X5 Retail Group N.V.
Online Businesses
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Speakers:

- Vladimir Salakhutdinov, Director of Strategy
- Leonid Dovladbegyan, Head of the Perekrestok Online Business Unit
- Vladimir Kholyaznikov FoodTech Director
- Svetlana Demyashkevich, CFO
- Natalia Zagvozdina, Head of Corporate Finance and IR
- Andrey Vasin, Head of IR

Natalia Zagvozdina:

Good afternoon, ladies and gentlemen, on behalf of X5 Retail Group it is my pleasure to welcome you to the call devoted to the development of our online businesses. In the presentations and the Q&A today you will hear our Director of Strategy, Vladimir Salakhutdinov; the Head of Perekrestok Online, Leonid Dovladbegyan; the Head of Food Tech, responsible also for the express delivery service, Vladimir Kholyaznikov; Svetlana Demyashkevich, the company CFO, as well as myself and Andrey Vasin, representing IR.

As to the format - we're going to start with a short 20 or 30-minute presentation, which is available on the webcast. Page 2 is our regular disclaimer. Then Andrey Vasin will tell you more about the Q&A ground rules. But now without much ado, I'm giving the floor to Vladimir Salakhutdinov.

Vladimir Salakhutdinov:

Good afternoon, colleagues! Let's start our presentation with slide 4. Before we start talking about our online businesses, let's talk a little bit about the market. In slide 4, you can see our view of the food retail market in Russia. Probably first of all we need to talk about the growth in its online segment. This growth has accelerated year on year. To a large extent this is related to the epidemic, but this trend started much earlier and it won't disappear beyond the pandemic. But now we see — and we are taking this into account in our strategy — that this trend will accelerate. You can also have a look at the share of online grocery in other countries. As you see, Russia is still lagging behind most of the developed economies. And so we expect significant growth here.

In the next slide, we are going to look at the e-grocery market in more detail. Here are its structure and segments. In the digital space, too, the differentiation between the formats and missions has emerged, and there is a different set of players in each format. We see ourselves present in two key formats and two key missions. The stocking up mission is served by the online hypermarkets, and today we will talk about our Perekrestok Online business.

The second format is the e-version of proximity stores, with the express delivery that we are doing from both Pyaterochka and Perekrestok stores.

The next slide is our mission, and importantly, none of these missions in e-grocery exists as a stand-alone business, we view them as the online extension of our existing customer value proposition (CVP). Right now there is no clear divide between the online and offline market. The customer journey even in the online store starts long before the customer enters the store. For example, we know that more than 60 percent of our customers already know what they will buy when they enter the store and how they will buy it, as well as the reasons why they have come to this particular store. So this experience is built before they come to a store. It's very important throughout the customer journey to be with our customers, at all steps of their journey, including planning and choice. And this is only possible if we develop the infrastructure of digital services, which are the key part of our strategy right now.

Slide 7 shows the positioning of X5 in the online food retail market. This is data for Q1 and for April, and according to Infoline estimates, X5 is #1 now. I believe that right now, the market is so big, and we see such fast growth that probably it is too early to literally compare different players. I believe there is enough space for everyone. And I'm also sure that those who focus on this, including those shown here, will definitely continue growing at this pace and together, we will build this market, and the customer needs.

If we look at where we see ourselves, for us, the online businesses are not optional or stand-alone. They are part of our core business built around the core CVP of our chains, and long term or mid-term, we are looking at 15 to 20 percent of this whole market. And we know how to get there, and we are planning this in our strategy. Now I would like to hand over the presentation to the host.

Natalia Zagvozdina:

Thank you very much, Vladimir. Thank you for the presentation. And now over to Leonid Dovladbegyan, who is going to give us more information about the stock-up mission.

Leonid Dovladbegyan:

Good afternoon, colleagues. My name is Leonid, and I'm Head of Perekrestok Online. Perekrestok Online is the online supermarket that is built around the customer's stock-up mission. What it means is that we compete primarily with online hypermarkets. As you can see the average ticket is quite big, and we do not do express delivery.

If you look at the global trends, the hypermarkets are losing their market share, while online is growing, with stock-up still being quite a big part of online businesses. And this is exactly what we see in Slide 9: the online hypermarket segment is growing. Slide 10 shows that our business model is about the assembly at dark stores. Basically, they are distribution centres with the target space of 15,000 to 20,000 square meters, the main facilities now are 18,000 square meters. We get orders from the desktop, app, and the mobile app. Each dark store has a certain

delivery zone. At the dark store the order is assembled by a picker, and the pick rate is quite high. And then the truck delivers it to the clients. We have selected this model since this is the most efficient one for stock-up, while ensuring high product availability and efficiency of assembly and shipping, which are often hard to achieve at a hypermarket. Slide 11 shows what our dark store looks like. It's similar to those of our international peers like Ocado, Tesco online and others. You can see that it is quite automated, with an implemented WMS and high product availability and quality.

