Company: **Magnit**

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Operator: Good day, and welcome to the Magnit Second Quarter and First Half 2019 Trading Update and Financial Highlights Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to the Director of Strategic Communications, Jyrki Talvitie. Please go ahead.

Jyrki Talvitie: Thank you very much, and good afternoon, everybody. So welcome to Magnit conference call dedicated to the operating and unaudited financial results for the second quarter of 2019. Our speakers today are our President and CEO, Mr. Jan Dunning, and our CFO, Elena Milinova. The presentation and announcement published this morning are available on our website. We will start with some prepared remarks, followed by the Q&A session.

With this, I would like to hand over to Jan Dunning, President and CEO of Magnit. Jan, please.

Jan Dunning: Thank you, Jyrki. Good day, everyone, and thanks for joining. On our journey, 2019 is a year of transformation. The company is going through an enormous amount of changes and we still have many challenges to overcome. With real disposable incomes continuing their negative trend and the Russian regions hit harder than big cities, our operating environment remains challenging.

With all this in mind, I'm pleased to report second quarter results close to our expectations. The main highlights include positive like-for-like sales for the third consecutive quarter. Traffic is still negative but with an improving trend. Sales growth accelerated to over 11% during the quarter, and EBITDA margin came in at 7.1%.

But are we satisfied? Not yet. The journey continues. I'll now like to touch upon some of the key areas we are focusing on. As already mentioned before, we're not changing the course of our strategy but rather prioritizing and focusing efforts on the crucial tasks to drag this transformation. One of my main focus areas is the team at the moment. We're now putting a lot of efforts to unifying the team and making sure our organization model serves the implementation of our strategic goals.

As you know from the previous calls, we split former COO role into two parts and I'm delighted to say that during the quarter we found two exceptional individuals to fill these vital roles. And as a result, we have significantly strengthened our operations, maintenance and development functions, which are crucial positions for further implementation of our new CVPs. We are also making minor changes to other head office departments in order to flatten the organization, lessen the bureaucracy and trying to increase speed of implementation of decisions making.

The regional structure will continue to rollout but we're fine-tuning the way formats are being managed within the regions. I'd like to take you through some of our priorities. The first one is the team has done a good job developing tailored CVP performance and adopted for big cities and rural regions. However, we now need to focus more on CVP implementation, speeding up the process and working on the differentiation of our offering, as well as messaging it to our customers.

As of the end of the second quarter we reviewed 95% of all assortment in the convenience and 80% in the cosmetics store, although we have to bear in mind that to achieve our target of best in local, additional work needs to be done with local SKUs when new regional category managers are fully in place.

Through our new production, we have unique opportunity to distinguish the Magnit offering, especially in fresh categories. Fruits and vegetables for all of Russia have been historically supplied from the southern region, our home base, where also most of our own production is located by the way. We are the only retailer that can truly control the product from field to plate and we will capitalize on this through an expanding range of private label products.

We also think that our one brand multi-format concept helps to differentiate us in the eyes of the consumers in addition to bringing us synergies. In March, we launched a cross-format loyalty program. Results have exceeded our expectations. To-date, we have actually issued over 1.4 million of cards. For the piloted over 800 stores sales penetration ratio has reached 59%. And we'll rollout the program for the whole network starting this quarter.

As our transformation progresses, we will gear up our communication to our consumers extensively conserving the new CVP, as well as what the new Magnit stands for that we're all proud to be Magnit. We'll now focus on fixing the existing business. We have reduced the number of store openings and increased the number of store renovations.

In the second quarter, we added 322 convenience stores, which by the way is 160 less than in the first quarter. We opened 340 cosmetic stores, 53 less than in the first quarter and this format is still showing strong performance in synergies with our convenience stores.

As all new stores have been opened with a new CVP and we refurbished 509 convenience and 256 cosmetic stores during the quarter, the share of stores operating with the new CVP inside reached 63% and 40%, respectively. On average, redesigned stores demonstrate high single-digit sales uplift, mainly driven by traffic improvement. The CVP for supermarkets is in the piloting phase.

As the CVP implementation, including assortment review progresses, we see the growth of average ticket outpacing the like-for-like sales growth - our customers` spendings per visit are increasing, which is in line with our ultimate goal of gaining a larger share of the customer wallet.

Our analysis shows that customers focused on the low budget SKUs visit us less but we attract new customers who buy P3 and P4 category ranges. Our CVP and newly launched loyalty program are designed to stimulate people to spend more in the family of Magnit stores.

