

O'Key Group
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Chaired by Maksim Kravtsov

Maksim Kravtsov

Dear ladies and gentlemen, welcome to our conference call. I'm here today with Patrick Longuet, CEO, and Sebastien Verhaeghe, Director of Executive functions. We are going to go through the results of the third quarter and nine months of 2011.

Third quarter of 2011 was a rather challenging period for us in terms of the economic situation and seasonal peculiarities of this year. We've achieved in the third quarter net revenue increase of 10.4% with the like-for-like revenue going up by 5.9%, supported entirely by the ticket increase. We saw slight traffic decline of 0.8%, but, if we look at the tendency by month, within the quarter the tendencies were very different and I'll go in more detail for this right now.

There are two factors that were at play during the quarter. They affected our results and caused slight deterioration from the second quarter levels in terms of the like-for-like performance. First factor that had the highest magnitude was the deceleration of food inflation. We saw it coming through from July and every consequent month our average basket increase slowed down further. In July we had the highest basket increase and then August and September showed slowdown in the growth rate.

At the same time we witnessed during the summer months, July and August, that the, there was a traffic outflow due to the seasonal effect. We saw from the numbers that the consumption of seasonal products such as drinks, ice cream and other products traded actively during the summer period went down quite substantially this year. The number of purchases there decreased quite a lot. We attribute it to the seasonality and weather conditions of this summer, which was mild compared to 2010 where summer was very hot. As a result, on the back of decline in sales of drinks and seasonal products we received a slight traffic outflow during July and August. However, in September we saw positive traffic dynamics and the traffic increased slightly above the levels of the second quarter. At the same time September was the month with the lowest increase in average basket due to decelerating inflation. These factors were compensating for each other.

During the third quarter we've opened one more hypermarket in St Petersburg and one additional supermarket. We've also reopened our store that was closed in January. We've opened it on the 22nd of September and the store started to sell there.

Talking about the overall sales of 10.4% we have the major contributions still coming from the like-for-like stores which is 5.9% and the rest coming from new stores. The new stores that are excluded from like-for-like calculation in the third quarter numbered four hypermarkets and four supermarkets. Their number was still quite low and it didn't change anyhow from the second quarter, therefore the tendency of progress remained the same as it was in the second quarter. Keep in mind that when we look at the progression of selling space of 9.5% between the 30th September of 2011 and 30th September of 2010

Ozerki store is included into space growth but in revenue numbers it's included only for the ten days of September.

In terms of the nine months result correspondingly our like-for-like performance improved a bit, increasing from 4.8% to 5.2%. Number of tickets didn't change anyhow, it still remained negative of, at 0.8%, but the average ticket increased a bit on the back of pretty high average ticket inflation in July.

I will now pass the floor to Patrick Longuet to talk about the consumption tendencies during the period and to give some outlook on the coming months. Patrick, please go ahead.

Patrick Longuet

Good afternoon, ladies and gentlemen. I would like to start by saying that the result of the third quarter for us is good if we compare it to the first and second quarter and if we compare to the market. I am very satisfied with the result and for example, as Maksim said, the traffic in September was positive and for me it's a very good sign.

As for the purchasing power, I think the today the purchasing power is limited by the level of increase in salaries. The salary increased between three to 4% year-on-year and today we have an increase of basket that is actually over the salary increase. For us it is also a good result.

I don't see any changes in the consumer behaviour, because when we look at the figures in food and non-food we have the same growth of average basket. This correlation shows that there is no significant change in the purchasing power. The fact of the matter today is that the inflation runs currently below the level of July by 1 or 2%.

During this quarter we opened one new hypermarket and one supermarket, as it was anticipated, and also we have reopened Ozerki store. Reopening of Ozerki brought some pleasant news to me as well as the store almost immediately regained between 80 to 85% of customers which it had before the accident. As well, one thing very important, we renovated the store by bringing in new furniture, more cash registers and adding a lot of fresh products. As a result we received a big increase in the average basket there.

At the end of this quarter, we opened two new platforms of logistic, of cross-docking; one in St Petersburg which has in charge of sourcing fruits and vegetables to our supermarkets O'Key-Express in that city. And the other platform, in light of expansion that we plan in Moscow in the future, we opened in Moscow region to deliver products to hypermarkets, supermarkets in the city and in close proximity to it.

