

## **O'Key Group FY 2013 Audited Financial Results**

### **March 26, 2014, 17:00 Russia Time**

Operator: Good day, ladies and gentlemen, and welcome to the O'Key Group Full-Year 2013 Audited Financial Results presented by Tony Maher and Maksim Kravtsov. Today's call is being recorded. And I would now like to turn the call over to Mr. Maksim Kravtsov. Please go ahead.

Maksim Kravtsov: Good day, ladies and gentlemen. Welcome to the conference call on consolidated financial results of O'Key Group S.A. for the full-year 2013. During the first part of the call we will comment on the full-year financial results and then we will have a Q&A session in the second part.

I will start with a brief recap of our key operating results which are important to keep in mind while analyzing financial performance. Those of you who wish to get more information on it may refer to the investors section of our website for more details.

In 2013 our total revenue grew by 18.9% to RUB 139 billion supported by the 8% increase in like-for-like revenue. Revenue from sale of good was equal to RUB 137 billion and other income to RUB 1.8 billion. Other income increased by 27%, where both rental income supported by 11% increase in leased-out space and revenue from advertising services posted high growth.

Cost of goods sold increased below the revenue growth rate driven by improvement in purchasing conditions. Within COGS, the level of shrinkage decreased by 1.1% of revenue, which was offset by an increase in logistics and other costs. As a result, gross margin increased by 0.4% and reached 23.9%.

General, selling and administrative expenses continued to increase as a percent of revenue driven by growing personnel costs and operating leases. In 2013 personnel costs increased as a percent of revenue by 0.4% to 9.1%. Half of this increase is due to reclassification of recruiting, training and travel expenses from other costs into personnel expenses and result in a corresponding decrease in other costs.

The other expense I think is significant in 2013 is operating leases, which increased by 0.2% and reached 2.2% of revenue. And the main driver of growth in this is the increase in average lease space which expanded following the addition of nine rented stores in 2013 and seven in 2012. At the same time average rent rates are increasing due to growing number of

stores in more expensive cities and weakening ruble. The resulting EBITDA margin came at 7.9%, in line with the company's guidance.

I would like to draw your attention to other operating income and expenses where we had a few significant one-off expenses in 2013. Due to their nonrecurring nature, these expenses are not included in the EBITDA calculation but have an impact on net profit.

The loss reported in this line occurred as a result of the accident in one of our St. Petersburg stores where we have incurred additional costs and had to evaluate properties. Write-off of receivables due to the bankruptcy of the subcontractor and provisions under a legal dispute around one of our land plots. Together these items account for more than RUB 500 million of losses.

Profit for the year increased to RUB 5 billion while net profit margin declined from 4% to 3.6% due to the changes described above.

Now, let's move to the cash flows, investments and debt. In 2013 we invested around RUB 11 billion in building and refurbishing new stores, acquiring land plots and expanding our IT infrastructure. More than 70% of the investment was financed through our operating cash flow, which amounted to RUB 7.9 billion. This result is lower than operating cash flow of RUB 8.9 billion generated in 2012 and the main reason is working capital.

In 2013 we had improved both trade payables and inventory turnover by 1B, but the improvement was offset by an increase in accounts receivable. As a result, 30% of investment was financed through raising new debt and, at the end of 2013, our gross debt came up to RUB 16.8 billion, which constitutes an increase of RUB 3 billion year on year.

During the year we had refinanced our US dollar denominated loan and part of the short-term borrowings with ruble bonds and long-term credits. Consequently, share of short-term borrowings accounts for less than 10% of gross debt as of the end of the year, which reconciles better with the profile of our investments.

Management pays close attention to changes in the level of indebtedness of the company and uses net debt is the main indicator. Given the acceleration in CapEx, level of net debt to EBITDA increased in 2013, but remained at a comfortable level of 1.2. The net debt itself at the end of the year was RUB 13.7 billion.

These were the key financial results and changes in 2013. But before moving to the Q&A session I would like to make an announcement on the change in our quarterly disclosure practices. The company has made the decision to introduce quarterly financial results disclosure starting from

the first quarter of 2014. The first set of results will be published in late April. The new disclosure will combine operating results published earlier in the format of trading updates and financial results for the corresponding periods. Financial results will include in turn the summary of company's profit and loss statement based on the management accounting data.

Management will also host conference calls on a quarterly basis to discuss each set of financial results. The new disclosure will replace the company's publication of quarterly trading updates. This move is in line with the company's desire to meet best practice reporting standards and to provide a higher level of transparency. Full details of the Group's disclosure calendar and conference calls have been published on our website for investors.

Now, operator, please open the floor to the questions.

Operator: Certainly. If you would ask a question at this time please the star or asterisks key followed by the digit one on your telephone keypad. Please ensure also that the mute function on your telephone is switched off to allow your signal to reach our equipment. Once again, to ask a telephone question at this time please press star-one. We will pause for just a moment to allow everyone to signal.