I would like to emphasize that we are trying to get more out of the visits and our loyalty program is based on the premise of the more you spend, the more you get. I believe this approach adds more value to our business.

With this, I would like to hand over to Elena, who will comment on our financial performance. Elena, go ahead.

Elena Milinova: Thank you, Jan. Hello everyone. You have seen the press release and presentation, let me just focus on a few main points of the second quarter from my point of view. Mainly it's one-off items, as well as working capital and shrinkage.

In the second quarter, we had several one-off factors affecting our P&L, namely, fire at the Voronezh DC, resulting in higher logistic costs and a negative impact on gross margin and EBITDA in the amount of RUB 1 billion. Additionally, due to the accident, part of equipment was written off, thus the impact on the net income was higher - RUB 1.2 billion.

Operational expenses in the second quarter, includes RUB 900 million relating to long-term consultancy contracts that were expensed in the second quarter as the project was finished. Also I would like to mention LTI expenses which affect year-on-year comparison, as we started to accrue them only in 2019. The amount of LTI accruals in the second quarter was RUB 557 million.

Working capital. As you know, working capital is currently one of the main focus areas. Earlier, we announced our targets of releasing RUB 25 - 30 billion from working capital by the end of this year. We stick to that plan, but due to transformation of our category management, it's not so visible in our balance sheet yet. However, we plan to achieve this through a combination of optimization of inventories, as well as improvements in the payable days by the end of this year.

On our inventory turnover days, our longer-term target is 49 days. This is higher than the food retail industry average of 35 days. But the higher number reflects our business structure, which includes our drogerie segment, as well as our own production and direct import. We also see further scope for improvement in the payable days of nine days in the long-term. The negotiation campaign for 2020 starts in September and we will use that to increase the payable days by two-three days.

To motivate further improvements going forward, we have adjusted the KPIs of our commercial department so that inventory and payable days are now a core part of their KPIs.
A gradual growth of shrinkage as a percentage of sales started in the third quarter last year relating very much to the transformation process and assortment review. In the second quarter, cross-functional working groups started to address the issue and we already see an improvement of 7 basis points compared to the first quarter.

The projects we are currently implementing include, the improvement of promo planning; introduction of an antifraud system; for ultra-fresh items we changed LIFO to FIFO in our operations; we enhanced our partnership with suppliers, improved the information sharing and reviewed quality requirements for fresh items. We will transfer part of the deliveries on to a cross docking supply chain solution. That's all from my side.

Jan Dunning: Thank you, Elena. I'd like to open the floor for the Q&A session now.

Operator: Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off. Again, press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal. And our first question is coming from Ulyana Lenvalskaya from UBS. Please go ahead.

Ulyana Lenvalskaya**:** Hi everyone. This is Ulyana from UBS. My first question will be on a bit of a traditional one on traffic. With the current pace of a turnaround, when do you expect to see a positive traffic?

Jan Dunning: It's an interesting question, Ulyana. I remember my first mention at economy where I was told that economy was all about trying the highest output from the lowest input. So seeing customers spend more, which is a bit of an impact from our CVP, and therefore coming less is something that we really need to monitor but I do not see this as a real big issue because what we see in our analysis and I think that's a bit of inside information. We see that we lose the smaller basket. If I look at the migration report – and by the way the migration report is available because JFK reports that on a quarterly basis, then you see that we actually are losing the small basket, the very low-income customer and that is a basket that comes very often with very low spend.

What we gained instead is more – true customer, the P2, P3 customer that comes to us that has a bit of different habit of purchasing. So, if you knit that out, I think that's also what I guide the team with is it is very, very important that we look at the like-for-like performance. It is also important to look at visits in itself but currently with the migration of customers, we are affected by visit drop. But on the other hand, we clearly show that the customers that we gain are spending more and the customers that stay are also picking up with regards to the CVP efforts that we do.

On top, although there is a small amount of stores because as you have noticed that when we do this currently at 800 stores but we are rolling out loyalty card. Our loyalty card is actually also not trying to push customers to come more but actually to spend more if they come. And we've had discussions, we know that there are all kind of promo activities ongoing, which stimulates – actually not even the visit increase but more a check increase, I don't find that a proper way or smart way to do business.

But like I said, we try to – we feel that if customers start spending more, then they will come less often but they stay customer that for a business economics is not so negative.

