increase (+) / decrease (-) in finished goods | 15,759 | -46,027 |
| Other income from operations | 139,984 | 128,619 |
| | | |
| Variable expenses | | |
| Materials and supplies | | |
| Purchases | 4,738,655 | 4,935,749 |
| Increase (-) / decrease (+) in inventories | -1,863 | 2,340 |
| Outside services | 117,262 | 103,595 |
| Personnel expenses | 487,543 | 487,072 |
| Other variable expenses | 577,526 | 577,297 |
| | -5,919,123 | -6,106,053 |
| | | |
| Gross profit | 1,161,996 | 1,279,921 |
| | | |
| Fixed expenses | | |
| Personnel expenses | 324,318 | 321,753 |
| Rents | 59,173 | 63,582 |
| Other fixed expenses | 459,024 | 397,685 |
| | -842,515 | -783,020 |
| | | |
| Net income before depreciation | 319,481 | 496,901 |
| | | |
| Depreciation on fixed assets and other capitalized expenditure | -250,867 | -257,923 |
| | | |
| Net income from operations | 68,614 | 238,978 |
| | | |
| Financing income and expenses | | |
| Dividend income | 2,547 | 1,750 |
| Dividend income from subsidiaries | - | 50 |
| Dividend tax credit | 977 | 700 |
| Interest income | 26,266 | 34,381 |
| Other financing income | 8,071 | - |
| Interest expense *) | -62,203 | -70,544 |
| Other financing expenses | -924 | -5,044 |
| | -25,266 | -38,707 |
| | | |
| Net income before extraordinary items, allocations and taxes | 43,348 | 200,271 |
| | | |
| Extraordinary items | | |
| Income | 40,060 | 9,408 |
| Expenses | -46,789 | -91,218 |
| | -6,729 | -81,810 |
| | | |
| Net income before allocations and taxes | 36,619 | 118,461 |
| | | |
| Increase (-) / decrease (+) in accumulated difference between planned and book depreciation | 51,143 | -56,436 |
| Allocation to (-) / from (+) optional provisions | - | 123,627 |
| Taxes | | |
| Current period | -21,154 | -52,985 |
| Previous periods | -369 | -16,000 |
| | | |
| Net income | 66,239 | 116,667 |
| *) Net interest expense | 35,937 | 36,163 |

All figures in FIM ’000s

# *PARENT COMPANY BALANCE SHEET*

| ASSETS | Dec. 31, 1998 | Dec. 31, 1997 |
|---|---|---|
| FIXED ASSETS AND INVESTMENTS | | |
| Intangible assets | | |
| Immaterial rights | 6,351 | 5,278 |
| Other capitalized expenditure | 81,645 | 61,431 |
| | 87,996 | 66,709 |
| Tangible assets | | |
| Land and water areas | 72,567 | 69,745 |
| Buildings and constructions | 764,954 | 798,548 |
| Machinery and equipment | 804,505 | 762,702 |
| Other tangible assets | 348 | 336 |
| Advance payments and construction in progress | 64,221 | 59,486 |
| | 1,706,595 | 1,690,817 |
| Investments and non-current assets | | |
| Stocks and shares | 79,693 | 69,564 |
| Shares in subsidiaries | 190,727 | 342,696 |
| Loans receivable | 24,737 | 90,478 |
| | 295,157 | 502,738 |
| CURRENT ASSETS | | |
| Inventories | | |
| Materials and supplies | 129,415 | 125,318 |
| Semi-finished goods | 88,023 | 72,341 |
| Finished goods | 389,489 | 388,166 |
| Other inventories | 3,851 | 7,330 |
| | 610,778 | 593,155 |
| Receivables | | |
| Accounts receivable | 484,273 | 584,216 |
| Accrued income and prepaid expenses | 114,312 | 97,323 |
| Other receivables | 35,682 | 41,165 |
| | 634,267 | 722,704 |
| Current investments | 560,881 | 770,483 |
| Cash and bank | 37,851 | 129,185 |
| | 3,933,525 | 4,475,791 |

All figures in FIM ’000s

| SHAREHOLDERS' EQUITY AND LIABILITIES | Dec. 31, 1998 | Dec. 31, 1997 |
|---|---|---|
| SHAREHOLDERS' EQUITY | | |
| Shareholders' equity | | |
| Share capital and legal reserves | | |
| Share capital | 586,340 | 586,340 |
| Legal reserves | 35,580 | 35,580 |
| | 621,920 | 621,920 |
| Distributable earnings | | |
| Distributable fund | 603,974 | 545,941 |
| Net income for the financial year | 66,239 | 116,667 |
| | 670,213 | 662,608 |
| PROVISIONS | | |
| Accumulated difference between planned and book depreciation | 779,002 | 830,145 |
| Obligatory provisions | 7,540 | 8,350 |
| | 786,542 | 838,495 |
| LIABILITIES | | |
| Long-term debt | | |
| Loans from financial institutions | 251,409 | 315,546 |
| Other long-term debt | 131,715 | 106,299 |
| | 383,124 | 421,845 |
| Short-term debt | | |
| Loans from financial institutions | 145,015 | 206,493 |
| Advance payments received | 1,427 | 1,593 |
| Accounts payable | 1,139,177 | 1,555,229 |
| Accrued expenses and prepaid income | 162,212 | 149,156 |
| Other current liabilities | 23,895 | 18,452 |
| | 1,471,726 | 1,930,923 |
| | 3,933,525 | 4,475,791 |

All figures in FIM '000s

# *PARENT COMPANY STATEMENT OF SOURCES AND APPLICATION OF FUNDS*

| | 1998 | 1997 |
|---|---|---|
| SOURCES OF FUNDS | | |
| Financing from operations | | |
| Net income before depreciation | 319,481 | 496,901 |
| Financing income | 37,861 | 36,881 |
| | 357,342 | 533,782 |
| Capital financing | | |
| Increase in long-term debt | | |
| Increase in loans from financial institutions | 11,201 | 302 |
| Increase in shareholder loans | 82,669 | - |
| | 93,870 | 302 |
| | 451,212 | 534,084 |
| APPLICATION OF FUNDS | | |
| Dividend | 58,634 | 58,634 |
| Financing and other expenses and taxes | | |
| Financing expenses | 63,127 | 75,588 |
| Extraordinary items, income (-) / expenses (+) | -29,150 | 81,810 |
| Taxes | 21,523 | 68,985 |
| | 55,500 | 226,383 |
| Capital expenditure and other non-current investments | | |
| Increase in tangible assets | 267,008 | 206,529 |
| Increase in stocks and shares and intangible assets | 60,967 | 43,393 |
| Decrease in fixed assets | -146,003 | -17,873 |
| Decrease in loans receivable | -65,741 | -12,408 |
| | 116,231 | 219,641 |
| Repayment of capital | | |
| Repayment of long-term debt | | |
| Decrease in loans from financial institutions | 160,209 | 133,099 |
| Decrease in shareholder loans | 15,122 | 59,185 |
| | 175,331 | 192,284 |
| Increase (-) / decrease (+) in obligatory provisions | 810 | -2,785 |
| Change in working capital | | |
| Increase (+) / decrease (-) in inventories | + 17,623 | -48,368 |
| Increase (+) / decrease (-) in current receivables | -389,373 | +166,728 |
| Increase (-) / decrease (+) in current liabilities *) | +416,456 | -278,433 |
| | 44,706 | -160,073 |
| | 451,212 | 534,084 |

*) Excluding repayment of long-term debt

All figures in FIM ’000s

# NOTES TO THE CONSOLIDATED AND PARENT COMPANY FINANCIAL STATEMENTS

## ACCOUNTING POLICIES

The consolidated financial statements include the parent company and those domestic and foreign subsidiaries in which the parent company holds more than 50 per cent of the voting rights, either directly or indirectly. Real estate companies in which the holding exceeds 50 per cent are not included in the consolidated financial statements. Had they been consolidated, they would not have had any effect on consolidated distributable earnings.

The consolidated financial statements have been prepared using the acquisition method. All intercompany accounts and transactions have been eliminated.

Inventories are stated at the lower of cost on a first-in first-out basis, or market. Fixed assets are depreciated on a straight-line basis over their estimated economic life. R & D costs have been charged to income as incurred.

The minority interest in consolidated net income and equity is disclosed as a separate item in the income statement and the balance sheet.

