

Risk management

While executing its strategy and reaching for agreed business objectives, Sanoma and its businesses encounter numerous risks and opportunities. Managing them is one of the daily responsibilities of Sanoma's management.

Risk management policy and process

Sanoma's Risk Management Policy describes the scope, objectives, processes as well as roles and responsibilities of various corporate bodies in the overall corporate risk management.

- The Board of Directors is responsible for approving Sanoma's Risk Management Policy and for overseeing the effectiveness of risk management.
- The Audit Committee regularly reviews and monitors the implementation of the Risk Management Policy and risk management process.
- The President and CEO, with the support of the Executive Management Group, is responsible for defining risk management strategies and procedures, and for setting risk management priorities. The President and CEO is also responsible for defining changes in the risk reporting process, in the Sanoma common risk language and in the applied risk model.
- The Audit and Assurance function coordinates the Group risk management process and produces periodical risk reports for the President and CEO and the Executive Management Group. Updated Group risk assessment results with related ongoing or planned mitigation actions are communicated to the Audit Committee and further to the Board of Directors at least twice a year.

The Group's risk management process is integrated into the systems of strategic planning, management monitoring and quarterly reporting. Strategic Business Units ('SBU') identify, assess, manage and monitor risks related to achieving the objectives in their operations.

+ Group internal control systems, as well as internal audit and external audit activities are presented in more detail in Corporate Governance Statement 2017, on p. 104. Additional information on management of non-financial risks is available in Statement of Non-financial Information 2017, p. 93.

Identified key risks

General business risks associated with media and learning industries relate to developments in media advertising, consumer spending, and public and private education spend. The general economic conditions in Sanoma's operating countries and the overall industry trends could influence Sanoma's business activities and operational performance. The volume of media advertising in specific is sensitive to overall economic development and consumer confidence.

In 2017, approx. 30% of Sanoma's net sales was derived from media advertising, approx. 33% from single copy or subscription sales, and approx. 22% from learning business.

In Sanoma's risk model, the Company specific risks are divided into four main categories: strategic, operational, financial, and hazard risks. The most significant risks that could have a negative impact on Sanoma's business activities, operational performance, or financial status if realised, are illustrated below by category.

STRATEGIC RISKS

Strategic risks include risks related to changes in customer preferences or the competitive situation as well as risks regarding suppliers or operating countries, intellectual property rights, laws and regulations. Risks associated with mergers and acquisitions, Sanoma's strategic agility, development of technology and innovation capabilities are also included in strategic risks.

At the Group level, the most significant risks relate to changes in customer preferences and the threat of new entrants, followed by risks related to the management and protection of customer and consumer data and intellectual property rights.

Changes in customer preferences and the threat of new entrants

Many of Sanoma's identified risks relate to changes in customer preferences. This applies not only to the changes in consumer behaviour, but also to the changes in the behaviour of business-to-business customers, and to the indirect impact of consumer behaviour on it. Ongoing digitalisation and mobilisation is the driving force behind many of these changes. The increased use of mobile devices has changed the way people consume media. There is also a trend of decreasing viewing time of free-to-air TV.

Sanoma's SBUs have action plans on how to respond to this change. As an example, the media units continue to develop their offering of hybrid products and services. The wide cross-media offering provides Sanoma a solid base to constantly develop its offering to advertisers and to introduce new services, such as cross-media solutions, native or branded and premium content. Nevertheless new entrants and/or new technological developments entering the markets remain a risk for Sanoma's established businesses.

Mergers & Acquisitions ('M&A')

Sanoma has previously grown through acquisitions. M&A risks may relate to the transaction process, integration of the acquired business, retention of key personnel, and achievement of the targets set.

