



## Magnit PJSC

### 4Q and FY2020 Operating and Unaudited Financial Results

**Magnit PJSC speakers** Jan Dunning (President),  
Dmitry Ivanov (Chief Financial Officer),  
Albert Avetikov (Chief Investor Relations Officer)

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Participants	Maxim Nekrasov, Goldman Sachs
asking questions	Nickolay Kovalev, VTB Capital Henrik Herbst, Morgan Stanley Marat Ibragimov, Gazprom Bank Alexander Gnusarev, VTB Capital Alexey Krivoshapko, Prosperity Egor Makeev, Raiffeisen Bank Kirill Panarin, Renaissance Capital Artur Galimov, SOVA Capital

#### OPERATOR:

Good day and welcome to the Magnit Q4 2020 operating and unaudited financial results 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):

Thank you, John. 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 Q4 of 2020 and full year. With me to review the results are as usually Dmitry Ivanov, acting CFO, and our CEO Jan Dunning. The announcement and respective presentation are available on our website. After our remarks, as usually, we look forward to taking your questions. Before we jump into the results, I would also like to remind you that today's financial results are based on the management accounts. And with that, I now turn the call over to Magnit's CEO Jan Dunning. Jan, please.

#### Jan Dunning (President):

Thank you, Albert. Good day, everyone. Thank you for joining. You remember that we started last year by introducing key strategic priorities for the business. The team had to focus on qualitative improvements in the stores and margin regain. In the second half of



the year we put most of attention to working capital improvements and still kept the main focus on LFL top line and margin improvements. Pandemic has also forced us to speed up reduction of debt burden. Despite macro headwinds and many other unpredictable and extraordinary challenges, I believe we delivered all what we promised.

Looking at the Q4, we delivered another set of strong results. We again showed double-digit sales growth. And this was driven by a hefty uplift in the mature stores and at a much lesser extent by selling space growth. We resumed our expansion and redesign program thanks to improved returns on new openings. We delivered industry leading LFL sales growth of 7.5% by far outpacing inflation, and our sales density increased by 6.5%. EBITDA margin improved by 160 basis points on better commercial terms, efficiency gains and operating leverage. We managed to release more than RUB 30 billion of cash out of the working capital, and our leverage reduced one time in a single year to 1.1 of Net Debt to EBITDA. Finally, we finished the year with outstanding free cash flow position of RUB 85 billion.

The results speak for themselves. The fact that we achieved almost twice higher returns on the whole business just within one single year, I consider as remarkable. So, we're entering 2021 with a completely different financial position. And this is a decent foundation for faster profitable growth and next phase of retail and digital transformation.

Now, let me add some color to the quarter developments.

We achieved strong LFL sales growth in the mature stores and resumed our expansion. The sales growth was double-digit driven by solid performance of the LFL stores. And as a result, total sales growth of 10.6% was a combination of LFL sales growth of 7.5%, and selling space growth of 3.6%.

In the Q4 we accelerated our expansion program underpinned by strong return dynamics and opened 445 stores on gross basis - more than in any quarter of 2020 and higher year-on-year. At the same time we closed only 35 stores - the lowest number in any quarter of 2020. Thus, we pass the bottom of selling space growth.

Same to previous quarters the main contribution to LFL sales growth came from mature stores. Younger stores continued, of course, delivering strong double-digit LFL sales growth but the share of these "first year" stores in the LFL panel was just 1.7%.

The LFL sales growth was positive across all formats and all regions and all vintages. It accelerated in the core convenience format and turned positive in the supermarkets and superstores. So, we overcame country-wide trend when consumers avoided visiting large stores and shopping malls. Drogeries remained a leader with double-digit LFL sales growth. We still see COVID effect, which we estimate at around 2.2% on a LFL basis.



Other company-specific trends included:

A weak frequency of visits due to the pandemic, partly offset by continuous inflow of unique customers, higher average spends per visit. Drivers of LFL ticket were volume growth, trading up and on-shelf inflation. Strong trading up was a result of ongoing assortment changes and inflow of more affluent customers. We estimate that large part of these new rich customers trade down to Magnit thanks to our value offering and improved assortment.

On-shelf inflation accelerated on the back of increased food CPI and lower promotional activity. We continue to attract customers from larger formats, some small players and unorganized retail. All regions demonstrated sound LFL results in each month of the quarter with Moscow and North-West in a double-digit growth zone. We note double-digit LFL sales growth in fruits and vegetables - the fastest growing category throughout the whole year and one of the key drivers of our new CDP.

The promo intensity remained lower y-o-y with a focus on efficiency. The promo activity in the industry remained rational. It has moderately picked up compared to the 3Q due to the seasonal factor but remained lower on a year-to-year basis. We hope that the market stays rational in 2021 as well. Currently, we don't see any reason to intensify our promo activity and will focus on driving sales by CVP improvements.

Our e-com initiatives are gaining traction. Since the second half of 2020 we have launched 6 e-com pilots including own express and regular delivery, partnerships and click & collect options. Today over 1,000 stores in 47 regions and 72 cities are covered. Around 50% of the current revenues are generated outside Moscow and Saint Petersburg. The average ticket for Magnit's own delivery service was about RUB 1,600, which is 4.5 times higher than in the offline stores. We fulfilled around 6,000 orders a day. And according to our data, most of the orders were placed by customers who didn't shop at brick-and-mortar stores before. During 2021 we plan to expand online delivery adding at least 1,500 stores in more than 50 regions across Russia.