Ulyana Lenvalskaya: Okay. So, it sounds that we should not expect the purchasers' traffic, right?

Jan Dunning: No, this is not what I say. I think the focus on the traffic is looking at the dynamics in the migration, plus our efforts on the loyalty card, is I think a focus which currently is not the right one. I think you should focus much more on how are like-for-like and CVP efforts doing because again that's going to be defining how much we're earning but also how much we're being perceived by customers.

But just as an example, I can do the loyalty card with a couple of different dynamics. We can say at least every RUB 550 that you spend, you get a point, which means that actually you stimulate customers to come more often spending RUB 550. We don't say now, listen customer, if you spend RUB 500, you get a point. If you spend RUB1,000 you get two points.

Now that's what we have to decide to do. When we see a need that there is a customer out there that's not spending more in order to get more points, is that worse because of that dynamics or not? And I think that's the question.

I think for me, I'm measuring the CVP, and I find it very important is do I see traction. And just as an example, the sales of the new SKUs that we have implemented and since last September we have added 893 new SKUs, all those SKUs having a relative share in the category above the category share. So that is for me positive, which means that we're actually making the right selection of articles.

All the time, Ulyana, that will translate into a more attractive environment to shop and I think that will also be translated into people coming more or more customers coming. And at the moment, we see that we are slightly winning customers but they have a different purchasing behavior, even because the ones that came very often and spend very little have migrated to one of the lower players in the market.

Ulyana Lenvalskaya: Okay, it makes sense. And the second question, if I may, on the EBITDA margin. Can you confirm the previous guidance to keep flat EBITDA margin year-on-year in 2019?

Elena Milinova: Let me answer. Yes, we confirm. So we will try to achieve the same level of EBITDA margin like last year.

Ulyana Lenvalskaya: Thanks.

Operator: Thank you. Again, as a reminder to our attendees, you may ask a question by pressing star one. If you find that your question has already been addressed, you may press star two to remove yourself from the questioning queue. We will next go to Victoria with Credit Suisse. Please go ahead.

Victoria Petrova: Good afternoon. I have several questions. First of all – and apologies if I missed something while being away. A year ago, when we had this call and Elena was also on the call, you were talking about getting rid of irrelevant SKUs and upgrading the assortment, which was expected to have some impact on margin, obviously a negative one. Is it done by now? Have the relevant assortment been sold off? And what impact on the margin it had in the first half 2018?

Jan Dunning: Now, to be honest, Victoria, we missed you. So, we're happy that you're back.

Victoria Petrova: Thank you.

Jan Dunning: The question is about the innovation level of the assortment, like I mentioned already earlier there has been around 1,000 items added to the convenience store and the share of – the shelves that they take is over the average shelves per category, which is positive. What is a problem and it's one of our challenges is the presence of old stock. I think we have to say that we have not been too active in trying to get rid of this and that's one of the things that we actually will start doing as of now because one of the CVP is that I find, on the shelf, the presence of new SKUs underrepresented to their shelf share.

So what I'm saying is that they deserve more phasings than what they do and that's because it's blocked - the presence of old stock.

Victoria Petrova: Can you point it by anyhow so we can just assume how much this old stock is or how much was it or how big it is?

Jan Dunning: Elena will definitely know this.

Elena Milinova: We see that it's a trend of six months RUB 33 billion of the stock which consists of SKUs which are not any more in the active market, of which only RUB 2 billion is still in warehouses. That's good. We moved it to the stores, so we cleaned up the system now. However, now it takes time to sell them through the stores and so that's we have free space on the shelves for the new assortment.

Victoria Petrova: You have RUB 53 billion of stock – or RUB 51 billion stock now on the shelf?

Jan Dunning: Victoria, RUB 33 billion.

Elena Milinova: RUB 33 billion.

Victoria Petrova: RUB 33 billion.

Elena Milinova: RUB 33 billion out of RUB 200 billion almost.

Jan Dunning: So it's around one-third.

Victoria Petrova: And the margin is obviously lower, right, because you need to get rid of it?

Jan Dunning: Yes. We will be selling that assortment with a lower margin.

Victoria Petrova: And will it be considered one-off versus your 7% EBITDA margin estimate? Are you casting the flip EBITDA margin year-on-year with the stock being sold or without?

