



O'KEY Group

Q1 2019 operating results
conference call edited transcript

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O`KEY Group speakers

Armin Burger, CEO

Konstantin Arabidis, CFO

Anton Farlenkov, Corporate Development Director

Veronika Kryachko, Head of Investor Relations

Participants asking questions

Marat Ibragimov – Gazprombank

Egor Makeev – Raiffeisen Bank

Artur Galimov – Sova Capital

Alexander Gnusarev – VTB Capital

Anna Butko - ATON

Presentation

Veronika Kryachko

Good day ladies and gentlemen, my name is Veronika Kryachko, Head of Investor Relations at O'Key Group. I'm honoured to conduct the conference call on first quarter 2019 operating results. Our call will start with updates on the Group's operating performance and key developments provided by Chief Executive Officer, Armin Burger, followed by Q&A session. The senior management team, Konstantin Arabidis, Chief Financial Officer, Anton Farlenkov, Head of Corporate Development are joining us today and will be happy to answer your questions. That's all on my side, and I hand over to Armin Burger. Please, sir, go ahead.

Armin Burger

Thank you, Veronika. Dear ladies and gentlemen, I'm happy to welcome you to our Q1 2019 Operating Results Conference Call. The consumer sentiment overall has remained mixed due to VAT increase and higher inflation. The Consumer Price Index, CPI, for food jumped to 5.8% during the first quarter, largely driven by a tighter supply-demand balance on the sugar market, rapid growth in meat and poultry prices, and higher prices for grains.

These trends have had two-fold impact on our top line. Firstly, we had a higher overall basket, and, secondly, lower traffic at the beginning of the year, especially, in January. The hypermarket like-for-like basket increased by 2.9%, this is excluding VAT, in the first four months of 2019. Traffic, at the same time, was down by 4.5% for the first four months. However, it is notable that initiatives which we launched at the end of 2018 aimed at improving logistic operations and overall quality of fresh and ultra-fresh goods at our hypermarkets led to a subsequent traffic recovery in February, March, and, especially, in April which supported overall revenue in the first four months of the year. We see a similar positive trend in May. It is what we see at the moment very encouraging.

Striving to improve our customer value proposition, in the first quarter, we pushed the effort to strengthen such key business areas as service level, assortment mix, and quality of fruit and vegetables, meat and fish. Subsequently, we want to be the ultimate destination for the customer's fresh and ultra-fresh shopping. In order to be more attractive to different customer profiles, we also continue to develop middle and premium

assortment ranges at our hypermarkets. To strengthen our position in the imported goods category, we expanded the wine and spirits section at our Litvinovo distribution center. Further strengthening of our own imports is a strategic priority.

Ladies and gentlemen, some comments to our discounter business. Our discounter business has demonstrated very good results in Q1, and also in April, and now in May. The growing appreciation of the business model focused on higher quality of fresh foods, fresh products, and our private label assortment continued to give us solid like-for-like traffic growth of 12.5% in the first four months.

In sales, we had a like-for-like growth of around 20%. This growth was supported by an increase in customer numbers, a better basket mix and inflation. In the first quarter, we continued to enhance our assortment matrix by listing of additional private label brands, such as our new Farm brand. At the same time, customer demands for cheaper private label products increased as inflation forces customers to save money. Here, the first time since I'm in Russia, the discount kicks in, and we see very nice increase in customer numbers and also in our sales.

To our 2019 guidance, we expect hypermarkets top line growth to be around zero for the whole year, as previously already said and predicted. We will continue to develop the discounter business by opening up to 30 new discounters by the end of the year. We expect the discounter business to deliver double-digit like-for-like growth in 2019, that means we continue discount positive trend, and to be breakeven by the end of the year, and definitely breakeven the whole of next year.

This concludes my update, and now we are ready to take your questions. Thank you.

Questions and Answers

1. Marat Ibragimov - Gazprombank

Thank you very much, I would like to ask a very simple question. What exactly have you done in hypermarkets between January and April which made the traffic to jump from minus 7% to plus 4%, or whatever the figure – yes, to 2.5%? What was wrong in general that you managed to fix in April? Thank you.

Armin Burger

Now, as you know, I took over in September last year, and we analyzed the trends, which were not very positive last year, and we analyzed the initiatives we had to take and have to take to turn the sentiment around. This is not a very easy and fast process, but it's a continuous process. Mainly what we did, we changed our advertising, we focused more on freshness, we changed our logistic, we changed our supply chain, we try to have fresher products in our store. If necessary, we reduce them earlier, write-off earlier, and give the customer a better shopping experience. Together with this additional advertisement, this led slowly but steadily to an increase in customer numbers. It's not – you know, we have to understand we didn't have a customer base which left us, we had the situation that the customers came less often to us. Due to this fresh advertising, they come more often again. And we see also, if they come to our stores, they buy additional products. This is the whole recipe we have behind this increase.