Then in Slide 12, you can see the evolution of Perekrestok.ru's CVP. Our delivery is not the fastest, but our assortment is quite wide, we are convenient for the customer, with high service quality. Our NPS last year stood at around 80 percent. And according to our model, you can see that our target is 50,000 SKUs by the year's end, currently it is 30,000. We use an EDLP model for the KVI basket and a high-low model for the rest of the assortment. Probably our model is most similar to Ocado's. So we grew really fast in the market, as you can see from Slide 13, and we are continuing our growth, last year we grew by 3.3 times which is a fast pace in the online hypermarket segment. This year we are continuing to grow and this growth has accelerated dramatically with the COVID-19 outbreak. Last year, we were #2 in the market. And this year, we are continuing to grow.

Then on Slide 14, you can see our key operating metrics. As you can see, we usually have 40 - 50 SKUs per order, which illustrates what stocking up is about. We have 30,000 SKUs in the assortment. Right now, we have 4 dark stores, 3 in Moscow and 1 in St. Petersburg. On top of that, I can tell you that we are also opening one in Nizhny Novgorod on the 30th of May. It is our first dark store outside the capital cities. Our key task is to become a leader in the online hypermarket (stock-up) segment in 2020 and achieve a positive EBITDA in 2021. This is the plan which we are able to deliver so far. That's it from my side. Thank you.

Natalia Zagvozdina:

Thank you very much, Leonid. And I would like to ask our next speaker, Vladimir Kholyaznikov, to speak somewhat slower so that the interpreter gets a chance to interpret it. OK. Over to Vladimir Kholyaznikov.

Vladimir Kholyaznikov:

Thank you, colleagues. This is Vladimir Kholyaznikov, Food Tech Director. In Slide 16, we show the new markets that started to emerge in 2019, and we saw the emergence and rapid growth of the new segment. By 2024, we expect it to come to at least 30 percent of the total e-grocery market in the key markets in Russia. In 2019 different players piloted different express delivery services with ultra-fast delivery. Express delivery stood at roughly RUB 1 billion in 2019, it is expected to grow to RUB 200 billion by 2024. As for the segment, we believe that this is the industry and the segment that will primarily develop in big metropolitan areas like Moscow, St.

Petersburg, and cities with population over 1 million, with a pronounced demand from the target audience for express delivery of groceries.

As to the key focus areas, the service is about a limited assortment and a hyperlocal infrastructure. Good knowledge of the clients and reliable delivery service. Slide 17 shows our business model. The express delivery business model relies on the infrastructure of our own stores, Perekrestok supermarkets and Pyaterochka proximity stores. We use a mobile-first approach; all the orders are placed through our mobile apps. We have two apps: Pyaterochka. Dostavka and Perekrestok Bystro. The system of order routing sends the order to the nearest store. The order assembly process is fully integrated both into the business processes of the store and the company overall. Order quality assurance and the picking is done by our store employees, and that's a new business process that we have already introduced in 200 of our stores.

As for delivery, we hand over the assembled order to our partners, third-party couriers. We have 10 partners in our cities of presence, in terms of SLA: during the COVID breakout, our delivery time that we call "click to deliver" was about 1.5 hours. Over the past weeks, we have targeted a shorter delivery time, and this is around 45 minutes in our main geographic areas. Around 25 percent of orders are delivered within 20 minutes after order and payment. As to our competitive edge, we've positioned ourselves around the current positioning of our chains within X5 group.

The online business is an extension of our chains' CVP. As to competitive positioning, we will continue to focus on our own infrastructure of more than 16,000 stores, and we see that 80+ percent households in Moscow are within 500 meters from our stores. Across Russia, on average 75 percent of households are within 1 kilometre of an X5 store. This means we can ensure quite a competitive delivery service in any Russian city long-term, once the audience there is ready to order groceries online.

As to the operating model, the main difference between ourselves and other formats is that we focus on quite a lean assortment, that of a proximity store. It is the assortment of Pyaterochka right now, apart from the categories that one cannot sell online. This includes around 4,500 SKUs at Pyaterochka, and around 8,000 SKUs at Perekrestok.

Slide 18 shows our main achievements over this short period of time. Right now, 200 stores are doing express delivery, while the audience is growing organically, and around 12,000 orders per day are delivered. We see quite a high average ticket as compared to brick-and-mortar stores, it's around RUB 1,800. We are delivering quite heavy orders, weighing around 12 kilos and including 15 - 17 SKUs. As to our current position in delivery, we offer paid-for delivery. Customers pay RUB 99 for any order. We believe that we are competitive in terms of our prices, assortment and availability.

Right now, we are big in Moscow. We have covered 80 percent of households in St. Petersburg and almost 100 percent of all households in Kazan. And by the end of this year, we expect to

enter 6 other cities with a population above 1 million with both the Perekrestok and Pyaterochka brands.

Then in Slide 19, I just have to thank you. That's it from my side.

