16 February 2007

Finland Post Corporation
Board of Directors' Report for 2006

Business Environment

Economic growth remained strong in Finland Post Group's market area, which contributed favourably to demand for the Group's services in Northern European countries.

European postal operators are facing radical changes in their business environment and business concepts. Accordingly, declining letter mail volumes spurred by the adoption of electronic communications and data transfer are forcing postal operators to seek growth through marketing communications, logistics and new businesses such as information logistics. Liberalising the EU postal market will open up the industry's value chains and attract new mail delivery operators. On the other hand, postal operators are tending to seek a new, firmer position in customers' value chains. The postal market will see greater service offerings, fiercer competition and stronger price pressures.

The EU postal market will undergo deregulation. The European Commission has issued a proposal for a directive aimed at opening up postal services to full competition from early 2009. Finland deregulated its postal market as early as 1991. The privatisation of national post offices has provoked debate in several European countries.

Logistics is becoming the other cornerstone of business for a growing number of postal operators. Demand for logistics services will rise as a result of growing goods flows between Asia, Eastern Europe and other growth zones. Customers are requiring services on a more global basis while outsourcing increasingly longer supply chains. The importance of ICT in logistics services is on the rise.

Net Sales and Profit Performance

Finland Post's consolidated net sales for 2006 rose by 15 per cent, to EUR 1,550.6 million (EUR 1,348.2 million in 2005), company acquisitions accounting for 12 percentage points of this growth. Finland represented 6 per cent and other countries 65 per cent of Group growth. Of consolidated net sales, 23 per cent came from outside Finland. All of the three business groups showed growth.

Consolidated operating profit decreased by 9 per cent, to EUR 89.0 million (97.8), accounting for 6 per cent (7 per cent) of consolidated net sales. Due to the transfer of Finland Post Pension Fund's pension cover, a total of EUR 56.4 million was recognised in the 2005 income statement and EUR 12.6 million in expense provision to be transferred to the Foundation for Wellbeing at Work. In addition, 2005 saw recognition of EUR 32.3 million in Information Logistics' goodwill impairment allocated to German and Scandinavian operations. Consequently, operating profit for 2005, excluding the abovementioned items, totalled EUR 86.2 million, representing 6 per cent of net sales. Favourable developments in the parcel business contributed to the improvement in like-for-like operating profit.

Consolidated profit after financial items amounted to EUR 94.4 million (103.7). Current tax totalled EUR 26.7 million and consolidated net profit totalled EUR 67.7 million (64.0). Return on equity stood at 10.1 per cent (10.0 per cent).

Finland Post Group's business groups – Mail Communication, Information Logistics and Logistics – form the primary segment reporting format under IFRS. Not allocated to these segments, costs resulting from Group management and centralised support functions are presented under other Group functions.

Key Figures and Ratios

	2006	2005	Change
Net sales, EUR million	1,550.6	1,348.2	+15
Operating profit, EUR million	89.0	97.8	-9
Operating margin, %	5.7	7.3	
Comparable operating profit, EUR million	89.0	86.2	+3
Profit before tax, EUR million	94.4	103.7	-9
Return on equity, %	10.1	10.0	
Equity ratio, %	65.1	63.5	
Gearing, %	-32.1	-34.3	
Average personnel	25,294	24,624	+3
Gross capital expenditure, EUR million	69.5	143.0	-51

Mail Communication

Mail Communication improved its net sales by 2 per cent, to EUR 841.7 million (825.7), due primarily to favourable developments in Press Distribution services.

Letter mail volumes fell at a quickening pace towards the end of the financial year, 1st and 2nd class letter volumes declining by a total of 2.4 per cent. Moreover, there was a strong tendency to shift from overnight letter delivery services towards slower delivery services.

1st and 2nd class stamps as well as International Economy and Priority letters in their lowest weight categories underwent price increases on 1 July 2006. On the whole, the average price of all letter mail rose slightly.

Unaddressed direct mail deliveries grew by 4 per cent over the previous year and their average prices fell due to tougher competition in the media market.

Magazine volumes delivered by Mail Communication increased by 1.7 per cent. The delivery prices of low-circulation magazines advanced because their price determination took more account of delivery cost development. Profit was eroded by difficulties related to the entry into force of a new collective agreement for Uusimaa's early-morning newspaper delivery. Demand for the delivery services of local free sheets remained strong, although Mail Communication lost a few customer contracts towards the end of the year.

The business group’s operating profit came to EUR 104.3 million (106.3), accounting for 12 per cent (13 per cent) of net sales. Profitability was weakened by the shift in demand towards lower-margin products and electronic data interchange, coupled with vigorous growth in production costs.