Jan Dunning: Now let's the – we just have had that discussion. I don't think we have quantified the total level. And we also – we don't know exactly yet the quality of that stock because some of the stock is actually relatively new that came out in-house and some of the stock is old. So the question is – I understand the question. I'm just flagging the idea that we will have carried off stock in order to get better presentation of the new assortment but I have too little view at the moment on the quality of that passive matrix in order to give you a definition on how we think or how much we need to cut down and potentially there will also be assortment in that we don't even have to –

Victoria Petrova: I understand but you're starting this process only now in the third quarter of 2019. Have I understood it correctly?

Jan Dunning: Yes, I think the biggest part of it we will see in the third quarter.

Victoria Petrova: Okay, thank you very much.

Jan Dunning: But what I want to emphasize is that this is an exercise that we have to do but underlying I see actually a quite healthy development.

Elena Milinova: We have several options actually, so we could do it faster than, of course, that's more we could do it with the lower fees and that's the options we evaluate and we just – our sell-in depends on the results we see every month. Therefore, it's difficult to say now what exactly the effects of all that into P&L because they affect some of the business decisions. And Jan just started as a CEO. With the current plan, we are able to maintain the margin at the prior year levels.

Victoria Petrova: And just on this one last clarification question. What is this not innovated enough stock could be? Is it something like a non-food product which is irrelevant or – can you give an example of what sort of irrelevant?

Jan Dunning: I can give you some examples: Cognac XO.

Victoria Petrova: Okay.

Jan Dunning: Cognac XO is not an article where your first initial idea is «I run to the convenient store to buy one». So there, we will be sending part of that stock to the hypers where we know that function is much better there. So I have tried to explain is that we do not know at the moment exactly the quality of that assortment and some of the assortment that will not even be priced down at all as it's an article which is positioned in the wrong place, and therefore it became old stock but that will also be something in which we will have to find a solution.

Other old stock is passive matrix that you call like this are promos that we've done with the suppliers like some shampoos that now the packaging has changed. We have a different shelf but the old packaging is still in some of the stores. Now is it harmful? Now we need to see. I'd like to say this. I'm already three-week CEO. I need to get a better view on what's the quality of that stock and how I want to organize this.

Victoria Petrova: Thank you very much. My second question, if I may, is related to this consulting costs. It's around RUB 900 million. What exactly has it been paid for? I know, Jan, you were not around, but in general, and what impact it had on company performance? What has been done for this RUB 900 million?

Jan Dunning: Okay. Now I need to support Elena. But what I have seen, I have seen several consultancy agencies. Having done actually pretty good work on developing the strategy supply chain for instance, HR, employer brand and the whole transformation and CVP exercise. And then there's all kind of smaller stuff that has been done as well on IFRS, logistic. Elena, did I miss something?

Elena Milinova: No. The logistics and the IT strategy was also a big part of that job as well.

Jan Dunning: Okay.

Elena Milinova: It was a number of consultants and we almost finalized.

Jan Dunning: Yes.

Victoria Petrova: And we will see the positive impact of these logistics and IT changes in the future quarters, right?

Elena Milinova: Of course, these plans include the action plans except budget and actions were taken to achieve decrease the logistic costs and improvements of our IT systems and so on.

Victoria Petrova: Do you have any consultants working in Magnit as of now and should we expect any more costs related to that of outside the costs obviously?

Jan Dunning: Victoria, there are two projects that has to be finished and that will be finished in August. Then – and we discussed that in the team. I think the team's view is we need now to organize troops. We need to organize ourself as a team and I think there's confidence enough in the team itself to pull it forward. If it is a field that we need more expertise from outside, then of course we will be looking at consultants. So one of my comments to the organization was as well in a transformation I would like to have focus and I think we've done too much that has led to distraction and we need now to get our troops together and focus on the issues that are outstanding.

The good thing is – and I want to repeat that is that the results of the second quarter have actually been in line with the expectations. So we feel confident that we're on the right track. But yes, is it perfect at the moment? Not yet.

Victoria Petrova: Thank you very much. And then in terms of the results, we're always trying to find sort of the bottom level of results with all the issues being obviously taken into consideration, the impact on different sort of leftovers from different teams, etc. Should we consider some positive trends in we are observing in the second quarter as the beginning of a consistent trend? Or is there a lot of things being done and we should expect sort of an improvement in like, for example, we have seen like-for-like positive dynamics between first and second quarter 2019. So do you expect even better like-for-like in the third quarter? Should we expect better like-for-likes in July?

Maybe you can comment on that. And in terms of profitability, do you think we are on a stable trend as well or is there work to be done before the company is restarted?