And our first question comes from Brady Martin of Citibank. Please go ahead. Your line is now open.

Brady Martin: Yes, good afternoon. Really two questions. The first question is more of a general question for Tony. I know it's new management. Maybe this is premature to ask this question, but I'm just wondering, now that management has changed over what should we expect in terms of -- I mean should we expect any major changes in terms of ability to open stores or I mean changes in strategy or execution, whether it's around store openings or whether it's around the new discounter format or any other changes in the current projects now that management's changed. That's the first question.

The second question is just more of a clarification question on things from the press release. Just if you can give more explanation of this increase in receivables, exactly what changed year on year and also explain this accident. That's the first time I've heard of this accident. I don't know if this is related to the Ozerki accident from 2011 or is this some new accident? Thanks.

Maksim Kravtsov: Thank you for the questions, Brady. So I'll start with the second part of your question. In terms of the receivables changes, so the main items that changed inside receivables are the VAT receivable, which doubled compared to 2012. And the second one is the increase in other receivables. Effectively, these are the bonuses collectable from suppliers.

There's also a two-fold increase in this item. So, this is what constitutes quite a significant increase in receivables of more than RUB 1 billion, so around RUB 1.5 billion in total.

Brady Martin: Right. But I see that in the numbers. Now, my question was really changed in the (INAUDIBLE) to cause an increase in the VAT receivables and the bonuses year on year? I mean, these are pretty dramatic changes. Just wondering was there some business reason why this changed?

Maksim Kravtsov: Each of these items has its own reason. So if we talk about VAT receivable, most of the increase is connected with the fact that we are doing more prepayments for the construction and for the acquisition of properties. And there, VAT cannot be refunded until we get the property title. So, we have more of those and, as a result, the VAT receivable is increasing.

And for the second part, the growth in receivables from suppliers, it is obviously connected with the increase in the volume of operations and there is no, I would say, particular trigger that have resulted in such a significant increase. So I think going forward we'll be able to optimize this number and reduce the amount of receivables.

Tony Maher: Brady, good afternoon. Obviously we should expect some changes, clearly, to the issue of new store openings. I mean we're not happy with the rate of which we open new stores. And that's not a 2014 question, that was 2013 also where we opened just two stores in the first six months and opened far too many in December, which has its own risks. So clearly, that's an area for improvement that we want going forward and we intend to make that difference.

In terms of overall strategy, really, there might be some execution changes, but in terms of the discounter project, I absolutely believe we're on the right track and we believe that we have a format that will be successful and no change there. Some other issues on the (INAUDIBLE) we expect to change.

Brady Martin: Okay. Thank you for that. Just a final question on this accident. What -- can you just enlighten us on what this accident was that caused the one-off charges in the quarter?

Maksim Kravtsov: In one of our St. Petersburg stores, on Savushkina, we had an accident in July where the fire was set to the store. And because of it, most part of the goods, trading equipment and the fit-out was damaged so we had to close the store. It was closed in July and we reopened the store in December after completing all the repair works. As of today the store is functioning, but because of the accident we had incurred losses related to the write-off of inventories and equipment. And since we're also the owners of the

shopping center itself we had around RUB 90 million of reevaluation on the property there.

Brady Martin: Alright. Okay, that's fair. Thank you.

Operator: Our next telephone question comes from Maria Kolbina of VTB Capital. Please go ahead. Your line is open.

Maria Kolbina: Yes, good afternoon. First of all, Tony, congratulations on your recent appointment. I have a few questions. The first one is can you at this point provide any data or share any ideas to where you see the store openings increase in years to come, in the midterm. Can you once again mention your store opening plans for this year and what kind of the change can we expect going forward, because this is the key focus for us and for investors. So, that's the first question. If you cannot provide any exact numbers, maybe you just can share some thoughts on that.

And the second question is on rental rates. Do you see more landlords renegotiating rental contracts with you and trying to change it to dual economics as it was mentioned on Magnit call yesterday? And can you remind us on the economics currently -- economics of rental contracts, ruble versus dollars? So, this is all from me. Thank you very much.

Tony Maher: Maria, hi. Good afternoon. Well, clearly the new store openings, the issue really has not been the targets that we have; the issue has been the execution against those targets. I've never thought our targets were particularly overambitious. So the issue is one of execution and there are many reasons for that. At the end of the day it comes down to better management and that's what we are determined to change. And we just have to manage the projects much -- in a much tighter way so that we deliver them on time. And on time doesn't mean within a year; on time means within a month or within a quarter at the very least.

Building is always a little bit -- there's always a little bit of uncertainty, but certainly the uncertainty we've had is greater than we should have. And that's going to obviously take a little bit of time to sort out because you don't open the stores we do which are -- and our format store by and large there's a lead time that has to take place. But for us, we feel that our long-term objective of opening between 15 and 20 hypermarkets, for example, a year is absolutely achievable. We just have to put in place the execution capability; not in the year of opening, actually. The problem always starts probably a year before that. So, it's a question of making sure our pipeline is full three years out as opposed to three months out or -- the problem is never then. The problem is always earlier. So, that's something we feel that we will succeed at. We don't have any doubts about that, but we have to -- it takes a little bit of time to sort out the current issues.

