MAGNIT 2Q AND 1H 2021 TRADING UPDATE AND FINANCIAL HIGHLIGHTS CONFERENCE CALL

OPERATOR

Good day, and welcome to the Magnit 2Q and 1H 2021 trading update and financial highlights conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Albert Avetikov. Please go ahead.

ALBERT AVETIKOV, CHIEF INVESTOR RELATIONS OFFICER

Thanks, Kristin. Good evening, good afternoon, and good morning, ladies and gentlemen. Thank you for joining us to discuss Magnit's operating and unaudited financial results for the second quarter of 2021. With me to review the results are our CEO, Jan Dunning, and CFO, Dmitry Ivanov. The announcement and respective presentation are available on our website. And after our remarks, we look forward to taking your questions. I would also like to remind you that today's financial results are based on the management accounts, and IFRS audited financials will be published later in mid-August. With that, I will now turn the call over to the Magnit CEO, Jan Dunning. Jan, please.

JAN DUNNING, CEO

Thanks, Albert. Good day, everyone and thanks for joining us. I'm delighted to see healthy development of the underlying operating and financial metrics. We are again delivering on our promises. Sales densities continued improving, supported by mature stores. We see margin is under control. We are generating cash and that remains strong. Working capital saw another round of optimization and leverage stayed even below our comfortable zone.

We've completed strategically important acquisition of the Dixy business with around 2,500 stores. And this deal dramatically changes our market positioning in both capitals and is value-accretive post-synergies for our shareholders.

Now, let me take you through the key highlights for the second quarter before we move into the details. The sales growth accelerated to almost 10% despite the high base effect of last year. LTM sales density increased by 4.6 y-o-y. LFL sales growth came higher versus previous quarter at 5.2%. This was driven by mature stores, but

not new stores in the “ramp-up” phase. Both sales growth and LFL sales growth were accelerating month-to-month. Customer behavior started to normalize with LFL composition returning to a healthy balance with continuous trading-up effect. In line with previous communication, we accelerated expansion and redesign program, expect further pickup in the second half. EBITDA margin improved versus previous quarter. We expect a sustainable trend to continue with annual margin improving compared to last year. Our working capital cycle improved again with inventory turnover 11 days better y-o-y primarily on more efficient stock management. Our financial position remains strong with a leverage of 1.2x. Full-year and long-term guidance remain unchanged. And finally, we have been placed third in the ESG ranking of Russian non-financial public companies produced by the National Ratings Agency. With that, I will now add some more color to the quarter's developments.

We achieved solid LFL sales growth in the mature stores and speed-up expansion. The total sales growth stood at 9.6%. LFL sales growth was 5.2%, pushed by mature stores despite the growing number of new stores. Expansion accelerated underpinned by strong return dynamics. We opened 519 stores on gross basis, three times more than a year ago. And for the first half we added 926 new stores - in line with our guidance of 2,000 store openings this year. LFL sales growth was positive across all regions and all formats. The key convenience format demonstrated leading LFL sales growth of 5.7%. It was closely followed by drogerie with 5.5% and the supermarkets turned positive with 2.0% LFL sales growth. Other Company-specific trends included: fast growth of the number of new unique customers as the main driver of our LFL growth. Visit frequency increased as well on the back of the low base effect last year. We continue to attract customers from larger formats, some small players, and unorganized retail. Number of active loyalty cardholders exceeded 50 million with 65% penetration in sales. Negative LFL ticket growth in April–May was due to stockpiling effect last year. Decline of the average number of articles in the basket was the only negative driver in the quarter. On-shelf price inflation decelerated versus its peak levels in January–February and landed in a comfortable zone in line with the food CPI. Trading-up effect continued as a result of ongoing assortment changes. Again, we don't see customers sacrificing quality of their purchases. Important that each month we were looking at further normalization of customer behavior. LFL composition was gradually moving to a healthy balance. Since June we are seeing both LFL ticket and traffic growth being positive with trading-up in place.