Jan Dunning: Let me answer the question. I think the dynamics that you see in the like-for-like is something that we expect to continue. As there's lots of new initiatives stepping in like the private label, like I mentioned, the redesign of private label, I think we're also starting to message different message about Magnit. They've always done before.

So that I think will give traction. The profitability, I do see underlying that we're actually having a healthy business but there is like now you mentioned phrases the old stock or passive matrix that is something that we'll have to clean up but that's not structural. That has to be done and then the impact you will see on the working capital. And I expect as well with the better facing of goods that have sold well, that is also helpful to boost sales.

Victoria Petrova: Thank you very much. And my very last question is, Jan, will you being a new CEO and having much more power, when do you think the full impact of all those changes which are being implemented right now would be seen on the results of the third, fourth quarter on the first, or more likely first half 2020?

Jan Dunning: Now, first of all, I have the same power as the previous CEO. I don't think that has changed. The second thing is that there are initiatives which will start this year and I expect actually that the biggest impact that you will see end of 2019, beginning of 2020 where we also said that should then actually be the implementation. There we should see impact of our efforts. And that's also where we were going. So just on the redesign of private label, I know that those focus will arrive in August. There's clearly the private label with a price hierarchy, with a clear definition of what to expect. I trust that's going to be much better than what we currently have.

There's other innovations in the assortments that's coming. We're stepping back a bit more from the promo. So I think very, very slowly we will see that translated into a top line. We, by the way, also see quite good impact of – although we ran back with the store growth, we see actually quite a good impact as well with the new stores which deliver good returns and close to forecasting. So, there are lot of positive signals as well.

Victoria Petrova: Thank you very much. Thank you.

Operator: Thank you. Next we'll go to Maxim with Goldman Sachs. Please go ahead.

Yulia Gerasimova: Yes, good afternoon. It's Yulia Gerasimova from Goldman Sachs. I have three questions please. So the first one I would like to start with the guidance on the store openings and the CAPEX. I think you promised us that potentially on the second quarter call, you will update us on the number of stores you are trying to open this year and the CAPEX, how it's going to be adjusted. That's the first question. I think let's take it one by one.

Elena Milinova: The guidance for this year was RUB 78 billion to RUB 75 billion of CAPEX and we confirm that. We also – we're going to open 1,500 of convenience stores now and we are going as well to stick to that plan. So nothing changed.

Yulia Gerasimova: Then the follow-up here, so what does it mean to slow down in the expansion program to focus fully on the turnaround, so when we will see that slowdown because you're clearly not slowing down. You are getting the same number of stores.

Jan Dunning: Actually in the second quarter, we opened considerably less than what we did in the first quarter. It was in my script. It was around 322 stores less. So looking forward, we are actually currently discussing the pipeline. I do not see a need to hurry. And why not? Because like I mentioned on the call, there are things that we have to solve. There is a good development but we're also going through organizational changes. So there was a tendency in my view to do too much. I think we should focus, get things done and then when we're confident we can step again on the gas because the market provides us with opportunities and I think we should go for them, provided we are confident in our bit we do not create additional problems to our organization.

Jyrki Talvitie: Just to clarify Jan's point on the slowdown. So it was some first quarter to second quarter.

Jan Dunning: Yes.

Jyrki Talvitie: So as Jan mentioned now again, 322 stores less opened in the second quarter than the first quarter. And I'd just like to point out also that in the first half of the year we opened zero supermarkets. So that has been put on hold until the CVP shows that that works.

Yulia Gerasimova: And also the question from this one is should we then consider that this annual pace of expansion of 1,500 stores is something that you're comfortable with even during your proceeding with a turnaround progress. So, only when you complete the turnaround is achieved, the operational turnaround, you may see yourself increasing that pace. But 1.5 it's something you're comfortable with even in a current circumstance? Is it a correct assessment?

Jan Dunning: No, this is actually thoroughly under discussion. My view is that looking at the returns we should try to increase the number of cosmetic stores because they are actually such an exciting business as you have seen. I'm inclined to say that we might want to do that at the cost of convenience stores, so do the less convenience in the future, but keep an eye open for the opportunities in the market, so not stop like we do in the supermarkets here at the moment and in the hypers. But more slow it down to say 100 convenient stores a month, so around 1200.