Now a bit on the recent trading. We showed strong momentum in January. Total sales growth remained double-digit almost fully matching previous quarter's average. And it continues by far outpacing space growth. The LFL sales growth came in line with the Q4 average despite much stronger base. And what is important, this strong trading was achieved despite much lower promotional activity - promo share in January was down versus the 4Q average. So, we're not driving sales by promo and sustain very healthy margins. No change in consumer patterns - lower frequency is overcompensated by higher spend per visit. The strong basket is first driven by growing number of articles, and economic environment remains tough with weak consumer incomes and purchasing inflation. But it's too premature to assess the potential impact of that.



Q4 and full year 2020 operating and unaudited financial results call transcript

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

Dmitry Ivanov (Chief Financial Officer):

Thank you, Jan and good day, everyone. Let me start with gross profit margin.

Gross profit margin improved by 168 basis points and stood at 23.3% of sales. We had positive impact from the following factors:

First of all we improved commercial terms with suppliers. Slowdown of promo share by 1 percentage point, which also came with better promo funding from suppliers and higher promo margin. Shrinkage improved by 44 basis points despite increased share of fresh food in sales. Our supply chain costs slightly improved on lower transportation expenses. We had favorable format mix. These positive factors were partly offset by continuous investments into loyalty program. If you look at the dynamics on a quarterly basis, it reflects some seasonality driven by assortment mix, moderately higher promotional activity and higher penetration of loyalty card in sales.

A few words about SG&A. SG&A expenses remained under strict control. SG&A as a percent of sales were down 41 basis points. We had negative COVID impact of 11 basis points or almost RUB 0.5 billion. Staff costs went down 13 basis points on higher productivity of in-store personnel and record low staff rotation. Lease expenses improved by 31 basis points on increased sales density, better rates per square meter and closing of inefficient stores which offset growing share of leased space.

Depreciation of assets improved by 39 basis points driven by growing sales density across all formats and slower expansion. It was partially offset by non-cash impairment provision in the amount of RUB 1.1 billion. Advertising expenses increased by 53 basis points on higher marketing activities including "Skrepyschi" and other loyalty campaigns, as well as digital marketing. Some other costs were affected by inflation and compensated by positive operating leverage effect.

As a result, EBITDA margin showed strongest year-on-year recovery by 160 basis points and stood at 7%. For the fourth 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 5 basis points higher, or 7.1%. Net interest expenses improved by 34 basis points, thanks to reduced cost of debt and debt repayments leading to lower total amount of debt. We had foreign exchange income of RUB 419 million related to direct import operations. As a result, net income tripled to RUB 11.1 billion rubles with a margin of 2.7%. Effective tax rates was 21%.

We managed to release RUB 30.5 billion of cash out of working capital. Our initiatives aimed at improvement of working capital cycle started to pay off. In Q4 we managed to decrease inventories by RUB 12.9 billion compared to end of 2019, despite total sales



growth of 13.5%, increased share of drogerie format, higher on-shelf availability and higher supplier inflation.

Trade and other payables remained flat year-on-year as extension of payment terms in trade payables were technically offset by other payables reduction due to high pace of expansion in 2019.

Accounts receivables decreased by RUB 5.4 billion. This came as a result of ongoing optimization initiatives including weekly tracking of overdue debts and clearing activities, as well as launch of electronic document flow with suppliers. We continue to focus on further improvements in the working capital primarily through the reduction of turnover in days.

We finished the year with very strong free cash flow position of RUB 85 billion. Our net operating cash flow doubled year-on-year, driven by a combination of sound sales growth, improved margins and positive working capital changes. CAPEX in 2020 decreased by 45%, and stood at RUB 32.1 billion on lower investments in expansion and redesign, economy gains from more efficient projects execution and some slippage for 2021. Due to the pandemic we had less openings in Q2 and Q3. But in Q4 you see a strong pickup of our space growth.

Also we significantly improved our debt burden on the back of deleveraging lower costs and increased duration. At the year-end our gross debt was RUB 166 billion, which is RUB 18 billion lower versus last year. With almost RUB 45 billion of cash on hand, net debt stood at RUB 121 billion. Duration of the debt portfolio increased from 17 months at the beginning of the year to 22 months. Debt profile has also improved. As of now long-term bank debt and bonds account for 99% of total portfolio, all are at fixed rates. 2021 is well secured for us with only 9% of debt to be refinanced or repaid. Cost of debt dropped to historical lows of 6.1% - down 1 percentage point year-on-year with some further upside. Net debt to EBITDA ratio improved to 1.1x versus 2.1x a year ago. This is way below our comfortable level of around 1.5 times.

And now I will give a floor back to Jan for guidance review and some closing remarks.

**Jan Dunning (President):**

Yes, thank you Dima. During 2020 we've substantially improved sales entities thanks to the revamped CVP. In a combination with better profitability, we got to very attractive return profile for new openings and redesigns. This encourages us, of course, to continue with smart expansion. This year we plan to open up around 2,000 stores and redesign around 700 stores, which is a big step up versus last year. Capital expenditures projections for 2021 of around RUB 60 to 65 billion reflect increased growth ambitions, as well as ongoing spending on efficiency projects. Yes, we benefited from macro environment last year. But most of the improvements came because of self-measures.





Economic situation remains difficult with a growing pressure on customer wallets. Overall, we feel we are well equipped to continue profitable growth in our business. With strong balance sheet, cash generation and further upside in working capital we see enough flexibility to fulfill our growth ambitions in combination with cash distribution to shareholders. Now, thank you for listening.

