



O'KEY Group

1H 2019 financial results
conference call edited transcript

27 August 2019

O`KEY Group speakers

Armin Burger, CEO

Konstantin Arabidis, CFO

Anton Farlenkov, Corporate Development Director

Participants asking questions

Aleksey Krivoshapko - Prosperity

Maksim Nekrasov – Goldman Sachs

Nikolai Kovalev – VTB Capital

Anna Butko - Aton

Egor Makeev – Raiffaisen Bank

Presentation

Anton Farlenkov

Hello everyone. My name is Anton Farlenkov, Head of Corporate Development at O`KEY Group. The team we have on the call includes CEO of the company, Armin Burger; CFO Konstantin Arabidis; and myself. Our call will start with update on the group financial performance and key developments provided by Armin followed by a Q&A session. All discussed numbers are based on new accounting standard if not stated otherwise. That's all on my side and I hand over the call to Armin, please.

Armin Burger

Thank you Anton. Dear ladies and gentlemen, I'm happy to welcome you to our first half 2019 Financial Results Conference Call. After a very difficult start, especially in our hypermarkets in January and February of this year, month by month we had a very steady recovery. Overall, we can be very satisfied with our first half-year results.

I will give you now some of the key figures. Organic group total revenue, excluding the effect of the supermarket business sale, increased by 3.4% year on year. Organic revenue generated by O`KEY hypermarkets, excluding the effect of the supermarket business sale, increased by 0.4% year on year, with very positive momentum in the last couple of months and we see this to continue. Revenue generated by DA!, our discount format, grew by 36.8% year on year, to RUB861 billion, supported by steady growth in traffic and the average ticket and also customer numbers. The group EBITDA grew by 6.9% year on year to RUB6.34 billion compared with RUB6.1 billion in the first half 2018. The EBITDA margin increased by 13 basis points year on year to 7.9%. O`KEY's EBITDA decreased by 0.4% year on year to RUB6.509 billion, while O`KEY's EBITDA margin increased slightly to 9.1% due to a slight decrease in operating expenses as a percentage of revenue. The EBITDA generated by DA! improved from negative RUB432 million – this is –6.9% of our sales – in the first half 2018 to negative RUB169 million – this is a –2% of sales. That means we had considerable better results in the first half of 2019, driven by new store openings and a higher like-for-like sales and also relatively better buying conditions. Our group net debt position improved also by RUB2.3 billion to RUB29.7 billion at the end of the first half of 2019, in comparison with RUB32 billion at the end of the first half of 2018.

I come now to the guidance for the year 2019. After careful consideration of our development –and we see here very positive aspects – we are revising our organic hypermarkets top-line growth guidance slightly upwards and now expect it to grow to a low single-digit number for the whole year. As before, we expect the double-digit, like-for-like growth for DA! and plan to open 20 discounters in 2019. On our last call, I told you we will open up to 30 discounters. In the meantime, we decided, together with the board of directors, to exchange some of the rented locations we wanted to open into very good own locations and therefore open only 20 stores. From the owned locations, on the other hand, we expect similar returns on investment as from these leased locations.

Some words to dividends. Due to the positive development of our businesses, we will open and recommend to our board of directors to pay a dividend of approximately 5.6% – \$0.056 in US dollar per share, which equals around RUB1 billion in total.

Let me talk about our strategy and initiatives that we made to keep the business on track. I will start with the hypermarkets. Firstly, the operational business in our stores. Here we concentrate currently on freshness. That means providing to the customer more freshness, more fruit and veg, better food qualities and a wider assortment. On the other side, own production also part of the freshness, we revised assortment and also our product range to serve more the customer needs and the modern customer needs. Another key topic in operations is currently shelf availability. Here we want to be better present until the evenings in all areas of our businesses. And one big concern of our business – operational business is the service and the friendly service. Here we launched a couple of training sessions with all of our staff to improve this service level.