The issue on renegotiating plots are -- I mean all our contracts for buying land and so on are in rubles, so that part is not an issue. There are -- where you have some rents, there are some rents agreements which are linked to dollars so that's -- that can be renegotiated maybe as well. So, these things can go both ways, I guess.

But in relation to -- will the ruble cost of doing business going forward increase with the devaluation, I guess the answer to that is probably yes, but then so will inflation and so will our revenue commensurate with that. So it's not a -- these things over time tend to balance out. The good news from my point of view is that all our debts are in -- practically all our debts are in rubles, so that's a big part of this compared to many other institutions.

Maria Kolbina: Tony, thank you very much. I just have a few clarification questions on the store openings. Do you stick to the guidance that was given to us before for this year store openings, i.e., selling space growth in line with the previous year and top line, if I'm not mistaken, within 15% to 19% top-line growth? So should we stick to the same numbers or do you foresee any changes for this year?

Tony Maher: I think it's -- it's a little bit early, but I think I think the likelihood is that the number of store openings that was given in the January call I think was -- is a little bit overly ambitious given what I currently see project by project. So, I believe we will -- certainly at the hypermarket level we will not open -- I think the number was 13 stores this year. I don't believe that we will open 13 stores this year. And even if we could, I don't want to open stores in the last 10 days of December so -- that's not value adding. And so I -- when we open stores, we'll be ready to open them, but I don't believe we'll open 13 stores in the calendar year of 2014.

Maria Kolbina: Okay. Thank you very much. And the last question from me. How big are the changes in management at this point of time? Like, how are you reshaping the current -- like corporate structure of the company? And how different, like, O'Key is now from what it was like half a year ago and how different will it be from like the top management perspective by the end of this year? So can you share some thoughts on that?

Tony Maher: No, I can't. (Laughter.)

Maria Kolbina: That's a clear answer.

Tony Maher: It's a short and easy answer, Maria, okay? (Laughter.)

Maria Kolbina: Okay. Thank you so much. Thank you, Tony.

Operator: Our next telephone question comes from Natasha Zagvozdina of Verno Capital. Please go ahead. Your line is now open.

Natasha Zagvozdina: Thank you very much. Hi, Tony. Hi, Maksim. I have a question on CapEx. Given what you've just told us about your opening plans and given that previously the company was guiding for quite robust CapEx numbers for 2014 -- we've heard \$20 billion -- and also because you've spent 20% less on CapEx in 2013 than originally guided for, what is the current understanding from company and the management on the CapEx spend for this year?

Tony Maher: Hi, Natasha. Well, firstly, the CapEx -- most of the CapEx for this year, or a big portion of it, would really be for stores that will open next year, also. And also, inside this year the additional element of bringing our discounter projects, factory to the warehouse, which is a big piece of that CapEx, will be finished in the third quarter of this year. And a lot of new stores which will come on line in the first quarter of next year will be -- are already starting to (INAUDIBLE).

So, some of the CapEx obviously will be against store openings of next year. I think it's a bit early for us to adjust our guidance on CapEx, honestly. If it's not RUB 20 billion, I don't think it's going to be a hugely significant number below that. I don't believe it'll be above that, but the -- actually, the issue is we want to be spending the money because that would mean we are bringing stores on line sooner. So, it's not really a -- it's not the area of focus right now in terms of cutting back on CapEx because it's about bringing projects to fruition and that obviously has different elements of payments to it. You don't pay for a store just when we open it. We pay for it from the day we contract for land and every week and every month all the way leading up to it. And in some cases, making prepayments for various elements of the store.

Natasha Zagvozdina: I understand, thank you. But still on the same subject, in the beginning of the presentation one of you mentioned that there will be effort made on certain improvements in working capital. So of the whatever number you have in mind for CapEx, should we consider that still a large portion, 30% to 40%, will be funded by your debt because you have so much of front load this CapEx which you're spending this year for future periods? How shall we think about that?

Tony Maher: Well, there's -- we are intending to do many things, including improve working capital, so we believe there's opportunities there both on the payables and on receivables. So we expect -- actually, if you look at some of our recently floated competitors, we think there's opportunities there certainly on our payables, for example, compared to what we have. So I think -- we think there are some working capital opportunities that we are going to obviously pursue and we are pursuing.

The issue on -- you're looking at around -- trying to understand debt, I take it. Are you, Natasha? Is that the--?

Natasha Zagvozdina: Yes. It was first part of my question, but the other was you have so much front-loaded CapEx that you're spending this year for the stores that will be operational in 2015, for instance, so discounted. That would mean that even a larger portion of this year's CapEx will be funded through new debt, almost 30% or 40% or in excess of 40%.

