




FROM BEIJING TO BUDAPEST

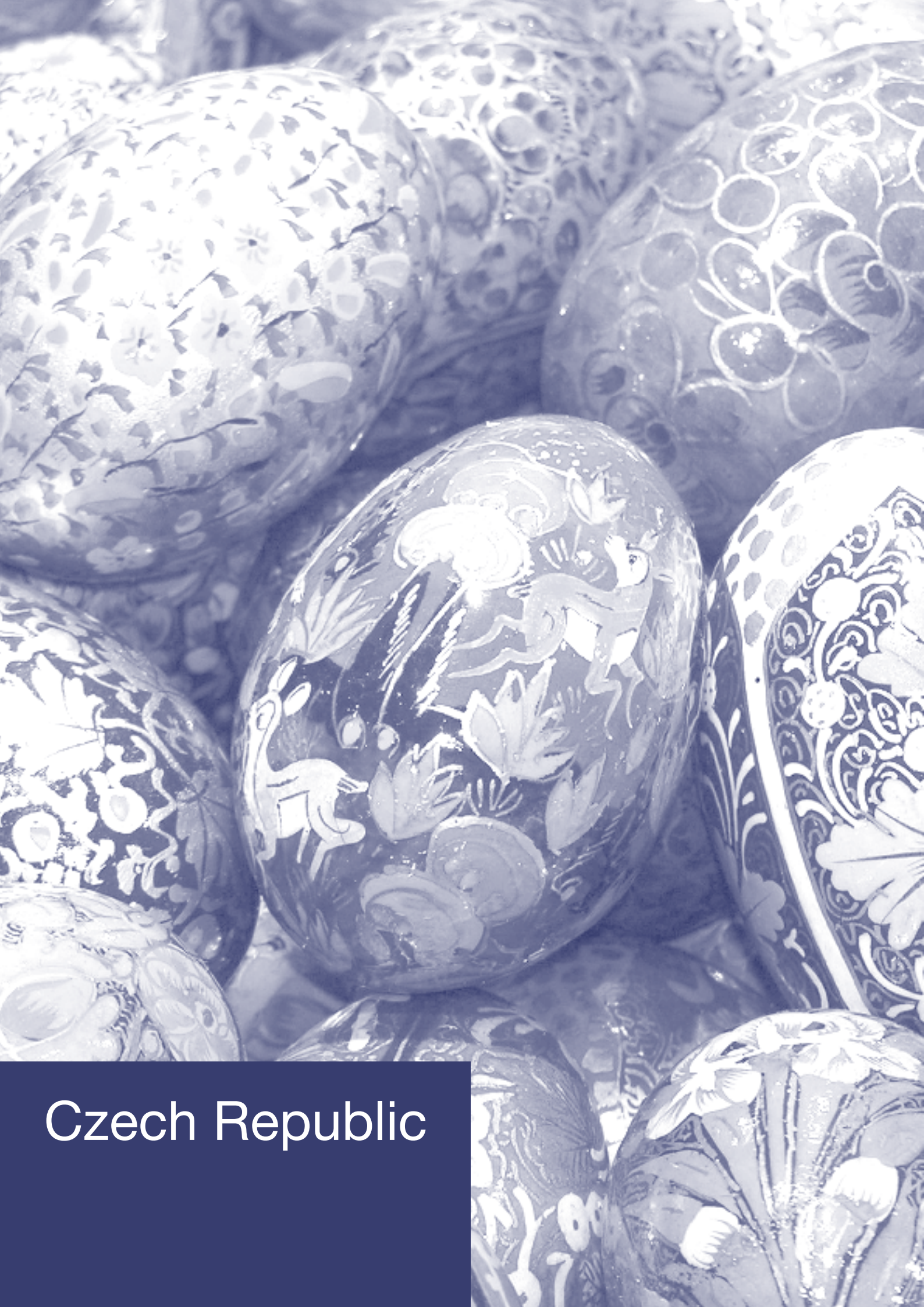
Winning Brands, Winning Formats*

2005/2006

4th Edition

*connectedthinking

PRICEWATERHOUSECOOPERS 



Czech Republic

Czech Republic

ECONOMIC OVERVIEW

GDP and CPI

The Czech Republic's GDP growth rates have been gradually increasing since 2002. The low inflation rates are the result of low production costs, low food prices due to the pressure of retail chains on suppliers and the strengthening of the Czech crown, which led to decreased import prices.

