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Press release

O'KEY ANNOUNCES FINANCIAL RESULTS FOR H1 2016

O'KEY Group S.A. (LSE: OKEY), one of the largest food retailers in Russia, announces financial results for the first six months of 2016 based on condensed consolidated interim financial report reviewed by the auditors. All materials published by the Group are available on its website www.okeyinvestors.ru.

Key highlights for H1 2016:

- Group total revenue increased by 10.3% y-o-y from RUB 75,885 million to RUB 83,672 million
- Revenue in the segment of hypermarkets and supermarkets grew by 7.3% y-o-y to RUB 81,416 million
- Gross profit rose 3.2% from RUB 18,084 million to RUB 18,667 million with gross margin contracting by 150 bps to 22.3%
- Group EBITDA fell 29.1% y-o-y from RUB 4,702 million to RUB 3,336 million with EBITDA margin decreasing from 6.2% to 4.0%
- EBITDA in the segment of hypermarkets and supermarkets declined 11.3% from RUB 5,161 million to RUB 4,577 million with EBITDA margin of the segment decreasing from 6.8% to 5.6%
- EBITDA in the discounters segment was negative and amounted to RUB 1,241 million (compared to a negative amount of RUB 459 million in H1 2015) as the discounter chain was launched in September 2015 and at the end of H1 2016 comprised 48 stores and an owned distribution center in the Moscow region with a total area of 59,000 m2
- Net loss for the Group amounted to RUB 786 million

Key events for H1 2016:

- During the period, the Group opened one hypermarket (one was closed), one supermarket (four were closed) and 14 discounters (one was closed)
- In April 2016, the Group placed RUB 5.0 billion ruble exchange-traded bonds on the Moscow Exchange with a coupon rate of 11.70%
- In April 2016, the Group repurchased the RUB 5.0 billion 05 bond in the amount of RUB 4.8 billion
- During the period, the Group has optimized it debt portfolio and decreased the weighted average rate from 11.87% at the end of 2015 to 10.71% at the end of H1 2016

Commentary

Heigo Kera, CEO and Chairman of the Board of Directors of O'KEY Group, said:

"In H1 2016, we delivered a 10.3% increase in the Group revenue. We have overcome negative trends of the previous periods in the business segment of hypermarkets and supermarkets and were actively developing the start-up of the food discounters under the *DA!* brand. Our business model of city hypermarkets offering a wide and diversified assortment for the whole family, optimal quality/price ratio, a pleasant shopping experience and high standards of customer service has proved sustainable even in the context of falling disposable incomes, stronger competitive pressures and evolving regulatory environment. In May 2015, my team started introducing changes to the assortment matrix, the sales mix, pricing and private labels development. These changes have ensured the recovery in traffic and strengthened our competitive positions in the market. But maintaining competitive levels of prices and intensifying promo-campaigns combined with the impact of the developing discounter chain has led to a reduction in the Group gross margin to 22.3%.

For the period, we also saw a contraction in Group EBITDA margin from 6.2% to 4.0% and EBITDA margin of the segment of hypermarkets and supermarkets from 6.8% to 5.6%. Group results continue to be impacted by the roll-out of the discounter chain, while performance of the business segment of hypermarkets and supermarkets was under pressure due to a decline in gross margin and rising personnel costs. Increase in personnel costs was needed to compensate for a certain decline in the traditionally high standards of customer service, following aggressive layoffs of the store personnel in early 2015.

The EBITDA margins which we demonstrated in H1 2016 don't fully reflect our ability to control costs. I am confident that the projects under way – from complex program of optimisation of the personnel costs based on the enhancement of the business processes to increased focus on our commercial activities to improvement in centralisation rate and transformation of IT-infrastructure – will allow us for the financial year 2016 to deliver EBITDA margin in the range of 6.5% - 7.0% for the segment of hypermarkets and supermarkets, while we expect topline growth in this segment in 2016 in the range of 5-8%. In mid-term perspective, we are developing a new strategy encompassing strategic initiatives, which in the three-year timeframe should lead to a substantial improvement in business profitability."