Tony Maher: I can't give you the percentage. Maybe we can come back to you on that but I -- for sure, yes, it will be -- there will be additional debt this year, absolutely.

Maksim Kravtsov: Because if you are looking at the calculation between the operating cash flow and EBITDA that we had in 2013, it -- the operating cash flow fell down a bit, but normally we should have a close correlation between EBITDA and operating cash flow. So if we were to assume that the 15% growth in revenues is achieved this year with the same kind of EBITDA that we had in 2013, then we would have around RUB 12 billion of EBITDA and operating cash flow should be close to the same number in 2014. At the same time you have the investment program of RUB 20 billion. So approximately RUB 8 billion with a very rough kind of calculation should be financed for new debt.

Natasha Zagvozdina: Thank you. Thank you.

Operator: Our next telephone question comes from Maria Berasneva of Morgan Stanley. Please go ahead. Your line is open.

Maria Berasneva: Good afternoon. Thank you for taking the questions. My first question is with regards to overall trading environment. Are you seeing any changes in consumer trading (INAUDIBLE)? And then I'll follow up with my other questions.

Maksim Kravtsov: In terms of the trading environment that we saw in January and February, for the two-month cumulative we're going below the guidance that we gave, 15% to 19%, below the bottom part of it. The trading looks very similar to the trends of December 2013 and the main reasons for this are the negative like-for-like traffic and lower number of openings in 2013 compared to 2012.

Traffic is under pressure, but not across the board. And the main reason for the traffic pressure is obviously in competition and here we mean both internal and external competition because we have opened in 2013 several stores that are influencing the performance of existing stores in the same locations.

At the same time, uncertainty around economic situation and weakening ruble are not improving customer expectations.



But when we look at the consumption itself, there are no visible signs of weakening. I mean, if you look at the basket of products that customers take, if you look at the basket inflation, which is running for the first two months of this year in line with the inflation level, close to 7%, and the number of items that customers take per basket, which stayed constant compared to 2013, we cannot really say that the customers are cutting back on their spending. Difficulties that we are experiencing are predominantly concerned with competition.

Maria Berasneva: And would you be able to quantify the cannibalization effect you're seeing in your own stores or is that too early to talk about it?

Tony Maher: It's very early because we opened quite a lot of stores, if you remember, in the final couple of months of 2013, so -- and we're talking about a few cities like Ufa, Krasnoyarsk as well, where we opened one store in addition to an existing two. And it takes time for stores to settle down, including when people move around it takes a bit of time so it's a bit early.

And when Maksim talks about cannibalization, it's really just -- overall, our numbers, customer numbers in those cities, those two in particular, are up substantially versus prior year. So overall, there's a quite large gain. But people -- a new store opens people are going to move to see it and so on so you have to give time for the thing to settle down.

Maria Berasneva: Okay.

Maksim Kravtsov: If you look at the loyalty card basis then you would see a different dynamic because on the loyalty card basis we don't have the traffic outflow. The traffic that's flowing out at the moment are actually the new customers that are not regular shoppers with O'Key.

Maria Berasneva: Okay, very good. Thank you. My other question relates to inflation in leases and labor costs. What inflation do you expect to see, maybe as a percentage of sale in 2014? And so you see room for improvement in operating expenses? Is there much room for optimization there?

Tony Maher: I think it's a bit early for us to give specifics on that, but the short answer is absolutely yes. There are definitely opportunities to reduce overheads as a percentage of revenue and in absolute terms, but it's too early to give any specific guidance on what that looks like. And frankly, if I could give guidance I probably wouldn't because I would want to, first of all, put plans in place internally to make some of those changes. But we are developing those plans and we will execute them, but there's no doubt we -- our G&A costs are higher than they ought to be and we pretty much know what we need to do to change that but it's a bit early to be more specific than that. But you will see, certainly from next year forward, and probably from even the latter half of this year, G&A as a percent of revenue coming down.

Maria Berasneva: Very good. Thank you. And one more question, if I may. With regards to the write-off of receivables which relates to advance payment for construction where your contractor went bankrupt, is this a common practice to prepay the contractor? Do you typically record this type of prepayment as part of receivables? And then what percentage of receivables are such prepayments represent?

Tony Maher: Well, it is common practice to prepay elements of building and that applies in most jurisdictions in the world, actually. Contractors typically don't do anything unless you pay them to do it in advance.

While we've made a provision under IFRS for this, we are determined to get our value back for the various elements. Whether we can get 100% or not back is questionable, but at this point I would say there's a good chance we get quite a lot of this back.

It's quite normal. It's very normal in Russia. And what I would say from my experience across Europe, it's not unusual to prepay contractors (INAUDIBLE). I think, by and large, this is a -- I would -- you can never say a one-off, of course, but I think there was -- this was one particular contractor in a regional city. It's life. These things happen, but we feel that we will certainly get -- we'll certainly give it a good go to get our value back for that money and we have plans afoot to do that. But under accounting, IFRS accounting, we have to provide for it.

