Magnit PJSC

Analyst call with Acting CFO of JSC Tander

Magnit PJSC speakers	Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander), Albert Avetikov (Chief Investor Relations Officer)
Participants asking questions	Maxim Nekrasov, Goldman Sachs Henrik Herbst, Morgan Stanley Marat Ibragimov, Gazprom Bank Ilya Ogorodnikov, Bank of America Audited Full Year 2020 Results call transcript

OPERATOR:

Good day and welcome to the analyst call with Dmitry Ivanov, acting CFO of Tander. Today's conference is being recorded. At this time, I would like to turn the conference over to Albert. Please go ahead, sir.

Albert Avetikov (Chief Investor Relations Officer):

Good afternoon, ladies and gentlemen, and welcome to our today's call. With me to review our results and update you on the recent development is our acting CFO of Tander Dmitry Ivanov. You have seen our full year 2020 audited financial results on Monday, which came fully in line with what we reported in February under management accounts. So we will not focus a lot on the result itself and will provide you with just a very quick overview, but spend more time on the update on recent development. With that, I would love to hand over the call to Dmitry. Dmitry, please. The floor is yours.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Thank you, Albert. Good afternoon, ladies and gentlemen, and welcome to today's call. As Albert just said, we won't focus a lot on our results which we disclosed on Monday, which by the way came fully in line with what we reported in February, but more focus on recent trading. But let me provide first a quick overview of our key achievements in 2020.

Last year, we focused on improvement of sales density across all formats, and we achieved 6.5% growth. We focused on profitability regain, and our EBITDA margin improved by 100 basis points last year. So we finished the year with EBITDA margin of

7% thanks to gross margin improvements and strict SG&A control. We also focused on significant improvement of working capital cycle and released RUB 30 billion of cash. As a result of some deleveraging, improvement of cash flow generation and low CAPEX spent, we finished the year with free cash flow of RUB 85 billion and almost doubled ROIC on the whole business, while return on investments on stores opened in 2020 stood at around 40%, which was net of COVID impact.

And now we entered 2021 with a completely different financial position, without any pressure from debt side. Flexibility of our balance sheet allows us to continue with a combination of fast expansion, investments in efficiency projects, IT infrastructure, supply chain and very strong cash generation and cash position, which may lead to continuous strong dividend payments.

Now, let me talk about recent trading, which is very important and positive. Some momentum continued since the start of this year. January delivered solid LFL sales growth, which was in line with Q4 average when we reported 7.5% LFL growth. Total sales growth also remained double digit. In February, strong trend continued with further acceleration of LFL sales growth above January and above Q4 average. Please note, that January and February came on a much stronger base with mid-single digit LFL sales growth in the same months last year.

March last year was the strongest month with record high double-digit LFL sales growth due to stockpiling effect on the back of pandemic. During first two weeks of March this year, again, we saw further acceleration of LFL sales growth versus previous months. In the last two weeks of March we'll face tougher base for comparison, it's logical, while we see that as a more technical effect rather than structural. For example, looking now at our daily statistics, daily trends, we have the same absolute level of sales as you saw in February.

LFL ticket growth was driven by growth of number of items in the basket, trading up trend and on-shelf price inflation. Inflation in January and February remains almost unchanged. If you look at more details from results observed across all formats, with convenience and drogerie segments leading the race, convenience stores show double-digit LFL sales growth, and notably our large formats deliver strong trading in a positive zone with acceleration versus previous quarter.

Moscow region delivered the strongest LFL sales growth in January and February. Mature stores and not new store openings entering LFL panel remain drivers of LFL performance. So our total sales growth is predominantly driven by improvements in the mature stores rather than new square metres. Selling space growth accelerated following speed up in expansion and currently stands at 4% growth YoY.

This quarter-to-date results came without any acceleration in promo intensity. It is another very important factor. Promo share as a percent of sales went down versus previous quarter being flat YoY, but sales continued accelerating. As a result, we see quite healthy development of margins, which is in line with our expectation. Margin is supported by better commercial conditions, lower promo, lower stock losses and strict control on SG&A. So we are not burning money in promo.

And now a couple of words on balance sheet. With recent 10 billion bonds redemption in February our upcoming refinancing and repayment needs this year stand at RUB 3.2 billion, which is about 2% of our total debt portfolio. So, compared to last year, we see no pressure at all from debt side. Cost of debt is now on the historical low level of below 6%. 99% of our debt is long-term with fixed rates. So we are well secured from any fluctuations on this side.

