Company: **Magnit**

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OPERATOR:

Good day and welcome to the Magnit Q3 and 9M 2020 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 Mr. Albert Avetikov. Please go ahead, sir.

ALBERT AVETIKOV:

Thank you. 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 third quarter of 2020. With me to review the results are, as usual, our CEO Jan Dunning and acting CFO Dmitry Ivanov. The announcement and respective presentation are, as usual, 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 with this, I will now turn the call over to Magnit's CEO and President Jan Dunning. Jan, please.

JAN DUNNING:

Thank you, Albert, and good day, everyone. Thanks for joining.

This is of course a very challenging and extraordinary time that we're in. As a retailer, we have specific challenges in that area. We are at the frontier to our customers, but also to our employees. We take huge responsibility to take care about our customers, to serve their daily needs, maintain necessary safety measures, and simply make people's life better. Looking at the team, I'm actually very proud of our joint team efforts to deliver all of that. I would like from this page as well to thank all the employees for their incredible contribution and dedication in this hectic time. For us there is no choice; we see customers make choices in coming less often, but as an employee of stores or as an employee of distribution centers, you have to be there every day, take the risks. Having said that—and that's also the contribution and the reward that we get—we see a continuous inflow of new customers, marked improvement in NPS scoring and reflecting the priority given to customer satisfaction. Magnit is gaining market share quickly as we are improving.

We've invested in value for customers and continued to make strategic progress as the business moves within its turnaround. There are still numerous uncertainties around grocery market dynamics, but this brings confidence - achieved results are sustainable. We are on the right track.

This quarter brought another set of strong results underpinned by fantastic performance of the like-for-like stores. Results came above our initial expectations, despite the macro headwinds and a lack of additional stimulus from the government. We showed double-digit sales growth driven by hefty uplift in the mature stores and, at a much lesser extent, by selling space growth.

We demonstrated the strongest year-on-year margin recovery - over a hundred basic points. And what is even more important, this came without dips and/or hikes, like we had last year and the years before. So, the margin is under control.

Another focus this year is on deleveraging, like I mentioned earlier on the earlier call, and improvement of the working capital cycle. First signs speak for themselves at the moment.

Yes, this year has tested our business in ways we've never ever imagined, but it was also rich in lessons. Throughout the crisis, we have been guided by key priorities – our results evidence we are in the right lane.

So in a combination with progress made on balance sheet and cash flows, we may find ourselves next year with completely different financial position. Coupled with a remarkable rise in store returns this looks like a good foundation for faster growth to come.

Overall, we may enhance the objective and ambitions that we have set for ourselves.

Now, let me pass the floor to Dmitry to walk you through our results in more details, and I'll come back to you at the end of the call.

DMITRY IVANOV:

Thank you, Jan. Good day, everyone. Let me tell you now a bit more of a detail on quarter developments.

We have strong like-for-like sales growth in the mature stores driving total company sales. Despite slower expansion, sales growth remained double-digit, supported by performance of like-for-like stores. As a result, total sales growth of 12% was a combination of like-for-like sales growth of 7% and selling space growth of only 3%.

Main contribution to like-for-like sales growth came from mature stores opened before 2019. Our younger stores continued delivering strong double-digit like-for-like sales growth, but share of these "first year" stores in the like-for-like panel decreased to 3.4%. In the third quarter, just over 600 stores entered like-for-like panel.

Like-for-like sales growth was strong in small formats and even accelerated in cosmetics. At the same time, like-for-like sales growth in supermarkets was negative – this format was penalized during pandemic, especially stores in the shopping malls. Another Company-specific reason was a decision not to repeat "bulk coupon discount" exercise lasting for six weeks last year. Yes, on a relative basis we didn't gain additional sales, but from the other hand, we didn't burn margin.

Other positive and negative macro factors influencing overall trading in the quarter were:

- late start of domestic tourist season and limited foreign travel activity,
- lack of government consumer stimulus after last portion in July,
- spike in food CPI despite traditional harvest season,
- record-high savings made by consumers in the second quarter,
- no stockpiling or forward-buying customer behavior in the food stores, but more self-restricted spending on nonfood, services, vacations and entertainment.
- We also experienced unusually warm weather with elevated demand for summer assortment. Altogether, we estimated that this had a positive effect of around 2.8% on a like-for-like basis.