Exceptionally low CPI in 2003 was underpinned mainly by falling prices for food and clothing. The 2004 increase was influenced by the transfer of certain items (especially services) from the reduced 5% to the standard 19% VAT rate and increases in regulated prices of services and utilities.

GDP and CPI

	2001	2002	2003	2004
GDP growth (%)	2.6	1.5	3.2	4.4
CPI (%)	4.7	1.8	0.1	2.8

Source: EIU, August 2005

Unemployment

The average annual unemployment rate rose from 6% in 1998 to almost 10% in 2003-04. This negative trend may be attributable to the pressure on productivity growth following the strengthening of the Czech crown and growing market competition.

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	8.6	9.2	9.9	9.8

Source: EIU, August 2005



Area ('000 sq km)¹: 78.87
(US 9,600 – EU25 3,981 – World 133,700)

Capital¹: Prague
(Number of inhabitants: 1.2 million)

Population (million)³: 10.2
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)³: 107.0
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)¹: 7,150
(US 37,870 – EU25 22,810 – World 5,110)

Currency: Czech Koruna (CZK)

Languages: Czech

Main religions: Roman Catholic, Protestant, Orthodox

Government type: Parliamentary democracy

Sources: CIA Factbook; (1) World Bank 2005; (2) City Population;
(3) Economist Intelligence Unit 2004 data

Economic forecasts

The economic forecast for key economic indicators is generally positive. The GDP growth for 2005-07 is expected to be higher compared to 2002-04 and to exceed 4% each year. The CPI is estimated to stay around 2%. After its peak in 2005, the unemployment rate is expected to fall in 2006 and future years.

Key economic forecasts

	2005	2006	2007
GDP growth (%)	4.3	4.5	4.5
CPI (%)	1.8	1.8	1.7
Unemployment rate (%)	9.6	9.0	8.4

Source: EIU, August 2005

REGULATORY ENVIRONMENT

Foreign direct investment

The Czech Republic is one of the most attractive countries with a transitional economy for foreign investors. Following the privatisation of former state-owned companies subsequent to 1990 and the introduction of investment incentives in 1998, the country has enjoyed a massive inflow of FDI, primarily from Germany, Japan, the United States and France, as well as from many other countries.

In 1998, the Czech Government introduced an investment incentives scheme for manufacturing companies which was extended further for strategic services in the telecommunication, software development and shared service centres sectors in 2000.

Although there are no import declarations for goods coming from EU countries, there are new requirements for submitting reporting and compliance documentation when goods move between two member states: EC Sales Lists and Intrastate returns.

Retail price differences between EU member states still remain. As a result, shopping malls were opened near the Czech-Austrian border aimed at influencing consumer spending in the less expensive Czech economy. Price differences in certain retail segments are also expected to affect movements of goods, even between the Czech Republic, Poland and Slovakia (similar to the situation in certain areas of Western Europe).

FDI

	2001	2002	2003	2004
FDI (CZK bn)	110.00	208.15	46.95	99.72
FDI (USD bn)	4.92	9.31	2.10	4.46

Source: EIU, August 2005 (Exchange rate: 31 December 2004)

Impact following EU entry

Competition in the Czech market following entry into the EU on 1 May 2004 has increased, while the integration of the Czech economy with the EU has created an excellent opportunity for Czech producers to enter foreign markets.

There are no customs controls or duties among member states, and when trading with non-EU states, EU customs duties and quotas apply. E-invoicing is generally accepted within EU countries. There are more goods and services subject to the standard 19% VAT rate, rather than to the reduced rate of 5%.

Property/Real estate regulations

The Czech property market is very attractive for foreign investors, and the retail property market has become rather dense in and around the large cities. A greater number of large international and Czech developers are in search of sites to establish new retail, business, industrial and logistic parks. New developments are subject to the zoning resolutions of municipalities, an Environmental Impact Assessment (EIA) and building permits, and may encounter difficulties with civic groups in certain areas and industries. Protests from civic groups may result in delays obtaining zoning and building permits, municipalities may refuse to approve building permits and companies may have to invest in "community projects" in exchange for building permits.