And what I also think is that we should – we've got a considerable amount of supers and hypers. It's also time that we get them under control and that we deliver better results there. And when that's done, we can start looking at, okay, what's the optimal mix of growth. I think the good thing on our side is that leverage-wise we're in a good position. We've got an attractive dividend. So we will be in a situation to start looking at capital allocation.

But I want first and it's also the message to the organization, let's first sort the internal issues. Let's first make sure that like-for-like is a convincing like-for-like in all the formats and then see which formats we grow, what are the other opportunities in the market as well because the market in itself is not consolidated. There are opportunities. And we should have a clear view.

By the way also just one of the things I was also looking at is if you look at our capability of production and the returns on those, there is also an interesting direction to look at and not by adding more but making sure that we have the capacity to actually fulfill all our demands if I look at the tomatoes, cucumbers – yeah, we currently are producing. We produce for a certain amount of stores but there's still in the east and still in the north stores out there which we can't provide because we don't produce enough.

You will see in the third quarter by the way as well that we`ll open in Tikhoretsk which is an investment plan of 2016 investor 30,000 hectares of greenhouse in as well, so that will help to improve. But the core message that I have is, let's focus on the like-for-like. Let's focus on the formats that we have. Let's make sure that all the formats are going to work the way we would like to see and then see what are the best ways to allocate our CAPEX.

Yulia Gerasimova: And do you think like that some of this target that you're right now still discussing internally, do you think you will be able to update the market or on those things on the Capital Markets Day and have you ever – have you set the date yet or still discussing this one?

Jyrki Talvitie: Yes, so the timing right now is that we're looking at this kind of strategy review in the early parts of September-October. And once we know when we get the results of that, we will announce the date of the Capital Markets Day. So it's a bit early. I hope to be able to announce it to the market in September when that date will be exactly.

Yulia Gerasimova: Okay. Thank you so much. And my last question was about the monthly trends that you have disclosed in your press release. There is a clear trend that month-by-month the performance has been deteriorating and June was actually the weakest month. So first of all, can you comment on the strength and what was actually driving the June performance. And secondly, I would like to just once again follow-up on what Victoria has been asking about the July trends. Can you just comment on how July is shaping up? Thank you.

Jan Dunning: Let me rate on June. June in comparison – by the way, we see a bit this in July as well, although July is performing better than June, - June was really affected by the world championship last year and much worse weather than last year as well. Maybe you recall that last year the June month was actually quite a warm month. This year we see different temperatures, and we see that as well reflected into the sales of ice cream, soft drinks, beer. So the typical football game assortment had got a hit in June. If you look at July, July is actually performing better also over the trend of the second quarter.

Operator: Thank you. And before we move on, was that your final question?

Yulia Gerasimova: Just wanted to clarify, two clarification questions. I think Elena mentioned about the RUB 33 billion of stock that is still needed to be moved. And I didn't catch the number of the amount of the stock which actually was moved from the DC to the stores. Was it RUB2 billion. Can I confirm that number, please?

Jan Dunning: What Elena said is that there is still RUB 2 billion left in the distribution centers that have to be transferred to the stores.

Jyrki Talvitie: So RUB31 billion has been transferred.

Jan Dunning: So the good thing is that from the passive stock, RUB 31 billion is already in the stores. So the average to be sold.

Yulia Gerasimova: Thank you so much.

Operator: Thank you. We will next move to Elena with JP Morgan. Please go ahead.

Elena Jouronova: Hi. Good evening. That's a pretty good call so far. I have a question going back to like-for-like sales. Jan, frankly I am puzzled by the comments because if I look at the sales density, it is down 3% in the second quarter. It was down 3% in the first quarter of this year. I'm talking about convenience format standalone. And food inflation is around 6%. That said, you're commenting that you already see a positive effect of the new CVP on the shelf where like-for-like in what 63% of stores where you have the new CVPs positive. So why are we still in a situation when sales densities are going down? And I could have taken the explanation that there is competition etc., but competition is there for all. And I'm not saying the same sales density trend that some of your competitors who also face the same competition and cannibalization. So can you please help me understand that sales density trend? That's my first question.

Jan Dunning: It is a complicated question but I've seen that myself as well, Elena. The part of it is the refurbishment in which actually the stores are closed. And what I've seen as a trend which I think we should stop is that there has been a desire to extend the sales base at the cost of the backrooms, which creates by the way not always the right dynamics inside the store. So that's one.