Logistic. Supply chain optimization and logistic optimization is the main topic on this side of the business. We consider currently new warehouse locations to optimize the routes – that means the costs generated by logistic – and also the freshness in our stores. These are topics we currently investigate and we will come soon to clear conclusions here.

Commercials. One of the biggest topics in the commercial department currently is the assortment structure we want to follow. Here we want to have a clear structured assortment with a clearly defined entry level, a big middle segment for our families and also a premium segment which saw – covers all needs also for our premium customers. In our non-food business, we reshaped currently the thinking regarding non-food but products we want to have on sale; and how we clearly identified that non-food assortment of tomorrow, considering internet and considering all the competitive advantages other channels we have.

One of the top priorities is regional buying for us. Here we want to be closer to the customer, we want to have more regional products in the different regions we operate in, to be much more in tune with the needs of the customers.

Import, another top priority for us. We want to import more wine, we want to import more fruit and veg. We want therefore to buy cheaper as well, we cut to the middleman. Here we try to have synergies with our second company DA!, our discount label we import together, and try to source as many synergies as possible. Our last initiatives currently is to relaunch our private labels. We currently redesigned them and we want, therefore, also after the redesign is done, relaunch these new designs in our store.

Then store development; here are two key initiatives. On the one side, we look for a new store concept which will make us more competitive in comparison to our competition; which is modern, which is trendy, which gives the customer the right shopping environment to shop with us and to enjoy their shopping. After this concept is launched, we want to renovate our stores in the next couple of years.

Some key initiatives in DA!, All the year we concentrate on freshness, the fresh side of the business, especially fruit and veg and our bakery, which is something others don't have, where we stand out in the competitive environment. Shelf availability and also service are top priorities for us.

On the commercial side, we fight for better buying conditions, for better gross profit. Together with O`KEY, we buy our brands and also our private labels. Here we raised currently a lot of synergies which help us to improve our margin. The cooperation with O`KEY therefore is one of the top issues and criteria. Import as

well is one of the top issues here again together with O`KEY. The development side, we prepared for faster growth and for faster store opening program in 2020. Here we want to open next year 30 to 40 stores. That means we want to speed up our development after we see very positive, encouraging developments in our balance sheet.

Overall, ladies and gentlemen, we see a steady growth in our business units and expect this to continue in the second half of 2019. Thank you very much.

Questions and Answers

1. Aleksey Krivoshapko - Prosperity

Hello Armin, Konstantin, Anton. Good afternoon. Thank you for your time. I actually have a question on store development. I was under the impression that you have some hypermarkets in the opening pipeline for this year. Can you comment on where you stand with respect to opening them right now?

Another question has to do with your sale of land plots in Moscow. Why did you do that? Can you comment on the rationale? I guess those are the two main comments. Thank you.

Armin Burger

Firstly, to your first question, there are no hypermarket openings planned. This year, we only opened discounters. In the hypermarket business, the next couple of years – to answer the next question as well already – we want to concentrate on our renovating the stores and making them more attractive. The development will go – just the second part of the business into DA!. Here, we want to open much higher store numbers so that we on the one side strengthen our hypermarket business as really the area where we earn our cash, and keep it steady and growing. Again, this is a very important thing. And on the other side we want to develop DA! to get synergies out of higher sales and higher store numbers to be profitable and to have enjoyable figures there as well.

The two land plots – this is a logical consequence of what I said now – we sold because we don't see them as key assets at the current time. And therefore after we had a very good price for the two land plots, we decided to sell them.

Aleksey Krivoshapko - Prosperity

Can I ask a follow-up question? Are there any other current hypermarkets under construction on land plots which you intend to sell? And if so, I mean, how much do you think you can get as sort of sale price?