Any company registered in the Czech Republic may acquire real estate without any limitations. Foreign companies are also permitted to hold real estate through a Czech branch. Purchases or transfers of real estate must generally be registered with the relevant Land Registry.

The real estate transfer tax is 3% of the selling price or the officially assessed value, whichever is greater, and is paid by the seller. An annual real estate tax is levied on land and buildings, although this is generally low.

Other regulations

Competition Law

Compliance with competition legislation (Act on Protection of Economic Competition) is monitored and institutionally secured by the Office for the Protection of Competition. The Office's activities are focused mainly on monitoring and controlling activities in the following areas: state aid monitoring, public procurement and the effort to introduce more severe punishment methods for serious violations of the Competition Act.

Tax

In 2004, the corporate income tax decreased from 31% to 28%. Further reductions (to 26% in 2005 and to 24% in 2006) have been already approved. There is no special corporate income tax applicable with respect to retail entities.

VAT

Czech accession to the EU has impacted Czech VAT rules and procedures, as EU directives and regulations now apply. The current standard VAT rate is 19% and applies to most goods and services; a reduced rate of 5% applies to certain services and essential goods.

Store openings

There is no specific legislation over shop trading hours, days of operation or price surveillance. Unlike retailers in many Western European countries, most Czech retailers

operate seven days a week. Some shops are even open 24 hours a day.

Czech Parliament has recently rejected a bill to restrict the opening hours of large retailers. The bill proposed limiting daily opening hours for retailers with a floor area of 200sq m from 6:00am to 10:00pm and restricting the stores' public holiday opening hours. The bill's sponsors argued that working conditions in large retail chains are bad and that limiting opening hours would give smaller retailers a chance to compete.

Specific measures

Czech Parliament has recently approved a significant amendment to the Excise Act. The new Act raises the excise duty on cigarettes and other tobacco products by roughly 10%, with additional tax hikes of around 10% planned for 2006. The new Act also allows persons registered in other EU member states who deliver or receive goods subject to excise tax in the Czech Republic to operate via a local tax representative, who can now operate a tax warehouse for such persons. The Czech warehouse keeper can make excise tax securement payments on behalf of the other party and can handle all other administrative requirements, which will greatly facilitate the transfer of goods subject to excise duty to/from the country.

Starting 1 July 2005, a new Law obliges producers, importers, and packagers of spirits with an alcohol content of 15% or higher to ensure their products are properly labelled with a new spirits stamp. The measure applies to packaged beverages intended for final sale in the Czech Republic.

Retail stores and restaurants will be required to use electronic cash registers with a fiscal memory beginning in 2007. The measure is aimed at battling the grey economy.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Population

	2001	2002	2003	2004
Population (m)	10.2	10.2	10.2	10.2

Source: EIU, August 2005

Population by age group

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	17.2	15.4	13.7
15 – 64 years	69.1	70.6	71.1
Over 65 years	13.7	14.0	15.2

Source: EIU, August 2004

Urbanisation of the population

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	74.6	75.0	75.5
Rural	25.4	25.0	24.5

Source: EIU, August 2004

Income/Buying power

Monthly average income, expenditure and savings rate

Monthly average (CZK)	2001	2002	2003	2004	2003-04 (%)	1Q05
Income	8,815	9,084	9,563	10,000	4.6	10,137
Expenditure	8,325	8,561	9,002	9,316	3.5	8,778
Saving	490	532	561	684	22.0	1,359

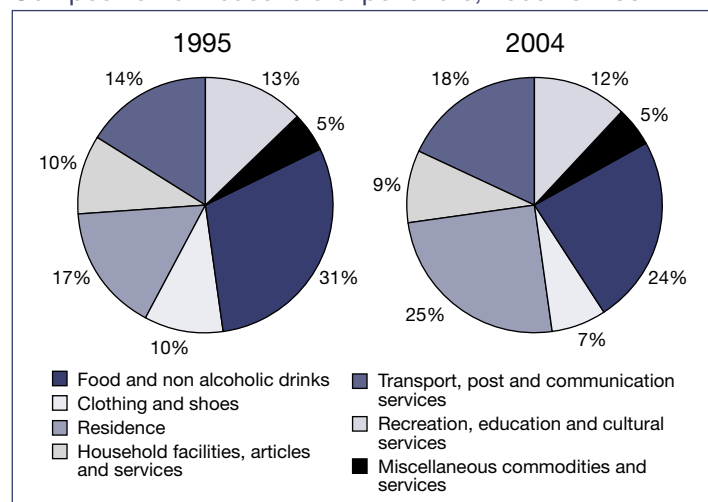
Source: Czech Statistical Office

Consumer behaviour

Average household spending patterns

Household spending has continued to grow at a solid pace and consumer confidence has been high, despite the subdued labour market. Increases in household wealth, together with increases in income, the boost to spending power from lower interest rates and easier access to credit have underpinned the growth in consumption.