Anton Farlenkov, Group Director for Strategy, M&A and Capital Markets, commented:

"We are in the final stages of forming a strategy for hypermarkets and supermarkets for the next three years. We can and should generate higher sales and EBITDA per square meter in our stores. We are confident that this strategy will allow us to unlock this potential. In two-three months, we will be in a position to present to the investment community a roadmap for development of hypermarkets and supermarkets, which we will follow, and the initiatives, which will lead to higher profitability of our operations, ensure higher return on investments and increase earnings."

Armin Burger, Chief Executive of the Discounter Chain, added:

"During the period, we continued expansion of our discounter chain the *DA!* brand, having added 13 stores in Moscow and neighboring regions. We have continued to enhance assortment, added more private label items across all categories and worked on a more efficient organisation of the floor space. Across the chain, we are seeing steady increase in customer traffic: the hard discounter project is finding its target audience, the rational customers appreciating value-for-money we are offering in our stores."

Financial results

Profit and losses

RUB mln	H1 2016	H1 2015	Change, y-o-y
Total Group revenue	83,672	75,885	10.3%
Revenue in the hypermarkets and supermarkets segment	81,416	75,885	7.3%
Revenue in the discounter segment	2,256	N/A	N/A
Gross profit	18,667	18,084	3.2%
Gross margin	*22.3%*	*23.8%*	*-150 bps*
SG&A	(17,753)	(15,224)	16.6%
SG&A as % of revenue	*21.2%*	*20.1%*	*110 bps*
Group EBITDA	3,336	4,702	-29,1%
EBITDA margin	*4.0%*	*6.2%*	*-220 bps*
EBITDA of the hypermarkets and supermarkets segment	4,577	5,161	-11.3%
EBITDA margin of the hypermarkets and supermarkets segment	*5.6%*	*6.8%*	*-120 bps*
EBITDA of the discounter segment	(1,241)	(459)	N/A
Net profit/loss	(786)	621	N/A

Revenue

In H1 2016, total Group revenue advanced by 10.3% to RUB 83,672 million driven by the growth in LFL traffic and LFL ticket in hypermarkets and supermarkets, the opening of the new stores (one hypermarket and one supermarket were opened, while the Group closed one hypermarket and four supermarkets in order to improve efficiency of the operations) as well by the growing contribution of the discounter chain (14 stores opened during the period and one closed).

By the end of H1 2016, total selling area increased by 6.4% to 602,208 m2, selling area of hypermarkets increased by 1.7% to 521,068 m2, selling area of supermarkets declined by 9.9% to 48,457 m2 and selling area of discounters reached 32,683 m2.

LFL revenue improved by 5.5% y-o-y with LFL traffic growing by 4.5% and LFL ticket rising by 1.0% as a result of the Company's focus on enhancing assortment, changing the sales mix and improving value proposition.

Y-o-Y change	H1 2016			H1 2015		
	Net retail revenue	Traffic	Average ticket	Net retail revenue	Traffic	Average ticket
Group	10.0%	12.8%	-2.3%	4.4%	3.4%	0.9%
Group LFL	5.5%	4.5%	1.0%	-1.7%	-3.6%	2.0%
Group net of discounters	7.1%	5.8%	1.2%	4.4%	3.4%	0.9%

Costs of goods sold and gross profit

RUB mln	H1 2016	% of revenues	H1 2015	% of revenues	Change, bps
Total revenue	**83,672**	**100.0%**	**75,885**	**100.0%**	
Cost of goods sold, including	**(65,004)**	**77.7%**	**(57,801)**	**76.2%**	**150 bps**
Cost of trading stock (less supplier bonuses)	(61,804)	73.8%	(54,645)	72.0%	180 bps
Inventory shrinkage	(1,478)	1.8%	(1,761)	2.3%	-50 bps
Logistics cost	(1,343)	1.6%	(1,011)	1.3%	30 bps
Labelling and packaging costs	(380)	0.5%	(385)	0.5%	0 bps
Gross profit	***18,667***	***22.3%***	***18,084***	***23.8%***	***-150 bps***

In H1 2016, gross profit grew by 3.2% to RUB 18,667 million, while gross margin contracted by 150 bps to 22.3%. Dynamic of the gross margin was impacted by:

- the policy of maintaining competitive prices level and increased share of promo in the sales mix;

- the effect of the lower gross margin in the developing discounter format;

- the growth in logistics costs due to the ongoing logistics centralization implemented to improve inventories management, which will also allow the Group to obtain better commercial conditions from the suppliers;

- substantial decrease in shrinkage as a result of the tighter control for purchasing and writing-off of the goods, working with security companies to improve security during the receipt of the goods and on the selling floor as well as a result of logistics centralization.