During the next quarter we will open nine new hypermarkets and the total will be 11, as I said a lot of times. Six hypermarkets will open before the end of first week of December. These hypermarkets are in St Petersburg, Ufa, Omsk, Astrakhan, Moscow region and Saratov. Three hypermarkets will open in the second half of December, one in Tyumen, one in Voronezh and one in Moscow region. These three hypermarkets may be delayed if we have authorisation delays with local administrations. But these hypermarkets are ready, we are ready to deliver goods to stores and if they don't open at the end of this year they will open one month later, in January. Plan for the next year has not changed since last

conference: we will open 13 new hypermarkets in addition to any delayed ones. The target for total space increase is the same - 30% more space each year.

As for the LFL revenue forecast for this year, we think that with current tendencies we will have 6% increase in the last quarter of this year. Voila, it's all for our part, now you can ask questions.

Questions and Answers

Daniel Wakerly, Morgan Stanley

Good evening, everyone. My first question is in the light of your like-for-like guidance for 4Q; what sort of sales are you looking for, for the full year? Are you still targeting 97 to 99 billion? That's my first question.

I think now we are under these figures, we are, I think we will end up the year between 94 and 97 bln RUB.

Okay, 94 to 97, understood, thank you. My next question is () X5 on Monday pretty clearly said they're planning to become more aggressive in terms of more promotions and price campaigns. Is that something you think you'll need to respond to?

We have a clear policy of advertising for the last quarter. We have not changed it so far because of new operations of a competitor. We have a programme of promotion during the next three months and also for the next six months. We plan carefully in advance of the season and are not ready to change it right away. And we don't want to make a price war because we want to keep our margin which is very important for us. I've made a decision not to make very low prices, it's not our policy.

Okay, thank you. Are you able to give any comment on the margin outlook for the, for this year?

My target for this year is the same, between 7.8 to 8% of EBITDA.

Okay, thank you. And, yes, just going back to your comments on the ticket, your growth of 6.7% in 3Q looks to be the highest of the year, so how do we square that with the idea of food deflation? Where's the strength coming through in that number? Is it good volumes? Is it something to do with mix?

Maksim Kravtsov

No, we don't think that high basket relates to the mix changes in particular. We haven't witnessed any significant changes in the mix. But where the strength is coming from is definitely July. In July we had a very good progress of average basket and then from July on progress was slowing down. As soon as the deceleration started in August we've seen it coming through quite strongly in our numbers, but July was a month with a very high average basket inflation.

Okay, thank you. So it sounds like when we're looking at 4Q to get to your guidance we're looking at slightly better traffic but lower basket?

Yes, the 6% that Patrick mentioned, it's almost fully coming from the average basket which would mean the basket increase between 5.0 and 5.5%. And then potentially there might be some increase in the like-for-like traffic, but it's going to be fairly minor.

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

Anton Farlenkov, Goldman Sachs

Well actually my questions were answered just a second ago. Thanks a lot.

Maria Kolbina, VTB Capital

Yes, good afternoon. I'm basically, I had the same situation, almost all of the questions been asked, so I would ask on 2012 opening plans, do you think you will have the same skewed in terms of the openings towards the year end? So it will be much easier for us to fine tune our models. Or you think it will be more even store opening distribution between the quarters of this year? So that's my first question.

And the second question on the land bank acquisition programme both for this year and the CapEx expectations, and do you plan to give out the discount project that you have previously mentioned? Are you still going with these plans? So that's it.

Patrick Longuet

For the next year openings, a lot of stores now are not far from being ready to open during first six months, but I think that four or five hypermarket will be opened during first six-seven months. And more than eight stores are to be opened during the second semester. It will be better than this year, a more balanced schedule.

As for the land bank, we will make strong effort this year acquire large quantity of land. I think we will have by the end of the year 17 new land pots that we acquired this year for expansion in 2013, 2014. And the last question was about discount project. Today we have no project of discounters really clear. As I said before we have decided to buy land in Moscow and Moscow region to ensure that our expansion of supermarket in this region will go as planned. For this reason we have decided to buy land in Moscow. At the moment we have not defined exactly if there should be a different concept or not.

So do I understand you correctly that you're currently securing the land bank which can be either used for supermarkets or for discounters?

Yes.

Okay. And with regards to store openings, with regards to supermarket opening plans for 2012, do you also think that next year you will have more even, quarterly distributions than skewed towards the year end in this format?

I say that for us supermarkets are an opportunity which we realize via rent. In which case time between decision to open one and actual opening is around three months. We have not determined exactly the number of supermarkets to be opened next year, but clearly

primary target for us is 30% expansion of square meters. If we have 30% increase in square meters coming from hypermarkets alone we can open just two or three supermarket, not more.