The promo intensity remained flat q-o-q. Y-o-y it has visibly increased. The low base last year due to country-wide lockdown was the main contributor to this growth. Seasonal campaigns were strong supported by favorable weather conditions and active domestic tourism. Overall promo level remains at a healthy level. We continue to focus on CVP improvement to drive sales in the first place. At the same time, we see improving promo margin due to better promo forecasting.

We continue to develop our e-com initiatives. We run several e-com pilots including our own express and regular delivery and partnerships. In the second quarter we launched our own delivery services from Magnit Cosmetic stores and superstores in the regions. And we've also started partnering with Wildberries in express delivery. We added 12 new cities and connected another 700 stores to our service. Today over

2,000 stores in 62 regions and 106 cities are covered by the online option. And we may finish this year with a total of over 4,000 stores connected. Looking at Data Insight statistics, we see that this is the highest geographical coverage amongst public retails. The run rate for Magnit's online segment stands at RUB 7.6 billion based on the last week of June. 61% of the current revenues are generated outside Moscow and St. Petersburg. We fulfilled around 15,000 orders a day - q-o-q growth accelerated to 58%. Till the end of 2021, we plan to expand online delivery, adding new stores and cities.

Now a bit on recent trading. July was also affected by high base effect. Last year July was the third-best month in terms of LFL sales growth after March and October. This was supported by limited domestic and international tourism and state subsidies. Despite that effect, we are happy to see further acceleration versus the second quarter average. July month-to-date sales growth went up to a double-digit zone. This was supported first of all by further pickup in LFL sales in the mature stores and a bit higher selling space growth. So we may finish July with higher LFL sales growth versus the second-quarter average despite even tougher comp. LFL composition remained healthy with a positive ticket and traffic growth. Trading-up continued in our stores. Looking into the next months we expect good momentum with strong trading. It may be supported by one-off "back-to-school" payment. According to a Sberbank survey, 50% of recipients intend to spend their additional social payments on food.

Now, let me pass the floor to Dmitry to walk you through our financial results.

DMITRY IVANOV, CFO

Thank you, Jan and hi everyone. Let me start with gross profit. Gross profit margin remained flat q-o-q at 23.4% but was 91 bps lower versus last year. We had a positive impact from the following factors. First of all, improved commercial terms with suppliers. We also improved promo funding from suppliers and we had higher promo margin. Shrinkage improved by 26 bps despite acceleration of store openings and thanks to strict oversight and solid LFL sales growth. We had favorable format mix on higher share of drogerie business. These positive factors were offset by:

2.9 pp higher promo share y-o-y due to low base in the same period last year and efficient seasonal campaigns this year. This resulted in around 60 bps effect according to our estimations,

relatively less favorable product mix versus last year with forward-buying of dry and non-food. This had a negative impact of around 10 bps,

slightly higher supply chain costs due to continuously improving on-shelf availability and increased transportation rates, and

recovery of HORECA consumption leading to a higher share of wholesale operations.

SG&A expenses remained under strict control. SG&A as a percent of sales were 10 bps down versus previous quarter and flat versus last year. That came despite some cost inflation and a growing number of stores in the "ramp-up" phase. Staff costs

went down 7 bps. Higher productivity of in-store personnel, especially in convenience and drogerie, fully offset additional pressure from new stores in the ramp-up phase and some turbulence in rotation due to pandemic last year. Lease expenses improved by 15 bps on increased sales density, better rates per square meter and closing of inefficient stores. That more than offset growing share of leased space and already mentioned ramp-up effect. Advertising expenses increased by 26 bps on higher marketing activities including loyalty campaigns as well as digital marketing. Depreciation of assets improved by 10 bps driven by growing sales density and the fact that more store openings are leased. That compensated some speed-up in expansion. Other costs remained broadly flat.