The financial statements of foreign subsidiaries have been translated into Finnish marks at the Bank of Finland year-end average rates of exchange. Gains or losses resulting from the translation are included in legal reserves as translation adjustments. Assets and liabilities of domestic group companies denominated in foreign currencies, have been translated into Finnish marks at the Bank of Finland year-end average rates of exchange.

All figures in the notes are in FIM '000s.

| | CONSOLIDATED | | PARENT COMPANY | |
|---|---|---|---|---|
| | 1998 | 1997 | 1998 | 1997 |
| **1. NET SALES BY DIVISION** | | | | |
| Fresh products | 2,855,445 | 3,104,631 | 2,792,725 | 3,031,326 |
| Edible fats | 953,815 | 1,001,358 | 952,695 | 987,530 |
| Cheese | 2,446,974 | 2,476,754 | 1,858,150 | 1,871,046 |
| Ingredients | 517,600 | 564,383 | 514,910 | 553,639 |
| Ice cream | 376,166 | 416,760 | 366,296 | 412,574 |
| Others | 454,947 | 491,658 | 440,600 | 447,267 |
| | 7,604,947 | 8,055,544 | 6,925,376 | 7,303,382 |
| **2. PERSONNEL EXPENSES** | | | | |
| Wages and salaries | 676,437 | 677,429 | 602,590 | 597,666 |
| Pension costs | 111,434 | 120,393 | 108,819 | 117,054 |
| Salary-related expenses | 114,193 | 118,552 | 100,452 | 94,105 |
| | 902,064 | 916,374 | 811,861 | 808,825 |
| Fringe benefits | 7,682 | 7,733 | 7,550 | 7,624 |
| | 909,746 | 924,107 | 819,411 | 816,449 |
| **3. PLANNED DEPRECIATION** | | | | |
| Goodwill | 15,484 | 13,419 | - | - |
| Immaterial rights | 870 | 735 | 740 | 611 |
| Other capitalized expenditure | 17,317 | 17,893 | 16,948 | 17,321 |
| Buildings and constructions | 71,570 | 73,429 | 68,459 | 70,266 |
| Machinery and equipment | 173,608 | 180,537 | 164,703 | 169,710 |
| Other tangible assets | 3,540 | 4,255 | 17 | 15 |
| | 282,389 | 290,268 | 250,867 | 257,923 |

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| INCREASE (-) / DECREASE (+) IN ACCUMULATED DIFFERENCE BETWEEN PLANNED AND BOOK DEPRECIATION | | | | |
| Immaterial rights | -164 | -109 | -180 | -128 |
| Other capitalized expenditure | -298 | -6,360 | -298 | -6,376 |
| Buildings and constructions | 27,241 | 1,267 | 27,241 | 1,329 |
| Machinery and equipment | 24,367 | -51,167 | 24,385 | -51,254 |
| Other tangible assets | 3 | -1 | -5 | -7 |
| | 51,149 | -56,370 | 51,143 | -56,436 |

Planned depreciation is calculated on the original acquisition cost of depreciable assets on a straight-line basis over their economic life as follows:

| | Years |
|---|---|
| Immaterial rights and other capitalized expenditure | 10 |
| Goodwill | 5 |
| Buildings and constructions | 25 |
| Machinery and equipment | 10 |
| EDP equipment and software | 5 |
| Transportation and equipment | 5 |

4. INTERCOMPANY FINANCING INCOME AND EXPENSES

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| Intercompany financing income | | | | |
| Dividend income | - | - | - | 50 |
| Interest income | - | - | 3,159 | 6,343 |
| Intercompany financing expenses | | | | |
| Interest expense | - | - | 3,699 | 4,922 |

5. EXTRAORDINARY INCOME AND EXPENSES

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| Extraordinary income and expenses comprise the following items: | | | | |
| Gain on sale of shares | 8,483 | 7,952 | 8,483 | 9,389 |
| Reversal of write-down of shares | 9,553 | - | 9,553 | - |
| Gain on sales of fixed assets | 2,915 | - | - | - |
| Merger gain | - | - | 22,605 | - |
| Losses on sale of shares | -250 | - | -580 | - |
| Group contribution | - | - | -1,000 | - |
| Write-down of buildings | -5,432 | -1,892 | -5,432 | - |
| Write-down of shares in subsidiary | - | - | -40,000 | - |
| Write-down of production line | -5,606 | - | - | - |
| Write-down of contingent pension liabilities | - | -87,171 | - | -86,216 |
| Payment to the Finnish Competition Board | - | -5,000 | - | -5,000 |
| Other extraordinary items | -1,106 | -272 | -358 | 17 |
| | 8,557 | -86,383 | -6,729 | -81,810 |

6. ALLOCATION TO (-) / FROM (+) OPTIONAL PROVISIONS

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| Transitional provision | - | 123,627 | - | 123,627 |
| Other provisions | -2,837 | 495 | - | - |
| Increase (-) / decrease (+), total | -2,837 | 124,122 | - | 123,627 |

| | CONSOLIDATED 1998 | 1997 | PARENT COMPANY 1998 | 1997 |
|---|---|---|---|---|
| 7. CHANGE IN OBLIGATORY PROVISIONS INCREASE (-) / DECREASE (+) | | | | |
| Provision for rental expenses + 1,583 and for contingent pension liabilities of the parent company -773 | 2,782 | -3,033 | 810 | -2,786 |

8. CONSOLIDATED AND PARENT COMPANY HOLDINGS

81. GROUP COMPANIES

GROUP OWNERSHIP

| | Ownership and voting rights % | Share of equity |
|---|---|---|
| Jäätelöyhtymä Oy, Helsinki, Finland | 100.0 | 2 |
| N.V. Valio - Vache Bleue S.A., Belgium | 100.0 | 46,294 |
| Frigo-Way S.P.R.L., Belgium | 100.0 | 6,126 |
| Vache Bleue S.A.R.L., France | 100.0 | 2,013 |
| Pakkasukko Oy, Helsinki, Finland | 100.0 | 11 |
| Smeds & Co Oy, Helsinki, Finland | 100.0 | 179 |
| Tapila AS, Estonia | 98.7 | 4,407 |
| UAB Valio International, Lithuania | 100.0 | - |
| Valio Eesti AS, Estonia | 100.0 | 1,136 |
| Valio International (Poland) Ltd, Poland | 100.0 | 11 |
| Valio International U.S.A. Inc., USA | 100.0 | 81,577 |
| McCadam Cheese Co., Inc., USA | 100.0 | 78,346 |
| Finlandia Cheese Co., Inc., USA | 100.0 | 4,602 |
| Valio International Middle East (Holding) SAL, Lebanon | 90.0 | 725 |
| Finnish Dairy (Holding) SAL, Lebanon | 20.0 | - |
| Valio Sverige AB, Sweden | 100.0 | 522 |
| Valio Engineering Ltd, Helsinki, Finland | 100.0 | 1,174 |
| ZAO Valio St. Petersburg, Russia | 100.0 | 608 |
| Asunto Oy Nastolan Maitotie, Nastola, Finland | 100.0 | 5,407 |
| Asunto Oy Vuorikummuntie 9, Helsinki, Finland | 98.5 | 2,718 |
| Kiinteistö Oy Hiirakkotie 6, Vantaa, Finland | 100.0 | 792 |
| Kiinteistö Oy Pähkinämetsä, Vantaa, Finland | 100.0 | 1,214 |
| Kiinteistö Oy Pähkinäpolku, Vantaa, Finland | 100.0 | 794 |
| Kiinteistö Oy Ratastie, Janakkala, Finland | 100.0 | 232 |
| Kiinteistö Oy Tehontie 31, Kouvola, Finland | 100.0 | 2,302 |