Armin Burger

Currently, we don't have any hypermarkets under construction and we don't plan to construct them. We want to enlarge two of our smaller stores. That's all that we do currently but they're on – we're on 1,700 square metre. Here we want to come to a square meter which gives us a better operational result and better sales figures, one in St Petersburg and one here in Moscow. Land plots, we have a couple where we are under negotiations. And whatever is not key for us for the next couple of years – and I told you we would like to concentrate on the renovations on this side – we will sell to generate cash and reduce our debts as we did this year.

Aleksey Krivoshapko - Prosperity

Clear. And Armin, just a final question if I may. When you talk about renovation, have you reconsidered the budget for renovation of your current hypermarket network? And if so, what are the amounts of money you are talking about, and what is your estimated potential impact from renovating those stores on the revenue in EBITDA?

Armin Burger

Good. We expect from the renovations – initially, for each renovation you have to close for certain amount of time, therefore you have a little drop in sales. Overall, we expect after the renovations at least a growth of 10%. That's what we saw with two or three renovations we did. Therefore, a positive impact on the EBITDA and also on the sales side. The cost side we have here in the budget around RUB150 million, round €2 million, which where we think is a sufficient amount of money to renovate our stores.

Aleksey Krivoshapko - Prosperity

Clear. Thank you so much.

Armin Burger

Thank you. We will take our next question from Maxim Nekrasov from Goldman Sachs. Please go ahead.

2. Maksim Nekrasov – Goldman Sachs

Yes, good morning. Thank – sorry, good afternoon. Thank you for the presentation. I have a few questions, actually. So the first question is regarding the margin trends and I'm interested in what margin trends do you expect in the full year 2019 in both segments. And in discounters, in particular, whether you expect to return break even in terms of EBITDA based on IFRS 6 in the second half of the year? And, yeah, basically what EBITDA do you expect in this segment for the full year? Thank you.

Armin Burger

Okay. Margin trend, here we expect in both – in DA!, we expect even a stronger trend. We see that in the moment, a very positive trend. We import a lot and the cooperation in O`KEY which is very intensified now – we have weekly meetings – gets us very far here. Okay, we also expect a positive trend which we saw in the first – in the last couple of months at least and we are very happy there as well.

Regarding EBITDA, in both accounting standards, we do expect towards the end of the year to be positive, and definitely next year as well in our discount business.

Maksim Nekrasov – Goldman Sachs

Okay. Thank you very much. And my second question is regarding the recent trends, which you said were quite good. And do I understand correctly that like-for-like trends are – in the third quarter so far are similar to the second quarter?

Armin Burger

Yeah. This is correct and we even have a little bit better figures in our hypermarket business. We are very happy there. We had a very rough start to say promptly in January/February in the hypermarket business and turned a corner now and have each month positive like-for-like results.

Maksim Nekrasov

And what do you see driving this same boom as compared to the start of the year?

Armin Burger

These are the changes we did last autumn. More freshness, concentrating on the fresh side of the business, putting the – fruit and veg, meat, these fresh items into the limelight of the customer, advertising it, making sure that we have stuff available. Talking about service with our staff, being more friendly – that helps as well. And freshness means that on the other side – that we should never forget that, that's why we do it – to have more customer frequency because fresh products you buy weekly. And if you offer the right assortment to the right price, people come more often.

Maksim Nekrasov

Okay. Thank you very much. And my last question is regarding CAPEX and basically what CAPEX do you expect this year and maybe next year as well?

Konstantin Arabidis

It's Konstantin. Normally we have CAPEX budget of around RUB5-7 billion per year on both formats and it is quite stable. And usually split is around 50-50 between two formats over the last years.

Maksim Nekrasov

Okay. Thank you.

Armin Burger

Thanks.

3. Nikolai Kovalev – VTB Capital

I have two questions. My first question is on your discount format. When you speak about the medium term rollout and strategy, I was wondering what kind of – on what share of private label are you going to rely? And as lately we see a growing focus from food retail in Russia on the private label, do you see this becoming tougher to negotiate terms with suppliers and work with them? That is the first question.