Maria Berasneva: Okay, very good. And do you record it as part of receivables? Do you know roughly what percentage of receivables that your prepayments represent?

Tony Maher: I don't. But if you can imagine, receivables, by and large, are from two sources. They're from this element, prepayments, and the second element is supplier bonuses, which typically we get after the event, if you like. I mean, they make them practically all -- and VAT, I guess -- that make up all of our receivables. So, I can't give you the percentages. Maybe Maksim can, but perhaps we should get -- we can get back to you, Maria, with the numbers. But we don't have -- the final consumer doesn't owe us any money. They pay us cash every time they go through our checkouts with their trolley, so it's those other three elements that make up all our receivables.

Maria Berasneva: Okay. Thank you very much. I will let my colleagues ask their questions.

Operator: Our next question comes from Victoria Petrova of Credit Suisse. Please go ahead. Your line is open.

Victoria Petrova: Hello, Tony. Congratulations on your new appointment. A lot of my questions have been answered. I would like to ask you regarding the

guidance which was provided by O'Key Group in January. Are you keeping it unchanged? Are you thinking about maybe coming back to us with an update once you get more involved in company operations?

And my second question is related to your KPIs. As the company CEO, is your performance linked to profitability? Is it linked to revenue growth? What is the key parameter for you which you would focus on in the next 12 to 36 months? Thank you.

Tony Maher: Hi, Victoria. We will do as Maksim said, a conference call at the end of the first quarter and during April. I think we've a date set the 14th of April, right?

Maksim Kravtsov: No, it's at the end of April.

Tony Maher: At the end of April, yes. 28th of April. And I think then we will talk about guidance for the year.

In relation to KPIs, it's all of the above. It's -- we want to develop on the good work that's already been done and to grow our business. So, it is revenue growth, it's profit growth, it's the various metrics on margins, it's working capital management. I mean, it's all of the above because I think you cannot have a business that is standing on one leg. You have to have a balanced business.

And we're not looking to increase margin at the expense of depressing revenue so that we're -- if we're going to increase margin it's not because we're going to put up prices, it's because we're going to manage our costs better and manage our buying better. So -- and so on and so forth. So, it's -- my ambition for this business is to maximize the long-term value for us and that's going to be only achieved by getting a balanced -- a balanced scorecard, if you like, in terms of the key indicators.

Victoria Petrova: Thank you very much.

Operator: Our next question comes from Erik Hegedus of Wood & Company. Please go ahead. Your line is open.

Erik Hegedus: Yes, good afternoon. Just one follow-up question on my side. Could you please give us an update on the discounter project? When do you expect the first openings and whether the scale of the project is still the same, so roughly 100 stores? Thank you.

Tony Maher: Well, the scale of the project is not 100 stores. The scale of the project is to open somewhere between 30 and 50 stores a year, and ultimately rolling out about 50 stores per year. We -- the project will -- our current plans are to open four stores in the first three or four months of next year and our

plan next year would be to open somewhere between 30, 35 to 50 stores, somewhere in that order, so north of 30, 35 stores, let's put it like that.

And we are on track. We've got locations. Some are being built, some are being rented. The warehouse, which is a critical platform for that type store, is practically finished and will be fitted out in the latter half of this year. So, everything is pretty much as we had hoped and expected it to be.

Erik Hegedus: Okay. Thank you very much.

Operator: Your next question comes from Boris Vilidnitsky of Barclays. Please go ahead. Your line is open.

Boris Vilidnitsky: Hi. Thank you. Good afternoon. A few questions from me. The first question, you mentioned your long-term goal is more store openings. Could you please comment on what do you see in terms of competition for space?

Tony Maher: Well, I guess you can always imagine that the best spaces in the best cities are always going to be competitive. The A locations will always be the A locations.

By and large, I think we don't -- and there's two elements of this. One is a space that we buy ourselves and the other element is space in -- where developers are developing a center and they want an anchor tenant. I think we are lucky in the latter part to be the tenant of choice for a great many leading developers in the country. So in fact, we've even been in a number of occasions, at least in two stores that I can think of, one in Moscow, one in St. Pete, where we have been -- we have replaced the existing anchor tenant at the request of the center owner because they believed, and as it turned out correctly, that we will bring more footfall s through the center and more revenue to all the shops. So, that's one element. And in that area we feel almost less competition than before.

In the case of sites that we develop ourselves, yes, they're competitive, but I wouldn't say unduly. Moscow is always going to be more expensive than, I don't know, Irkutsk or Krasnoyarsk, but then there's more income here. It's not at a level where one would say that it doesn't represent a good return on investment. We think it's still fine.

Boris Vilidnitsky: Right. Thank you. Now, you mentioned that your longer-term goal, perhaps, is to open 15 to 20 stores per year. And if I remember correctly, up until now your logistics only allowed for opening about 14 stores or maybe 15, I don't know, and if you've noticed already where the bottlenecks, what can be improved to really make that number grow higher.