Information Logistics

Information Logistics improved its net sales to EUR 197.5 million (186.0), or 6 per cent. Net sales showed favourable developments in all product groups and countries, with the exception of Germany. Data management services in particular recorded growth due to new outsourcing agreements.

The business group posted an operating profit of EUR 1.2 million (a loss of EUR 26.7 million), accounting for 1 per cent (–14 per cent) of net sales. Its operating profit was affected by the restructuring of German operations and EUR 2.0 million in goodwill impairment recognised by Scandinavian operations. As part of the adoption of IFRS, German and Scandinavian operations were subject to EUR 32.2 million in impairment losses recognised for 2005 comparatives. In Germany and Sweden, profit was primarily burdened by price competition and lower volumes in printing services as well as investments in launching electronic services. The business group as a whole has considerably increased its investments in electronic services. Favourable developments in data management and e-business services, especially in Finland and Estonia, enhanced the operating profit.

In Sweden, the business group completed the integration of the iPost service, corresponding to the Finnish eLetter service acquired from Edita in June. In addition, the year-end saw the acquisition of the scanning business from DigiDoc AB.

Logistics

Logistics’ net sales soared to EUR 530.0 million (354.7), up by 49 per cent year on year, acquisitions accounting for 44 percentage points of this growth.

By region, Denmark showed the most vigorous growth due to the acquisition of Combifragt Group A/S, whose accounts have been included in Finland Post since 1 September 2005. In Finland, net sales were boosted by the acquisition of Logia Moda Oy and AW-Store Oy in May 2005.

In February, Finland Post bought Roadlink Spedition AB, a Swedish provider of transport and forwarding services in Europe and distribution services in Sweden, which has been included in consolidated accounts since 1 March 2006. Acquired in the third quarter, Universal Spedisjon AS, a Norwegian logistics company, has been included in consolidated accounts since 1 September 2006. Based on an agreement concluded in early September, DHL bought Finland Post’s shareholding (49 per cent) in Kelpo Kuljetus Fi Oy, co-owned by DHL and Finland Post, and Finland Post acquired the regional transport business of Kelpo Kuljetus.

In the autumn, Finland Post concluded a lease agreement for a 20,000 square metre logistics centre in Moscow, in order to be able to start Russian operations in the spring of 2007.

The business group’s operating profit rose to EUR 26.9 million (14.4), accounting for 5 per cent (4 pre cent) of net sales, due to favourable developments in the volume of corporate parcel services. Parcel services in Finland are facing fiercer competition.

Business segments (EURO million)	**2006**	**2005**	**Change**
Mail Communication			
Net sales	841.7	825.7	2%
Operating profit	104.3	106.3	-2%
% of net sales	12%	13%	
Information Logistics			
Net sales	197.5	186.0	6%
Operating profit	1.2	-26.7	-104%
% of net sales	1%	-14%	
Logistics			
Net sales	530.0	354.7	49%
Operating profit	26.9	14.4	87%
% of net sales	5%	4%	
Other activities			
Net sales	23.3	19.8	18%
Operating profit	-43.4	3.8	-1242%
% of net sales	-186%	19%	
Intra group sales	-41.9	-38.0	10%
Group, total			
Net sales	1,550.6	1,348.2	15%
Operating profit	89.0	97.8	-9%
% of net sales	6%	7%	

Business Risks

On the basis of the risk management assessment carried out by the Group's Internal Auditing in the autumn of 2006, Finland Post will systematise its risk management further in 2007, as part of the Group's management and development processes.

Business environment risks are associated, for example, with changes in communication technology. Major near-term uncertainties relate to the shift from conventional towards electronic communications, which will reduce letter mail, perhaps at a quickening pace.

Major risks affecting profit performance include an increase in significant cost items, such as fuel, energy and labour.

The entry into force in 2009 of the Postal Directive, proposed by the European Commission, may cause changes in competitive positions and the industry structure in the postal sector.

Risks associated with human resources and competencies have a significant effect on the smoothness of service operations and financial results. Finland Post will simultaneously face both worsening labour shortages and the need for streamlining its operations. Major uncertainties which may affect profit performance in the next few years relate to how well Finland Post will be able to adjust its labour costs to changes in letter mail volumes. Preventing occupational accidents, disability cases and sick leaves are included among the tools for managing risks associated with occupational safety. Finland Post also places an emphasis on preventive occupational healthcare services.

Information system and technology risks are associated, for instance, with system usability, data security and data access.

Note 31 to the Consolidated Financial Statements provides a detailed description of financial risks and their management.

Risks associated with operational control and decision-making information include operational challenges in pricing, contract management and performance measurement managed by means of process management and systematic quality management work.

The Group aims to take out insurance for all risks that it deems financially or otherwise reasonable with respect to risk management. The Group manages insurance for personnel, the continuity of business, assets and liabilities on a centralised basis. Liability risks include risks caused by operations and products, as well as corporate management liabilities. In dimensioning the related excesses, the Group takes account of its risk tolerance.