PARENT COMPANY OWNERSHIP

| | Ownership % | Number of shares | | Face value | Book value | Net income/ (loss) in latest year-end accounts |
|---|---|---|---|---|---|---|
| Jäätelöyhtymä Oy | 100.0 | 200 | | 2 | 1 | - |
| N.V. Valio - Vache Bleue S.A. *) | 98.3 | 4,682 | BEF | 65,930 | 110,122 | -8,840 |
| Frigo-Way S.P.R.L. | 0.0 | | | | | 82 |
| Vache Bleue S.A.R.L. | 0.0 | | | | | -274 |
| Pakkasukko Oy | 100.0 | 150 | | 1 | 1 | - |
| Smeds & Co Oy | 100.0 | 25 | | 50 | 50 | 129 |
| Tapila AS | 98.7 | 4,211 | EEK | 6,401 | 2,411 | -313 |
| UAB Valio International **) | 100.0 | - | | - | 696 | -176 |
| Valio Eesti AS | 100.0 | 15,000 | EEK | 1,500 | 2,452 | -224 |
| Valio International (Poland) Ltd | 100.0 | 40 | PZL | 4 | 11 | - |
| Valio International U.S.A. Inc. | 100.0 | 1,000 | USD | 24,501 | 48,173 | 1,147 |
| McCadam Cheese Co., Inc. | 0.0 | | | | | -2,084 |
| Finlandia Cheese Co., Inc. | 0.0 | | | | | 3,582 |
| Valio International Middle East (Holding) SAL | 90.0 | 1,278 | USD | 128 | 722 | -530 |
| Finnish Dairy (Holding) SAL | 0.0 | | | | | - |
| Valio Sverige AB | 100.0 | 15,000 | SEK | 1,500 | 5,444 | 3 |
| Valio Engineering Ltd | 100.0 | 500 | | 500 | 503 | 705 |
| ZAO Valio St. Petersburg | 100.0 | 29,010 | RUR | 2,901,000 | 3,177 | -276 |
| Asunto Oy Nastolan Maitotie | 100.0 | 1,361 | | 5,444 | 1,829 | - |
| Asunto Oy Vuorikummuntie 9 | 98.5 | 2,325 | | 2,462 | 9,988 | - |
| Kiinteistö Oy Hiirakkotie 6 | 100.0 | 650 | | 650 | 900 | - |
| Kiinteistö Oy Pähkinämetsä | 100.0 | 1,000 | | 1,000 | 1,213 | - |
| Kiinteistö Oy Pähkinäpolku | 100.0 | 380 | | 798 | 798 | - |
| Kiinteistö Oy Ratastie | 100.0 | 450 | | 450 | 450 | - |
| Kiinteistö Oy Tehontie 31 | 100.0 | 23,000 | | 2,300 | 1,786 | - |
| | | | | | 190,727 | |

*) Group company Smeds & Co Oy owns remaining 1.7%
**) Only paid-in share capital disclosed

82. AFFILIATES

GROUP OWNERSHIP

| | Ownership and voting rights % | Share of equity |
|---|---|---|
| Creative Food Systems Ltd, UK | 20.0 | 439 |
| Pakastamo Oy, Helsinki, Finland | 50.0 | 4,244 |
| Suomen NP-Kierrätys Oy, Helsinki, Finland | 25.0 | 25 |
| Turengin Meijerikiinteistöt Oy, Janakkala, Finland | 50.0 | 482 |
| Yoplait Valio Nord AB, Sweden | 50.0 | 1,365 |
| Yoplait Valio Nord Oy, Helsinki, Finland | 50.0 | 264 |
| Kiinteistö Oy Teollisuusneliö, Haapavesi, Finland | 39.0 | 260 |

PARENT COMPANY OWNERSHIP

| | Number of shares | Face value | Book value | Net income/ (loss) in latest year-end accounts |
|---|---|---|---|---|
| Creative Food Systems Ltd | 52,000 | GBP 52,000 | 346 | 643 |
| Pakastamo Oy | 660 | 3,300 | 3,300 | 698 |
| Suomen NP-Kierrätys Oy | 10 | 10 | 25 | - |
| Turengin Meijerikiinteistöt Oy *) | 50 | 500 | 500 | 1 |
| Yoplait Valio Nord AB | 3,500 | SEK 3,500 | 2,430 | -2,130 |
| Yoplait Valio Nord Oy | 500 | 500 | 500 | -473 |
| Kiinteistö Oy Teollisuusneliö | 1,875 | 188 | 188 | 40 |
| | | | 7,289 | |

*) Year-end accounts Aug. 31, 1998 and financial year 12 months

83. PARENT COMPANY OTHER STOCKS AND SHARES

| | Ownership % | Number of shares | Face value | Book value |
|---|---|---|---|---|
| Alma-Media Oyj, Helsinki, Finland | 0.8 | 120,587 | 1,206 | 1,742 |
| Finnair Oy, Vantaa, Finland | 0.0 | 28,080 | 140 | 391 |
| Lännen Tehtaat Oyj, Säkylä, Finland | 5.0 | 324,552 | 3,246 | 7,664 |
| Metsä-Serla Oyj, Espoo, Finland | 0.2 | 250,750 | 2,507 | 3,092 |
| Vakuutusyhtiö Sampo Oyj, Turku, Finland | 0.0 | 9,348 | 47 | 387 |
| Meijerien Keskinäinen Vakuutusyhtiö, Helsinki, Finland | - | 100 | 10,000 | 10,064 |
| Kiinteistö Oy Biocity, Turku, Finland | 5.5 | 1,246 | 12 | 10,000 |
| Shares in housing | - | - | - | 28,043 |
| Other stocks and shares | - | - | - | 11,021 |
| | | | | 72,404 |

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| **9. TANGIBLE AND INTANGIBLE ASSETS** | | | | |
| Immaterial rights | | | | |
| Acquisition cost at beginning of year | 8,226 | 14,557 | 7,633 | 6,350 |
| Increases | 1,874 | 1,290 | 1,813 | 1,283 |
| Acquisition cost at year-end | 10,100 | 15,847 | 9,446 | 7,633 |
| Accumulated depreciation at year-end | -3,518 | -9,720 | -3,095 | -2,355 |
| Book value at year-end | 6,582 | 6,127 | 6,351 | 5,278 |
| Accumulated difference between planned and book depreciation at beginning of year | 464 | 355 | 489 | 361 |
| Increase | 180 | 128 | 180 | 128 |
| Decrease | -16 | -19 | - | - |
| Accumulated difference between planned and book depreciation at year-end | 628 | 464 | 669 | 489 |
| Other capitalized expenditure | | | | |
| Acquisition cost at beginning of year | 163,780 | 134,442 | 155,820 | 132,806 |
| Increases | 37,911 | 23,075 | 37,192 | 23,034 |
| Decreases | -29 | -113 | -29 | -20 |
| Decreases *) | -10,641 | - | -10,641 | - |
| Acquisition cost at year-end | 191,021 | 157,404 | 182,342 | 155,820 |
| Accumulated depreciation *) | 10,641 | - | 10,641 | - |
| Accumulated depreciation at year-end | -118,764 | -95,211 | -111,338 | -94,389 |
| Book value at year-end | 82,898 | 62,193 | 81,645 | 61,431 |
| Accumulated difference between planned and book depreciation at beginning of year | 17,360 | 11,000 | 17,360 | 10,984 |
| Increase | 298 | 6,376 | 298 | 6,376 |
| Decrease | - | -16 | - | - |
| Accumulated difference between planned and book depreciation at year-end | 17,658 | 17,360 | 17,658 | 17,360 |
| *) Other capitalized expenditure no longer in use | | | | |
| Land and water areas | | | | |
| Acquisition cost at beginning of year | 74,299 | 76,369 | 69,745 | 69,776 |
| Increases | 3,718 | 506 | 3,718 | 478 |
| Decreases | -2,102 | -509 | -896 | -509 |
| Book value at year-end | 75,915 | 76,366 | 72,567 | 69,745 |

| | CONSOLIDATED 1998 | 1997 | PARENT COMPANY 1998 | 1997 |
|---|---|---|---|---|
| Buildings and constructions | | | | |
| Acquisition cost at beginning of year | 1,687,786 | 1,670,613 | 1,630,423 | 1,611,023 |
| Increases | 51,500 | 25,819 | 44,501 | 24,582 |
| Decreases | -17,183 | -7,852 | -9,637 | -5,182 |
| Acquisition cost at year-end | 1,722,103 | 1,688,580 | 1,665,287 | 1,630,423 |
| Accumulated depreciation at year-end | -930,972 | -861,307 | -900,333 | -831,875 |
| Book value at year-end | 791,131 | 827,273 | 764,954 | 798,548 |
| Accumulated difference between planned and book depreciation at beginning of year | 316,826 | 318,095 | 316,826 | 318,155 |
| Decreases | -27,241 | -1,268 | -27,241 | -1,329 |
| Accumulated difference between planned and book depreciation at year-end | 289,585 | 316,827 | 289,585 | 316,826 |
| Machinery and equipment and other tangible assets | | | | |
| Acquisition cost at beginning of year | 2,511,573 | 2,363,640 | 2,342,961 | 2,200,929 |
| Increases | 224,376 | 163,047 | 213,997 | 150,279 |
| Decreases | -15,795 | -10,964 | -7,461 | -8,247 |
| Acquisition cost at year-end | 2,720,154 | 2,515,723 | 2,549,497 | 2,342,961 |
| Accumulated depreciation at year-end | -1,858,433 | -1,683,255 | -1,744,644 | -1,579,923 |
| Book value at year-end | 861,721 | 832,468 | 804,853 | 763,038 |
| Accumulated difference between planned and book depreciation at beginning of year | 495,501 | 444,332 | 495,470 | 444,209 |
| Increases | 16 | 51,261 | - | 51,261 |
| Decreases | -24,386 | -93 | -24,380 | - |
| Accumulated difference between planned and book depreciation at year-end | 471,131 | 495,500 | 471,090 | 495,470 |
| Accumulated difference between planned and book depreciation, total | 779,002 | 830,151 | 779,002 | 830,145 |
| Book value of machinery at year-end | 682,151 | 633,372 | 645,702 | 592,704 |