John, thank you. We are ready for the Q&A session.

**OPERATOR:**

Thank you, sir. Ladies and gentlemen, if you would like to ask question, please signal by pressing \* followed by 1. \*1 if you wish to queue for a question. We pause for a brief moment to allow everyone an opportunity to signal for questions.

We will take our first question from Maxim Nekrasov from Goldman Sachs. Please go ahead. Your line is open.

**Maxim Nekrasov:**

Yes, good afternoon. This is Maxim Nekrasov from Goldman Sachs. Congratulations with the very strong results and free cash flow achieved this year. I have a few questions actually on this and on capital allocation. So the first one is regarding your leverage. Basically, what is the maximum level of leverage that you would not want to exceed in the medium term? And could you once again remind us what is the optimal leverage you see in the medium term? And also related question on dividends: Basically, how do you envisage dividends going forward? And do you plan any commitment to certain dividend policy? And if not, just how do you think about dividends going forward? And where do you see potential for gradual dividend increase? Thank you.

**Jan Dunning (President):**

Thank you, Maxim. Let me answer the first question. The leverage is of course not a fixed thing. When last year having 2.1x, seeing the interest rates actually still quite high and having returns on the average of the business on a low level, you understand that leverage is on your agenda. And that's why also with regards to the recovery of the business we were focusing on LFL performance that creates the biggest return on the boost. Second is margin regain. And the last part is also capital allocation, so working capital efforts. And if you ask me now concrete in the current environment, with the interests on a low level, I think now with 1.1x, we're actually very comfortable with leverage, it's potentially even low. And we have always stated that we would like to see a comfortable leverage of 1.5x. But like I said, it's a dynamic thing. Most important is: are we able to find investments with the proper returns? Because just to go and make sure that I'm on the leverage of 1.5x by investing into products which in the end, do not have



the appropriate returns is not the best option as well. Where I would feel uncomfortable and especially looking at the size of our business, that it also depends is around 2x. I think 2x is the max I would like to go to, but I also look at the outlook. If you have one year more and you know that it is going to recover in the sense that, just as an example, an acquisition, you know that the year after you will see enough synergies to bring that back to the appropriate level, then that's something that you can discuss with me. But for the time being, I think I would see looking at the interest rates, looking at our returns, 1.5x is a good number. Then the dividend question, I think that's a question I would like to hand over to Albert.

**Albert Avetikov (Chief Investor Relations Officer):**

Maxim, thank you for the question. We fully understand this is an important part of this story. So first of all, this is a priority of the Board to provide a recommendation to the shareholders making decisions on dividends. You know, Magnit has a good track record of sustainable and strong dividend payments. And looking at the financial position with which we finished 2020 and which was extremely strong, and with very low leverage, we feel that this provides enough flexibility to see a combination of fast return-driven expansion and strong cash distribution to shareholders. But again, we'll leave it up to the Board to decide on a specific level. Our first priority, as for the management team, is to grow the business with a strong focus on higher returns. Thank you.

**Maxim Nekrasov:**

Okay, thank you very much. That's very clear.

**OPERATOR:**

We will move on to our next question from Nick Kovalev from VTB. Please go ahead. Your line is open.

**Nikolay Kovalev:**

Yes. Hello to everybody. I have a couple of questions mostly on the top line. So previously, you disclosed the base of 9.5% for the beginning of January. So can you maybe comment to us to what extent it was further translated in January and maybe early February? And given the base, how much it could be ahead of your, maybe by the magnitude, ahead of your annual forecast for this year. And also, the second question is on the inflation. We see across the country it's picking up for food. So can you also share with us what on-shelf inflation you see now and where you see it also next couple of quarters, maybe? Thank you.

**Albert Avetikov (Chief Investor Relations Officer):**



Hi, Nikolay, let me just jump into the first question. And then Jan and Dima can continue. Just to explain on the recent trading, which covers January, you're absolutely right, we provided the market with total sales and LFL for the first ten days of January, when we issued our New Year sales results. Now we are ready to provide the market with full month results. If we look at total sales growth, it fully matches the average for the Q4. If we look at LFL sales growth, it's more or less in line very close to the average of the Q4. And what is the most important, that comes with much lower promo activity versus Q4 and especially versus seasonally higher level in December. So again, we're driving sales, not by promo, but by qualitative improvements in the stores keeping healthy level of margins.

**Jan Dunning (President):**

But I would like to remind as well, bear in mind that this is a LFL on a strong base of last year as well. So the base has improved. And that's what we will see because the second part of the question was on the outlook. Yes, we will have periods where it will be difficult to match last year sales due to the speculative buying of consumers, that we're actually quite confident that the plan that we have in mind is what we are cruising on and that we will bring it in.

**Albert Avetikov (Chief Investor Relations Officer):**

And let me add to this, Jan. Particularly with promo share, because given our promo share rates down versus previous quarter, we can expect quite acceptable margins level in January. And coming back to the second part of the question with regard to food inflation levels, in December we saw food inflation level in line with Central Bank and Rosstat rates. We have almost similar level plus minus. And in January, we expect the same level but maybe with some acceleration. Nikolay, I hope that we answered both, right?

**Nick Kovalev:**

Yeah. I mean both, for sure. Thank you.