The second one is the – if you have seen the openings in the first and the second quarters, those are ramping up and come up with a clear lower sales density as the existing ones. Those are two explanations I have for now seeing that 60% of the convenience stores have come through a remodeling and they have let to an extended sales area where actually the catchment area is not getting bigger, is something that we need to rethink. Certainly, if I see what's the consequence for the background, so that is – like I said there are certain issues that we have to solve.

Looking at the food inflation, there is a legitimate comment because that means you need – that's not the like-for-like sales that we project and that's also one of the problems that we address. How come we do not cover a 78% of the food inflation and it's a like-for-like projection. And that means that we're actually losing relatively volume.

And one of the things I can say there is that by the way that's also applicable for the sales density. We clearly are affected by the fact that we are a federal chain. We have a relatively big representation in the regions and some of the regions are economically not in a healthy situation. So that's where we clearly see that we're having issues. If I look at the south of Moscow then actually those stores do relatively much better. Some of the Volga and center regions are economically in trouble.

Elena Jouronova: Okay. Thank you very much. I think that the last point in particular does explain the sales density in my opinion. And my second question was actually on the selling space increasing in the stores because I've clearly noted that in Q1 and Q2 it looks as if the adverse space of the new stores that were opened increased substantially but what we're probably seeing is actually the increase of selling space in existing stores that drives the numbers up. Is that a fair observation? I mean, like during the refurbishment you probably are increasing space.

Jan Dunning: That's a fair observation, yeah.

Elena Jouronova: And by what percentage did the selling space increase in the refurbished stores roughly?

Jan Dunning: Sorry, I don't know the percentage but I've seen some examples where it reaches 10%, 15%.

Elena Milinova: All right.

Jan Dunning: We can give you the number if you want.

Elena Jouronova: Yes, that would be actually helpful. Thank you very much. And then I wanted to ask a question about the gross margins. So I actually saw that your commercial margin, it must have been pretty strong because despite the shrinkage, despite logistics course and the DC incident, you've managed to actually like meet to like 24% gross margin target. Can you help me understand why the commercial margin is so strong? Is it a situation that you have invested something additional in working capital special like payment terms to certain suppliers? Has that been driving the commercial margin up or what's going on there because it seems to me that stronger than I would expected it to see considering the promo intensity in the industry. So has there been any change in special agreements with suppliers?

Jan Dunning: I think the commercial team has done a good job. So there's clearly part of it coming out of better terms. And why those better terms? Traditionally, Magnit was a biased organization and there was less, call it, joint business negotiations ongoing. And I think certainly now with that it is changing. We have a more end-to-end negotiation with the suppliers with regards to assortment, assortment innovation, promo, promo debt but also working capital allocation for them and for us, where are we going to keep stock and how are we going to get it as cheap as possible to the shelves.

Like I mentioned before, we've had some consultancy on supply chain and logistics and that is helping us to get those conditions. Then on top, if you look at the imports, imports are also growing a bit in the fresh departments which are delivering a bit more margins as well. So overall positive sign, positive development, and especially knowing that we're not there totally because I meet the suppliers as well. I think there's lot of space to improve still. But yeah, this moves into the right direction.

On top if you look at the projects of shrinkage, although still very high in the second quarter, I see also there that we see positive dynamics with regards to trend. So I believe that also there we will see a bit more improvement as well. Don't expect it to get to the level of last year yet but our target is there to make sure that we keep on seeing the trends that we do now.

Elena Jouronova: All right. Thank you. And just a few more from me please. So, this incident with the fire at the DC that was not insured, is this generally normal practice in Russia not to insure the distribution centers? And do you consider changing that going forward?

Jan Dunning: That's a good question. It took me personally by surprise but it's not uncommon not to insure because if you look at the incidents and the frequency that happens, just as an example in 25 years this is the first time that we have an incident in a distribution centre. If we would have paid the insurance premium every year, we could probably have paid for two distribution centers. The problem is always that if it happens in a year, then yes, then it's one-off.

Elena and I are currently discussing, okay, what's the sense of insuring or should we make provisions or still we continue the way we have done that in the past as well.

Elena Jouronova: All right. And then a final one from me. So probably broad question actually. I hear a lot of questions from investors from myself or colleagues to you and everyone is asking when the turnaround happens, when like-for-likes get better, when the margins improve? I want to ask you a slightly different question. What does the turnaround mean for Magnit's management team and what do you want to see as the CEO in the results to say, okay, now the turnaround is done. Now the business transformation has taken place. I'm happy for now and I'm like prepared to look ahead for the bright future. For you, what does this actually mean, one or two metrics in financials?