10. TAXATION VALUES

| | CONSOLIDATED 1998 | 1997 | PARENT COMPANY 1998 | 1997 |
|---|---|---|---|---|
| Land and water areas | 125,756 | 125,851 | 122,408 | 121,054 |
| Buildings and constructions | 515,888 | 512,213 | 489,710 | 483,193 |
| Stocks and shares | | | | |
| Real estate subsidiaries | 18,347 | 22,969 | 18,347 | 22,969 |
| Subsidiaries | - | - | 173,741 | 339,576 |
| Other companies | 77,805 | 84,874 | 77,092 | 84,413 |
| | 96,152 | 107,843 | 269,180 | 446,958 |

Where taxation value is not available, book value is used.

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| 11. STOCKS AND SHARES AND LOANS RECEIVABLE INCLUDED IN LONG-TERM INVESTMENTS | | | | |
| Group companies | | | | |
| Stocks and shares | - | - | 190,727 | 342,696 |
| Loans receivable | - | - | 24,199 | 89,916 |
| Affiliates | | | | |
| Stocks and shares | - | - | 7,289 | 5,364 |
| 12. RECEIVABLES DUE AFTER ONE YEAR OR LATER | | | | |
| Accounts receivable | 1,459 | 1,908 | 1,459 | 1,908 |
| Other receivables | 16,805 | 17,344 | 16,805 | 17,299 |
| 13. RECEIVABLES AND PAYABLES/ GROUP COMPANIES AND AFFILIATES | | | | |
| Accounts receivable/Group companies | - | - | 35,283 | 56,671 |
| Accounts receivable/Affiliates | - | - | 315 | - |
| Other receivables/Group companies | - | - | 4,974 | 8,118 |
| Other receivables/Affiliates | - | - | 200 | 20 |
| Accounts payable/Group companies | - | - | 4,706 | 160,483 |
| Accounts payable/Affiliates | - | - | 953 | 1,932 |
| 14. CHANGES IN SHAREHOLDERS' EQUITY | | | | |
| Share capital, Jan. 1, 1998/Jan. 1, 1997 | 586,340 | 586,340 | 586,340 | 586,340 |
| Share capital, Dec. 31 | 586,340 | 586,340 | 586,340 | 586,340 |
| Legal reserves, Jan. 1, 1998/Jan. 1, 1997 | 54,494 | 40,610 | 35,580 | 35,580 |
| Change in Group structure | - | 8,540 | - | - |
| Translation adjustments | -9,401 | 5,344 | - | - |
| Legal reserves, Dec. 31 | 45,093 | 54,494 | 35,580 | 35,580 |
| Distributable earnings | | | | |
| Distributable fund, Jan. 1 | 552,331 | 401,252 | 545,941 | 394,862 |
| Transfer from retained earnings | 58,033 | 151,079 | 58,033 | 151,079 |
| Distributable fund, Dec. 31 | 610,364 | 552,331 | 603,974 | 545,941 |
| Retained earnings | 25,368 | 138,916 | 116,667 | 209,713 |
| Dividends | - | - | -58,634 | -58,634 |
| Transfer to distributable fund | -58,033 | -151,079 | -58,033 | -151,079 |
| Group distribution of retained earnings | -58,634 | -57,780 | - | - |
| Retained earnings | -91,299 | -69,943 | - | - |
| Net income for the financial year | 59,450 | 95,311 | 66,239 | 116,667 |
| Distributable earnings, Dec. 31 | 578,515 | 577,699 | 670,213 | 662,608 |

| | CONSOLIDATED 1998 | CONSOLIDATED 1997 | PARENT COMPANY 1998 | PARENT COMPANY 1997 |
|---|---|---|---|---|
| 15. LIABILITIES DUE AFTER FIVE YEARS OR LATER | | | | |
| Loans from financial institutions | 13,109 | 15,201 | 149 | 1,649 |
| 16. ASSETS PLEDGED AND CONTINGENCIES | | | | |
| For own liabilities | | | | |
| Pledges | 122,832 | 240,427 | 122,832 | 240,427 |
| Mortgages | 1,066,940 | 1,111,175 | 1,066,940 | 1,053,025 |
| For liabilities of Group companies | | | | |
| Guarantees | - | - | 213,626 | 183,040 |
| For other companies | | | | |
| Guarantees | 10,300 | 3,000 | 10,300 | 3,000 |
| Other contingencies | | | | |
| Leasing commitments | 22,387 | 22,676 | 21,550 | 21,420 |
| Pension liabilities | 561 | 650 | - | - |
| Other contingencies | - | - | 88,039 | 101,326 |
| Total | | | | |
| Pledges | 122,832 | 240,427 | 122,832 | 240,427 |
| Mortgages | 1,066,940 | 1,111,175 | 1,066,940 | 1,053,025 |
| Guarantees | 10,300 | 3,000 | 223,926 | 186,040 |
| Pension liabilities | 561 | 650 | - | - |
| Other contingencies | 22,387 | 22,676 | 109,589 | 122,746 |
| | 1,223,020 | 1,377,928 | 1,523,287 | 1,602,238 |

# *PROPOSAL BY THE BOARD OF DIRECTORS TO THE ANNUAL GENERAL MEETING*

The consolidated distributable earnings at Dec. 31st, 1998 are FIM 578,515,000.
Parent company distributable earnings at Dec. 31st, 1998 are:

| | | |
|---|---|---|
| Distributable fund | FIM | 603,974,036.76 |
| Net income for the financial year | FIM | 66,238,582.33 |
| Total | FIM | 670,212,619.09 |

| | | |
|---|---|---|
| The Board of Directors proposes to the Annual General Meeting that a dividend of 6% on the nominal value of the shares or FIM 1,200 per share be declared | FIM | 35,180,400.00 |
| to the distributable fund be carried over | FIM | 31,058,182.33 |
| Total | FIM | 66,238,582.33 |

Should the Annual General Meeting approve the above proposal, company shareholders' equity would be as follows:

| | | |
|---|---|---|
| Share capital and legal reserves | | |
| Share capital | FIM | 586,340,000.00 |
| Legal reserves | FIM | 35,579,851.98 |
| | FIM | 621,919,851.98 |
| Distributable earnings | | |
| Distributable fund | FIM | 635,032,219.09 |
| Total shareholders' equity | FIM | 1,256,952,071.07 |

Helsinki, March 18th, 1999

*Kari Inkinen* *Tauno Uitto* *Matti Kavetvuo*
President, CEO

*Juhani Hörkkö* *Esa Juntunen*

# *AUDITORS' REPORT*

To the Shareholders of Valio Ltd

We have audited the accounting, the financial statements and the administration of Valio Ltd for the period January 1st, 1998 through December 31st, 1998. The financial statements, which have been prepared by the Board of Directors and the CEO, include the report of the Board of Directors, the consolidated and parent company income statements and balance sheets and notes to the financial statements. Based on our audit we express our opinion on these financial statements and on the administration.

We have conducted the audit in accordance with Finnish Standards on Auditing. In this respect, we have on a test basis examined evidence supporting the amounts and disclosures in the financial statements, assessed the accounting principles used and significant estimates made by the management, as well as evaluated the overall financial statement presentation to obtain reasonable assurance about whether the financial statements are to a substantial extent correctly prepared. The purpose of our audit of the administration is to examine whether members of the Supervisory Board, the Board of Directors and the CEO have legally complied with the rules of the Companies Act.