Tony Maher: Well, the bottleneck is not logistics, actually, because we rely -- rightly or wrongly, we rely on, by and large, direct store deliveries for the majority of our produce and so that's not the bottleneck. The bottleneck has been really our project management. I was just -- maybe that's probably the best catchall I can give you in terms of -- from the time of acquiring plots to the time of getting the store opened. That's the bottleneck and that has to be the place where we're putting our focus. It's not about internal or external logistics.

Boris Vilidnitsky: I see. I see. And has that been a problem with construction crews or just managing the project better or pushing the construction crews faster?

Tony Maher: You can continue listing it out and I guess it's yes to all of the above there.

Boris Vilidnitsky: Fair enough. And then, last--.

Tony Maher: Maybe I'll ask you for a check list later and you can help me to identify even more opportunity. (Laughter.)

Boris Vilidnitsky: Fair enough. And the last question from me, the traffic outflow that you mentioned as a result of competition, is that based on pricing? Do you see more aggressive promotions? Maybe you could comment on the regions?

Tony Maher: No, that refers to a couple of stores, actually. It's not a widespread issue. It refers to a couple of stores in one area. Overall, like-for-like is actually okay. It's not -- there isn't particularly more aggressive competition. I mean, it varies from city to city from week to week, but nothing different than before; let's put it like that, I would say.

Boris Vilidnitsky: Understood. Alright, thank you so much and congratulations on your new position.

Tony Maher: Thank you.

Operator: Our next question comes from Alexey Krivoshapko of Prosperity Capital Management. Please go ahead. Your line is open.

Alexey Krivoshapko: (INAUDIBLE) Tony, it looks like all your friends are on this call today. Actually would like to ask you about internal formats. And having looked at stores for the last weeks, what are your kind of preliminary conclusions in terms of competitiveness, pricing levels, assortment, productivity? How do you see O'Key right now in terms of where it stands as a (INAUDIBLE)?

Tony Maher: Hi, Alexey. I'm glad all my friends are on. That's -- I'm very reassured about that, so thank you.

Look, I think by and large our formats are winning formats. I mean, the glass is definitely more than half full. I think the quality of our stores is superior than anything in the marketplace and that applies to our hypermarkets for certain and I think our supermarkets, too. I think our personnel are well trained and we don't outsource personnel. There's a lot more loyalty in our people. We have less turnover than our competitors. Our level of customer service is definitely better. The range of our goods is -- we have a pretty strong assortment. The quality of our fresh product I believe is absolutely excellent and that goes for fruit, vegetables, meats and so on. It's -- and it's across the board and it's noticeable.

And by the way, I haven't been just visiting stores for the last couple of weeks. I've been visiting stores for the last 20 years in Russia. So, it's not -- this is not something I've learned in the last couple of weeks.

Our pricing is competitive. Our loyalty program is excellent. We have a huge amount of regular shoppers and more than 95% of our business is done with -- by true regular shoppers. And the weaknesses are the ones I talked about. I think we -- new store rollouts is definitely the primary weakness and one that we are determined to address. I think we can sharpen our marketing, perhaps, both our catalog and on our outdoor campaigns and so on.

We also think there's opportunities in buying. So, if some of my other friends from FSGG companies are listening to the call, I think they should probably keep that in mind when they're talking to us or we are talking to them. And our overheads probably need more attention than they were given. But the list of things that we need to improve versus the list of things that are -- we are strong in and that we can still improve upon, of course, the world never finishes moving and the demands from tomorrow will be always greater than what we delivered yesterday.

Overall, it's not a question of a radical change. It's a question of perhaps better execution. That -- we think -- we believe that the formats we have are good formats and the quality of what we're building is definitely better than most of our competitors. If you go into our stores, the shopping environment is a very pleasant environment, up there with anything you find in Western Europe or beyond and that's something that's I think quite unique. You don't find danger from pallet trucks and (INAUDIBLE) drivers inside in our shops. That is not true for many of our large format competitors. So, you can walk around the aisles of our shops feeling comfortable and unharried by equipment and by store employees, which you cannot find with any other large format competitor, by the way. So, much is right. It's just some items that we can -- some elements that we can improve upon that we will and are improving upon.

Alexey Krivoshapko: Well, thank you very much. That's very reassuring. Good luck.

Tony Maher: Thanks, Alexey.

Operator: And we have a follow-up question from Natasha Zagvozdina of Verno Capital. Please go ahead. Your line is open.

Natasha Zagvozdina: Thank you. I'd like to ask when, Tony, you think the company will be able to provide a little bit more clarity on the discounter format? You said that in the first quarter of '15 you should start seeing these stores being opened. Then my question is do the economics of this format, the level of gross margin at which you're planning to operate, the (INAUDIBLE) amount of operating costs as a percentage of revenues that you are targeting? Do you think that in the last quarter, towards the end of this year, we would be able to get this information from you guys, if not earlier?