Other Company-specific trends included:

- some stabilization of traffic but still lower visit frequency,
- higher average spends per visits overcompensating weaker traffic,
- Compared to the second quarter, drivers of like-for-like ticket growth were trading up, slightly higher on-shelf inflation and, at a lesser extent, volume growth.
- Strong trading up was a result of ongoing assortment change and inflow of more affluent customers.
- We continue to attract customers from larger formats, some small players and unorganized retail. Thus, our market share increased by 1.3 percentage points up to 10.8% year-to-date.
- All regions demonstrated sound like-for-like results in each month of the quarter, with Northwest and Moscow in a double-digit growth zone outpacing the rest.

<u>Promo</u>. <u>Promo intensity was lower year-on-year, with our focus on efficiency</u>.

Promo activity in the industry remained rational. It has moderately picked up compared to the second quarter driven by stabilization of traffic after lockdown and some seasonal increase.

At the same time, customers continued looking for “value” deals, making reference towards better assortment, quality, decent pricing, service level and safety.

We made a deliberate choice to follow our “smart” promo tactics and didn't intensify promo competition.

With this, promo share went down year-on-year, while slightly picked up quarter-on-quarter.

In parallel, we are working on personalization of our promo activity, increasing penetration of our loyalty card and gradually replacing coupons and category discounts.

<u>Now a bit on our recent trading, what we have seen in October</u>.

I`d say that trading is fantastic. In October we continued seeing strong overall trading result with double-digit sales growth. And it continues by far outpacing space growth. Every day we are looking at daily sales, and now we can expect October to be one of the best months in like-for-like sales growth.

We do not observe abnormal stockpiling trends as in March, but some increased demand for dry food and basic necessities was noted recently due to accelerating cases of COVID infections in Russia.

As a result, visit frequency went down versus previous months, but ticket size started growing again. Number of articles in the basket is now the main driver of this trend.

With that I will turn to our financial results and start with the gross profit margin.

Gross profit margin showed strongest year-on-year recovery of 134 basic points to 23.8% of sales. We had positive impact from the following factors:

- improved commercial terms with suppliers,
- Slowdown of promo share by 2 percentage points which also came with better promo funding from suppliers and higher promo margin.
- Our shrinkage improved by 69 basic points despite increased share of fresh food categories in sales.
- Supply chain costs improved as well on lower transportation expenses.
- And we also have favorable product mix.
- All these positive factors were partly mitigated by the continuous investments into loyalty program, reaching 69 basic point in the third quarter and higher share of wholesales segment.

If you look at the dynamics on quarterly basis, it reflects some seasonality, driven by assortment mix, moderately higher promotional activity and higher penetration of loyalty card in sales.

SG&A expenses remained under strict control.

SG&A expenses as percent of sales were 54 basic points down despite negative impact of COVID, of around 13 basic points or RUB 500 million. COVID costs were, as in the previous quarter, predominantly related to payments to frontline personnel, and purchase of health and safety protection items.

Personnel costs went slightly up on the back of increased payment to retail personnel, which was partially offset by growing in-store productivity and record-low staff rotation.

Utilities expenses increased due to annual electricity rates indexation and higher frequency of cleaning in our stores.

Marketing expenses decreased on lower promo activity and more efficient marketing tools.

Lease expenses improved by 40 basic points year-on-year on increased sales density and better rates per square meter, which offset growing share of leased space. We continue our renegotiation campaign on rental rates with landlords as one of the measures to counteract the impact of the outbreak.

Depreciation of assets as percent of sales improved by 40 basic points driven by growing sales density across all formats and slower expansion.

Other expenses also remained under strict control.

We also note quarter-on-quarter dynamics of SG&A expenses – it was almost flat despite negative operating leverage effect.

As a result, EBITDA margin improved by 133 basic points year-on-year and stood at 7.2%.

For the third consecutive quarter EBITDA margin is improving driven by gross profit margin recovery and better SG&A expenses.

Adjusted for LTI expenses, EBITDA margin would be 8 basic points higher or 7.3%.

Net interest expenses improved by 23 basic points thanks to reduced cost of debt.

In the third quarter we had foreign exchange loss of around RUB 900 million related to direct import operations.

Overall, as a result, net income increased 2.7 times to RUB 9.6 billion with a margin of 2.5%, and the effective tax rate was 23.5%.

Working capital. It's another strong improvement. Working capital improved by RUB 10 billion driven by inventory optimization.

In the third quarter, we managed to decrease inventories by RUB 9.7 billion compared to the end of June despite ongoing improvements of on-shelf availability, increased share of drogerie format and supply inflation.

Trade and other payables also increased by RUB 3.6 billion in the third quarter as a result of measures and at extension of payment terms.

This positive was partly offset by increased accounts receivables by RUB 3.1 billion. We reiterate our focus to deliver improvements in the working capital in the second half of the year.