As a result, EBITDA margin improved q-o-q to 7.1% but was down y-o-y. Adjusted for LTI expenses, EBITDA margin would be 8 bps higher or 7.2%. Net interest expenses reduced by 25 bps y-o-y, and this came despite a recent increase in the total amount of borrowings at somewhat higher rates, which was netted by interest income. FX gain of RUB 600 million was related to direct import operations. As a result, net income in 2Q decreased by 6.0% y-o-y and stood at RUB 12.1 billion with a margin of 2.8%. Net income for the first half-year grew by 34.6% with the margin improvement of 56 bps to 2.8%. Effective tax rate was 22.5%.

We are on track with working capital cycle optimization. Inventories reduced by RUB 19.5 billion y-o-y resulting into faster rotation by 11.2 days despite acceleration of store openings, increased share of drogerie format, higher on-shelf availability, and supplier inflation. Trade and other payables grew by RUB 27.5 billion versus last year driven by higher sales and increased payment days. Accounts receivables increased by RUB 2.4 billion versus last year due to higher sales and improved commercial terms with suppliers. We continue to focus on further improvements in the working capital in days.

CAPEX increased on acceleration of expansion. CAPEX in the second quarter tripled to RUB 17.2 billion due to much faster expansion - three times more stores were opened versus last year. We also continue with our redesign campaign and this quarter we covered another 143 stores. We reiterate our guidance for the year to open around 2,000 stores on gross basis, redesign about 700 stores, and spend RUB 60–65 billion on CAPEX. With this, you may expect us to accelerate expansion in the next quarters. Redesign program will be even more backloaded.

Our financial position is stable on comfortable leverage, extended duration and low cost of debt. At the end of the second quarter, our gross debt was RUB 265 billion. This came at 58% higher versus the end of the last quarter. Faster expansion and financing of the Dixy acquisition were the main reasons for this increase. Cash position increased accordingly to RUB 129.4 billion resulting in net debt reduction of 15.8% versus the end of the previous quarter. Average cost of debt increased to 6.4%, which is just 12 bps higher than a year ago. Despite a different monetary policy with rising market rates, our recent borrowings came below the state bonds yield. And cost of our debt portfolio is below the key rate. Net debt/EBITDA ratio was 1.2x versus 1.4x three months ago. Now I will give a floor back to Jan for some closing remarks.

JAN DUNNING, CEO

Thanks, Dmitry. Just a few notes before we move to the Q&A. The results for us are another clear signal of our turnaround. We are delivering on our promises and in some areas we're actually moving faster than originally planned. Mature stores continue driving sales densities, organic expansion accelerates. We keep our margin under control - without quarterly dips and hikes it steadily improves. This trajectory will remain going forward. Efficient inventory management leads to working capital optimization even ahead of our plan. And despite some headwinds, we keep our long-term guidance unchanged. With the acquisition we recently completed, our market positioning significantly strengthens. And even more, this dramatically changes our investment case. We are becoming a business with fast double-digit top-line growth, continuous margin gains, strong balance sheet, cash generation, and sustainable dividend distribution.
Thanks for listening and we are ready for your questions.

ALBERT AVETIKOV, CHIEF INVESTOR RELATIONS OFFICER

Now we are ready for the Q&A session. Thank you.

OPERATOR

Yes, thank you. [Operator’s instructions] We'll go to our first question from Nikolay Kovalev.

NIKOLAY KOVALEV, VTB CAPITAL

I want to ask a couple of questions. The first one is on your release. Basically, we saw ongoing optimization of shrinkages and inventories. And I was wondering, can you describe maybe more details about operations and what you did in order to sustain this kind of improvement? Maybe you can also give us guidance by how much these two lines can be further optimized and if you can clarify what kind of level of shrinkage you operated in the last quarter, it will be helpful if any. The second question I wanted to ask is on the Dixy acquisition. It's basically clear you're going to keep label Dixy and stores for now. But I was wondering: are you scheduling any immediate investments in order to improve the internal level of service at the stores to that of Magnit? I mean the internal outfit, maybe lighting, lines, cashiers. It looks like Dixy service is lower than that of Magnit. I was wondering, are there any CAPEX scheduled here? Thank you.