In our opinion the financial statements showing a profit of FIM 66,238,582.33 for the parent company and FIM 59,450,000 for the Group have been prepared in accordance with the Accounting Act and other rules and regulations governing the preparation of financial statements. The financial statements give a true and fair view, as defined in the Accounting Act, of both the consolidated and parent company's result of operations as well as the financial position. The financial statements together with the consolidated financial statements can be adopted and the members of the Supervisory Board, the Board of Directors and the CEO of the parent company can be discharged from liability for the period audited by us. The proposal of the Board of Directors regarding the disposal of retained earnings is in compliance with the Companies Act.

Helsinki, March 18th, 1999

SVH Pricewaterhouse Coopers Oy
Authorized Public Accountants

*Tauno Haataja*
Authorized Public Accountant

# *STATEMENT BY THE SUPERVISORY BOARD*

We have examined the financial statements for January 1st to December 31st, 1998, and the auditors' report.

We recommend approval of the parent company income statement and balance sheet, and the consolidated income statement and balance sheet, and concur with the Board of Directors' proposal for profit disposal.

Their term in the Supervisory Board ends this year for the following members: Seppo Hakola, Pertti Heinonen, Hannu Kainu, Martti Nevalainen, Heikki Olkkonen, Airi Raussi and Osmo Sikanen. Furthermore, a new member must be elected to the Supervisory Board to replace Reino Tapani, who has resigned before the end of his term.

Helsinki, March 19th, 1999

On behalf of the Supervisory Board

*Seppo Hakola*
Chairman

# Milk Procurement

There were 25,431 milk producers in Finland at the end of 1998. The year before that number stood at 27,395; 1,964 farms ended production. There were 17,491 milk producers in Valio Group at the end of the reporting year.

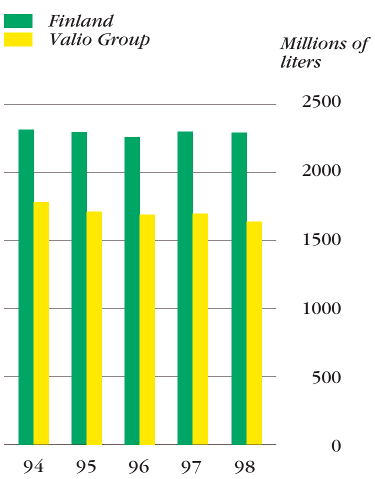
Valio Milk Pool handles milk procurement and sales to production plants. It draws up contracts and makes collection plans with the co-operatives for the volume and quality of the milk purchased. The Pool also sees that the milk is processed into products that guarantee owners the maximum return on their investment. Milk procurement data systems have been intensively developed for introduction in 1999.

The co-operatives supplied a total of 1,581 million liters (69 per cent of Finnish production) to the Milk Pool in 1998. Valio Group took delivery of a total 1,728 million liters, including milk taken in by units operating abroad.

The volume of organic milk supplied grew significantly in 1998; Valio Group took in 4.4 million liters.

The seasonal variation index (June/November milk volume ratio) stood at 111 per cent, compared with 110 per cent the year before. A 63 per cent share of Valio Group milk intake in 1998 was processed for the domestic market and 37 per cent for foreign markets.

VOLUME OF DAIRY MILK




# Member Relations

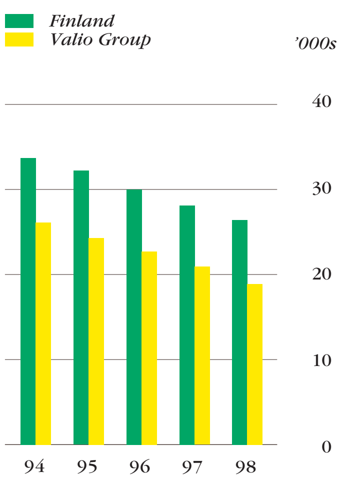
Farm Services and Member Relations handles relationships with the co-operatives, trains producers, offers expertise in silage production, feeding, cattle care and health, milking and milk handling at farms, and runs Valio regional laboratories.

Member relations were maintained as before through a producer magazine and bulletins. The co-operatives' training program "Know Valio" continued as in the previous year and many producers visited Valio in Helsinki.

Regional laboratory operations will be concentrated in Seinäjoki and Lapinlahti by the end of 2001; they are currently spread over four locations. The Laboratories Quality System was completed last year in accordance with the EN 45001 standard, while Farm Services' separate research activities were ended. Research, development and advisory services will in future be realized together with our main domestic and foreign interest groups; a research co-operation contract concerning these services was made with the Agricultural Research Centre of Finland, and Kemira Group. The same model will be applied later in other Farm Services development projects.

The quality of producers' milk measured by hygienic criteria was the highest ever. Animal drug residues were also reduced.

NUMBER OF MILK SUPPLIERS




The Farm Services advisory unit assisted dairy farms in their investment planning. The unit also advised on functional planning for farm buildings, and on the purchase of milk-handling equipment and silage systems. Advisory testing of milking machines and cutting-time analyses for silage also continued.

Five new projects were started around Finland to expand preventive healthcare work on bovine diseases, partly financed by local employment and business centers. Finnish animal protection organization Animalia awarded a Pro Animalia medal to Valio veterinarian Maria Tirkkonen.

*Valio cattle care is founded on preventive healthcare and respectful treatment of animals. Ethical values are an important part of the quality chain and a core value at Valio; the others are responsibility, the customer, innovation, learning, know-how and co-operation.*

# *Production Policy*

The EU country quota for milk production in Finland was 2,318.9 million liters for the quota year April 1st, 1997-March 31st, 1998. Milk production fell just a little short of the quota at 99.9 per cent and the country quota increased by 6.2 million liters for quota year 1998/99.

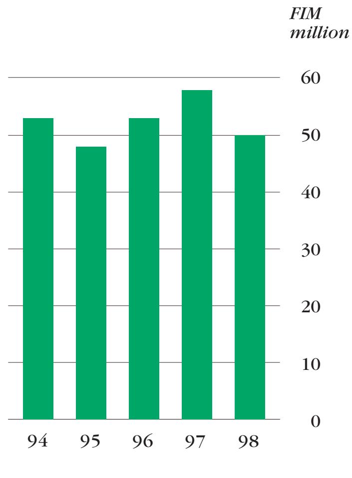
Trade in reference volumes, not including field cessions, was conducted through the administrative system at FIM 0.65 per liter. The producers can, however, sell half their reference volume at a self-determined price, if the other half is sold through the system. Prices in free quota trade varied from FIM 1.00-1.50 per liter in 1998.

Nationally financed transition period support was paid from the beginning of April 1998 at FIM 0.42 per milk kilo in Zones A and B and FIM 0.22 in Zone C. Support values were FIM 0.03-0.11 lower than the previous year. Support paid in January-March was lower than during the rest of the year, although this included FIM 0.02 compensation related to quotas being cut.

An Arctic subsidy of FIM 0.32-1.65 was paid in Zone C from the beginning of April to the end of the year. This was an increase over the previous year of FIM 0.06-0.07 per milk kilo. Like transition period support, the Arctic subsidy was also lower in January-March than in April-December.

The Finnish markka (FIM) exchange rate remained stable, so there was no change in the green rate last year. The WTO Agreement that replaces GATT caused problems in dairy exports early last year. Export subsidies had to be eliminated for milks, creams and fermented milk products with a less than 21 per cent fat content. Prior to this decision, there had been many hold-ups in the granting of export permits for these products and for whole-milk powders. Export subsidies otherwise remained unchanged or grew. The subsidy for skim-milk powder was raised twice because of the global market situation. Subsidies for cheeses exported to Russia were also increased as a result of the economic crisis in that country.

**GROUP RESEARCH AND DEVELOPMENT EXPENSES**




# *Research and Development*

Valio investment in research and development totalled FIM 50 million or 0.7 per cent of Group net sales in 1998. Valio's Product Development Center focuses on long-term strategic development projects and also offers special analytical services, expert services and sensory evaluations for product development purposes, by Valio product division.

R & D underwent extensive organizational reforms towards the end of the year. Even more was invested in nutrition research to test the probiotic bacteria and milk components used in functional foods. Lactic acid bacteria know-how is core area at Valio and this too was strengthened. Process technology projects developed both new functional food processes and techniques aimed at production cost savings.

As a part of its organizational reforms, Valio established a special unit for licensing its Lactobacillus GG probiotic bacteria and serving LGG customers abroad. LGG agreements are in force with 18 companies, and products containing LGG were launched in eight new countries during the year. LGG research was especially focused on finding curative effects on children's allergies, and positive evidence has already been collected.