Tony Maher: Well, I would be very happy to show you around those stores in the first quarter of -- or four months of next year. The gross margin obviously is a function of buying and selling, but also a function of mix of products between private label and branded goods and so on. Over time, we don't think that this format will be dilutive to gross profit at all, actually. We think it will be pretty much on an average, but for different reasons with mix and so on. And also, the format will have lower operating costs than you -- than we would have in our other format because of the amount of SKUs we'd carry and equally because of the logistics within the store. Maybe it won't be quite as efficient as an (INAUDIBLE) because those stores, typically there's a lot more pre-merchandised products going on the shelves and so on.

But the principles of the format, where it's a comfortable shopping environment, limited amount of products on offer, very I guess consistent type of infrastructure where goods flow from the goods inward side of the store all the way through to the cash at the other side, those kind of formats heavily exist today in Russia because of the amount of compromise that operators have done by buying existing (INAUDIBLE) or building at the bottom of apartment blocks and so and so forth. So, this format is -- while it's a discounter format, it is not a typical Russian discounter format that you currently see in the marketplace.

Natasha Zagvozdina: And I presume that if you open -- or you target third quarter this year to open the distribution center, it will not be serving any stores but the company will be incurring a certain upgrading (INAUDIBLE). So, we should expect for a few months pressure on margins from that--.

Tony Maher: I--.

Natasha Zagvozdina: Temporary (INAUDIBLE) or not.

Tony Maher: Well, I mean we're -- the company is incurring costs today and incurred costs last year because we have a team of people working on this project. And that team gets bigger and bigger because, obviously, you don't open a store and start the team then, but -- or open a business in this case. But of course, it's also getting some synergies from our existing business.

I think in the case of that warehouse, that warehouse can serve -- obviously, its primary purpose is to serve the discounter format, but it can also be utilized for our existing stores. So, it's a question of -- I don't think it's a meaningful issue, to be honest with you, vis-à-vis that warehouse, we can certainly utilize that warehouse while we have -- because there's a lot of capacity being in-built in there for our existing format in the near term. Just as -- I know over time to offset -- well, I wouldn't say offset. I would say over time actually to utilize the capability that this infrastructure gives us.

Natasha Zagvozdina: Alright, fair enough. Thank you, Tony.

Operator: And our next question comes from Irina Aracharskova of Renaissance Capital. Please go ahead. Your line is open.

Irina Karacharskova: Yes, I have two quick questions. The first question on your net debt to EBITDA target. Is it still below 2?

Tony Maher: It's approximately 2.

Irina Karacharskova: Yes. And the second question on your logistics. Just want to ask is there any changes of management's view on logistics? Could you explain when O'Key would start, for example, to construct their own distribution center for hypermarkets?

Tony Maher: I think that's open for review. Whether we construct or lease or whatever is another matter. But we think that there's definitely opportunity, but that opportunity is accretive to margins rather than otherwise, to manage logistics a little bit more hands-on than we have been in the past. But it's - it doesn't mean necessarily that you have to take that in-house, vis-à-vis building a warehouse or whatever. It doesn't mean we wouldn't, either, but we can equally lease such facilities and -- but I do think we will have some change in logistics over the next 24 months.

Irina Karacharskova: Okay, thank you. And the final question on your staff costs. I'm looking at your financial statement and the note number 11 of your financial statements, I see the breakdown of your staff costs. (INAUDIBLE) are increased very significantly (INAUDIBLE). Could you comment what was -- why this happened?

Maksim Kravtsov: So the biggest part of the increase there is coming from reclassification of training, recruiting and travel expenses.



Irina Aracharskova: Oh, okay.

Maksim Kravtsov: That's the majority of it. Because if you do the same -- if you include the expenses into 2012 line then you would get close to RUB 650 million on that line and then the increase is not that sharp.

Irina Aracharskova: Okay. Thank you very much.

Maksim Kravtsov: And then the second part is that we have changed several items in there and that resulted in the increase. But that part of increase is not that significant.

Irina Karacharskova: Okay, thank you. That's all my questions.

Operator: Our next question comes from Anton Farlenkov of Goldman Sachs. Please go ahead. Your line is open.

Anton Farlenkov: Hi, Tony. It's Anton here from Goldman. Actually, all my questions -- pretty much all my questions were just answered. Probably the last follow-up question about the CFO position. Do you plan to hire someone for CFO or plan to combine (INAUDIBLE) forward? So, given that the company plans to accelerate the store openings, I would assume workload will go up so how do you plan to deal with it?

Tony Maher: Hi, Anton. Actually, we had a CFO and we still have the same CFO, it's just that he wasn't reporting direct to the CEO. And for me, that's an anomaly that I hardly understand. So, Dmitrii Prianikov is our CFO and has been for -- since the foundation of the company, will continue to be and I really enjoy working with him. So, we have -- and by the way, his capability from a workload is unlimited, I would say, from what I've seen. So, I don't have any -- at least we'll test that going forward, but I don't see that as an issue at all. Dmitrii knows the business extremely well and he -- just that he was before reporting to somebody who was reporting to my predecessor, but -- just as much as the head of legal and some other folks were. But for me, this is normal to report directly to a CEO. It's not -- it's -- it wasn't the structure I was familiar with, let's put it like that.