JAN DUNNING, CEO

Let me start with the first shrinkage question. I think shrinkage is always a result of the processes that you put in place. That's of course heavily connected to the transformation that we're actually trying to put in place here. What we've seen is, of course, last year a big improvement in shrinkage, which was due to a bad pretty low base. This year, we see a continuous improvement and that's mainly because of supply chain improvements, but also because of the whole process of ordering other quantities, the box sizes, and adjustment of store orders. There are quite a lot of people involved. But we made an important tracker for where we are in our overall improvement of the concept. I'm happy that that is still developing. Now, of course, and I think that's also what we were mentioning, we should also be realistic. The improvements that we've seen last year and part of this year, of course, will not be seen next year or going forward. But we still believe that there is space to improve. We're currently cruising around 3% and we believe that we still have an opportunity to go lower. But what is the signal that we give to the organization? If you start squeezing that too much, you immediately affect the top line. That balance we need to find, and therefore we're more oriented on process optimization than on this clean shrinkage reduction. Then the second one is the Dixy acquisition. We are currently in the process of understanding the business, in the sense of what their CAPEX plan is. How do they cooperate between the commercial, operational and marketing departments? We see already that indeed, the level of money spent on maintenance, and especially also store operational execution is not in line with what we do in Magnit. You will see that we will take there some influence, that we want to see that change, but it will take some time. And by the way, what's also important to realize is that we want the management team of Dixy to stay in place, but with the help of KPIs and discussions, get them spend more on their store operation because we believe, therefore, there's also still some space, some upside in the sales development that they show. That will improve and we'll have better circumstances in the store.

NIKOLAY KOVALEV, VTB CAPITAL

Clear. Thank you very much.

OPERATOR

We'll take our next question from Maxim Nekrasov with Goldman Sachs.

MAXIM NEKRASOV, GOLDMAN SACHS

Hello, thanks a lot for this call. I have a couple of questions. The first one is also related to Dixy. I believe we haven't touched that earlier this week. Basically, as a part of the Dixy deal, as I understand, Magnit took some obligations to establish a

zero mark-up on certain socially important goods such as milk, bread, chicken. Basically, the question is what kind of impact do you expect from those measures? How can you comment on that? Do you think it may change this promo and pricing dynamics that we see for competitors as well?

DMITRY IVANOV, CFO

Hi, Max. Let me take this question. Let me start from the solution of our pricing policy, which implies low mark-up for socially important articles. Anyway, we are trying to keep low prices for a limited number of price entry items in many product categories. The majority of these items are already keeping prices in line with the new pack of responsibilities prescribed by the Federal Antimonopoly Service. According to this prescription, we have to keep a zero mark-up, one SKU initial for three categories, which are bread, milk, and poultry. We estimate it given local assortment where these categories and these items are quite widely present. Overall, this will cover around slightly above 100 SKUs in our assortment. The majority of these SKUs we see in the milk category. Overall, it represents less than 1% of total sales over the Company. All in all, we don't see any significant impact on profitability. It will be really minor, and even more given that these entry-price SKUs are traffic builders. We expect better customer traffic and bigger baskets, which will compensate this minor negative effect.

MAXIM NEKRASOV, GOLDMAN SACHS

OK, thanks a lot. That's very clear. My second question is regarding your loyalty card. Basically, as I remember last year, rising loyalty card penetration was putting some pressure on the margin. The question is: have you started to see any benefits in terms of margins? Have you started monetization of your loyalty card? And if not, when do you think you can see some benefits in terms of margins from loyalty cards?

JAN DUNNING, CEO

Now, the loyalty card we are currently using is providing us with insight. That's very helpful for the category management so that we are improving our offer. It is less oriented on the margin increase. It's more oriented on loyalty and understanding our customer better. We know that people appreciate our loyalty card and therefore are spending more than they what they did in the past. The second part of the question was on the monetization. We have not started that yet. But we are about to start. We're actually looking to see how we can organize it. But our ideas are doing that external with an agency or internal in the house, and that’s the discussion that we have. But I assume that in the course of this year and, end of year, we will start monetizing part of the data.