Also, we are enhancing our financial position substantially improving cost of debt and increasing debt duration.

As of the end of the quarter, our gross debt was RUB 184 billion which was RUB 25 billion lower versus the second quarter.

With RUB 5.6 billion of cash on hands Net debt stood at RUB 178 billion.

We are using the momentum of historically low market rates to reduce costs of debt and improve debt maturity:

The duration of debt portfolio increased from 17 months at the beginning of the year to 23 months now.

Debt profile has also improved. As of now, long-term bank debt and bonds account for 94% of total portfolio and all at fixed rates.

Cost of debt dropped to historical lows of 6.2%, down 1.6 percentage points year-on-year.

With RUB 10 billion bonds with 7.85% coupon rate coming due in December and some scheduled loan repayments at the year end, we expect cost of debt to continue falling this year closer to 6%.

Net debt to EBITDA ratio leverage as at the end of the quarter improved to 1.8 times. We expect it to go down further by the year end.

CapEx guidance for 2020 decreased to RUB 35–40 billion.

CapEx in the third quarter stood at RUB 7 billion, and the amount for nine months reached RUB 19.3 billion.

New capital expenditures projection for 2020 is based on lower investments in expansion and redesign, economy gains from more efficient projects execution and some slippage for 2021.

No changes were made with regard to already revised number of store openings and redesign program for 2020.

Due to pandemic, we had less openings in the second and third quarters, but we see strong pick up of our space growth starting from this quarter.

The number of openings in the fourth quarter will be already much higher than in any previous quarter of this year. This is well reflected in remaining CapEx plans for the fourth quarter.

We are well on track with our digital initiatives.

As you know, in September we launched our e-pharmacy and started to provide Click & Collect service from over a hundred pharmacies throughout Moscow and Moscow region.

In the weeks to come we will announce our online initiatives in the grocery part of the business.

You have also seen us announcing our first Metropolitan convenience store concept, which was already opened in Moscow. This store has a combination of new layout, assortment and latest technologies offering high-tech environment to the customers.

On ERP transformation, we now start our work with selected integrators. In two years we will build all we need on piloted volume to roll it out in the next three years. So, in total about five years for full-scope transformation, including Goods Movement & logistics, HR, finance, non-commercial procurement and real estate.

Our digital initiatives will evolve in the future with a greater focus on implementing of new technologies in the business and for our customers.

With this, we will still maintain our strong focus on improvement of our ”brick and mortar” business.

And last but not the least, our impressive results of recent M&A activity.

In the third quarter, we entered premises of Evroros and Intertorg in the Northwest region taking over 166 stores. This has significantly extended our footprint in that region.

We highlight fast integration of stores into our network and sales performance above initial expectations.

We're excited with our dynamics specifically in St. Petersburg where like-for-like sales growth remains double-digit.

And we continue to look for bolt-on value accretive acquisitions of small-to-medium size.

And now I will give a floor back to Jan for some closing remarks. Thank you, Jan.

JAN DUNNING:

Thank you, Dmitry. Just a few notes before we move to the Q&A.

The crisis brought additional challenges, which we've spoken about, but showed also our ability to seize opportunities to create value. We're more than satisfied with the progress we're making so far. The team has been able to make a significant and lasting contribution towards improving sales densities and keeping margins sustainable. And regular analysis shows better returns across all formats and regions.

With stronger balance sheet—and that was one of our targets—cash generation and working capital improvements, we may find ourselves next year with an absolutely different financial position, like I mentioned before.

And this serves as a good foundation for faster expansion going forward and in general our heightened ambitions in the market itself.

Of course, in a combination with returning surplus cash to shareholders, where we don't see downside risk, but, potentially, upside.

Thanks for listening. And I think we're ready for questions.

DMITRY IVANOV:

Operator, thank you, we can start the Q&A session.

OPERATOR:

Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. And we will pause for just a moment to allow everyone an opportunity to signal.

And our first question comes from Kirill Panarin, please go ahead.

KIRILL PANARIN:

Hi, everyone. Thank you for the call. A few questions from me, please. Firstly, could you elaborate on your growth ambitions next year? How materially do you want to accelerate openings? And could faster expansion mean some pressure on profitability or you think margin increase could continue next year?

JAN DUNNING:

The growth ambitions are actually coming from the focus on returns. So, what we see is that the business in itself, the like-for-like performance, and the modeling and the CVP, the customer value propositions that we add into this, is delivering very good returns. We do a quarterly post investment analysis on the stores. There is actually no reason not to have higher ambition for growth. We see that higher ambition for growth in the cosmetics business, we see that ambition as well in the Convenience. We will focus more on the customer value proposition implementation on the hyper- and supermarket business. You will see us do more remodeling there next year. As we see that the remodeling also delivered us very good returns. If that is confirmed further, then, of course, there for the first time in years, next year we'll do some additional openings as well.