**OPERATOR:**

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

**Henrik Herbst:**

Yes, thank you. I have a few questions as well. First one, I just want to follow up on the on the first question regarding dividends. And I think you mentioned that you've got a history of sustainable dividends and dividend growth, etc. How do you think about that from the perspective of obviously a very strong cash flow in 2020 and balance sheet





position? Are you happy to sort of set the dividends that are as sort of a one off level and then be happy to bring it down again or do you want to sort of continue to grow the dividend over time? And just because it was a one off year in terms of strong cash flow, so you can give back in one off big dividends? But it could be higher. And then the other question, the very low store closures, as you mentioned, in Q4. I was just wondering whether that's by any chance sort of COVID related and just pushed out store closures into 2021? Or do you think that it is actually a result of improved CVP and it's just the business performing better and you're seeing sort of an underlying improvement? And the last question was just on the online business, where you're saying, a lot of customers were actually not customers in your brick-and-mortar stores. Do you know where they used to shop for food before if they didn't shop in your stores? Thanks very much.

**Jan Dunning (President):**

Thank you. Let me answer this question. Of course, it's not our intention to pay dividends and then a year after change the payout fully or be insecure on what's the dividend payment in the end. It of course is and stays the authority of the Board to propose. So as a management, we are actually more into execution than deciding. If I look at the discussions, it's clear that we would like to see a sustainable dividend payout. And we see that last year, part of last year, which is also the dividend announcement is we've been spending less Capex. Therefore, as well, we were a bit richer in cash and had the opportunity to pay dividends like we did. But of course, we know that shareholders do not like big deviations in payout. So we have to come to an amount of dividends, which we think we can sustain in the next couple of years.

So the next one is the store closures. We closed 35 stores. So part of the stores that we close is of course because of our expansion, so we were opening more stores, and some of the stores are just replacement of existing older buildings. I do not know the exact numbers, but I know that that has an impact. And yes, there's also closure of stores that have been successful in the past or have never been successful in the past, but then came into a red zone where we feel that because of the infrastructure, roads, changes, apartment block changes that we feel okay, this is not a good proposition anymore, so let's close. What is good to see is that actually their number is relatively low. And that's actually confirms that our CVP effort to lift up the whole base of LFL to a level that we're much more profitable and therefore take out much higher returns out of the assets is paying off.

Then, the last one, the online business. What's important is that we started it earlier in the year. We also have been profiting from the pickup because of COVID. We did that through partnership, it was not us and our platform, and actually we were using our purchasing power to support platforms to run e-commerce. We did it partly because we wanted to learn the trick. We wanted to know the operating model, and what are the



issues to pay attention to. But over time, especially in the fourth quarter, we opened up our e-pharma and we opened up our e-grocery. We see that that is now picking up and we see an increase of orders. The number that I was mentioning is actually already the number of last year, fourth quarter. We are currently already on a level of around 7,5 thousand orders a day. So you see that in January it is growing steadily and February we'll see the same dynamic. In this respect, we're actually quite optimistic. We're keeping on investing in e-commerce, but it's also important to highlight that it's not always just about e-commerce, it's also about digitalization. How much insight do we get in our business, and that gets to your question. Yes, we have the insight with the data that we have, that we are attracting new customers. And we have the insight that part of the customers that are with us, on the e-grocery side, are not our brick-and-mortar customers, are not our traditional customers. We do not know where they come from, but we do know that they start to shop with Magnit. I hope this answers your question.

**Albert Avetikov (Chief Investor Relations Officer):**

On store closure program: you know, we had the wide one last year and closed around 450 stores. Speaking about 2021, as we provided guidance on growth basis, we do not expect any significant number of store closures, we've just limited stores to be closed. On net basis, it will be very close to the gross numbers which we provided.

**Henrik Herbst:**

Great, thanks very much.

**OPERATOR:**

Once again, if you would like to ask a question, please press star followed by one. We'll move on to our next question from Marat Ibragimov. Please go ahead. Your line is open.

**Marat Ibragimov:**

Yes, thank you very much. The question is about your negotiation with suppliers. Your progress in top line growth was very clear, very visible through the year. The question, is when you negotiated the last time, I guess, at the end of the year with your suppliers, did you use this argument that you are now in much better shape, you're selling more products, etc. to improve your supply terms further? Thank you.

**Jan Dunning (President):**

Yeah, of course, the supply negotiations happen shortly before the end of the year for the New Year, but even within the year you do the supply negotiations if you feel that there is a reason to. There are couple of dynamics in supplier negotiations as far as transparency towards each other, partnership, to which extent you help the supplier and the supplier helps you, and on-shelf availability, on clean correspondence, on being available for innovations. I think that has improved a lot. The mentality we might need



was more like we do negotiations with a knife on the table, but I understand and they understand by now that potentially by trying to work as partners together and create win-win you gain more. That's one dynamic. The second dynamic is of course, that, in the negotiations, the number of SKUs that you carry off of one and the same supplier is, of course, defining what kind of discount you get, the growth rates that you show, the relative growth rates, are you gaining market share in the segment. And of course, also the innovations. I think that whole spectrum creates greater willingness for suppliers to invest. I think that's where we have improved a lot. There's still a lot to be done, but overall, I think that's where we made big steps.

**Marat Ibragimov:**

And I hope you also use your arguments when you're planning to significantly accelerate your store openings, right?

**Jan Dunning (President):**

That's the growth argument, but our suppliers are also interested in it like we are as well. We invest into digital to make sure that we start to understand our customers better. Transparency for the supplier is also important, for him it's also important to know what kind of customer group we reach in Magnit with this range of assortment. To be more open and transparent about this, suppliers are willing to then tailor promotions, compensate better for promotions. And then, of course, always the volume argument.