Selling, general and administrative costs

RUB mln	H1 2016	% of revenues	H1 2015	% of revenues	Change,bps
Personnel costs	(8,360)	10.0%	(7,101)	9.4%	60 bps
Operating leases	(2,638)	3.2%	(2,213)	2.9%	30 bps
Depreciation and amortisation	(2,195)	2.6%	(1,834)	2.4%	20 bps
Communications and utilities	(1,724)	2.1%	(1,483)	1.8%	30 bps
Advertising and marketing	(764)	0.9%	(631)	0.8%	10 bps
Security expenses	(413)	0.5%	(351)	0.5%	0 bps
Repairs and maintenance	(531)	0.6%	(425)	0.6%	0 bps
Insurance and bank commissions	(348)	0.4%	(350)	0.5%	-10 bps
Operating taxes	(355)	0.4%	(346)	0.5%	-10 bps
Legal and professional fees	(266)	0.3%	(332)	0.4%	-10 bps
Materials and supplies	(139)	0.2%	(141)	0.2%	0 bps
Other costs	(20)	0,0%	(19)	0,0%	0 bps
Total: selling, general and administrative costs	***(17,753)***	***21.2%***	***(15,224)***	***20.1%***	***110 bps***

Selling, general and administrative costs of the Group grew by 16.6% y-o-y to RUB 17,753 million under the impact of the increased personnel expenses, operating lease, depreciation and amortization as well as higher utilities costs and advertising and marketing expenses.

Personnel costs

A 17.7% y-o-y increase in personnel costs up to RUB 8,360 million was attributable primarily to increased headcount in the stores (while office personnel was reduced), increase in the salaries of the personnel in the stores in line with the industry trends in September 2015, as well as the development of the discounter chain. In H1 2015, personnel costs in the business segment of hypermarkets and supermarkets declined as a result of the aggressive layoffs in the stores which has led to a certain deterioration in the traditionally high customer service standards. To compensate for this negative impact, investments in hiring additional staff in the stores and in increasing salaries were made. These investments allowed the Group to substantially reduce the level of staff turnover and retain the best people. This, among other factors, has contributed to a strong growth in traffic and turnover in hypermarkets and supermarkets in H1 2016.

Operating leases

Operating lease costs grew 19.2% y-o-y to RUB 2,638 million primarily due to the development of discounter chain as well as the impact of the USD and EUR rate increase on the lease agreement nominated in foreign currencies, the growth in lease payments linked to the turnover of the stores and to inflation. In the segment of hypermarkets and supermarkets, the Group has optimized its lease costs by renegotiating lease agreements nominated in foreign currencies (fixing the currency rates or moving to rubles) and closing inefficient stores.

Communication and utilities cost

Communication and utilities expenses rose by 16.3% y-o-y to RUB 1,724 million due to an increase in utilities tariffs and the roll-out of the discounter chain.

Advertising and marketing expenses

Advertising and marketing expenses grew by 21.1% y-o-y to RUB 764 million under the impact of advertising and marketing expenses related to the roll-out of the discounter chain and due to intensification of promo activities and promotion of private labels in the business segment of hypermarkets and supermarkets.

Depreciation and amortisation

Depreciation and amortisation rose by 19.7% y-o-y to RUB 2,195 million primarily due to the expansion of the discounter chain.

Net finance costs

Net finance costs declined by 7.3% y-o-y to RUB 1,560 million as a result of the Group's success in optimization of its debt portfolio. During the period, the Group has continued to optimize it debt portfolio and extend the tenor of the loans and achieved a decrease in the weighted average rate from 11.87% at the end of 2015 to 10.71% at the end of H1 2016, which is one of the lowest indicators in the industry and reflects the standing of the Group as a reliable borrower.