Changes in Corporate Structure

March saw the merger of Roadlink Spedition AB, a Swedish transport and forwarding services provider, with the Group. With a staff of 61, the merged company has annual net sales of around EUR 25 million.

In early September, Finland Post acquired a Norwegian provider of freight, forwarding and contract logistics services, Universal Spedisjon AS, with a staff of 86 and annual net sales of around EUR 44 million.

In early September, DHL Express Finland Oy bought Finland Post Corporation's shareholding (49 per cent) in Kelpo Kuljetus Fi Oy, a transport company co-owned by the buyer and the seller, while Finland Post acquired the regional transport business of Kelpo Kuljetus, comprising transport services from sorting centres to Finland Post's delivery post offices and customers. As a result, 259 employees within regional transport services joined Finland Post's staff.

At the end of the financial year, North Euroway Oy and Logia Moda Oy merged with Logia Oy, renamed Itella Logistics Oy, and Elma Electronic Trading merged with Itella Finland Ltd, renamed Itella Information Logistics Oy. On 31 December 2006, IT Optimo Oy, in charge of the Group's internal IT services, merged with Finland Post Corporation.

Capital Expenditure

Finland Post Group's capital expenditure totalled EUR 69.5 million (143.0), the most significant investments being allocated to machines and equipment and buildings. Company acquisitions amounted to EUR 27.3 million (76.5).

Research and Development

Research and development expenditure for 2006 totalled EUR 32.8 million, accounting for 2.2 per cent of the Group's total operating expenses.

The most significant Group-wide development programmes in 2006 included the SCM programme related to supply chain management and the TAHA programme focusing on address management, both programmes proceeding from specification stages to implementation.

The SCM programme's key development area covered production and system platforms for service logistics, with sorting technology and the network structure for letter mail operations forming the other area. The co-ordination of the SCM programme, launched within the Business Development unit, transferred to the Logistics business group in 2006.

The TAHA programme created a new-generation management system for address and contact data and the Mail Communication business group took charge of its further development.

The 1st of January 2007 saw the creation of the following two units in charge of the development of new businesses: the Netposti Services business unit and the RDV unit (Research, Development & Venturing), the latter being built by extending the Technology Centre's line of operations. Both will play a key role e.g. in the development of value added services within the TAHA programme.

Group technology development focused on mobile, positioning, sorting automation and tracking technologies. In 2006, Finland Post implemented e.g. an RFID pilot applying to rolltainer traffic. Finland Post takes the view that RFID and positioning form key technologies that it will utilise in the development of its services.

Environmental Policy

Finland Post Group implements its internal environmental efficiency in Finland with respect to the following four aspects, in particular: reducing vehicles' fuel consumption and buildings' energy consumption, intensifying recycling and waste management, as well as purchasing. It improves its external environmental efficiency by providing customers with logistics services for the reuse and recycling of products and product packaging for the needs of both urban and regional logistics.

Financial Position

Consolidated net cash flow from operating activities totalled EUR 97.5 million (197.1) before investing activities. The Group had no net interest-bearing liabilities. On 31 December 2006, interest-bearing liabilities came to EUR 35.4 million (40.2) and cash and cash equivalents totalled EUR 253.7 million

(265.2). On the same date, the equity ratio stood at 65.1 per cent (63.5 per cent) and gearing was –32.1 per cent (–34.3 per cent).

Share Capital and Shareholding

Finland Post Corporation is wholly owned by the Finnish State, the share capital consisting of 40,000,000 shares of equal per-share value. The company holds no treasury shares, nor has it subordinated loans. It has neither granted loans to related parties nor given contingent liabilities on behalf of them. The company has not issued shares, stock options or other rights entitling to holdings in company shares. The Board of Directors has no authorisation to issue shares or stock options or other special rights entitling to holdings in company shares.

Administration and Auditors

In April 2006, Finland Post Corporation's Annual General Meeting (AGM) elected the following members to the Board of Directors: Eero Kasanen (Chairman), Rector; Mikko Kosonen (Vice Chairman), Senior Vice President; Kalevi Alestalo, Financial Counsellor; Hele-Hannele Aminoff, General Manager; Erkki Helaniemi, Partner; Soili Suonoja, Kauppaneuvos (Finnish honorary title); and Pirjo Tiiri, Managing Director. The AGM re-elected Antero Palmolahti, National Chief Shop Steward, and Mirja Sandberg, National Chief Shop Steward, employee representatives to the Board.

It re-elected KPMG Oy Ab (Authorised Public Accountants) and Jorma Heikkinen (Authorised Public Accountant) Finland Post Corporation's auditors.