Marat Ibragimov

So, in other words, to sum up what you said, you are increasing the offer in fresh foods, vegetables in other words, or fresh offer, and you actually advertise that through your customers. Right?

Armin Burger

This is correct. What we try to do is to bring customers more often – that means every week – into the store. Fresh products mean you have to come weekly doing your shopping. And if the customer is happy with us,

and this is what we want to achieve the next couple of months, they will come weekly instead of probably 1.2 or 1.5 times a month.

Marat Ibragimov

Thank you. And my other question on discounters, have you done exercise by calculating your costs, fixed costs, operating costs per square meter and comparing them with publicly listed competitors, for example, Magnit. If you've done that, are you less or more efficient than Magnit? Thank you.

Armin Burger

The fixed costs, depending now on how you define fixed cost, we did, obviously, our calculations. We have a much higher turnover per square meter already now and growing. That's point one. And point two, our fixed costs aim to be lower in comparison with the competition.

Marat Ibragimov

So, in other words, what you are saying, that your EBITDA per square meter should be higher – should be lesser than that of Magnit. Is it true?

Armin Burger

Put it like this, as soon as we have the right number of stores, you obviously have an overhead, a buying department, management, and so on, which you have to distribute over a certain amount of stores and turnover. As soon as we have the critical mass, this is for me around 120-130 stores – that's why we next year definitely will be in a nice, positive turnaround. As soon as we achieve this, we have better cost structures than other competitors. This is our aim.

Marat Ibragimov

Okay. And final question on hypermarket guidance, you earlier said when you released full-year IFRS results that you are targeting low single-digit top line growth, but now you are saying zero top line growth for hypermarket. Why are you downgrading your forecast, especially, given the fact that food inflation is picking up as far as we see? Thank you.

Armin Burger

We don't want to downgrade our forecast; I was only careful. I do see a very positive trend currently. And if you call it now zero to low digit growth – I do think we achieve more than zero growth.

Marat Ibragimov

Okay, thank you. That's all from my side.

2. Veronika Kryachko – Head of IR

Ladies and gentlemen, it's Veronika, we have some questions which were submitted online for us from one of our investors, and I just would like to read it on his behalf. So, the question is; when do you expect discounters to breakeven for the whole year? What do you need to do to achieve breakeven? What should be improved to achieve breakeven?

Armin Burger

So, this question I answered already. We will breakeven the first time around the end of this year and the whole of next year. One of the areas where we have some additional potential is the margin side. We have a very positive trend here and we will continue having it next year. Here we use also the synergies between

the two chains, that means between O'Key and Da!. In other words, both sides will, at the end, subsequently have a positive impact of this cooperation.

The other areas to improve to achieve breakeven is always the cost side. Here, we work very hard to increase our productivity in the stores and also the additional store numbers will help us to diminish the fixed cost and split them in between more turnover.

3. Egor Makeev – Raiffeisen Bank

Good afternoon. Actually, I have a couple of questions. So, my first question is where is the company now in terms of reaching synergies between the two formats?

Armin Burger

Here we currently started a very close cooperation between the buying departments. Import is one of the key areas of synergies. We – fruit and veg, we want to do together. There is no problem doing it. We have synergies in the private label business and in the branded business. Private label business, here we have a core business unit in Da!, this is the business of discounters. On the other hand, in the branded business, we have, obviously, all the capacities in O'Key which in combination gives us a lot of possibilities to purchase together and have synergies.

Egor Makeev

Okay, thank you. And when are the effect of the synergies should be seen in full in your opinion?

Armin Burger

We see already first signs now, especially when I look at the commercial margin in Da!. Obviously, during the year, as soon as we increase the joint buying, we will have additional synergies. But I do see within the first year of cooperation that we see the full impact.

Egor Makeev

Okay, thank you. And are there any other potential synergies in SG&A and where is the company now in terms of realizing such synergies?

Armin Burger

We have some synergies in buying of equipment, that's a typical area where we can jointly probably get better terms and conditions, and we do it pretty intense already. In all other areas, I tend to keep the businesses separate to keep the identity of both formats – discount and hypermarket are two different kettles of fish, and I don't want to mix up the two different identities.

Egor Makeev

Thank you, it's clear. And my second question is do you plan to open any hypermarkets this year? And, well, maybe you could share the openings pipeline for the next year as well.