Anton Farlenkov: So basically, what Sebastian was doing will -- that workload will be moved to the -- well, the CFO, existing CFO.

Tony Maher: No. I can't -- well, I can't tell you what Sebastian was doing, necessarily, but I can tell you that he was in a role which was where he had a number of corporate functions, as it was called, which were including the CFO, Dmitrii Prianikov; the Head of Legal; Maksim of Investor Relations; and IT reporting to him and then he was reporting, up to a couple of weeks ago, me. In my previous life, whether it was in Wimm-Bill-Dann or Coca-Cola or whatever, the CFO reported to me. The Head of Legal, certainly

in Russia, would report to me and will always report to me. IT can be a question mark and Investor Relations and Molina Cargen inside -- in Wimm-Bill-Dann reports to me.

So, I have no problem with that. So, maybe if any workload increases it's mine, but it's fine. I'm very comfortable with all of those functions. In fact, I deem at least three of those functions to be absolutely crucial they report to me, so I wouldn't have it any other way. So, I'm not going to comment on what Sebastian was doing. This is -- it was -- he had (INAUDIBLE) reporting to him.

Anton Farlenkov: Okay. Very, very clear. And the last question about the traffic. Did I understand correctly that in the first two months traffic for the Group -- like-for-like traffic for the Group was negative? Because you made some statements that only a couple of stores suffered, but the rest were absolutely fine.

Tony Maher: Overall -- first and foremost, what we said was that there were a number of stores where like-for-like traffic was impacted by new store openings by us and in a number of cities, partly St. Petersburg in part of the city, and also in Ufa, Krasnoyarsk. And so that was the main difference in like-for-like. So if you were to net that out, like-for-like traffic is fine.

Anton Farlenkov: Okay. Thanks.

Operator: As a reminder, ladies and gentlemen, to ask a telephone question, please press star-one on your telephone keypads. And our next question comes from Maria Berasneva of Morgan Stanley. Please go ahead. Your line is open.

Maria Berasneva: Thank you. I have a couple of follow-up questions. Well, question number one is do you think the suppliers have already passed onto you the inflation from the ruble depreciation in the form of higher prices, or do you think we still have a couple of quarters of that process?

Tony Maher: That's -- there's always price increases taken by suppliers, ruble inflation are not. And there's other elements of inflation as well; inflation in the meat area, there's inflation in -- which is beyond rubles; there's inflation in the dairy industry, which is again beyond -- given the price of raw milk is very high, etc. So, this is a -- this is evolutionary rather than revolutionary, to be honest. And the same with suppliers is -- no supplier, other than perhaps he's doing direct imports, is going to take ruble -- a direct correlation between ruble and euro immediately. It's a function of over time because they don't want to kill their business no more than we want to kill their business by pricing products too highly.

So, it's evolutionary. It's continuous. And the same from our point of view or the retailer point of view in terms of passing those prices on.

Again, evolutionary. It's -- I think there's probably not a day that goes by that -- without prices being changed one way or another. That's always the way of business.

But, suppliers are not going to take a ruble devaluation in one go or -- and may be not even in several goals. That happened in -- the last time I saw that happening was 1998 and it didn't work, by the way. So, since then I think every supplier, including or mainly foreign companies, have learned that most overheads are ruble. And so you don't always get the complete negative hit from devaluation of the top line in euro terms. You don't always need to see that reflected in ruble pricing.

Maria Berasneva: Okay. Thank you very much. And question number two, if I may, with regards to the legal dispute over land lease in Volgograd, what processes did you put in place, if any, to minimize risk of disputes going forward and do you see this as an issue for the market and sector overall?

Maksim Kravtsov: If we're talking about the dispute around the land plot, the legal case that we have on the go, actually we're in court on that dispute and have been in the court for some time already. I think this is already the second instance. And we are going to continue the procedures around that land plot. So, the measures that you can take are actually only within the court. You cannot influence the situation in any other way. I mean, you cannot stop buying land because of it.

Tony Maher: There's always going to be risks of doing business, right? That's just the way it is. I mean, you have to take some element -- there's always some element of risk but it's a question of managing of that and there's -- are there going to be issues? Yes. Are they overall material? Probably not. We have -- we do good due diligence in everything that we do, but there's going to be something sometimes and that's the cost of doing business.

Maria Berasneva: Okay. Thank you.

Maksim Kravtsov: Operator, as we've run out of time I would like to wrap up the call.

Operator: Okay.

Maksim Kravtsov: Okay. Thank you very much, everyone, for participating in today's call and we'll look forward to speaking to you and seeing you in the future. Thank you.

Tony Maher: Thank you. Bye-bye.

Operator: That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

**END**