The Tikkurila expansion was completed. This unit concentrates on the production of special microbes and capacity has doubled thanks to the investment. The use and production of T101 antibiotic test grew steadily and exports to regions in neighboring countries rose. Genetically modified T102 test has stabilized its position in quick testing of milk tanker loads in Finland.

The Technology Development Centre of Finland (TEKES) has provided significant funding for research and product development, and Valio is involved in four EU projects.

# Valio Fresh Products

Valio Fresh Products division manufactures and markets fresh products in Finland and abroad. As Finnish market leader, Valio promotes the success of the company and its customers' business by offering more value added products, and doing this in a profitable and competitive way.

Fresh products were manufactured at 12 production plants in Finland at the beginning of the year, falling to 10 at the end. The division is also responsible for subsidiaries in Sweden, Estonia and Lithuania.

Valio Fresh Products net sales totalled FIM 3,036 million in 1998 and capital expenditure stood at FIM 92 million, while personnel numbers averaged 861. All Valio dairies have an ISO 9002 certified quality system that will be expanded to ISO 9001 to cover Valio's entire business operation. ISO 14001 environmental systems are also under construction to complement the three production plants already certified that way.

Valio Fresh Products strengths lie in a group of well-known brands, a refrigeration chain that guarantees product freshness, and customer- and consumer-oriented operations. The key brands are Valio *maito* (milk), Valio *piimä* (fermented milk), *Valiojogurtti* (yogurt), *Gefilus* (LGG products) and *Tutteli* (baby foods).

Total milk consumption in Finland for 1998 declined by more than 2 per cent against the previous year, while the shift in consumption to low-fat and skim-milk products continued. Sales of Valio milks in Finland therefore decreased in an increasingly competitive environment. Consumption of fermented milks remained almost static and Valio's market share remained large, thanks in particular to strong sales of *Gefilus* fermented milk.

There was a decline in the overall consumption of creams due to the increased presence of substitute products. Valio lost market share as a result and sales decreased, but sales of other cooking and food services products remained at the previous year's level. Valio yogurt sales increased slightly over last year, although competition again tightened with a new manufacturer in the market. The total market continued to grow by volume. Fat-free yogurts were particularly successful, especially the new variety Valio *A jogurtti*.

Valio and French dairy co-operative Sodiaal established Yoplait Valio Nord Oy in 1997, which commenced operations at the beginning of 1998. This joint venture handles the marketing of Yoplait products in Finland and Yoplait Valio Nord Ab markets in Sweden.

The trend for falling consumption and sales of *viili* fermented milks continued from the previous year, as yogurts substituted for unflavoured products in particular. The most successful *viili* products were the flavoured varieties, especially *Viilis*. Ready-to-serve desserts were led by *Nami nami*, a product for children that exceeded its sales expectations. *Fanny* dessert sales fell short of targets. There were new competitors, especially in fromage frais desserts, but the total market grew very little.

*Tutteli* continued to be the undeniable Finnish market leader in milk-based baby foods, and total sales rose over the previous year. The fall in the birth rate in Finland cut demand for infant formula, but there was a clear increase in the consumption of ready-to-serve porridge and gruel.

Sales volumes of other than milk-based drinks remained steady from the previous year, although extremely tough price competition cut sales of orange juice, the major product item in this group. There was a clear increase in sales of a variety of value-added products, such as *Gefilus* and *Hedelmätarha* whey drinks. Sales of freshly squeezed *Tropicana* juices imported by Valio also rose. Sales of ready-to-serve berry and fruit soups developed favourably as in previous years.

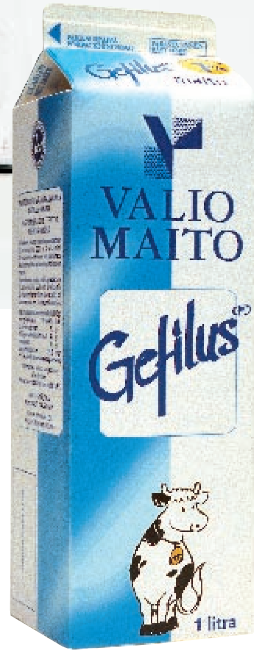
Product development led to the launch of Valio *kalsiummaito* enriched with 50 per cent more calcium than ordinary milk. *Gefilus* products continued their success story as sales grew by more than 30 per cent over 1997. The most important new products in this group were *Gefilus* fermented skim-milk and five-fruit juice. Valio cooking cream was the most notable new product for cooking and catering. In yogurts, Valio's new seasonal flavours gained great popularity. In snack products, Valio launched *Hillo Viilis* (fermented milk with jam) and *Nami nami* layered dessert.

For the juice market, Valio launched juices in WalkiCan portion packs and the *Grandi* series was expanded with e.g. a sugar-free version. *Hedelmätarha* was established as a product family when a new variety with added multiple vitamins was launched alongside calcium-fortified juice. In berry soups, a sugar-free blueberry soup was very well received.

The key export targets for Valio Fresh Products were Sweden, and northwestern Russia and the Baltic

States. Exports to Sweden and the Baltic States were slightly up on 1997 and exports from Finland to Russia declined towards the end of the year. Efforts will be made to strengthen the position of Valio branded products in these markets, with sales handled through Valio subsidiaries and by direct export to customers. The commencement of Yoplait yogurt exports to Sweden had a positive effect on fresh product sales to that country.

In Estonia, Valio Eesti AS continued to grow and Alma products manufactured by Tapila AS were a sustained success. The Alma product family was expanded to include e.g. milk in plastic pouches. However, the economic situation in Russia adversely affected Tapila during the latter part of the year. Valio founded UAB Valio International during the financial year, a new subsidiary in Lithuania.




THE SUONENJOKI JAM PLANT

The Suonenjoki jam plant manufactures and develops products primarily for the use of Valio divisions. The focus lies on berry and fruit preparations used in flavouring milk products, and on jams and marmalades for bakeries and the food services sector, where Suonenjoki leads the Finnish market.

Suonenjoki generated net sales of FIM 108 million in 1998, 11 per cent from non-Valio business. The plant employed an average of 98 people.


# Valio Cheese

Valio Cheese manufactures, develops and markets cheeses in Finland and at selected locations abroad. In addition to sales in Finland, the division also comprises subsidiaries in the United States and Belgium as well as representation in Moscow.

Valio Cheese has seven production plants in Finland. Belgian subsidiary Vache Bleue has its own cheese packing facility and American subsidiary McCadam runs production and packing plant. Following the structural development plan already underway, the decision was made to end production at Iisalmi in Finland during 1999 and continue production in Toholampi and Äänekoski for the time being.

All Valio Cheese production plants in Finland except Iisalmi run a certified ISO 9001 quality system. This covers product development, manufacture and marketing of cheeses, plus divisional administration in Helsinki. ISO 14001 environmental certificates have been granted to five plants and the system will extend to the Toholampi plant and divisional administration in 1999.

Valio Cheese net sales, including subsidiaries, totalled FIM 2,457 million at almost the same level as 1997. Capital expenditure, again including the subsidiaries, totalled FIM 79 million. Key investments were in production line development at Lapinlahti, Vantaa and Joensuu plant. Personnel numbers for the year averaged 1,150 of whom 860 were employed in Finland.

The cheese market overall in Finland grew by almost 5 per cent during the year under review. The most important segment, retail sales, increased some 6-7 per cent by value. Domestic sales of Valio Cheese also grew. Growth was heaviest in special cheese groups, demand for low-fat cheeses rose particularly strongly and Valio cheeses were highly successful in these product groups. *Polar 15* and *Oltermanni 17*, for example, are the best known low-fat cheese brands in Finland. Prices developed favourably due to the enhanced product range and profitability of cheese manufacturing improved. Increasing imports that already cover one fifth of total consumption further expanded the Finnish cheese market.

Success in foreign operations and sales had two key dimensions over the past year. On the one hand, exports to the West and subsidiaries operating in western markets developed steadily, but on the other, the economic crisis in Russia beginning in August caused demand for cheese there to contract almost completely. Strong prices in the US cheese market helped strengthen the position of *Finlandia Swiss Cheese* as one of the leading imported cheeses, and further improved McCadam's result. US business operations were split into two separate profit centers at the start of the year: McCadam Cheese Inc. and Finlandia Cheese Inc.

The market in Belgium remained relatively stable. Two Belgian subsidiaries were merged and operations concentrated under the name of Valio - Vache Bleue S.A. Russian sales records were broken for the main export products, Viola and Oltermanni, but the economic crisis there obliged Valio Cheese to adapt its operations as demand decreased to a fraction of its previous level.