Armin Burger

This year, we have in mind to extend to smaller stores. For next year, we have the plan of building hypermarkets again, plus the main focus is on renovation for us in the next couple of years, reinvestment in the existing store network to improve the experience of the customers.

Egor Makeev

Okay, thank you. That's all from my side.

4. Artur Galimov – Sova Capital

Good afternoon. Two quick questions from me, if I may. The first one, Armin, you just mentioned that hypermarkets saw a pretty positive trend in May, and probably similar to April. Could you somehow quantify this statement in terms of either retail revenue growth or like-for-like as three weeks of May are behind us already?

Armin Burger

That's very easy – like-for-like, we have a plus, currently, of 3%.

Artur Galimov

That would be for hypermarkets standalone, right?

Armin Burger

This is for hypermarkets. And in the discount business, we are around 20% like-for-like than in the past. You know, we had some changes due to the bank holidays and the figures will turn out a little bit better than they show in the moment, that's my opinion. But let us wait for the next couple of days – the weather and the impact of other issues.

Artur Galimov

Right. Just to clarify, 3% like-for-like is an aggregate growth rate for the whole business – discounters and hypers. Is it correct?

Armin Burger

Yes, correct.

Artur Galimov

Right, thanks for this. And, secondly, do I understand correctly that the Board of Directors currently doesn't intend to recommend any dividends for 2018 anytime soon?

Armin Burger

Those dividend is not decided yet. That's obviously up to the Board of Directors, and we will have to come back here at a later stage.

Artur Galimov

Okay, thank you very much.

5. Marat Ibragimov - Gazprombank

Thank you very much. I would like to ask how would you describe the situation with competitors how the market environment changed since the beginning of the year or compared to last year. Do you see inflation pressure on that cost? And, also, in general, how will you describe the competitive situation in the food retail market now? Thank you.

Armin Burger

To the competitive situation, we do see that it stabilizes on a very competitive level. For all of us, currently, that's, at least in my opinion, very difficult in this inflationary scenario which we had the first couple of months to stabilize our margin and to stabilize the way we operate. Therefore, I see a little bit less activity currently. We saw some inflationary pressure at the beginning of the year with some of the contractors. This problem is solved. We see overall – if you don't know about the retail margin and the margin in our goods – in the

discount business, we see a very positive trend. In O`Key, we see a very stable trend on a high level. We did quite a good job here in agreeing, together with the synergies I mentioned before, acceptable terms and conditions.

Marat Ibragimov

And what about price competition? Other retailers say that the share of profits has stabilized in the beginning of this year, so they don't want to obviously go into price cuts? Do you see relief on that side? Do you see relief – less pressure on your margins from competition?

Armin Burger

To the shelf promo, here we want to stabilize on the level we are. I don't intend to have higher promo share in the higher price in the discount business. The discount business has, obviously, a very low double-digit number; the hypers between 25% and 30%. We don't want to go any higher here, it's not good for the business. We want to concentrate on our fresh activities, delivering the best quality for our customers, and being number one here in the future. Therefore, I do see some pressure but with our different activities and the way we compete here, we have no problem to sustain the margin we're on and be very competitive as well.

Marat Ibragimov

Thank you very much. Thank you.

6. Alexander Gnusarev – VTB Capital

Greetings to everybody, just one question from my side, if I may. It's not really to your operating results, it's rather related to the recent news about Sberbank's interest on your hypermarket's format. Perhaps you could provide some maybe small update on the situation on the development from the interest of Sberbank? Thank you.

Armin Burger

Thank you for the question; but, as you can imagine, I will not comment on any speculations in the market. We run our business and want to run it.

Alexander Gnusarev

Fair. Thank you.

7. Anna Butko

Hi everyone. Thank you for your kind presentation, I just have one question, if I may. So, you indicated that there were additional advertisement campaigns to attract traffic to hypermarkets. My question is, will we see any significant uptick in marketing costs in the first half of 2019 as a result or how it will be factored? Thanks.

Armin Burger

No, definitely not. We want to stabilize our cost base – I even have in mind to reduce the cost. Here we reshaped some of the marketing activities to the campaigns in the Fresh sector which are, in my opinion, much more efficient than a lot of other activities we had.

Anna Butko

Thank you very much.

Veronika Kryachko – Head of IR

Ladies and gentlemen, it's Veronika Kryachko speaking. Thank you for your participation in this conference call today. If you have more questions, please contact us any time. Thank you and have a good evening.

Armin Burger

On behalf of the management, I would like to say thank you. And thank you for your time and have a good evening. Thank you.