Net loss

In H1 2016, net loss amounted to RUB 786 million compared to net profit of RUB 621 million a year ago. Net loss/net profit dynamic was primarily impacted by the deterioration in gross margin and growth of SG&A, increase in D&A and higher loss from the disposal of the assets due to the closing of the inefficient stores.

Cash flow and working capital

RUB mln.	*H1 2016*	*H1 2015 (As restated)*
Net cash from/(used in) operating activities	141	(522)
Net cash used in investing activities	(2,469)	(4,319)
Net cash (used in)/from financing activities	(3,166)	134
Net decrease in cash and cash equivalents	**(5,494)**	**(4,706)**
Effect of exchange rate fluctuations on cash and cash equivalents	(29)	3

Net cash from/(used in) operating activities

In H1 2016, the Group has achieved strong improvement in working capital dynamics which has allowed to compensate negative impact of EBITDA reduction and increased VAT payments to the budget. As a result in H1 2016 net cash from operating activities amounted to RUB 141 million, while in H1 2015 the Group reported negative operating cash in the amount of RUB 522 million.

Net cash used in investing activities

Net cash used in investing activities declined from RUB 4,319 million in H1 2015 to RUB 2,469 million in H1 2016 as a result of the Company's efforts aimed at streamlining its real estate portfolio. In H1 2016, proceeds from sales of property, plant and equipment and intangible assets (excluding VAT) amounted to RUB 910 million. The Group has divested a land plot in the Moscow region as part of the strategy of divesting non-core assets non-compatible with Group's concept of city hypermarkets.

Net cash (used in)/from financing activities

Proceeds from new loans and borrowing less the repayments reached RUB 3,166 million as the Group made repayments in the amount of RUB 9,110 million and attracted financing in the amount of RUB 8,040 million, while the amount of interest paid decreased compared to H1 2015 and amounted to RUB 2,046 million as a result of the Group's efforts aimed at optimization of the debt portfolio.

Working capital

As of 30 June 2016, the Group's working capital, defined as current assets (excluding cash and cash equivalents and short-term investments) less current liabilities (excluding short-term loans), was a negative RUB 5,918 million compared to negative RUB 8,023 million as of 31 December 2015. Working capital figures in the food retail industry are usually negative, and the Group intends to maintain a negative working capital position.

Debt

	As of 30 June 2016	As of 31 December 2015	As of 30 June 2015
Total debt, including	**34,355**	**35,558**	**34,490**
Short-term debt	10,616	12,000	14,751
Long -term debt	23,719	23,558	19,739
Less cash and equivalents	(4,245)	(9,768)	(1,107)
Net debt	30,090	25,790	33,384
Net debt/ LTM EBITDA	3.4	2.6	3.0

The Group considers the net debt/EBITDA ratio as the principal means for evaluating the impact on its operations of the size of the Group's borrowings. As of 30 June 2016, net debt/EBITDA ratio was 3.4 compared to 2.6 as of 31 December 2015 and 3.0 as of 30 June 2015. The increase in the ratio compared to 31 December 2015 was impacted by a decline in EBITDA and seasonal factors.

actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

None of the future projections, expectations, estimates or prospects in this announcement should be taken as forecasts or promises nor should they be taken as implying any indication, assurance or guarantee that the assumptions on which such future projections, expectations, estimates or prospects have been prepared are correct or exhaustive or, in the case of the assumptions, fully stated in this announcement. We assume no obligations to update the forward-looking statements contained herein to reflect actual results, changes in assumptions or changes in factors affecting these statements.

COMPANY OVERVIEW

O'KEY is one of the largest retail chains in Russia. Its primary retail format is the modern Western European style hypermarket under the "O'KEY" brand reinforced by O'KEY supermarket. The Group is developing the innovative discounter format under the "DA!" brand. O'KEY is the first among Russian food retailers to launch e-commerce operations in St. Petersburg and Moscow based on hypermarket assortment.

The Group opened its first hypermarket in St. Petersburg in 2002 and has demonstrated continuous growth ever since. As of 17 August 2016, O'KEY operates 158 stores across Russia: 72 hypermarkets, 37 supermarkets and 49 discounters.

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