Valio Cheese division owes its strength to market, customer and profit orientations allied with international expertise. Ongoing brand development programs were thus extended to further deepen market and customer alignment. Special attention was paid to low-fat items in developing product range and package sizes. Category management has now realized a number of concrete customer projects. Other development priorities at Valio Cheese included cost-effective production, operating processes, quality management and deliveries.


POLAR 15
Aamupala
ILVES
VALIO
VIOLA

# Valio Edible Fats and Ingredients

Valio Edible Fats and Ingredients develops, markets and sells edible fats, powders and value-added products. The division is characterized by its market responsiveness and a firm emphasis on profitability for Finnish and foreign customers alike.

Edible fats and ingredients were manufactured in five production plants in 1998. Edible fats manufacturing was ended at the Lapinlahti plant and production concentrated to Seinäjoki during the financial year. A decision was also made to end small-pack powder operations in Nastola and move them to Lapinlahti where whey product manufacture continues. All production plants have a certified ISO 9002 standard quality system and ISO 14001 environmental systems were certified at the Seinäjoki and Haapavesi plants.

Net sales for the financial year totalled FIM 1,467 million, dropping 7 per cent off target due to falling sales in Russia. Domestic sales accounted for 42 per cent of net, foreign sales the remaining 58 per cent. Capital expenditure during the financial year totalled FIM 41 million. Key investments were directed at developing milk powder and edible fats lines to better meet customer expectations. Divisional personnel numbers averaged 445, a drop of 18 people on the previous year. Valio sold subsidiary VBF Trading S.A. in Switzerland.

Valio Edible Fats core brands are *Voimariini*, *Voilevi* (butter blends), Valio *meijerivoi* (dairy butter), and *Midnight Sun* (dairy butter) abroad.

Domestic marketing in 1998 showed success. Sales of *Voimariini* and *Voilevi* in particular increased, and Valio *meijerivoi* held its ground reasonably well. In fact, Valio's market share of edible fat retail sales increased as a whole. Of the new products, HYLA low-lactose varieties of Valio *meijerivoi* and *Voimariini* performed particularly well.

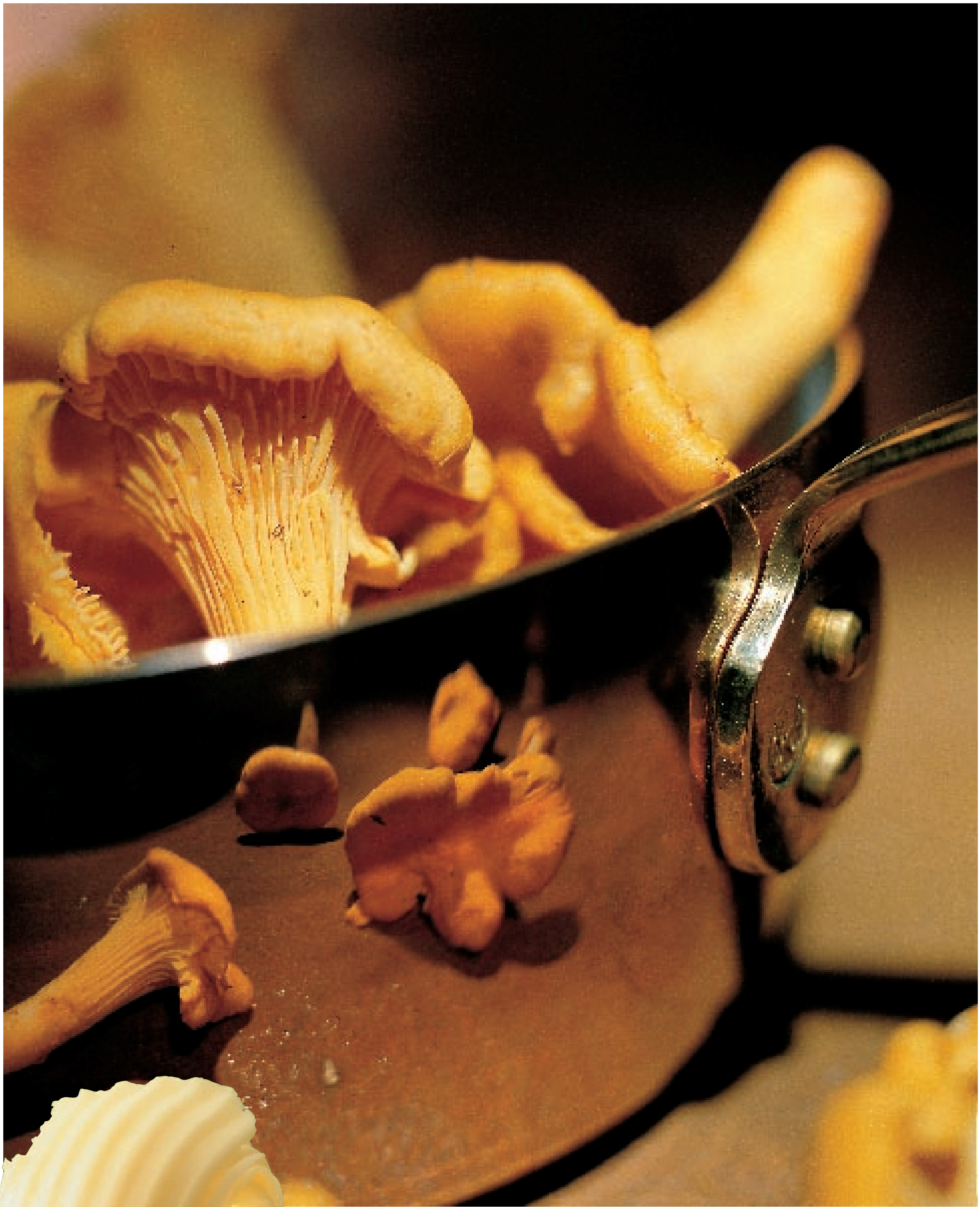
In domestic powder sales, competition in industrial products remained tight and prices low. Imports of milk powder grew and Finnish industries that use whey products moved some of their production and purchasing abroad. In retail products, sales of Valio *maitojauhe* (milk powder) rose on the previous year.

Foreign sales of edible fats declined by 1,600 tonnes from 1997. The Russian trade crisis arising in late summer slowed sales growth and indeed sales of more profitable products, although butter pat sales rose. The change in the Russian market situation has also clearly affected inventories and price levels in the EU internal market and other export countries.

Foreign sales of powder products grew by 2,000 tonnes. Sales volumes of milk powders, *Demi* (demineralized whey) powder and lactose nevertheless remained almost static year-on-year. Milk powder prices fell in 1998 and approached the EU intervention level. Milk-based blends were launched as a new product group.

The excess supply of lactose in both European and world markets saw prices fall over the previous year. Demand for whey protein powders continued to be strong. Sales of infant formulae did not develop as expected, again due to the Russian economic crisis. The new product launches were two special infant formulae, *Soya Tutteli* and *Peptide Tutteli.*

*Startti* silage held its position in the calf-milk replacers market.

# Valio Ice Cream

Valio Ice Cream manufactures its products for sale in Finland and neighbouring countries. Net sales totalled FIM 372 million in 1998 and capital expenditure stood at FIM 10 million. Personnel numbers averaged 235.

Valio Ice Cream expertise is well established and its extensive high-quality range of branded products is well known. Ice cream is manufactured at the Turenki plant, where emphasis on operational development has focused on a more demand-oriented and cost-effective model for logic and control systems. Valio Ice Cream division has been ISO 9001 quality certified for production, product development, marketing and export since 1994.

Valio Ice Cream retained its position as Finnish market leader in ice creams, although market share declined slightly. Valio's greater emphasis on impulse items and scoop ice creams meant poor weather in Summer, 1998 affected the company's sales relatively more than those of its competitors.

Annual ice cream consumption fell 5 per cent year-on-year, but the total value of the Finnish market declined further still. Indeed, a comparison is being drawn between two extreme summers in Finland – very hot in 1997 and very rainy in 1998. Sales in general retail outlets last year remained on a par with the year before, but fell more in kiosks and on petrol station forecourts, where ice cream is often an impulse buy.

Half of all ice cream is sold during the summer season and June-August 1998 saw ice cream consumption 17 per cent lower than the year before. Measured by value, the change was even greater because ice cream sales centered on take-home products. The rainy summer most adversely affected sales of impulse items and scoop ice cream that are important to profitability.