Having said that, we also have taken the decision to roll out further and to extend the pilot of the Magnit City which is actually called Grab&Go which, in the pandemic situation, is not well positioned but we see that with us it runs actually quite well. And we see also quarter-on-quarter like-for-like improvements.

So we've decided to extend that pilot to 50-100 stores. And the one that we have actually accelerated is the discount business. Moya Tsena is the name for the stores (or My Price stores), which is a store that sells our price-entry and we call it value articles P1/P2, with a very low cost

structure in which we actually offer those goods as well with a lower price than we do in our normal stores. Then, those are stores that are, of course, low in rent, because it's a different concept. Therefore, also the locations are a bit more complicated. But we see that those stores actually on a shelf density level and return level are good investments. I think the first one we opened at the end of July–beginning of August. We took by now a decision to have at least in the next half year 100 of those stores opened. So, that's a bit the direction that we are going to. And then, what Dima already mentioned earlier, we do, of course, a lot of initiatives on the e-commerce side, mainly also given the current circumstances with the pandemic, which clearly has a tailwind impact on e-commerce. We've started several products with good e-commerce players where we are actually their provider of goods. But I think by end of next week, we will also announce our own capabilities of having developed an e-grocery platform and also starting to deliver ourselves. And that will be in various alternatives because, on e-commerce, we are actually in the piloting stage, we do express delivery, we do the dark store, and we will do a regular e-commerce delivery, and then see what is the best model that will work for us. And, potentially, if they're all working for us, then we'll keep all of them on the back of the improvement and the turnaround of the existing business, and bear in mind, we've got the biggest network of stores in the country. If we can tap out of that base of stores more, that does not inquire additional investments, therefore, we think that the initiatives that we're having in plan for next year will actually not affect the returns that much.

Your second question was more on the profitability. As we are return-driven, we do not believe that faster growth will come at the cost of profitability unless we're actually overstretching ourselves into incredible big growth ambitions. That's not the plan. What we will be looking at, because we see that the market is also shaping, is acquisitions. That's also mainly stimulated by the experience that we now have in the Northwest, we see that our capability of integration and picking up in friction is actually very good. We also see, by the way, that those like-for-like Intertorg stores are coming at exciting returns. I don't think that comes as a threat for profitability. And if it is, then we'll just turn that down. Because there is no reason for me in a business of the size of Magnit to do things that are irrational.

DMITRY IVANOV:

Jan, let me add to this. The retail is about volume and volume increase. And volume increase is driving two big things. The first one is better supplier conditions, better supplier terms and scale effect on costs. With volume increase we will gain on operating leverage.

JAN DUNNING:

Therefore, I don't think that faster growth that we have in mind for the next year will jeopardize our profitability. On the contrary, I think, what you said might actually contribute.

ALBERT AVETIKOV:

Kirill, I hope that answers your questions, right?

KIRILL PANARIN:

Yes, it does. Thank you. Thank you very much. I have just one follow-up on working capital. You've been focused on this for a while. It looks like the results have started to come through. Could you elaborate on the initiatives that drove improvements in Q3? I think you mentioned some cross-functional initiatives in your press release. Maybe you could give some examples of those? Is there a medium term target or KPI in terms of inventory turnover days? Or it's premature to talk about that? Thanks.

DMITRY IVANOV:

We were focused on working capital improvements quite a lot and put really a lot of efforts on getting these improvements in this year already. We were focused on three main areas of working capital improvements, which are inventories, accounts payables and accounts receivables. With inventories, we have already achieved the biggest improvements with collaboration inside company with supply chain teams, with commercial teams and operational teams, we developed several reporting systems which help us to monitor inventory structure and make it more transparent and thus manage inventory amounts and reduction. Also, we were very much focused on optimization of our promo forecasting in order to buy exactly what we need for promo, not more or less, which also helps us to optimize promo inventory levels. Also, we looked at a clusterization of our inventories by ABC classification, and adjusted our ordering system with more items of A and B, which are highly in demand, and less of C and D items. And really a lot of other things which all together by small parts brought quite significant improvements.