And the second question is on your financials. Can you share with us estimate for consolidated EBITDA or EBITDA margin and the bottom-line if we would apply IFRS 17 for the first half 2019?

Armin Burger

Good. First to the discounter business and the private label share. Currently we have in sales volume, nearly 50% our volume in private labels. We want to keep it like this. On the one side, we have our specialized private label. When we go to new areas, we need to offer a certain amount of brands that people find their used environment and slowly but steadily they go and buy our private labels as well. And especially in all the stores where we are a couple of years already in the businesses, we see a much higher private label share already. This is strategy long term, around 50% of our products in private label.

To the negotiation, and the possibilities to achieve the prices we want, here we see a very positive trend for us. We are growing. People know that we are in the market, people know that we will stay in the market. This is always a doubt when you are a little start-up. Will the mother company pull you through or not? In our case, we proved that we want discounters and the suppliers to understand this now and therefore, we have better buying conditions and better negotiation standpoints as before. Therefore, it's quite a positive environment.

Konstantin Arabidis

Regarding your question about IFRS 17 results, actually management in the beginning of the year decided to switch fully to IFRS 16 numbers, given the budget was prepared in accordance with amended standard. That's why we are not fully supporting IFRS 17 result. We didn't have any review of IFRS 17 numbers.

Therefore, we prepared for you IFRS 16 result for first half 2018 for comparable reasons and we believe this is the most correct way of looking on the numbers now because IFRS 17 is the best. And supporting of two parallel formats is something we don't want and don't have to do. We don't think this is right, so please refer to IFRS 16. And if you have any questions, you can ask Anton or myself offline. We are ready to answer.

Nikolai Kovalev

Okay. That's clear. Thank you very much.

4. Anna Butko - Aton

Good day everyone. Thank you for the presentation. I just have two quick questions. First is the small clarification. Am I correct to assume that the proceeds from the sale of two land plots in Moscow are presented under Other Operating Income? And the second question, so you had a partnership with Familia to boost sales in the hypermarkets. Can you please update on the partnership results? Thank you.

Armin Burger

Regarding your first question, yes, you are correct. The net result of the deal regarding sale of land plots is presented in Other Operating Income and Expense in the respective note in statements.

Regarding the partnership with Familia, we still consider each other as partners. But on the other hand, we also talked with other partners, or future partners, to give us the best – depending on the location, the best possible solution. We are quite flexible, in other words.

Anna Butko

Okay. Thank you very much.

5. Egor Makeev – Raiffeisen Bank

Good afternoon and thank you for the presentation. Could you explain, please, what's the source of the FX gain in the first half, rising from inter-group loans?

Konstantin Arabidis

Yeah, actually, it's quite easy. We have inter-group loan from Luxembourg to Russian companies. And according to IFRS, forex exchange gains and losses are reflected in these kind of balances, even though they are intergroup, and if you can see last year figures, we had a huge loss. On this line, this year we have just better forex for us, for this loan. Therefore, you see a gain. That's it. Pure accounting.

Egor Makeev

Thank you.

Konstantin Arabidis

Right

Egor Makeev

Yeah. Okay, thank you. And is it correct to assume that the sensitivity of this FX gain or loss of FX rate will remain as it is now?

Konstantin Arabidis

Yes, it will remain the same. At least before we will return the money from Russia to Luxembourg and, actually, we are not willing to do this in a bigger scale. It's actually more or less internal financing stories for the group, maybe it will be a little bit less but not a lot, depending on the exchange rate.

Egor Makeev

Okay. Thank you. That's all from my side.

Anton Farlenkov

Thank you so much to everyone. Please get in touch with me if you have any further questions. You know my number and email. Have a good evening. Thanks for joining.

Armin Burger

Thanks a lot from everybody here, and have a good evening.

Konstantin Arabidis

Thanks a lot. Bye.