Okay. And my question is on the share of real estate ownership. Where you do you see, based on what you're, like, constructing now, how many of the hypermarkets for the next year will be owned? How many will be leased? And what is the ownership breakdown for supermarkets?

Next year we plan to open six owned hypermarkets and seven rented ones.

And with supermarkets?

I told you that we rent supermarkets O'Key-Express. If we decide to open a supermarket, we can open it three months later. This way there might be between five to ten but these are not exact figures, okay? It depends on opportunities in each city. We have to find a good location and the proper size. There are not many supermarkets with size between 1,000 to 1,500 sq.m. that is why for us it's more difficult to make expansion in supermarkets.

Okay, thank you. And do I understand correctly that the discounters will be mostly on a leased basis, as well, if you're, if you stop on this format?

Maksim Kravtsov

Sorry, again?

The discounters, if you continue developing, if you start developing this format will they also be on a leased basis, similar to your supermarkets?

Patrick Longuet

No. I explained that for such a project in the Moscow region we need to acquire land because we don't find places to lease. But we want to secure supermarkets for the future and to do so we've decided to buy land in Moscow region. However, it is just for Moscow region, not for other regions. In other regions, other cities, we rent space for supermarkets.

Okay, thank you very much.

Natasha Zagvozdina, Renaissance Capital

Yes, thank you. Did I hear the management correct that you reiterated your margin target 7.8 to 8% this year?

Maksim Kravtsov

Yes, this is correct.

And then it means that in second half of the year your EBITDA margin should be running above 9.5%, close to 10% even?

That's correct.

Do you expect the impact, the positive effect of, what, sales of non-food with a nice margin or where the margin expansion is actually coming from between the first half of the year and second half of the year?

To be more precise it's not 9.5 to ten, but it will compensate the weight of the first half because the sales of the second half are much higher, so on EBITDA margin we confirm that we target to achieve between 7.8 to 8%.

But still, it's not only the higher share of revenue. We understand that revenue in the second half of the year could be some 17 or maybe 20% higher than in the first half, but it probably does not explain in () with the margin expansion.

There is a combination of factors and I guess the weight of sales is the biggest one but not, of course, the only one. During the first half because of the sales we had quite a lot of fixed cost going up as a percent of revenue; therefore the margin was under pressure. As well we had the closure of Ozerki store which resulted in negative EBITDA for this store in the first half. And, as we've said, we've estimated it around 0.3% and this is purely a direct effect of this one store.

Now, in the second half we feel that we're through the consequences of the accident. We have reopened Ozerki store, so in the fourth quarter it will be working full time. It's going to help on margins. As well bonus arrangements with suppliers for the second half, they're traditionally higher as we have higher volumes going through. Also, as we said previously, we have increased the gross margin to compensate for the effect of higher social tax and higher utility cost and it's effective starting July. So we should see some margin improvement because of this fact on the gross margin side and it's also going to help us out on the EBITDA side in the second half.

But when, even if you look at the results of 2H2010 you would see that there we were close to 9% of EBITDA margin. Traditionally in the second half of the year we have significantly higher EBITDA margin. This year the tendency is going to be seen even more clearly, because we had the accident and lower revenue in the first half.

Okay, thank you very much.

So 9% is not something which is coming as a surprise. We see now how to achieve it and we see that it's achievable.

I think, and my final question, with the company consider giving us quarterly rather than semi-annually financial results based on management accounts, because the quality of disclosure or even frequency of disclosure from O'Key is below the industry standard for the other listed retailers?

For 2012 we're not going to increase the frequency of reports. But as we said previously we're going to consider this issue going forward. Though in 2012 it's not going to change.

Thank you. I have no further questions.

Boris Bilinsky (?)

Hi, good morning, quick question about your guidance for likes-for-likes for the fourth quarter. So you mentioned that you've seen food prices decreasing throughout the third quarter, so what gives you the confidence that basket sizes increase by five to 5.5%? A

And if you're mentioning basically that traffic will stay flat to slight increase does that mean that essentially your current stores are mature entirely and that you'd, going forward the only increase we're going to see is in line with inflation?

Patrick Longuet

Are you asking me if my forecast is good?

No, I'm asking you what gives you the confidence that, why 6%, why not four, why not eight? I mean, of course, seeing slowdown in prices, what gives you the confidence you're going to be able to increase your average basket and increase prices essentially by about 5%?