MAXIM NEKRASOV, GOLDMAN SACHS

OK. Understood. Thanks a lot.

OPERATOR

We'll go to our next question from Marat Ibragimov with Gazprombank.

MARAT IBRAGIMOV, GAZPROMBANK

Thank you very much for the call. I have a question on your gross margin performance q-o-q. If you look at the second-quarter figure, it corresponds to the first quarter, almost very close, which is unusual, because seasonally in second quarters you have slightly higher gross margin. It looks like you had an additional impact on your gross margin, maybe a higher share of promos or product mix effect which negatively affected your gross margin. Can you please comment in this respect, do you expect the recovery of the gross margin until the end of the year? Thank you.

DMITRY IVANOV, CFO

Hi Marat. First of all, we aim to keep a stable and steadily improving level of gross margin. Given all initiatives that we are running in place, we are very much sure that we can deliver this and secure stable level of gross margin, to what all hikes and bikes in development. As for the second quarter development compared to the first quarter, we have tried to focus on our approach. Of course, there were several one-offs in the second quarter to the first quarter. One of these effects is a bit change in seasonality. Another one is a slight change in categories mix with a bit higher share of fresh products in the mix with lower margin compared to dry and non-food categories. Also, we have some changes in our emotional loyalty campaigns, which have for sure a certain impact on gross margin. Also out of other components of gross margin, I think what can be relevant for other players is changes and a slight increase in supply chain tariffs driven by a tariffs increase for containers related to China.

MARAT IBRAGIMOV, GAZPROMBANK

Thank you. Another question is on your personnel. According to your monthly data, your number of staff in the distribution division has declined by 10% y-o-y. Can you please comment on that? Is it efficiency improvement or you outsource it, some of your logistics and distribution services? Thank you.

JAN DUNNING, CEO

Let me take that part. There is intended and non-intended impact here. The intended impact was, indeed, that we have increased the outsourcing a bit. We have also seen the improvement of productivity. The non-intended impact and that is what you see currently in the labor market is we are facing pretty strong pressure locally on the HR ability. We see that there's a shortage of labor in certain regions. That leads as well to operational issues in the distribution centers and partly in the stores. That's not Magnit's specific problem. That's I think a country-wide problem. We see that more retailers (we saw that as well in Dixy, and we see that as well in the competition), more retailers are having issues and by the way, also suppliers are having issues.

MARAT IBRAGIMOV, GAZPROMBANK

That's clear and in convenience stores a number of personnel also declined despite the growth of the network. Is this also for the same reason?

JAN DUNNING, CEO

Yes.

MARAT IBRAGIMOV, GAZPROMBANK

OK. The last question, very short. From which date are you planning to consolidate Dixy operations?

JAN DUNNING, CEO

The consolidation will take place as of the day of the deal closure, which is July 22, but the operational consolidation will happen at the moment we have actually also ready-made migration to an ERP and goods management system. For now, Dixy will operate as Dixy and will run on its own systems. Of course, we will start aligning procedures, we will start aligning, like we mentioned earlier already, the maintenance levels, operational levels and also the procurement conditions. But the idea is as long as we do not have an ERP system integration, we will keep them separate.

MARAT IBRAGIMOV, GAZPROMBANK

OK, I remember you told us about that. But I mean the financial numbers will be consolidated in the second half, which should support your top line.

DMITRY IVANOV, CFO

Financial numbers will be consolidated from the second part of 2021. And in our Auditor's IFRS Report for 2021, which we are going to issue somewhere at the beginning of March 2022, Dixy will be already included.

MARAT IBRAGIMOV, GAZPROMBANK

And you will provide some separate numbers, as you promised, right? Standalone Dixy and standalone Magnit.