Composition of household expenditure, 1995 vs. 2004



Lifestyles/Shopping habits

Expansion of retail chains on the Czech market has significantly changed consumer behaviour. Consumers tend to prefer shopping for food and consumer goods in large shopping centres and, as a result, small shops' profits are consistently decreasing. The behaviour of a Czech consumer is now similar to that of a Western consumer.

After dramatic changes in the retail structure in the past years, the market position of individual retail formats is stabilising and the shopping preferences of Czech consumers are becoming more distinct.

One of the main trends is the differentiation of shopping behaviour, which can be analysed using three main factors: price sensitivity, mobility (cars enable big purchases) and demand for comfort in-store. Advertising, publicity and promotional leaflets affect only a portion of the customers. For example, the most challenging hypermarket customer has a reserved attitude towards such promotional materials; advertising the price level could have the opposite affect, de-motivating customers.

According to research done by Incoma Research, about 75% of Czech families are loyal to one shop. The most loyal are customers of hypermarkets, followed by those of small shops. Hypermarkets continue to represent the main

sector for food purchasing for 35% of Czech households. On the other hand, the trend of decreasing utilisation of supermarkets has stopped; about one fifth of Czech families prefer to shop in supermarkets. Discounts are popular with 22% of Czech households. The rest of the population (23%) is loyal to small self-service shops and counter shops.

The main criteria for Czech consumers in choosing a store are: type of shop (hypermarket, supermarket, discount etc); availability of fresh goods; discounts/special offers; queues; availability of parking; long opening hours; and pleasant staff.

RETAIL & CONSUMER SECTOR PERFORMANCE

Major consumer goods players

Most consumer goods production segments in the Czech Republic are dominated by multinational companies that invested large amounts of capital into local production capacity over the previous decade, gradually taking over traditional Czech production.

Group	Sector
Coca-Cola Beverages	Beverages
Danone	Food
Kimberly-Clark	Health and hygiene products
Madeta	Milk, milk products
Nestlé	Food
Nowaco	Food
Philip Morris	Tobacco
Procter & Gamble	Household, health and beauty care products
SABMiller (Pilsner Urquell)	Beer
Unilever	Food, cosmetics

Food & beverages

Food and beverages represent a traditional manufacturing industry for the Czech Republic.

During the 1990s many large multinational food groups, such as Nestlé, Danone and Unilever, either built their manufacturing facilities in the Czech Republic or bought traditional local producers from the government. In certain segments of the food market, however, local groups,

such as Hamé, Madeta, Nowaco, Emco, managed to maintain or increase significant market share and are often expanding into other countries in the region.

One of the leading sub-industries in the Czech consumer goods sector is beer production. Czech beer brands are world famous and beer production has a very long tradition in the country. In 2004, the country had 48 breweries producing 18.75 million hectolitres (hl) of beer under 362 brands. Total beer production increased by 0.25 million hl compared to 2003. Beer export in 2004 increased by 24% compared to 2003, reaching 2.60 million hl. Most exports were directed to Germany, Slovakia, Hungary and the United Kingdom.

The key players in the Czech beer market remain relatively stable. They are SABMiller with 8.4 million hl production (brands Pilsner Urquell, Radegast, Gambrinus), InBev (2.9 million hl, brands Staropramen, Branik, Ostravar), state-owned Budejovický Budvar (1.1 million hl), PMS Prerov (1.0 million hl, brands Holba, Litovel, Zubr), Drinks Union (0.9 million hl, brand Zlatopramen), Heineken Group (0.8 million hl, brands Starobrnno and Hostan) and Dr Oetker (Krusovice brewery).