With regard to accounts receivables, we were focused on decreasing our accounts overdue with suppliers, and mostly focused on speeding up documents flow with electronic document flow system, which we introduced with the biggest suppliers. And this had already some results. And with payables, this is our regular negotiation campaign and process with suppliers, where we are steadily improving our payment days. But there is still a huge potential, in my opinion, in this area. With regard to KPIs, for example, this is my personal KPI - working capital improvement. There are also KPIs for working capital improvement for all linear managers who can have an impact on this metric.

ALBERT AVETIKOV:

Kirill, these all projects mentioned by Dmitry are ongoing, and we expect lasting contribution from these ones, including in the next quarters to come.

KIRILL PANARIN:

Okay, great. That's it. Thanks a lot.

OPERATOR:

Thank you. Our next question comes from Elena Jouronova, please go ahead.

ELENA JOURONOVA:

Good evening, gentlemen. Congratulations with very solid results. I also have a few questions. So the first one is: can you quantify us the contribution of on-shelf inflation to like-for-like ticket growth in the third quarter?

DMITRY IVANOV:

Elena, first of all, good evening. It's nice to hear you. If I'm not mistaken, on-shelf inflation contributed around 4–5%, maybe slightly less.

JAN DUNNING:

Actually, I think, on-shelf inflation started to move up in September and started actually on a very low level. I think, it's around 3.5–3.8%.

DMITRY IVANOV:

Yes, that's closer. I'm referring already to October, back in July and August it was much, much lower.

JAN DUNNING:

We came from a pretty low inflation environment, but due to the exchange rate changes, you see that currently, over the last month, in September, and now in October, we see on-shelf inflation moving up. But having said that, procurement inflation in October is higher than our on-shelf inflation. We are pushing back a bit.

ELENA JOURONOVA:

That's interesting. The second point I wanted to discuss was actually on operating leverage. To be honest, I wasn't that impressed with operating leverage effects in the third quarter, because if I strip out depreciation from your OPEX, then in fact OPEX as percentage of sales was flat and I would have expected some more tangible improvement considering that you have 7% like for like sales growth and similar sales density expansion. Maybe you can share your thoughts on my comment and tell us what are the expectations going into Q4 and next year, especially considering that you really are keen to intensify growth.

JAN DUNNING:

Yes, let me give a bit of a high-level picture. A part of it was already mentioned at the call. We were confronted with the heritage of that, previously, we had to increase the salary, especially in the big-boxes, which we have done in the beginning of the year, second quarter, so that has

impacted the third quarter. Then, as you have noticed, we have been investing quite a lot in management structure, and especially in the big store management structure, which is on top as well.

What I think is important for you to realize is that we keep on focusing on operating efficiency, and we see that we have the results there. But if you want to change things, then you need to invest first, and so that that's the deliberate choice, I think, Dima can go much more in details.

DMITRY IVANOV:

Jan, let me add to this. Also, it is quite important, we improve very much service, and look and feel in our stores. By the way, we significantly decreased staff rotation in our stores, and this has resulted in like-for-like sales improvement, and also in average cost. Please don't forget that every year we have inflation on our utilities, just electricity, fuel, all this monopoly on things which add from 5 to 10% of increase. And also, which is quite important, due to COVID, we spend a bit more on cleaning inside stores, on safe and cleaning measures to keep our customers and our employees in a more comfortable and safety conditions.

ELENA JOURONOVA:

Okay, thank you. That's clear. My other question was a follow up on Kirill’s question on working capital. Dima, is there some sort of a minimum level of cash release from working capital that you think you can certainly achieve this year? I mean, there could be upside, but is there like a minimum number, which you certainly know you can get?

DMITRY IVANOV:

Lena, I would not like to promise you anything. But, believe me, there is still quite a strong potential, especially for this year.

JAN DUNNING:

Lena, maybe you recall that we had a meeting as well at the end of the second quarter where I mentioned that, and also on the call, that there was a plan of what's the focus for which period of the year. So, remember the second half year of 2019. My first half year as a CEO, the focus was on “get traffic back, get store performance better, make people feel that it's a store that you can go to”. Then in the second half, which is the first half of this year, it was margin regain. We saw customers coming in, but we didn't see this translated into better margins, which we managed. Now in the second half of this year we are focusing on working capital improvement. We have our stock meetings, we have our overdue receivable meetings. And by doing this, making the organization aware and also coordinating this, you see that also is now starting to improve. Therefore, the fourth quarter is still in that plan. We would like to see the stock coming down further. As you know, by the end of the year, our payables are always more than stock level. So

I think, by the end of the year, we'll see also our net debt coming down and leverage coming down. And that's also what we need because if you want to have a sound financial position, that's what you need if you want to grow. Like I mentioned, it is consolidation time, we believe, so why not make sure that we are ready in any way, that we can join those potential biddings.