Take-home items increased their share of consumption for the third consecutive year. A 43 per cent share of total ice cream sales in 1995 rose to 53 per cent in 1998. Vanilla flavoured *Valiojäätelö* in a one-liter pack topped the "most bought ice creams in Finland" chart in Summer, 1998. As in previous years, the Valio *Pingviini* chocolate cone was top of the impulse category.

In addition to its annual variations and seasonal nature, the ice cream market is characterized by a rapid turnover in product range and a large raft of new products. So each year, more than one fifth of Valio product is new. Valio launched 27 new ice creams in Spring, 1998 and 6 new take-home items in the Autumn; the new products fared well.

Valio Ice Cream exported to Estonia and Russia in 1998. Export volumes decreased from the previous year, due to competitive pricing and the improved quality of local ice creams, as well as to the problems in the Russian market.

The Russian economic crisis also reflected on Valio's St. Petersburg subsidiary, whose net sales fell behind the previous year on declining export volumes in September-December. Nevertheless, exports continued uninterrupted and recovered little by little towards the end of the year. Valio delivers a wide range of products directly to retailers in St. Petersburg and Moscow from its Lappeenranta terminal.

# *Valio Domestic Sales*

Valio Domestic Sales division serves as the joint sales and distribution organization for Valio product category divisions and produces marketing-related services.

Valio divides Finland into nine sales and distribution areas. Some changes were made to this structure after milk-packaging operations ceased in Helsinki at the end of May, leaving warehousing for centrally distributed goods and a fresh products terminal in the Finnish capital. Domestic Sales offices are located in Helsinki, Turku, Tampere, Riihimäki, Kouvola, Seinäjoki, Jyväskylä, Joensuu and Oulu, and a distribution operation in Rovaniemi.

Operations in Tampere were shifted from the dairy to Lakalaiva at the beginning of June, where there is also a fresh products terminal. For sales alone, Finland is further divided into six areas serving the food services sector and three for industry. Riihimäki and Helsinki sales and distribution areas were united at the beginning of 1999.

The Domestic Sales retail organization was restructured on September 1st, 1998 by establishing a new Customer Relations unit. Staff handling both national and local customer relations was then concentrated there. As a result of the reorganization, local sales control can better meet the needs of the customer retail chains.

Division net sales totalled FIM 5,080 million and capital expenditure stood at FIM 39 million. Personnel numbers averaged 1,199 and staff increased somewhat due to internal transfers and temporary boundary changes.

The market situation for fresh products in Finland changed fundamentally with a new competitor entering the marketplace. Fresh products sales volumes reached their target but price levels fell off significantly. A small decline in market share combined with decreased consumption meant total sales volumes over all products were 4 per cent lower than the previous year, but 2 per cent above target. The continuing fall in sales volumes creates ongoing pressure to improve cost structures.

The priority in operations development lay in data systems related to customer profitability and customer and consumer feedback, as well as on making sales operations more effective and raising efficiency in the order-delivery process.

Competition will continue to be very tight this year, too, and especially in fresh products where the new competitor aims to grow market share significantly beyond its current level. In delivery contract negotiations, Valio's strong brands, sales know-how, long-term customer relations and reliable deliveries continue to be highly regarded and market share is holding up.


*Valio Viesti ski relay brings Valio together with the Finnish Ski Association to help build good skiing skills for children. How life is lived in adolescence can affect bone strength for life.*

*The Valio Viesti finale was skied in Jyväskylä in March, 1998.*

## GOOD FOOD FROM THE VALIO TEST KITCHEN

Valio's Test Kitchen produces new recipes for both the food services sector and domestic cooks. These are used in advertising, recipe leaflets, direct marketing campaigns and food services magazine *Ruokavuosi. Kodin ruokavuosi* consumer recipe club publishes a quarterly recipe magazine of its own. Both publications present tried and tested recipes from the Valio Test Kitchen.

The Test Kitchen produces validated information on the use of Valio products in cooking, including e.g. how milk products under development behave in cooking and baking. Tests produce findings on factors such as how products react to acidity and heat, how cheese is suited to melting etc. Finished products are sometimes tried and compared, too.

The Test Kitchen also arranges cooking courses for retailers and food services staff, as well as for Valio's own sales staff. Training events where people cook together using Valio products have proved particularly popular.

*Staff from the Euromarket/ Maximarket chain undertake cheese training.*

# *Valio Ltd Owners December 31st, 1998*

| Name | Domicile | Number of shares |
|---|---|---|
| Alavuden Osuusmeijeri | Alavus | 102 |
| Alueosuuskunta Promilk | Lapinlahti | 2,218 |
| Etelän Maitokunta | Vihti | 393 |
| Evijärven Osuusmeijeri | Evijärvi | 42 |
| Hirvijärven Osuusmeijeri | Jalasjärvi | 46 |
| Hämeenlinnan Osuusmeijeri | Hämeenlinna | 1 |
| Härmän Seudun Osuusmeijeri | Alahärmä | 82 |
| Iisalmen Osuusmeijeri | Iisalmi | 287 |
| Kainuun Osuusmeijeri | Kajaani | 898 |
| Kangasniemen Osuusmeijeri | Kangasniemi | 80 |
| Kauhavan Osuusmeijeri | Kauhava | 72 |
| Kaustisen Osuusmeijeri | Kaustinen | 1 |
| Keski-Pohjan Juustokunta | Toholampi | 1,271 |
| Keski-Suomen Maitokunta | Jyväskylä | 1,378 |
| Kiuruveden Osuusmeijeri | Kiuruvesi | 233 |
| Koilliskuntain Osuusmeijeri | Salla | 112 |
| Kortesjärven Osuusmeijeri | Kortesjärvi | 37 |
| Kuusamon Osuusmeijeri | Kuusamo | 265 |
| Kyrönmaan Osuusmeijeri | Isokyrö | 124 |
| Laaksojen Maitokunta | Ylivieska | 1 |
| Lammin Osuusmeijeri | Lammi | 113 |
| Liperin Osuusmeijeri | Liperi | 162 |
| Nilsiän Osuusmeijeri | Nilsiä | 288 |
| Nurmeksen Osuusmeijeri | Nurmes | 626 |
| Osuuskunta Idän Maito | Joensuu | 2,877 |
| Osuuskunta Lapin Maito | Rovaniemi | 584 |
| Osuuskunta Maito-Aura | Turku | 1,571 |
| Osuuskunta Maitojaloste | Seinäjoki | 2,588 |
| Osuuskunta Maitokolmio | Toholampi | 244 |
| Osuuskunta Maitomaa | Suonenjoki | 290 |
| Osuuskunta Maito-Pirkka | Tampere | 1,616 |
| Osuuskunta Normilk | Jyväskylä | 5 |
| Osuuskunta Pohjolan Maito | Haapavesi | 2,980 |
| Osuuskunta Satamaito | Pori | 348 |
| Osuuskunta Tuottajain Maito | Riihimäki | 7,250 |
| Paavolan Osuusmeijeri | Ruukki | 32 |
| Tyrnävän Osuusmeijeri | Tyrnävä | 1 |
| Vieremän Osuusmeijeri | Vieremä | 99 |
| Shareholders, total 38 | | 29,317 |
| Total Share Capital | | FIM 586.34 mill. |

# *Valio Group and Owner Dairies*

Net Sales and Personnel, 1998

| | Net sales FIM million | Personnel Dec. 31, 1998 |
|---|---|---|
| **Valio Ltd** | 6,925 | 3,831 |
| **Valio Ltd Subsidiaries** | | |
| McCadam Cheese Co., Inc. | 441 | 173 |
| Valio - Vache Bleue S.A. | 326 | 102 |
| Finlandia Cheese Co., Inc. | 109 | 8 |
| Valio Sverige AB | 63 | 26 |
| Valio Eesti AS | 59 | 16 |
| Tapila AS | 38 | 57 |
| VBF Trading S.A. | 15 | 0 |
| ZAO Valio St. Petersburg | 14 | 29 |
| Valio Engineering Ltd | 13 | 25 |
| Valio International Middle East SAL | 0.1 | 1 |
| UAB Valio International | 0.1 | 2 |
| **Valio Group, total** | 7,605 | 4,270 |
| **Owner dairies** [1)] | | 373 |

[1)] Shareholder dairies that have marketing contracts with Valio, and other co-operative dairies

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VALIO