It was about cash flows, most of the focus on working capital. Working capital remains one of our strategic priorities and is, in fact, one of my KPIs, as Company's CFO. We continue with all our initiatives aimed at faster inventory turnover days, higher payables and lower receivables, and current results are encouraging. Inventory is almost flat versus end of December, and lower versus Q1 2020 despite double digit sales growth. As a result, stock days improved by almost six days versus last year, driven mostly by drogerie stores inventory. Receivables are lower versus the same period of last year, despite higher sales, driven by overdue control and faster documents collection. Payables are higher than in the same period of last year driven by turnover growth and better payment days.

Now I would like to briefly update you on the status of ERP implementation, which is one of the drivers of our long-term improvements, including working capital. Now we are finalizing blueprint design for all three functional projects (Goods movement system, Finance integration and HR). And it is planned by the end of March. In the beginning of April, we're going to start realization phase in parallel for all three systems. And in IT Project we're in the process of integration bus realization. Pilot rollout is planned for fourth quarter of 2021 across stores located in the South region, and after pilot we plan wide rollout across all geography with 250–300 stores per week with simultaneous implementation in our DCs. With such pace, implementation will take around 3–4 years from now, including all stores and DCs.

And finally, short update on our e-com results. Magnit online services today cover over 1,400 stores in 98 cities and 59 regions. We fulfil about 9,000 orders per day. Annualized GMV run-rate of our online segment stands at RUB 3.3 billion. Convenience store-based express delivery has the highest sales and shows the best growth dynamics. We deliver from 29 stores in Moscow, including two recently launched mini dark stores. Average ticket for Magnit's own express delivery service in Moscow is over RUB 1,300, and almost RUB 2,000 for regular delivery mission in Krasnodar, which is around 4–6 times higher than in offline convenience stores, and much higher versus average ticket of express delivery by our partners. It means that customers use Delivery Club and Yandex.Eda to buy food for now or ready to eat meals, while they order directly via Magnit for stock up purposes. Thank you for listening. Now we are ready for your questions.

Albert Avetikov (Chief Investor Relations Officer):

Dmitry, thanks a lot for the update. As you heard, we are running now above our internal expectations and see continued strong momentum. So, operator we're ready for the questions.

OPERATOR:

Thank you. [Operator instructions]. We now have a question from Maxim Nekrasov from Goldman Sachs. Please, go ahead.

Maxim Nekrasov:

Good afternoon. Thank you very much for this call. I have a few questions, actually. And the first one is on your margins. Basically, shall we expect that the margin profile that you saw last year, which is about 7%, should be sustained in the first quarter and going forward? This is the first question. And the second one is on the drivers of acceleration of LFL growth that you saw, this continuous acceleration since January. What were the key drivers of that? I will probably stop here for now.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Hello, Maxim. Thank you for this question. Let me start with the margins. Yes, you're right, we finished last year with the 7% EBITDA margin and we see this new sustainable level for us and we plan to stick to this level in 2021. And this is by the way reflected in our budgets and in our models. Why do we think that this level is sustainable? As we already disclosed and explained during CMD and other calls with analysts, we have several drivers which can help us to sustain a margin level at 7% or above, which are steadily increasing sales densities which help us with increased volumes to negotiate better buying conditions with suppliers. Also, we see that we have still the fastest-growing segment, which is cosmetics, in our portfolio. And you know, cosmetics segment is a segment with the highest margins. Also, what we see now in current statistics, in current trading and in our current financial results, because we have already closed two months, we see further improvement in stock losses. It will be obviously a continuous driver of margin improvement. We see some progress in private label penetration growth. And of course, as our new normal is strict control upon SG&A. All these components make us confident in the sustainability of our margin going forward.

If you look at LFL drivers, what are the key drivers of such fantastic performance on the high base of last year? First of all, as I mentioned already, LFL is driven by improvement in old mature stores which were opened before 2019, and this growth is driven by improvement in stores. We call it CVP (customer value proposition). What does it mean?

It means improvements in all components which make our customers happy visiting our stores. It's a wide assortment, quality assortment, freshness, clean stores, safety stores, good look and feel, clear navigation, friendly cashiers, no queues. All these small things are helping to drive customer loyalty and attract more customers to our stores and result in good sales update. I see this in our statistics when we're looking at traffic and tickets. We see that in our tickets, there is an increase in the number of items. We have a volume increase. We also see how our customers perceive a change in our assortment because we see a trading up effect, so customers are trading up to Magnit. They appreciate a change in assortment, new ranges, an extension of needs in assortment, they like it. Inflation is another driver, but it's I think to a lesser extent because it's stable. It is not changing.