Patrick Longuet

Our regular target is to increase like-for-like by the inflation plus 1% of traffic. It's a general target for each year. Now, when we look at the end of the year, we see traffic increase in September. We think that for the next quarter it will be the same tendency, maybe zero but not less. My estimation is that the inflation will be the same as now. And if the level of inflation increases a lot during the last three months maybe it will be less than these figures, but I think there will be no big decrease in inflation during the last months, between October to November. During the summer, because of specific reasons which we explained there was deflation.

We see clearly that deflation today is driven by the fruit and vegetables, price of which decreased by 25% last month. It's very important because last year their price increased a lot. However, in the fourth quarter we don't see why fruit and vegetable prices should deflate. I am not sure what happens if inflation stays flat, but if inflation decreases a lot it will be very difficult for us to keep increasing the basket.

Maksim Kravtsov

But currently the figure that was given, the target that was given, is based on the result that we saw in September, in terms of the basket increase. September already accounts for two months of decelerating inflation so the picture in September includes quite a lot of deceleration in inflation. It makes us believe that basket increase will stay close to the level of September. And based on this logic assumption of 6% is achievable target.

I must have missed that; what was the number for September specifically? And do you happen, do you guys have some data about the first, you know, week and a half in October?

No, we're not disclosing the data by weeks and months, but the level of basket increase in September was close to the level that we've identified, I mean between five and 6%. So this is something that we believe, currently at least, is sustainable going forward.

Okay, thank you.

Anton Farlenkov, Goldman Sachs

Yes, hi, once again. I have two follow-up questions. First of all you mentioned that you bought this year 17 land plots. Where did you buy them; which cities? And the second question is did I understand correctly that the traffic was, in September was in a positive territory on a year-over-year basis? Thanks.

I'll start with the traffic question. Yes, in September the like-for-like traffic increased and it increased slightly more than what we saw in the second quarter. In the second quarter traffic increase was at 1%, so in September the number was slightly over that figure.

Patrick Longuet

For the first question, the land we bought this year, sorry, but I cannot give you exactly the location, okay, because I think it's the information that I need to keep for myself.

Erik Hegebus

Yes, hello, just one follow-up question on the slightly reduced revenue guidance for 2011. The 94 to 97 range, does that reflect the possibility of the three stores being potentially delayed to 2012?

Maksim Kravtsov

Yes it does. The range that was given accounts for that because we assigned almost no revenue to the stores that are going to be opened at the end of December. In our forecast there is almost zero revenue from them anyways.

Okay, thank you. And just one last thing, in the previous conference call you were mentioning the high food inflation affecting negatively the hypermarket format which has a large proportion of non-food sales which are suffering in such environment. Do you see some of that trend reverting or being positive for you as the food inflation is decelerating?

Patrick Longuet

I'm sorry but I don't understand your question. You say me that the inflation was good for us?

No. I mean in the previous conference calls you mentioned that high food inflation which was running at around 13, 14% was negative for the hypermarket format as people didn't, were not inclined to buy so much non-food items. Now with the food inflation decelerating is that trend reverting? Is that something which could be slightly positive for you?

Yes, because we have the same growth in non-food today as in food. I think this increase is a good result for us.

That's fine, thank you very much. That's it.

Jamie Coleman (?)

Yes, hi guys, I've got three questions. One, I know it's not been long but the accident store, how has it been performing? Have people come back to shop there? That's number one. Number two is hypermarkets versus supermarkets; have the performance of the hypermarkets been improving? Because I know in the past you say you've had, struggled a bit with the hypermarkets and the supermarkets are where the growth in sales have been. Is that still the case? And number three, dividend policy going forward, what are you, what are your plans with that?

Maksim Kravtsov

Okay, in terms of the Ozerki performance, the first question, as Patrick said we saw very good performance from the very moment of reopening this store. So currently the store is running, and it's just operating for two weeks, it's running at 80 to 85% of the normal traffic. By normal traffic I mean traffic that it had before the accident. So the ramp up is pretty steep; it got almost immediately a lot of customers back.

Patrick Longuet

And with higher basket, taking into account all the modernisation we're done in the store. As for dividends policy the target is the same, 25% of the net profit to be distributed, net profit plus amortisation. So, and what was your third question, sorry?

Hypermarkets versus supermarkets.

Hypermarkets versus supermarkets; just to translate, excuse me. You say that, what is the difference between the result of the hypermarket and supermarket? It's what you're...?

No, it's more of the fact of, you know, sales growth in hypermarkets from what I gather had been slowing whereas in supermarkets they'd been improving and I want to know if that's still the case.