ALBERT AVETIKOV:

As Jan mentioned, Elena, we are absolutely confident that we finish the year with absolutely different financial position. Part of that comes from working capital improvement. We will continue working on that to get more upside by the end of the year.

ELENA JOURONOVA:

Okay, but then, on leverage, where do you think you can be at the end of the year in terms of net debt/EBITDA?

JAN DUNNING:

I think, we'll have a pretty big improvement. I can give you a range of around 1.5–1.6x.

ELENA JOURONOVA:

Okay, that's good enough for me. Thank you. And the final question I had was about recent color on hard discounters. I know I'm asking it every time but I'm really curious to know how this format is performing.

JAN DUNNING:

I hope you read my Forbes interview on discounters.

ELENA JOURONOVA:

Which one? I mean, probably, I've missed that. Sorry.

JAN DUNNING:

You should look it up, you will like it. We had a couple of stores which were just zero bottom line businesses. What do you do? You use them to keep volume or you find some other purpose. By analyzing this, the main reason, because you see that other stores perform, the main reason was location. Now, you have a choice, you continue or you do something else. We decided to do something else. And then, what are we going to do? We need to give customers a reason to come. And what we did then is we reduced the number of SKUs to around 1600 SKUs. We use for a big part our own production. As you know, we have 11 factories, and a lot of our private labels are made in our factories. So we used that production volume to go to those stores, we call the stores Moya Tsena, which is our price entry level. We have a concise but relevant range in the store at a price level which is around 10 to 15% lower than our normal store base, which is

also below than what we call hard discounters like Svetofor, Fix Price. And what we see is that, indeed people that is a customer group that is attracted to this that makes that additional mile and we saw stores growing around 30−40% of sales. And we see that the stores now are having positive operating contribution, where in the past it was around zero, and some of them even minus. Looking at the investment level, which is also 30–40% lower than the regular stores, we see that the returns on that model is actually quite interesting. Of course, the margin in itself, I don't expect that to have an EBITDA margin of 7%, but we have set ourselves a certain target. And that's what we are delivering. Now looking at the returns, this is a business that deserves to grow. And that's what we're going to do.

QUESTION:

Yes, Jan, thank you very much. I agree. That's all from me.

OPERATOR:

Thank you. And our next question comes from Maxim Nekrasov. Please go ahead.

MAXIM NEKRASOV:

Yes, good evening. Thank you very much for the presentation. Congratulations with strong results. I wanted to follow up on your margin sustainability. Basically, you showed a very strong EBITDA margin improvement over the last couple of quarters to above 7%. But if we look at the next year and going forward when you have more openings, and also considering the ERP and IT transformation, and as well as potentially higher promo activity as people start visit more stores. Basically, what makes you sure and what are the key factors that will help you to sustain your EBITDA margin at above 7%?

JAN DUNNING:

Yes, this is going to be a bit of a long answer. So what are we doing to sustain our margin? What we have started doing recently, we have invested in the commercial department by adding a procurement department. I have appointed a procurement director directly responsible for own production, imports, private label. The reason for this is that Magnit still had the import responsibilities and private label responsibilities in the capital management sector. And that is not a good place to be. A retailer of our size should have a professional import department. That's what we're going to start up. It means that we potentially will cut out a lot of the middlemen that we still are working with, and we are trying to create critical masses in different parts of our business. And I believe that is going to contribute to margin. I also believe that with the growth, and bear in mind, especially in the growth of our cosmetics business that we should be able to get rewards from suppliers. Tomorrow we have our supplier conference. And I tell you that the suppliers are actually very happy with the changes that they see in Magnit. And that should also

be translated in a more on a higher level of collaboration with them, and therefore also a better gain on our side. And that's also what we have seen this year.

And the third factor, which you mentioned is that we have started the loyalty card. And the loyalty card provides you with a lot of insight and a lot of information. But also on the digital side, we have started our advanced analytics. One of the first things we've asked them to do is look into the effectiveness of promo. And we see that we actually can improve the effectiveness of promo much, much more than what we have done in the past traditionally. And we have now insight into cannibalization, into profitability and we can make that happen better. With the loyalty card, we also know what kind of campaigns are attracting to what kind of customers, and what's the total gain out of those customer groups. In any advanced analytics, I think that is also money gain that we can tap from. And that's a basic principle from my side, as we now are a business that runs multiple formats, Magnit should start to focus much more on the mission of those formats. And what we have done is … I saw that in the market and I hope that comes down. The market was not rational with regards to promotions.