**Marat Ibragimov:**

In other words, you want to additionally capitalize to win from better knowledge of your customers, to sell you these data and to do joint promo campaigns, am I right?

**Jan Dunning (President):**

It's not only about selling. Once again, I know negotiation is about money. But negotiation is also about "if I can give information to suppliers, so that we can become better in promotion, better in promo compensation, better in defining the volumes that we need for the promo, and that's also money." It's not only "Okay, should we have supply and now I have an offer you can't resist and you have to pay for it." It's also "I need suppliers to improve my business as well." And I think that's the mentality we need to get in. Because the moment the supplier understands this better, he will serve us better. It's all about top line, and, therefore, also "how do I take the money?" I mentioned it already once in an earlier call. If I look at the contracts that we have, the problem is not our contracts. The contracts are pretty okay. The problem is execution. And what's in there more? Do we cover everything? No, we don't. So let's sit and see where there's more to get. I think that's where the whole commercial department has done an extremely good job starting actually already from the first and second quarter. And that continues.

**Marat Ibragimov:**



Okay, and then another driver of your gross margin growth is a growing share of personalized promo instead of mass promo. That means, I suggest, that your gross margin will continue growing next year. If I am correct, could you please give some guidance and by how much basis points do you think your gross margin will expand?

**Jan Dunning (President):**

I'm not going to guide on improvement of gross margin, but I see opportunities to improve. Getting to your personalized part, is yes, with the loyalty card we have become smarter, we know better what customers want and we can target those groups. We can create those groups and we're also into creating collabs where we also therefore have tailored promotions and that gets back to my answer to the earlier question. That's information suppliers like. There's also information I'm willing to share with suppliers to understand, "okay, this is a group of customers that is interested in your products and this is a group that actually has reacted on your innovations", and on that kind of information, but also targeting and getting a better on-shelf availability, I am able to get more money out of my shelves."

And also, remember, it's a bit of an old saying, but you don't make margins with negotiation. You make margins with sales.

**Marat Ibragimov:**

So you are open to have win-win situations with your suppliers, not someone winning someone losing, right? Now, what I can get is that part of the reason why you can get much lower store openings, fewer stores next year, you're accelerating this year. I mean, should we expect some working capital investments and lower operating cash flow because of that?

**Dmitry Ivanov (Chief Financial Officer):**

Marat, thank you for your question. You should understand that, this year, we started from, I would say, low base, and we collected low hanging fruits in terms of improvement of our working capital, working with inventories, payables and receivables. Still, improvement of working capital remains one of our main priorities for next year and for other years. We have several projects in place which we've already started in 2020 and continue and will continue in 2021. We also have several new projects, which will help us to improve certain components of working capital. But we believe that we'll be able to deliver these improvements despite growing sales, despite quite a big number of new store openings with needed investments into inventories, despite change in assortment and other so-called negatively influencing factors in terms of working capital. And also we think it's important to notice here that we plan to strengthen our working capital cycle without any pressure on our profitability, on our margins.

**Jan Dunning (President):**



Also in this respect we are investing currently in a new F&R tool. I don't think that that will be effective this year, but at least from next year onwards that will also help to improve working capital. Because the F&R tool is a complicated one that we have currently, so our ability to forecast and especially do the demand forecast, it's quite complicated.

**Albert Avetikov (Chief Investor Relations Officer):**

Marat, we have a long list of initiatives, part of which have been already launched. Part are in our plans, you can find this list in our regular IR presentation. And yes, we do target farther improvements in turnover days.

**Marat Ibragimov:**

Thanks very much. That's it from my side.

**OPERATOR:**

We will now move on to our next question from Alexander Gnusarev from VTB Capital. Please go ahead. Your line is open.

**Alexander Gnusarev:**

Gentlemen, greetings. Congratulations on your results. Actually, many of my questions were answered. I just have, I suppose, one clarification question. Did I get it right that by year-end 21 you assume that net debt is going to be at the level of 1.5x, right?

**Jan Dunning (President):**

No, that's not what I have said. I explained that leverage level is depending on the number of products that you have, and the returns that you can achieve. I would feel comfortable with 1.5x, but I'm not saying that we will end up on 1.5x. I think, once again, the net debt leverage ratio is very much depending on "how can you allocate your finance, how can you allocate your money, and are those products indeed giving the right returns?" And we are a return led business. We've got a pretty strict CAPEX process in place. But at the moment we have enough projects that we think make a lot of sense, I'm willing to move up to a 1.5x. And even if it's very accretive, potentially as a max, I might move up to two. But it's always with a view to returns because it should create shareholder value.

**Alexander Gnusarev:**

Okay, that's clear. Thank you. And just the second one clarification question. Did I get it correctly that your discounter pilot project My Price is going to have 100 stores in 2021?

**Jan Dunning (President):**

Yes. What we have decided is that after the pilot was extended last year to 16, we have a plan now to at least get 200. But that's not set in stone, we haven't changed our



decision to have 100. If I can get 200, once again, and they are returning like they do, then that's the number. Now, we're actually quite excited with the model. There's also, by the way, still quite enough improvement necessary but for now it's a good model.

**Alexander Gnusarev:**

Okay, thank you, that's clear.

**OPERATOR:**

We will now move on to our next question from Alexey Krivoshapko from Prosperity. Please go ahead. Your line is open.

**Alexey Krivoshapko:**

Good evening, gentlemen. Thank you very much for the call. And, obviously, congratulations with pretty strong results. I'd like to ask a few questions, if I may. I guess firstly, you've been quite successful in kind of bringing down shrinkages to the last year and a half. Do you think there is more to go, or are we now more or less at the level where we should be?