Jan Dunning: Okay. Now first of all, a turnaround is not just a switch of the button. That is a process that takes long. What are the important features for me in the turnaround is that this company starts thinking of customers first, I am exaggerating but the process has been that everything was well organized but the stores were a bit ashtray of this organization. And I think that should change. That means that requires your mentality change. That requires your culture change and that's what we're working on.

When do I see a finished turnaround? By the way, I don't believe that you're ever ready in retail. I think there's always work to be done. And I think that also is – that's why it's so nice to the retail because you're never ready. One of the other things what I think is a clear feature of a turnaround is we should on a like-for-like basis be able to compensate for inflation. And whether you take the CPI index of 5 and say okay this I want to have 80% or I want to have 100% but currently the gap is too big.

And that's something over the longer run we need to have as a clear target. I think it's very important that if they allocate money that we're very convinced that the returns are appealing. What I want the team to do is to think of how we can differentiate from competitors and make, call it, an attractive proposition for customers, which is clearly matching the future.

One of the things that I use a lot is actually what I want to do is I want us to have a purpose but I also want us to be fit for future. And on those aspects at the moment, Magnit falls short, but we're working on it. And I think it's captured. People understand. And I think also in the next half year you will see features coming out which are more relevant for the current trends than trying to be in a me-too environment.

On the matrix more concrete for you is returns. Returns are also expressed into sales densities Top line, market share and I think we should also look at the current Russian investment environment. Dividends is also something that we have to really look at.

Operator: Thank you. We'll now go to our final question from Marat with Gazprombank. Please go ahead.

Marat Ibragimov: Thank you very much. First question I'd like to follow-up on Yulia and Victoria's question on July trends. What top line growth are you seeing in July? Maybe I missed that. Thank you.

Elena Milinova: The top line growth for the month as of 24th yesterday for retail is 10.8%.

Marat Ibragimov: Okay. Thank you very much. Second question to Jan. Will you have a chance to look at what is wrong with Magnit CVP? You may explain probably the different explanations why, like what is not good, but we see that in real terms the average basket is declined, i.e., if we were to adjust for inflation also the traffic is declined. What is your impression of what Magnit is doing not right I would say because Magnit has renovated almost two-thirds of its stores. What do you think Magnit should do this in a different way?

Jan Dunning: To be honest, I think the CVPs that are finished are actually quite good but they're technical. So it is an instruction to the organization. Where we are struggling is how we communicate now to the markets, our customers, what we stand for, what we want them to get from us and that's something that we also are working on because like I said, the CVPs are in place. They are very good. They are understandable and they are relevant. The only thing is it's a distraction. It's not a message. And the messaging is something that we have to improve.

The second thing what we have to improve is culture. I think people should feel respect but also appreciation for what they do in our business whether it's in their head office, in the stores, in the DC, in their home, factories that we should get a culture in which I mentioned already that they should be proud to be Magnit and we're proud to be colleagues. And that's something that we need to work on as well. So what I found is quite strong orientation and I think that that has to be broken, we have to cooperate. We have to work together. And by the way there are signs that that it's being picked up.

Assortment is still not finished. I think that's also what we have to work on by the way. That is part of the CVP but I would like to see that more announced and expressed. I find our marketing is not the strongest. So also there I think we have opportunities to improve. Having said that there is by the way quite a lot of things that we have started or that have been initiated that actually are going go into the right direction and are delivering us results and better results.

What I think we, as Magnit, have an issue is that all the initiatives that have been started, we've forgotten to tell the markets what's the advantage, what's your advantage to come to us. Why do you think – why do we think our offer is appealing. And that's what we need to work on. So the store operations, the assortment but there's also the messaging on our own production, on our private label that has to improve.

Marat Ibragimov: Okay. And final question to Elena. What's your average cost of debt now?

Elena Milinova: It's 8.0%.

Marat Ibragimov: 8%. Okay, thank you. That's all from my side.

Operator: That was our final question. So, I'd like to turn the conference back to our speakers for closing remarks.

Jan Dunning: Thank you very much. Thank you everybody for participating and obviously, like always, should you have further questions, our investor relations as always ready and happy to liaise and help you and obviously we will be talking to you again after the third quarter. So thank you very much and goodbye.

Operator: Thank you. And thank you all for your attention. This concludes today's conference. All participants may now disconnect.