Yes, okay. I said earlier this year that turnover of supermarkets increased a lot compared to hypermarkets because customers did not have money to spend on additional non-food items. And now the situation is a little different because the growth of non-food and food is the same for the moment in hypermarkets. It's for this reason I said that there is no big change in the consumer behaviour today and I think people have the same purchase power as a year ago.

So supermarkets are doing better, so why open so many hypermarkets? Why not focus on the supermarkets?

No.

Sorry, it's what I understand.

No, that's not what Patrick said. He said that when the economic situation is difficult for people, that's what we experienced the end of last year and in the beginning of this year, they tend to go more frequently to supermarkets because they don't intend to shop with high baskets. And what we have seen recently, I mean during the summer, is that it has been rebalanced now where we see a progress in food and non-food which is now the same. It shows that this is rebalancing now which will benefit more hypermarkets. Now we see that hypermarkets are doing just a bit better than supermarkets.

Okay, cool. Okay, great, the trend's reversed, okay. Thank you.

Ivan Kuschch

Good afternoon; several questions from myself. The first one is how many rentals have you already secured for discounter format?

We have not secured any rentals for discounter project because we are considering Moscow region in particular and trying to find a way to get into Moscow with supermarkets. Now, Moscow is quite a particular, I would say, difficult market, so we're looking at different ways of getting in, maybe with the smaller supermarket than we currently have. Currently our selling space is around 1, 200 square meters. Maybe for particular case of Moscow we'll have smaller supermarkets and, as Patrick said, we are buying land or we intend to buy land in Moscow for that purpose. We haven't bought it yet, but intend to buy land. Therefore, for this particular issue we're not going to rent stores, we're going to buy our land plots and develop those smaller supermarkets on our own land.

Sebastien Verhaeghe

I just want to add something because everybody speaks about this kind of project; there is no new format that is validated as of today. I repeat what I said in earlier conferences, due to the peculiarities of the Moscow market we have launched several actions in order to see how we can develop ourselves in this market. What Patrick mentioned is that recently we have decided that it would be hard to find rental locations in Moscow and around Moscow and for that we made the decision that we will do, acquire land to be able to secure our development in supermarkets.

And in addition we are thinking to see how our supermarket format fits to this. Maksim mentioned one of the ideas that follows this, that's whether we need to work on the smaller format or not, but as of today there is no validated new concept or new format or anything from the company on that, so there is no such discounter project.

Okay, thank you. And next question is how does CapEx for the full year 2011 looks like at this stage?

Maksim Kravtsov

CapEx programme right now is in line with what we said before: we plan to spend around ten billion roubles for the year including everything, I mean acquisition of land plots,

maintenance CapEx and construction of our stores that we're planning to open 'til the end of the year. So far we are on track to that target. We don't see any changes to that programme. Next year we plan to spend more than ten billion roubles because we're going to open more stores with approximately the same split between owned and rented, so the programme is going to be larger in absolute terms.

Okay. And a couple of clarification questions. Do I get it right that to the end of the year you are going to open five hypermarkets, so nine in total? And what is the risk of shifting some of those which are to be opened from the end of the year to the beginning of the next year?

No, we're not going to open nine; we're going to open 11 in total in 2011. To date we've opened two hypermarkets, which means that in the coming months we're going to open nine. In the second part of December we have three hypermarkets to be opened, which are currently being built. They are on track, but should there be some delays with the administration, in getting permits to open those stores, they might slide to January. So there are three of them. But, as I said, the total number for the year is 11, it's not nine.

Sebastien Verhaeghe

It's not a particular risk to these hypermarkets, it's a typical risk of the process of construction where the once we have cleared all the risks on terms of construction and today that's perfectly clear for us. There is always a potential delay at the last moment that concerns every hypermarket. It's just that because three of them as of today the opening date is planned on the second half. Again that, it might switch, it might shift a little bit, but hopefully it won't.

Sure, thank you. And do the 13 hypermarkets which you plan to open in the next year include some potential shifts from 2011? I guess not, but I just would like to clarify this.

Maksim Kravtsov

No, the figures that Patrick has given are the openings for next year. If a hypermarket gets shifted to next year it will add to next year, so it does not change the total target. The nine hypermarkets coming to open are part of the 2011 target of increasing 30% the selling space and we have the same target on the top of that for next year.

And final question from my side, just to clarify 94 to 97 billion roubles sales for the current year, is this total sales or just retail sales guidance?

Sebastien Verhaeghe

Total revenue.

Thank you very much. That's it, thank you.

Closing Comments

Thank you very much for participating in this call and we look forward to hearing you again. Thank you very much. Goodbye.