**Dmitry Ivanov (Chief Financial Officer):**

Good afternoon. Yes, shrinkage is one of the problems which we faced and solved in 2020. And we still see quite a good potential to improve some margins and shrinkage. We believe that level somewhere below 3% of sales is achievable with a mix of our formats and current systems that we have.

**Jan Dunning (President):**

Can I add you to Alexey? Shrinkage is a result of process. What you see is if you open up more new stores, then those new stores bring in a higher shrinkage, because people have to get used to how to work, we need to see the right forecasting in place. I do believe, and I do totally agree with Dima, I do think that we still have opportunities to improve, but don't expect the improvements, which we showed last year.

**Alexey Krivoshapko:**

Okay, I guess, clear, that was my question. Secondly, we have seen quite nice improvements in sales densities, new stores, old stores, maturity adjusted stores, LFL, it doesn't matter. But obviously, it's coming up quite nicely this year. It's still kind of below the levels of four or five years ago, but it has returned to, I guess, meaningful levels for the small stores. But I guess the hypermarkets which are now called supermarkets, which are still, I guess, hypermarkets, are still largely underperforming. What is your current thing there? And I mean, do you have any plans in place? And can you please comment on that?





**Jan Dunning (President):**

I totally agree with you. Bear in mind, Alexey, that we improved the sales densities in the hypers. Because we will show in them LFL plus very small, but the execution and especially the CVP, there's a good CVP plan. But the assortment that we have in the hypermarkets is currently not yet on the level I would like to see it. That's where we are working on. And we spend actually quite a lot of time to get that done. But you're right, the hypers are not on the density levels that I would like to see. Therefore, also you see in the store opening plan that we relatively opened little amount of hypers as because of the densities, the returns are less attractive than the returns of convenience or cosmetics.

**Alexey Krivoshapko:**

I see. Can you also comment if that's possible about pharma? Because I guess there were some plans in the past to open pharmacies, which you have then kind of postponed. I mean, then we talk about wonderful e-grocery, e-pharmacy. But still, I mean, do you still have some plans to speed up or open physical pharmacies?

**Jan Dunning (President):**

The plan is still there. Although we need to be fair as well, the pharmacy industry starts to move more and more into online. We've invested in the online pharmacy. That does not mean that we will stop growing, but I think we need to adjust the growth path. As if you look at the Russian market, 30-40% of pharmacy is done online. We should spend a lot of energy and time on e-commerce.

**Dmitry Ivanov (Chief Financial Officer):**

Maybe let me add to this, Jan, because we believe that without pharmacy source we can't still cover quite an important mission in our CVP whether you have a convenience store, grocery or drogerie, pharmacy nearby or inside. And we are focused on improving the performance of our pharmacies, we also spend the time on it and we see the respective potential. And when we succeed with the right business formula, maybe we can make a decision to allow significant growth of this.

**Jan Dunning (President):**

I think I agree, but, as I said, we need to balance out "Okay, whether this market is useless and if it's going to be an online market. And then I would like to step down with the growth. For the time being, we're monitoring that. With regards to e-pharma, we would like to grow that business.

**Alexey Krivoshapko:**

Clear. And I guess the final two questions, Jan, I promise. You did say that you estimate positive COVID impact on LFL of 2.5% if I am correct. Is it for Q4?



**Albert Avetikov (Chief Investor Relations Officer):**

Alexey, could you please repeat the question on COVID effect on LFL basis? And the question is on...

**Alexey Krivoshapko:**

Yes, from what I heard, maybe I just got it wrong, Jan said that the positive COVID impact on LFL is 2.5%. Is it 2.5%?

**Albert Avetikov (Chief Investor Relations Officer):**

It's 2.2%, Alexey.

**Alexey Krivoshapko:**

It's 2.2 on Q4 LFL, yes? This is how you estimate it.

**Jan Dunning (President):**

Correct.

**Alexey Krivoshapko:**

Can I ask you how do you work around this number because there are no lockdowns anymore, why do you still see this some positive COVID impact?

**Jan Dunning (President):**

We knew you would come up with that question.

**Dmitry Ivanov (Chief Financial Officer):**

Alexey, let me answer this question, how we came to 2.2% as the impact of COVID on our LFL sales. We just compared two sales lines with two different seasonalities: our normal seasonality based on pre-COVID environment and COVID seasonality. And then on our normal seasonality, which is pre-COVID, we added some factors which can influence on CVP improvement, liability improvement, other factors, also change in inflation, and then delta between our kind of normalized seasonality and actual seasonality including COVID is exactly this COVID impact on LFL sales. This is just delta case.

**Alexey Krivoshapko:**

Maybe it's just you're doing some better work or something else, who knows.

**Jan Dunning (President):**

It might be, but then that's a positive surprise for this quarter.

**Alexey Krivoshapko:**



Because in reality, seriously speaking, there's no real operational negative impact from COVID and everything is functioning the way it used to function last year, so you shouldn't really expect anything of that nature.

**Jan Dunning (President):**

Yes or no. And I think that's what we might explain. What we do see and still see is a changed behavior of customers due to COVID, which is, they visit less often but they buy much more. Maybe that's a new reality that we see what we see. And that's, of course, difficult to assess.

**Alexey Krivoshapko:**

The final question. Did you mention that you plan this supplier inventory management in the warehouse, which I guess sounds quite cool. How should one estimate the positive impact on inventory or any other operational financial metrics on this? And how do you actually run it? Given the fact basically it still will be your warehouse and basically there are many suppliers. I think operationally it should be quite challenging.