Maxim Nekrasov:

Very clear. Thank you very much. Just a small technical question on your LTI expenses that actually went down last year. What is the outlook for LTI expenses for this year, and then going forward, just to put it on models?

Albert Avetikov (Chief Investor Relations Officer):

Maxim, all the details of the LTI programme are well-disclosed in our annual report and other public documents. You can see that the trigger for the first part of the LTI is EBITDA CAGR. And the trigger for the second part is stock price. At the moment, right now, I cannot provide you a quantification of all the LTI expenses for this year, as it's a bit too premature to calculate. According to the programme, we'll be able to provide you the details and you will see that at a bit later stage.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Let me add to this, Albert, and Maxim. You are absolutely right that in 2020 we have some decrease in this P&L line. It was driven by two things. First of all, changes in the management structure. We have some outflows and inflows and newcomers receive a lower portion of LTI comparing to those who left, because they worked less compared to those who left. Also we have quite strict rules and triggers for LTI achievements. And practically for 2019, we didn't make these rules with the triggers. And therefore there was some reversal of accruals for LTI.

Maxim Nekrasov:

Understood. Very clear. Thank you very much.

OPERATOR:

We will now take our next question from Henrik Herbst from Morgan Stanley. Please go ahead.

Henrik Herbst:

Yes, thanks very much. I have two questions, please. Firstly, just a follow-up on margins. I mean, you talked about the margin as sustainable at 7%, but at the same time, you're guiding for margins trending towards 8%. Why are you just saying this sustainable or not? And why shouldn't we expect margins to improve? I think everything else you're saying, as well would imply that margins are sort of improving, right? LFL sales are very strong. You're seeing better execution leading to essentially lower shrinkages and things like that, I guess. Do you see an upside to the 2021 margins improving versus 2020, versus 7% in 2020? And I guess more specifically, so far in Q1: are the margins improving versus Q1 last year? Then secondly, I just wanted to check as well, I didn't really hear. I think you said something about your expectations for the last two weeks of March. I just wonder if you could please repeat that. Thank you very much.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Henrik, thank you for your question. Let me start with the margin qualification. We were talking about our margin expectations for the first quarter of 2021. We expect that it will be in the direction of 7%. For sure, it will be much higher than the margin of the first quarter of 2020 driven by factors which I mentioned before. If we talk about 8%, 8% margin is our strategic ambition, which we plan to deliver steadily over the next few years, gradually improving all components and adding every year from 15 to 25 basis points. Of course, for full year 2021, we expect, and this is in our models, plans and budgets, to deliver a higher margin than 7%, higher than we achieved in 2020.

With regard to sales for last two weeks of March, if you remember, there were two big impacts last year. The first one was somewhere in February, end of February, the first wave of the rouble devaluation. And then, at the end of March, it was quite a strong stockpiling by customers driven by the COVID-19 pandemic. Namely, it was two days in March. It was 17 March last year and 27 March last year. These days, we experienced quite a strong uplift in sales, mostly in commodities, sugar, grains, toilet paper, and sunflower oil. Of course, we treat this as a high base for this year. We think these are technical factors, which will affect our relative performance over the last two weeks of March. We are also looking at absolute amount of sales, and absolute amount of sales so far what we see now, because we look at the daily statistics, in retail we monitor sales daily, absolute level of sales is very similar to what we saw in February. And also in our expectations and our models, we expect that for the next two weeks of March, we will see the same levels, with some adjustments on quality of days, calendar days, like usually on Fridays, we have higher sales than on Mondays, on Saturdays we have higher sales than on Fridays, etc. Did I answer your question?

Henrik Herbst:

Yes, I think pretty much. Can I just sort of confirm? So you're saying that for Q1, you expect margins to be around 7%? And I guess what you were saying is that for 2021 the margin improvement should be in that sort of 15 to 25 basis points range.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Yes, absolutely right.

Henrik Herbst:

Brilliant. Thank you very much. Bye.

OPERATOR:

[Operator instructions]. We will now take our next question from Marat Ibragimov from Gazprombank. Please, go ahead.

Marat Ibragimov:

Thank you very much for the call. A very simple question on inflation, which you currently see on your shelf YoY. What kind of inflation? What is the inflation rate you're seeing? Because you're on the front line of this inflation and everybody's talking. And another question: is the inflation decelerating in March or accelerating? Because a couple of days ago Rusagro reported financial results and they disclosed that January – February price trend is upward. So we're seeing acceleration of inflation on meat, on vegetable oil, etc. Could you please clarify? Thank you.