The mineral and table water production is another important segment in the Czech Republic. Decrease in domestic consumption by 11% in 2004 compared to the previous year is being attributed to a relatively cold summer. Statistics show that three quarters of the Czech population consumes bottled water. The mineral and table water market has been dominated by companies such as Karlovarske Mineralni Vody (brands Mattoni, Magnesia and Aquila), Podebradka, Hanacka Kyselka, Karlovarska Korunni Kyselka, Coca-Cola Beverages (brand Bonaqua), and HBSW (brand Dobra Voda) etc.

Electronics

Production of electronic goods became one of the fastest growing industries in the country after the change of political regime in 1989. The mixture of originally inexpensive but qualified labour, investment incentives in the form of tax relief and availability of made-to-measure manufacturing sites attracted a number of large multinational manufacturers. The most important producers of consumer electronics are Japanese Matsushita Electronic, Siemens, Tyco/AMP, LG Electronics, Philips, Honeywell and ETA.

Consumer products manufactured in the Czech Republic include TV sets, mobile phones, plasma screens, automobile audio systems, air-conditioning systems, cooking and cleaning appliances, and DIY tools such as electric drills.

Clothing

In 2004, textile industry revenue decreased by 4% compared to the previous year. Chain stores' buying power and competition from cheap Asian imports pushed domestic manufactures' sales prices and sale quantities down. Czech producers sold 35% of their 2004 output on the domestic market where the decrease was particularly visible. Export sales (mainly fashion garments, underwear and outdoor clothes) were relatively consistent with the prior year.

The major local suppliers are OP Prostějov, producing a wide range of textiles, and smaller- and medium-size producers concentrating on niche markets such as Blazek Praha (men's fashion), pietro filipi (men's and women's fashion), JITEX Písek (garments made from yarns and knitted fabrics), TONAK (headwear), and OTAVAN (work and fashion garments).

Market shares by retail channels – food only

(%)	Hypermarkets	Supermarkets	Discount stores	Convenience stores	Other formats
2004	35	20	22	20	3
2003	37	19	19	18	7

Source: Shopping monitor 2004/2005 (Incoma Research, GfK Praha)

Major retail players

Retail sales

Competition in the Czech retail market has been increasing over recent years. It is expected that the market is reaching saturation in certain segments, and growth or expansion of one of the key players will be possible only at the expense of another. The trend in increasing popularity of modern retail formats, offered to Czech customers by international chains, and decreasing popularity of smaller shops continued in 2004.

Total retail sales growth

	2002	2003	2004
Total sales excl. VAT (EUR m)	21,718	21,729	23,908
Growth rate (%)*	6.5	0	10.0

Source: Czech Statistical Office, Czech Ministry of Industry and Trade

Breakdown by number of stores

Number of stores	Hypermarkets	Supermarkets	Discount stores
2004	160	520	405
2003	145	515	358

Source: Shopping monitor 2004/2005 (Incoma Research, GfK Praha)

Key food retailers

Ranking 2004 (2003)	Group name	Store brands	Retail formats	Number of stores	2004 Sales (EUR m, incl VAT)
1 (1)	Makro (Metro)	Makro	Cash and carry	11	1,282
2 (2)	Ahold	Albert, Hypernova	Supermarkets Hypermarkets	184 47	1,161
3 (3)	Schwarz	Kaufland, Lidl	Hypermarkets Discount stores	57 96	1,159
4 (4)	REWE	Billa, Penny Market	Supermarkets Discount stores	71 151	782
5 (5)	Tesco Stores	Tesco	Hypermarkets Department	19 6	705
6 (6)	Globus	Globus, Baumarkt	Hypermarkets DIY	10 2	638
7 (7)	Tengelmann	Plus, OBI	Discount stores DIY	113 17	634
8 (9)	Carrefour	Carrefour	Hypermarkets	10	369
9 (10)	Spar	Interspar, Spar	Supermarkets Discount stores	17	369
10 (8)	Delhaize	Delvita, Delvita City Proxy, Sama	Supermarkets Convenience stores	76 21	336

Source: Incoma Research, Incoma Research estimates

Key specialty stores

Retail formats	Store brands	Number of stores (2004)	2003 sales (EUR m)
1. DIY	Obi	17	168
	Baumax	21	150
	Hornbach	4	86
	Bauhaus	5	n/a
	Mountfield	50	58
2. Furniture	Ikea	5	82
	Sconto	4	34
	Asko	7	31
	Europa Möbel	3	30
3. Electronics	Okay	45	81
	Datart	16	53
	Electro World	5	27
4. Clothing & shoes	Bata	69	66
	Kenvelo	62	32
	Adidas	6	32

Source: Albertina CZ, Dun and Bradstreet, Moderni Rizeni, CTK (Czech Press Agency) and annual reports

Food retail channels

Hypermarkets

After years of rapid expansion, the hypermarket retail channel witnessed stagnation in 2004. Despite the slight decrease in format preferences, hypermarkets retained their top position in sales of high turnover products.