Jukka Alho, M.Sc. (Tech.), acted as Finland Post Corporation's President and CEO in 2006.

Antero Kekkonen, MP, and Leena Harkimo, MP, were re-elected Supervisory Board Chairman and Vice Chairman, respectively.

Human Resources

The number of Group employees averaged 25,294 (24,624) and the year-end number totalled 24,806 (24,408). The full-time equivalent of Group employees averaged 19,297 employees in 2006. Growth in staff numbers was due to company acquisitions within Logistics and the acquisition of the regional transport services business. The number of parent company employees averaged 21,938 (21,378), while the number totalled 21,609 (21,453) at the end of the year, this growth being due to the September acquisition of the regional transport services business and the year-end merger of the IT subsidiary with the parent company. Acquisitions abroad increased the number of employees outside Finland to 1,550 (1,156).

Group personnel

	2006	**2005**	**2004**
Wages and salaries, EUR million	604.5	554.0	529.1
Personnel in avarage	25,294	24,624	23,544

Mail Communication, Production Support Functions and Sales & Marketing underwent restructuring, resulting in a total of 89 job losses in the parent company, applying mainly to managerial and expert positions. The reorganisation of German operations reduced the number of jobs by 69. With respect to Group permanent staff, employee turnover was around 14 per cent.

Profit for the period included EUR 4.2 million (3.0) in expense provision for the employee bonus scheme.

Transition to IFRS

Finland Post Corporation adopted IFRS-compliant accounting policies on 1 January 2006 and prepared its first financial statements for 2006 under IFRS. Comparatives for 2005 were changed to comply with IFRS, whereas the five-year comparatives for 2002–04 were prepared under the Finnish Accounting Standards (FAS). The consolidated financial statements were prepared in compliance with the valid International Financial Reporting Standards approved for application within the EU.

In comparison with FAS, the adoption of IFRS weakened consolidated net profit for 2005 by EUR 31.2 million and operating profit by EUR 38.0 million. The largest changes came from the accounting treatment of depreciation/amortisation and impairment, as well as the classification of finance leases and operating leases. The adoption of IFRS increased the opening consolidated balance sheet on 1 January 2005 by EUR 75.8 million. The largest changes related to assets under finance lease recognised under property, plant and equipment, and development costs capitalised under intangible assets. Note 33 to the Consolidated Financial Statements provides detailed information on comparison data on IFRS adoption.

Events after 2006

In January, Itella Sweden, an Information Logistics company, acquired Infologistics Scandinavia AB of Sweden, a Bisnode Group company specialising in electronic invoicing, the digitisation of information flows in printed form and the quality assurance of business-critical databases. The acquiree’s net sales for 2006 amounted to EUR 8.5 million. As a result of the acquisition, 112 employees will join Itella Sweden’s payroll.

In early 2007, Finland Post Group established a new business unit responsible for providing electronic services for consumers (Netposti Services). Antero Sarèn, formerly Vice President for Information Logistics, was appointed the unit’s head and his successor, Heikki Länsisyrjä, took up his duties on 15 January 2007.

As of 1 January 2007, the Executive Board will comprise the following members: President & CEO (Jukka Alho) and directors of the following areas of responsibility: Mail Communication (Kari Kivikoski), Information Logistics (Heikki Länsisyrjä as of 15 January), Logistics (Vesa Vertanen), Sales & Marketing (Tarja Pääkkönen) and Finance (Tuija Soanjärvi).

In addition to these members, the Management Board comprises the directors of Human Resources (Tuike Karppinen), Production Services (Seppo Salomaa), ICT Services (Lauri Vihonen), Business Development (Juhani Strömberg) and Netposti Services (Antero Sarèn).

Prospects for 2007

The economic outlook is predicted to remain favourable in Finland Post's operating region in Northern Europe. Finland's brisk economic growth and foreign trade will maintain demand for Finland Post's services, especially logistics and direct mail services. In letter communication the digitisation trend is projected to intensify in 2007.

Structural rigidities in production costs will make it more difficult for Finland to adapt to volume fluctuations and a boom may worsen the availability of production resources.

Finland Post expects its net sales to continue to rise during the financial year 2007. Modernising the production structure will add to capital expenditure.

Board's Proposal for Profit Distribution

According to the financial statements for 2006, the Parent Company's distributable profits total EUR 638,128,485.20, of which net profit for 2006 accounts for EUR 47,832,927.90.

No material changes in the Group's financial standing have taken place since the end of the financial year 2006, neither does the solvency test, as referred to in 13:2§ of the Companies Act, affect the distributable profits.

The Board of Directors' proposes to the Annual General Meeting that the distributable profits be allocated as follows:

- Paying a per-share dividend of EUR 0.675, or a total of EUR 27,000,000.
- Retaining EUR 20,832,927.90 under shareholders' equity.