**Jan Dunning (President):**

I don't have the numbers. What I can explain to you is, what's the difference between how we work now and how it should be. What we now have, we don't have an integrated program, we have different 1C programs that then have to be aggregated. And out of those, we need to then ventilate in order for the suppliers. In the new F&R system, it's one platform where there's no manually done any more and we just can project. Okay, based on all kinds of parameters and algorithms that we have in, this is based on sales last year, this year, temperature, etc., promo, this is the order that has to go out. And we believe that the new program should create advantages in stock days, as it's simply more accurate.

**Dmitry Ivanov (Chief Financial Officer):**

And Jan, let me add to this about the suppliers' inventory management system. First of all, this will lead to improvement of service level, supplier service level on our DCs and then for better service level from DCs to stores. And therefore it will help us to have better availability in stores and a much lower level of lost sales. These are the logical consequences of why the systems are very useful, and how we can estimate financial implications after implementation.

**Alexey Krivoshapko:**

It's all very clear. Thank you very much.

**Dmitry Ivanov (Chief Financial Officer):**

Thank you.



**OPERATOR:**

We will now move on to our next question from Egor Makeev of Raiffeisen Bank. Please go ahead, your line is open.

**Egor Makeev:**

Good evening and congratulations on good results. I actually have a couple of questions. My first question is: could you please elaborate on the benefits of having your own payment system and maybe provide more details regarding your plans of the Super App? And my second question is: could you please provide the CAPEX split for this year between organic expansion, redesign, maintenance and efficiency projects and maybe highlight the most important efficiency projects to be carried out this year?

**Jan Dunning (President):**

On MPay, of course, we're very happy with it. It gives us the opportunity especially on e-commerce to be much more efficient and quicker in payment. Potentially, if that really is launched and it sets off, it also helps us to reduce the client fee because as you know the banks are greedy. I am spending on an annual basis 0.6 of my margin on acquiring fees. I remember that my old finance director always mentioned that that was the biggest legalized theft he has ever seen. That is 0.6 we will come down and therefore we see also financial benefits. But it's important that MPay is getting introductory a good launch. It is currently working and the more people that will start using this, the better it will be for us.

**Dmitry Ivanov (Chief Financial Officer):**

And maybe let me take the second question with regard to CAPEX structure. Around 60% of planned CAPEX for 2021 will be allocated to expansion including new store openings, redesign and maintenance CAPEX. The rest we plan to spend on the supply chain, for example, new trucks fleet recently announced and several IT and efficiency projects, including e-comm initiatives, or IT projects, which are quite important for us like ERP implementation, F&R implementation, etc.

Egor, I hope that answers your question, right?

**Egor Makeev:**

Thank you. Yes. That's pretty clear. Just on my first question, well, maybe you could share your plans regarding the Super App in general, like what else do you plan to add there?

**Jan Dunning (President):**

Yes, that's actually going to be the heart of our e-comm initiatives that we are going to do which primarily will be focused on the initial stage which is customer and customer



needs. We're working on nutrition, part of the sustainability policy that we have in place on giving people more information about healthy living, so recipes, lifestyle, that kind of info will be in there. But there will also be the info on promo, you will have your personalized cabinet potentially and therefore see what kind of individualized promos to add there from you. That will also contain, by the way, the employees' info about: I can log in and see when my next salary will be coming in, my KPI fulfilment. There are a lot of initiatives. We have to do it now phased and step by step. But the idea is to create an app, and in that app to have all the alternative applications in.

**Egor Makeev:**

Thank you.

**Operator**

We will now move on to our next question from Kirill Panarin of Renaissance Capital. Please, go ahead. Your line is open.

**Kirill Panarin**

Hi, everyone and thanks for the call. Two questions from me. Firstly, I just wanted to follow up on promo activities. You said the environment is stable and promo share was down year-on-year in Q4. But at the same time it looks like there was quite a material increase in advertising costs during the quarter. Could you comment on that, please? Isn't that a sign of higher need to invest in order to sustain growth? Not in prices directly, but in marketing anyway.

And second, quickly. Just given the strong like-for-likes in Moscow and St. Petersburg regions, how many of the 2,000 openings this year are going to be in those regions? That's it. Thanks.

**Jan Dunning (President):**

Thank you, Kirill. I'm actually quite convinced that the promo activity is on the proper level for the businesses that we're in, and I think I mentioned that in the previous quarter as well, what we see in terms of insecurity and COVID, clearly, is an insecure time, is that people look for security, they look for value. What I think we should do is we should not use the promo for promo's sake, we should do promo for customer's sake. So that relevant promo items with a price that's attractive and I see that also within Magnit where promo was somehow the idea to drive traffic and when we were slashing prices, we were investing into margins. Actually what we would achieve is that customers more and more wouldn't understand our price policy. By having a stable promo approach with a price strategy and policy aligned with the suppliers, I think we are much better off and we take much quality value for our customers.



You've noticed that the marketing expenses went up. I can give you two reasons why. The first one is our "Skrepyski action, which is this plastic which is very popular with the kids, and that was an expensive promotion but created quite a lot of traffic and loyalty. So I think overall we were very satisfied with that investment; and the second part is also with the way we have started doing promotions, we have changed the mix a bit, so in the marketing mix we went into a bit more expensive TV, for instance, moving from radio. That also had an impact.