You have to have a promo and promo intensity, if you have a business that needs to draw customers out of town to your location, the hypermarket, but the convenience is a totally different region to go to. Of course, you need to do promotions, but you don't need to do the promotions in the intensity that you do in a hypermarket because that is simply first not smart, second, does not add, and potentially, after a certain percentage of promo share, and that's also what the advanced analytics shows, they're actually cannibalizing your sales. So why would you do this? By having that insight and spreading that insight in the organization and getting more control over what we are exactly doing, I believe that we still have an opportunity to take more money out of our trading. And we've seen that this year on the promo efficiency. By the way, bear in mind, the margin that you look at, you know that there is a 0.7 investment into the loyalty card. On top, we have been able to compensate that by better managing the business. And I think that's what we'll do going forward.

Then on the supply chain, I think that's not a project of a year or half a year. I think that's a multiple-year project but on the supply chain as well we have a very efficient supply chain for the convenience store. We have a less efficient supply chain for the cosmetics store. And we have a disastrous supply chain for the hypers and the supers. Also there we need to gain and get some additional margin over them out.

I think I answered the question on growth, which you also mentioned as a threat. As long as we are doing growth with the brain, which means I don't need to grow, I only need to grow if it makes sense, the growth is purely return-driven. And as long as that's the case, and we follow up on analysis afterwards, we become smarter and smarter in finding the success factors for future growth. I am not considering that growth is going to jeopardize my margin.

DMITRY IVANOV:

Jan, let me add to this. With new tools we are implementing with SAP implementation, with F&R implementation, this will also help us to improve our stock losses, because of better promo forecasting accuracy. The second thing, which is quite important, with volume growth, and also with new technology sets and new systems implementation, we can leverage our scale effect more with head office costs, and with admin costs, getting more positive impact from operating leverage.

JAN DUNNING:

I hope Max that gives you a bit of comfort.

MAXIM NEKRASOV:

Yes, thank you very much. Very clear. And I have another question on capital allocation and dividends. Basically, do you see potential to increase dividends for nine months and the full year? And also on capital allocation: what kind of CAPEX do you expect next year? What kind of increase are we talking about?

JAN DUNNING:

It's the easiest answer to the last one: we're not guiding yet on CAPEX next year, we're in the middle of the budgeting process and therefore have no approved budget yet with the Board of Directors. And now that I mentioned the Board of Directors are the guys that actually define the level of dividend that's going to be paid out. But let me give at the call the management view. Looking at the business results and improved profitability we see no management or business reasons not to improve dividends, but it's not a decision that we take.

ALBERT AVETIKOV:

Maxim, I hope that answers your question, right?

MAXIM NEKRASOV:

Yes, thank you.

ALBERT AVETIKOV:

There is no white smoke yet but I guess, in the next time to come, you will hear us announcing the decision of the Board when it's made. Thank you.

MAXIM NEKRASOV:

Thank you very much. That's it from me.

OPERATOR:

Thank you. Our next question comes from Yulia Kazakovtseva. Please go ahead.

YULIA KAZAKOVTSEVA:

Hello, my question is on LFLs. Do you see supermarkets LFLs positive in October? Or is it still negative?

JAN DUNNING:

No, actually, it is small, but it's positive.

YULIA KAZAKOVTSEVA:

Could you please elaborate a bit on those supermarkets which are in shopping malls? What do you see there?

JAN DUNNING:

Yulia, it is clear because it's a very relevant question. It is clear, of course, that we call them the malls as people are having changed their purchasing behavior into "we go less often to stores because we want to learn as little risk as possible". The standalone stores are performing better than the mall stores. Now, fortunately, we do not have a lot of mall stores. And actually during the first wave of the pandemic I think we had to close or limit the opening times of four stores only. That didn't have an impact on our business at all.

YULIA KAZAKOVTSEVA:

Thanks a lot. It's clear.

ALBERT AVETIKOV:

Thank you. Any more questions, operator?

OPERATOR:

We have one additional question from Henrik Herbst. Please go ahead.

HENRIK HERBST:

Yes, thanks very much. I've got a few questions actually and apologies I dialed in a little bit late, so I might have missed, you might have answered this already. But the first question is in terms of the 70 bps drive on your margins from loyalty program, should we now assume that that has peaked? I think it's pretty similar to the drive in Q2. At what point could that reverse? I mean, it sounds like you want at some point try to get suppliers to contribute to the promotions and loyalty and maybe do a bit more efficient. How much of that be reversed over time, you think? And then secondly, I guess your drogerie business is performing very strongly. To what extent do you think that is driven by competitors being in the malls, etc.? Basically, your competitors are not seeing

as much traffic anymore. Then the third, question, I guess is, how much of your promos are actually covered by suppliers currently? And what do you think that could get to? And then the last question is in terms of all these new investments. I apologize I haven't covered Magnit for very long. But in terms of returns, cash flow generation or returns on invested capital, what are the targets or hurdles, when looking at those different investments? Thank you very much.