DMITRY IVANOV, CFO

As we promised during our conference call on Monday on Dixy, we plan to report our operational results for Dixy separately, while we plan to report the financial results as one segment, combined Magnit and Dixy.

MARAT IBRAGIMOV, GAZPROMBANK

OK, thank you. That's it from my side.

OPERATOR

If you would like to ask a question, please press *1 at this time. We'll go to our next question from Henrik Herbst with Morgan Stanley.

HENRIK HERBST, MORGAN STANLEY

Thanks very much. I had sort of three and a half questions, quite quick ones. Firstly, I think you have given some pretty encouraging details on LFL trends, and, in particular, with your existing customers, which really, as you say, shop with you more frequently and spend more each time. If you could give a little bit of color on what's driving that. Is it just that they are buying more expensive things or buying stuff they didn't use to buy with you before? Then secondly, I was wondering as well, if you could give us a little bit of color on the COVID impact. I think last year you gave us... I don't remember the exact numbers but how much of LFL growth reported was coming from COVID? And what are we seeing this year? Is it reversing? You've got a bit of a headwind in your reported LFL, while still seeing sort of tailwind. Then the third question is just in terms of integration costs. Maybe this was a question for

the call you had earlier in the week, but are there going to be integration costs in EBITDA this year? And then, sorry, the half question. It is just my line was pretty bad at the beginning of the call, but did you say that you expect margins to improve y-o-y in the second half? I know that was quite a few, but thanks very much.

JAN DUNNING, CEO

OK, let me start. The LFL is partly coming of, I think, our customers' trading up. And that's a result from the category management initiatives. I think we have more logic range coming on the shelf than we had a year ago. And it's ongoing because what we see is rather catman cycles are coming in. The biggest secret is that we were having a quite big assortment, if you look at the convenience. And it's actually better to have a bit more wide and less deep. And that's the whole exercise that we're doing. That's one element of the LFL.

The other element, which is not so important is what we see in the migration reports, is that we acquire also quite a lot of new customers. Those new customers come from the larger stores and from the non-organized retail. And what those new customers do, they overall are a bit more affluent than our existing customers. When people from those formats are looking for a way to trade down, they end up with us, and actually are also creating a kind of trading up of the customer. That has a pretty good impact on our LFL. And we see that quarter by quarter still new inflow of new customers, which is actually encouraging.

Then the COVID impact we assess of around 1.0 - 1.5% in the LFL. What you should realize is that the COVID also, of course, last year had a pretty strong impact on the margin because what happened: the malls were closed and people therefore for the non-food assortment primarily came to the food retailers. And we have relatively little non-food, but in our bigger boxes and in our convenience we have some non-food. So we started to sell more non-food. Therefore we saw as well a much bigger margin impact last year. Now you see the margin y-o-y is lower, but quarter on quarter it makes actually quite a nice development because this is much more sustainable, this is based on more normalized environment.

Then the last one is the integration costs. I think, of course, we will have to make some costs. But there's also some upside: this part of the integration costs that we have to make is to optimize taxes, to cut down cost overtime. And I think my own position is actually the cost that we have to make will be matched with the additional benefits that we get out of this. There's a couple of things that we have to do within the year, and we also are earning back the cost imposed by the measures that we have to take.

Then you asked the last, the ‘half’ question on margin improvement. What I do see and it's also what I told you initially is, I see a sustainable control over the margin that we acquire. I do believe that with shrinkage control, the promo control, the promo margin control, the supply chain improvements that we have, we will show improvement of margin in the second half of the year, leading to a higher end year margin than last year. That's what I'm calling it so.

HENRIK HERBST, MORGAN STANLEY

That's very helpful. Thank you very much.

OPERATOR

It appears there are no further questions at this time. Mr. Avetikov, I'll turn the call back to you for any additional or closing remarks.

ALBERT AVETIKOV, CHIEF INVESTOR RELATIONS OFFICER

Thank you very much for listening to our call. I would like to remind you that we will report 3Q results in the end of October. Thank you and have a nice evening.