**Dmitry Ivanov (Chief Financial Officer):**

Let me add to this. Within our loyalty campaign for getting more data on our customers, we also start pushing additional messages, additional SMS, additional offers for our customers. That also had influence on our costs.

**Jan Dunning (President):**

As for Moscow and St. Petersburg, we're actually very excited with the outcome of our like-for-like in the fourth quarter, because, as you probably remember, it was always a bit of a problem for Magnit to get traction in the bigger cities. But we're getting there now finally. In our plan for this year, we dedicate 25% of our expansion to St. Petersburg and Moscow. We believe that we need more brand equity in those towns. And also, by the way, looking at e-commerce, both cities are actually pretty eligible to e-commerce, and I think we need more presence to get people come and also visit us online.

**Albert Avetikov (Chief Investor Relations Officer):**

Can I just remind you that last year we did a big step forward in our expansion in the North-West, especially in St. Petersburg. In addition to Murmansk, we actually opened a lot of stores in the premises of the former big retailer, Intertorg, around 170 stores last year, which is a big part, quite sizeable of our total expansion last year.

**Kirill Panarin**

Okay, great. That's all clear. Thanks a lot.

**Operator**

We will now take our final question from Artur Galimov of Sova Capital. Please, go ahead. Your line is open.

**Artur Galimov:**

Good afternoon, gentlemen. Let me join congratulations with the strong results, particularly on the cash flow and working capital side. Basically, my question would sound like this: Where do you see the top sources for upside in terms of both growth and





margins for this year, maybe in the midterm, in context of some set of the normalization of consumer behaviour, that we're still looking for potentially going into the second half of the year? Basically, as far as I understand, you still want to keep increasing your margins from the levels of 2020. However, obviously, I think we will see a deceleration of like-for-likes, and sales densities growth this year from a very high base of 2020. So where do you see the biggest potential for Magnit to keep improving further in terms of both efficiency and sales?

**Jan Dunning (President):**

Thank you, Artur. I still think we haven't changed the plan. So I think, actually, top line is one of the important areas to focus on. Potentially, we might have a bit more moderate expectation, but looking at our expansion, I think we should keep an eye on top line, our sales densities.

The second one top line is gross margin. I think negotiations gives us also optimization, promo optimization. Partly, potentially also, shrink optimization is one of the things we highly expect that we would have. And we're not talking about points, but we talk about bits and that's where I see opportunity. And then I also believe, with a bit of restructuring of supply chain, and that's potentially important for our big boxes to go for different flow types, that we also there might see some advantages coming in in cost. Bear in mind, we opened 3 DCs in comparison to last year, we opened in Surgut and Novosibirsk. But we also reopened our Voronezh DC that should also start to take in, where we see some logistic advantages coming in as well.

The biggest threat is, of course, marketing. I think we will have to spend more shortly if we want to get traction on the e-commerce, and what I'm also concerned about is the utilities. Because that's always something you cannot influence. We will continue pushing pressure on rent rates, which we successfully did last year as well. I think we should continue doing that this year to get a better balance between returns of landlords and returns of ours.

**Dmitry Ivanov (Chief Financial Officer):**

Jan, let me add to this. If we have chances for this year, we feel to invest quite a lot in our loyalty program, and we are only at the beginning of monetization of insights with the help of customers. This will help us a bit. And if talking about risks and threats, we also might face some apparent increase not only in utilities, but also in some kind of facility services like cleaning and transportation services, outstaffing, which might happen because of lack of personnel and sort of widening of this market.

**Albert Avetikov (Chief Investor Relations Officer):**



So Artur, basically most of the chances are coming from the level of the top line and gross profit.

**Artur Galimov:**

Right. And I think you also mentioned that you're still determined to extract more improvements from the working capital side. Obviously, the magnitude of those improvements is unlikely to be as significant as we saw in 2020. Still some improvements should be underway, if I understand correctly.

**Albert Avetikov (Chief Investor Relations Officer):**

Yes. What Jan and Dimitry mentioned is that we still target and are putting our efforts to get improvements of the working capital in days turnover, while, of course, we should be careful as we don't plan to get the same scale of improvements versus last year. As Dima just recalled, most of the low hanging fruits have been already collected.

**Artur Galimov:**

Right, thanks for this. The very final from me on competition. We know pretty well what's going on with your largest competitors that report their results. My question would be about competition coming from smaller players, from strong regional players, they are not public but that still make a difference for regional competitive landscape. What do you see, how things changed? Do you think that the pandemic will continue to change the landscape? What players benefit? What players are quitting the market? And what's the outlook for this year?

**Jan Dunning (President):**

Competition has always been there. I think it's really important that you focus on yourself, and where do you see opportunities for improvement. What I see is that real improvements that we made in the customer value proposition (the CVP) is that we have actually grown our market share last year. We see by the way as well that some local players are also picking up, but also some local players are getting into trouble. I think for us, it's important that we continuously, year-on-year, make improvements in value drivers for the customer. If you do that, then I guess that also customers will recognize and continue shopping with us, but also come shopping with us. That's what we have seen and I want to see that this year as well. There is improvement opportunity still there.

**Artur Galimov:**

Thank you very much and good luck.

**Jan Dunning (President):**

Yes, thank you.



Albert Avetikov (Chief Investor Relations Officer):

Jan, I think with that we conclude the call, but just wanted to remind the audience that in two weeks, on 18<sup>th</sup> of February, you're welcome for Magnit's Capital Markets Day.

OPERATOR:

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.

Albert Avetikov (Chief Investor Relations Officer):

Thanks, everyone.