JAN DUNNING:

Thank you. And the second question I didn't get totally was related to traffic. Maybe you could repeat that, because the rest of the questions I got.

ALBERT AVETIKOV:

Was it related to the supermarkets in the mall, Henrik, right?

HENRIK HERBST:

No, sorry. The second question was on your drogerie business which has been very strong. And to what extent do you think that benefited from your competitors being in malls?

JAN DUNNING:

Yes, clear. Let me start with the loyalty question. It's a bit of a complicated question. Of course, we ask suppliers to do joint activities with us. And certainly, if you do personalized promos, whether there is a willingness to compensate or to pay for those, with our advanced analytics, and also with our data, we expect next year to get part of the investments that we do monetize. But I think, the biggest value in this loyalty card, and that's for me really worth the money. It's, you get a much more fact-based insight in your customer behavior and missions. And if you are a category manager, and certainly, if you're in the convenience business where the completion is high, then you need to know what you're doing. You can't just go on the average temperature in the hospital, it's just you need to know what in my category should I add, what's in my category should I skip. And I can give you a lot of simple details or experiences that I have with this. But it's that if we are able to help the category managers with data, actually, to prepare the choice, then for them it becomes much easier and better, we will be able to be much more efficient and relevant on the shelf. And I think that's where my first gain is because part of the CVP (the customer value proposition), and that's also what we see by the way, if you look at the impact and the returns of the remodelings, a pretty big part of that is actually the improvement in assortment. Now, if you can invest 0.7 to get more out of sales, more out of your customers in general, then that might look like a lot of money. But I think it's well-spent.

Very short, yes, we will try to monetize. I don't think it will cover everything but it gives me insight into promo effectiveness where I think there's a lot of money left. And I think it's a good investment overall.

Then the drogerie, which is a shorter answer. Yes, of course, the drogerie is profiting from the fact that the malls are closing or have been closed or people do not like to go there. Therefore, our standalone drogeries are popular. But if I look at Q1, Q2 and Q3, the growth in the drogeries is actually pretty progressive. And the third quarter was the quarter in which the consumer was after the lockdown acting differently. There was no COVID anymore. What I do think and it is my conclusion: we have shown an audience, in the second quarter there was no alternative, that actually coming to our drogerie store makes sense, is an experience that you would like to repeat. That’s what we see in the third quarter. And I expect that to continue in the fourth as well.

Then the third question was on promo coverage, to which extent what our suppliers are sponsoring. Overall, the intention is, of course, as you do promo together, it's not that I as a retailer do the promo, the supplier also does a promo. He also has his budgets and his ideas of sales. Overall, I think we should go and try to get rid of the promo or win situation which means that we invest both a certain amount of money. With the advanced analytics, we become smarter. We also know now to suppliers and this is not a smart promo for you, this is the discount that we think is better. The overall 70% of our promo activities are covered by supplier funding. As we do not really grow our promo intensively, if you look at it y-o-y, we're actually declining. That of course also delivers you a bit more money, but the promo coverage last year was abominable. It was very bad. That's one of the biggest improvements that we have done this year.

And then the last question is on the ROIs. When I arrived here in 2018, I remember the first post-investment analysis arrived and the 2018 stores were really very poor. And that was not because what the current management was doing was wrong. But that was not really getting a translation to the stores what’s the CVP and the category management changes. And I think that's what we have put in place. Since then you see that remodellings, but also new stores, the hurdles that we have are actually assume at a similar level. We expect that to be around 25% higher. And on average we are reaching a higher level of ROI.

HENRIK HERBST:

Thanks. Thanks so much. Sorry. It is 25% higher. What's that? Okay. Got it.

JAN DUNNING:

Over time, we might want to move it up or down depending on accuracy, but for the time being, we feel confident with 25%, we don't rock the boat.

HENRIK HERBST:

Okay. Got it. Thank you.

ALBERT AVETIKOV:

Do we have more questions?

OPERATOR:

We have no additional questions at this time.

ALBERT AVETIKOV:

Then in that case, we would like to thank everyone for joining and listening to us. We will speak to you again in the beginning of February on the Q4 and full year results. Thank you everyone. Bye.