In the Czech Republic the penetration of hypermarkets is the highest in the Central European region. There are 16 hypermarkets per million inhabitants in the Czech Republic, compared with 14 in Slovakia, 8 in Hungary and 5 in Poland.

Supermarkets

The position of supermarkets as a retail channel was stabilised in 2004. In preceding years their position had been decreasing at the expense of the growth in hypermarkets.

Discount stores

Discount stores are targeted by price-sensitive shoppers. This retail format is the most popular in towns with populations from 5,000 to 20,000 citizens. Discount stores operating on the Czech market include Penny Market, Plus, Kaufland, and, from June 2003, the German chain Lidl, which was the most rapidly expanding retail chain in 2004. The popularity of discount stores is expected to continue to grow.

Convenience stores

Convenience stores are a retail channel popular with customers mainly due to the proximity to their homes. These stores do not offer a wide range of products and charge higher overall prices than other formats, but their location, opening hours and amiability of staff won 20% of all retail food sales in the country in 2004, which is 2% better than 2003.

Specialty stores

The non-food retail market is relatively less concentrated. The 15 largest retailers of non-food products take up only about 20% of total revenue, while the large retail chains clearly dominate the food and beverages market. According to research carried out by Incoma Research and GfK, the trend of concentration of non-food retail market continues but at a much slower pace than in the food and beverages sector.

DIY

From 1995 to 2000, multinational DIY chains significantly expanded in the Czech Republic. After 2000 the expansion slowed. The majority of the key players on the Czech market now focus on middle-sized and smaller towns. The largest DIY retailers operating in the country are Baumax, Hornbach, Bauhaus and OBI. Local chain store Mountfield specialises in garden machines and swimming pools.

Furniture

There are about 2,000 furniture stores in the Czech Republic. Alongside a large number of small local shops there were four large multinational chains competing for 10 million potential customers – Swedish Ikea and German groups Sconto, Askö (Firmengruppe Bozkurt) and Europa Möbel. Some local furniture producers developed small networks of their own retail outlets. In June 2005, Austrian group Leiner/kika entered the market and opened its first large store in Prague. The group intends to launch another store by the end of 2005.

Consumer electronics

Fierce competition is typical in the consumer electronic market. Companies go beyond simple price cutting and use a whole range of marketing tools such as favourable credit terms, innovative distribution channels (e-shops), leaflet promotion etc. Some companies have not been able to withstand the competitive pressure and withdrew from the market or declared bankruptcy, including Greek chain Electrocit, which closed all of their 16 shops in early 2004.

The consumer electronics market has been undergoing a phase of consolidation. The major retail chains operating in the Czech Republic are Datart (Kesa Group), Electro World (Dixons) and Okay. It is estimated that approximately 75% of total consumer electronic sales are generated in specialised retail outlets, the remaining 25% in hypermarkets and other non-specialised retail formats. The size of the market has grown with the disposable income of Czech households. In addition, strengthening of CZK against USD in recent years had a favourable impact on prices and encouraged consumers to buy.

Clothing and shoes

The clothing and shoes retail market in the Czech Republic is much less concentrated than other segments. The 15 largest retailers (being 6 hypermarket formats and 9 specialised store chains) control approximately one quarter of the segment sales.

A major identifiable trend is a steep increase of small retail outlets in shopping malls, which have become a popular place for leisure shopping. The number of such outlets increased from 960 shops in the beginning of 2003 to 1,300 in March 2005.

Czechs prefer to shop in specialised stores when supreme quality is sought, for example business clothing and specialised sports clothing. Casual daily apparel and children's wear are often bought in super- and hypermarkets, or indoor and outdoor market places.