Regarding risks associated with acquisition decisions, Sanoma Corporate Governance Principles specify the approval procedures for investments, including acquisitions. The Group's M&A Policy defines decision-making, organization and follow-up procedures for M&A cases. In addition, various bodies discuss investments when addressing strategies as well as action and operational plans that are outside the formal process set out in the M&A Policy. Final investment decisions are made on the basis of specific proposals, in accordance with the form set out in the M&A Policy and authorisations governing approval of investments. For a major acquisition, a specific proposal with information on the strategic reasoning of the transaction, major risks, key terms of the underlying documentation, and synergy calculations is prepared for decision-making. In the Group's M&A Policy, there is also a procedure for follow-up of acquisitions.

Laws and regulations

Changes in laws and regulations may affect Sanoma's ability to effectively conduct business. Changing regulations regarding the use of consumer data for commercial purposes and the deterioration of publisher's and broadcaster's copyright protection, or changes in legislation related to education can have an impact on Sanoma's commercial propositions and content investment needs. Furthermore, changes in tax legislation, such as higher value added tax rates for printed products, may have significant financial consequences.

Continuous monitoring and anticipation of regulatory developments and adaption of business models accordingly are ways to partially mitigate these risks. Legislation related to education, in particular, typically is country-specific limiting the magnitude of the risk on the Group level.

Intellectual Property Rights ('IPRs')

Key IPRs related to Sanoma's products and services are copyrights including publishing rights, trademarks, business names, domains, and know-how, as well as e-business-related patents and utility models owned and licensed by the Group.

The acquisition, management and exploitation of IPRs involve risks associated with the scope of rights, continuity of rights and insufficient protection of rights or infringements. Unauthorised use of IPRs increases with the digitalisation of media. Copyright enforcement lags behind the rapid development of technologies making it possible for new players to enter the online advertising market without own content investments.

The new emerging regulation resulting from the Digital Single Market Strategy by the European Commission is likely to have an impact on existing business models concerning licensing and distribution of content, and to increase competition, complexity and cost pressure in the industry.

Sanoma manages its IPR in accordance with the Group-wide IPR Policy and procedures. Because of a dispersed IPR portfolio, no material risks are expected to arise due to individual IPR cases.

Political Risks

Political changes or instability in its operating countries may affect Sanoma's ability to effectively conduct business. Political risks may relate to changes in government, legislative bodies, other foreign policy makers, or even a military intervention. Monitoring and anticipating developments regarding changing political climate are one of the top priorities of the local management in Sanoma's operating countries.

Currently Sanoma faces political risks in particular in Poland, where legislative changes may have significant impacts on the learning industry and Sanoma's business. Close monitoring and anticipation of political and regulatory development and adaption of business models accordingly are ways to partially mitigate these risks.

OPERATIONAL RISKS

Operational risks relate to the quality of products and services, customer satisfaction, readiness to change, information and communication technologies, integration of new operations, human resources and leadership as well as to knowledge management.

Operational risks related to product and service quality and customer satisfaction vary between SBUs. At the Group level, the most significant risks are associated with leadership and human resources, knowledge management and security of information technology systems.

Leadership and human resources

The Group's successful performance depends on how competent its management and its personnel are, as well as the ongoing development of their competencies and skills. In particular, their competencies and skills in developing appealing products and services for Sanoma's customers in line with customer needs in a constantly and rapidly changing environment play an important role. The Group's success requires a culture that supports innovation, facilitates change and renewal, and encourages balanced risk taking. The managers play an important role in creating the desired culture and in leading by example.

Nowadays, recruiting and retaining the right talent is becoming more and more challenging. Sanoma's primary respond to this is to offer all employees an innovative workplace as well as opportunities for learning and professional development, for example by providing e-learning and other in-house training programmes. The learning opportunities focus mainly on transforming employees' current skills into skills required in the digitalizing world. In addition, Sanoma's strong brand portfolio supports its employer image towards potential employees. Finally, to enhance the retention and recruitment of talented personnel, remuneration principles and practices are aligned across the Group. For the Group and SBU management level, Sanoma has continuous/annual succession planning procedures in place. There are supporting HR systems in use to keep track of employee's performance.