Albert Avetikov (Chief Investor Relations Officer):

Marat, thanks a lot for your question. Speaking about inflation levels on our shelves in January and February. Yes, on-shelf price inflation in those months was a bit higher than in Q4, which is absolutely in line with a countrywide trend evidenced by the figures reported by Rosstat. You remember the headline food CPI for February was 7.0%. So basically our on-shelf price inflation is more or less at the same level. And in January and February, it was stable. It was not moving up or down. Our original expectations were that in March, we'll see the pick. At least due to high base. Last year in January and February, Magnit was still in a deflationary environment on the shelves, while in March last year, we already saw slightly positive on-shelf inflation. Looking at the development now, in the recent weeks and days, we do see deceleration of on-shelf inflation, which is a good sign of correctness of our original expectations. We were right, inflation has picked. And here we are in line with the forecast we hear from experts and state officials that annual food inflation and headline CPI are going to be lower than that what we saw in the last quarters of the last year. Dima, please, if you want to add something.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Albert, I think I don't have a lot to add to this. It was quite a detailed answer. Maybe if you look at key drivers of inflation, in recent months they were mostly commodities and some fresh categories like eggs, oil, butter and to a lesser extent non-foods, cosmetics and detergents. Given this is the highest level so it will decelerate over the next couple of weeks and next month.

Albert Avetikov (Chief Investor Relations Officer):

And we believe it's a good sign. The consumers are not becoming much stronger. So if inflation stays at the mid-single digit level, it's going to be supportive for retailers.

Marat Ibragimov:

Okay, because you will accelerate LFL. The next question is about your gross margin. I think you should be delivering higher gross margin versus your closest peer because you have your own production. Although it doesn't cover a significant part of your cost of goods sold, still, you can save on that and have stronger gross margin. Can you please assess how many basis points does your own production add to your gross margin? Thank you.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Marat, you are absolutely right. With own production facilities in our portfolio, we have by the way now 17 facilities, 13 industrial production, it's mostly grocery production and some bakery production, and four agricultural production — cucumbers, tomatoes, mushrooms and greens — we have a really nice competitive advantage and quite a good contributor to our margin mix. Because we control here not only selling price, but also costs of production. We practically control the whole chain. And with growing penetration of private label, which is sourced by own production, we expect further positive contribution from target to have own production facilities. Given current share of own production, products and sales of around, if I'm not mistaken, up to 3% contribution to gross margin with profitability of own production up to 30% is quite significant. By the way, we also expect with growing private label share improvement in utilisation of own production facilities, especially industrial, because at the moment they're not fully utilised. Average utilisation is slightly above 60%. So here we have the upside potential not only from margin mix coming from selling price, but also from costs.

Marat Ibragimov:

So to clarify, in total all production accounts for about 3% of your total sales, and in average the gross margin is 30% higher than on other items, right?

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Yeah, right.

Marat Ibragimov:

Thank you very much.

OPERATOR:

[Operator instructions]. We now have a question from Ilya Ogorodnikov from Bank of America. Your line is open, please go ahead.

Ilya Ogorodnikov:

Yes. Hello, Dmitry and Albert. It's Ilya from Bank of America. Thank you very much for taking time. I have a question on the upcoming dividend proposal. Do you, as a management team, see capacity for similar payout in absolute terms as we saw for the first 9 months if we take into account your investment priorities for 2021? Thank you.

Albert Avetikov (Chief Investor Relations Officer):

Ilya, thanks for your question. First of all, we'll leave this opportunity to the Board to discuss that. You'll definitely be informed as soon as the Board provides its recommendation to the shareholders on the second portion of dividends. Looking at the financial position of the Company, given our strong cash generation, very low leverage, and as of now, we are looking at the basically same levels compared to the end of last year, and additional and further improvements of the working capital, we see scope for a very nice combination of faster expansion, investments in IT, redesign programme, supply chain infrastructure, and continued strong dividend payments. But on the absolute terms, we definitely need to wait for the Board's decision. Thanks.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Yes, that's up to the Board to decide. As management, we will make recommendations based on our performance and, what Albert mentioned, cash generation, working capital improvements, CAPEX plans and management structure.

Ilya Ogorodnikov:

Yes, that's very clear. Thank you very much.

OPERATOR:

There are no further questions. At this time, I would like to turn the call back to your speakers for any additional or closing remarks.

Albert Avetikov (Chief Investor Relations Officer):

Cecelia, thanks a lot. Everyone, thanks for listening. We'll speak to you next time when we report Q1 results in the end of April. We aim to continue updating you on our recent trends with higher regularity. Thanks a lot.

Dmitry Ivanov (Acting Chief Financial Officer of JSC Tander):

Thanks a lot. Have a nice day.