Major specialised clothing and shoe retailers are Bata, Adidas, Kenvelo, OP Prostějov and H.I.S. The largest sales of clothing and shoes in hypermarkets have been achieved by Tesco, Kaufland and Carrefour.

E-commerce

According to the research of Factum Invenio carried out in January 2005, 16% of Czechs aged 15 years and older have personal experience with purchasing via the internet. However, only 4% had used the internet to purchase consumer products more than five times.

A few years ago, a typical internet customer was a university educated young male. Nowadays the customer base includes a much wider range. Identifiable trends are widening of the age spectrum of internet customers and an increasing percentage of e-shopping women.

The volume of internet sales is growing proportionally with the spread of the internet and its availability to the general public. According to a Czech Statistical Office release on 4 May 2005, the number of Czech households with a computer grew from 25% to 30% last year, while only some 19% have access to the internet from their homes. Compared to the EU, where some 42% of households are connected to the web, the Czech Republic is still far below the average.

Despite leading internet sellers not reaching the quantities comparable to traditional stores, their sales are growing at a much faster pace than super- and hypermarkets.

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

Consolidation of the retail market

Some analysts believe that the number of large chains in the Czech Republic exceeded the capacity of the domestic market and further consolidation of the market in the near future is possible for longer-term sustainability. The share of the top-five retailers in the Czech Republic is 45%, which is significantly less compared to the majority of Western European countries (e.g., in Austria the share of the top-five retailers is 73%).

Besides the consolidation of the existing retailers in the Czech market, many experts expect the entry (through acquisitions) of such retail giants, as Wal-Mart or German discount chain Aldi.

Pressure from regulatory bodies

Increasing calls for stricter regulation of the opening hours in hypermarkets and department stores resulted in a draft law being discussed in the Czech Parliament in 2004 and 2005. The proposal suggested opening hours in all stores with a shopping area over 200sq m should be limited to 6:00am to 10:00pm, but was not accepted. As a result, there is no law or regulation limiting opening hours. Pressure from labour unions and certain political parties in the future can be expected, but are unlikely to result in greater regulation. Opinion polls carried out in the Czech Republic showed that Czech consumers and the general public are against any restrictions to opening hours in large stores.

Opportunities

Retail brands

There is still large potential for retail brand products in the Czech Republic. The share of products sold under the store label in the Czech Republic (6% in 2004) still lags significantly behind Western European countries.

Retail brands allow chains to distinguish themselves from the competition and improve customer loyalty. The usual strategy is to increase the product range of own labels to cover all price segments from cheap to supreme quality products. The focus is, however, placed on low-price goods.

Quality expectations

Shopping centres, especially in large cities, need to focus on quality development aspects. Customers prefer those shopping complexes, which in addition to a hypermarket, include varied shopping, restaurants and entertainment facilities.

Focus on non-food retail and smaller cities

The food retail chains' expansion and revenue increases have slowed as the market, especially in certain segments and areas, is becoming saturated. The focus is on non-food retail, such as specialty chains selling fashion, shoes and furniture. Hypermarkets have already started adapting to this trend by changing their position of non-food goods from being purely supplemental to being equally focused.

Increased interest in building new stores in areas that have previously been ignored has been noted since 2003. Both hypermarkets and supermarkets are being built in smaller versions to make it feasible to operate in smaller cities and towns.

Emerging trends

Increasing portion of discount sales formats and smaller hypermarkets

There is a trend towards further expansion of the discount sales format and small hypermarkets (at the bottom limit of hypermarket format recognition).

Several retail chains are now building new hypermarkets and supermarkets in smaller versions to make it feasible to operate in areas with a smaller number of customers or in city centres (e.g., Delvita City).

Multifunctional shopping centres

The number of multifunctional shopping centres, offering facilities such as multiplex cinemas, restaurants, leisure activities and petrol stations, alongside core retail activities, has increased significantly. While the largest number of such projects has been completed in Prague, the trend has started to catch on in other cities. New shopping centres are not only being built on the outskirts of large cities, but also in city centres.

Increasing importance of internet sales

It is estimated that online shops in the Czech Republic posted sales of over EUR169 million in 2004, up by nearly two-fifths year-on-year. The internet is the fastest growing distribution channel and is experiencing a widening of age spectrum and an increase of female users.