Knowledge management

The management and transfer of knowledge across the Group are crucial for the success of Sanoma. It is important that information, best practices and successful business concepts are obtained and shared within and between SBUs. One way to ensure efficient flow of knowledge is to ensure that the business and supporting processes are clear. During the recent years, Sanoma has reviewed and renewed its Corporate Governance Framework and most of its policies and created a Code of Conduct. Internal online training on e.g. ICT security and privacy continued on an ongoing basis throughout the year.

Information and Communication Technology ('ICT') systems

Reliable ICT systems are an integral part of Sanoma's business. The systems include online services, newspaper and magazine subscriptions, advertising and delivery systems, digital learning platforms, as well as various systems for production control, customer relations' management, and supporting functions.

ICT security risks relate to confidentiality, integrity, and/or availability of information, as well as to reliability and compliance of data processing. The risks can be divided into physical risks (e.g. fire, sabotage, and equipment breakdown) and logical risks (e.g. data security, employees, and software failure). Sanoma has established continuity plans for its critical systems. Sanoma's ICT governance model includes responsibilities regarding ICT security.

Data is an increasing part of Sanoma's products and services through personalized features and content recommendations. Sanoma's principles and governance model for privacy and data protection are approved by the Board of Directors, and in 2017 the Group-wide training on these policies continued.

FINANCIAL RISKS

Sanoma is exposed to financial risks including interest rate, currency, liquidity and credit risk. Other risks include risks related to equity and impairment of assets. Financial risk management is centralised to Group Treasury, and aims to hedge the Group against all material risks. Group Treasury operates as a counterparty to business units in financial transactions and financial risk management.

Financial risks can be mitigated with various financial instruments and derivatives whose use, effects and fair values are clearly verifiable. The Group's interest rate risk is mainly related to changes in the reference rates of floating rate loans in its loan portfolio, and managed by using a mix of fixed and floating rate loans. Interest rate derivatives may also be used. In 2017 all external loans of the Group were denominated in euro.

The majority of the Group's cash flow from operations is denominated in euro, but the Group is exposed to some transactional currency risk resulting from revenue and expenditure in other currencies than euros. The main source of transaction risk in 2017 was the acquisition of TV programming rights in US dollars for SBS in the Netherlands during H1 2017 and for Media Finland TV channels throughout the year. The Group uses foreign exchange forward contracts as means of hedging its significant transaction risks.

Liquidity risk relates to servicing debt, financing investments, and retaining adequate working capital. Sanoma aims to minimise its liquidity risk by ensuring sufficient revenue financing, maintaining adequate committed credit limits, using several financing institutions and forms of financing, and spreading loan repayment programmes over a number of calendar years.

Sanoma's long-term financial targets include a capital structure with the ratio of net debt to adjusted EBITDA below 2.5 and equity ratio of 35%-45%. Key elements in achieving the long-term financial targets are ensuring solid cash flow from operations and managing financial risks efficiently.

The consolidated balance sheet on 31 December 2017 included EUR 1,185.7 million (2016: 2,095.8) of goodwill, publishing rights and other intangible assets, most of which are related to magazine and TV business in the Netherlands. In accordance with the IFRS, instead of goodwill being amortised, it is tested for impairment on an annual basis, or whenever there is any indication of impairment. The impairment losses on goodwill, immaterial rights and other immaterial intangible assets for 2017 totalled EUR 17.0 million (2016: 36.6). Changes in business fundamentals could lead to further impairment, thus impacting Sanoma's equity-related ratios.

[+ A more detailed description of the Group's financial risk management can be found in Note 29.](#)

HAZARD RISKS

Material hazard risks of Sanoma include business interruption as well as risks associated with health and safety or environmental issues. They are mitigated through operational policies, efficient and accurate process management, contingency planning, and insurance. Due to the nature of Sanoma's business, hazard risks are not likely to have a material effect on Sanoma's performance.