Natalia Zagvozdina:

Vladimir, thank you very much for this presentation. We are happy that we were able to make the presentation in the 20 minutes that we allocated and now Andrey Vasin will tell you how we're going to run the Q&A.

Q&A

Andrey Vasin:

Thank you very much, colleagues. Since we are running this call as a webcast, while some people are using phone lines – some are on the Russian lines, some are on the English – please send in your questions, and we will try to answer all of those. If you are on the Russian line, please send the questions in Russian, we will have them translated. Natalia will start with the first questions.

Natalia Zagvozdina:

All right. We already got some questions. And I suggest we start with the more "strategic questions". Vladimir, the first question is to you. Could you once again specify the strategy of X5 in e-grocery, what segments do you believe are most promising? Is it possible you will launch new online services?

Vladimir Salakhutdinov:

Now this is our vision about working in the digital space. First of all, our target is to cover all the client missions in buying food in the digital space.

That refers to all our formats, the online hypermarket, for stocking up, as well as buying with express delivery. What's very important for us also, as I said before, we are looking at the digital space from the angle of the customer journey. We want to be everywhere, starting from planning and selection of what to buy, and where to buy it, and all the way to the purchase itself. And the third important point is that we are not scaling up services or businesses where we don't see positive unit economics. We are not looking at the digital space as stand-alone venture projects that are not related to the core business. Today, we cannot talk about retail without taking into account its online component. So we only develop and scale up the models where the unit economics are positive. And we keep our promise to the shareholders and investors to achieve positive financial results in all our investment projects after 3 years of operation. And this is how we develop our digital strategy.

Andrey Vasin:

Thank you very much, Vladimir. And the next question probably is a continuation of the previous one. It's to our CFO, Svetlana Demyashkevich. When did you start investing in online? How much

have you invested? What is the potential return on these investments and when do you expect them to recoup the cost?

Svetlana Demyashkevich:

Good afternoon, everyone. That's right, we started the first pilot projects in Perekrestok in 2017. And since then, just as in all the other businesses, the model has changed, because we always use iterations. We start with the pilot projects, then we find the model which we believe is most efficient in terms of growth and our financial results, and then we start scaling up. So we started with Perekrestok Online in 2017. As for express delivery, we began investing in local pilot projects in a few stores, tested how we should build a platform – doing it in-house, or through an acquisition. We acquired an existing team of a platform, which insured the much-needed speed for the development of the service. And active roll-out started this year. For you to understand the scale of our investments, we would like to share a few estimates. Since 2017, we have invested around RUB 3 billion in CapEx. The OpEx at different stages of the project is a comparable amount. At the early stages of the projects they are considered a loss. We believe that for a company of our size, these five to six billion roubles for the development of businesses, which are so visible and significant both for X5 and the whole of Russia, are a very efficient investment.

Let me remind you that we have a hurdle rate of 19 percent IRR on our investments, which also applies to new businesses. So all of them when approved should meet that minimal IRR requirement, and in all the financial models it is even higher. There is an additional condition, too: after 3 years of initial investing, we should achieve a positive EBITDA. As Vladimir has mentioned, so far, we have adhered to this. We believe that in Russia, where there is no capital available for investing in loss-making businesses for a long time, that is the right approach.

Natalia Zagvozdina:

Thank you, Svetlana. Leonid, here is the question to you. So far the leader in the stock-up mission is Utkonos. Are there any advantages in the operational model of Perekrestok, which will enable X5 to become a leader?

Leonid Dovladbegyan:

Right now, we see that Perekrestok Online was the fastest-growing operator in 2019, it grew by 3.3 times, this is quite a mature business, and now we are number 2 in the market. And it also shows excellent results in 2020.

As to the operating model, given the purchasing power of X5, and the strong operating model with dark stores of about 20,000 square meters, as I said before, 15,000 to 20,000 square meters, which are located near to the customers while having enough space to ensure the stock-up mission. As we said, the target for us this year is 50,000 SKUs. These dark stores are located on the outskirts of St. Petersburg and on the Ring Road in Moscow, we believe this is an ideal model for operational logistics. This is proven by our stop metrics - now it is 16 to 18 stops per

truck per trip, and this is very good. We see that NPS is really high, last year, like I said, it was 80 percent, our customer retention numbers are strong, which attests to the efficiency of the operating model. I would also like to note our assortment policy, the level and quality of client services, as well as two-hour delivery slots, a good level for the market, which make us operationally efficient and attractive for customers.

Natalia Zagvozdina:

And now the question to Vladimir Kholyaznikov that we got from several participants. It is quite generic. What is the difference between the delivery model between the segment leaders – X5, Samokat, Yandex.Lavka? And how is X5 different and maybe better than the competitors in express delivery?

Vladimir Kholyaznikov:

Thank you for the question. As to our business, we are definitely leveraging the main advantages of the company. We are building delivery around our own stores, on the basis of our stores, which suggests a faster rollout and low CapEx long-term, because the main model in these services requires building physical infrastructure, such as a set of local dark stores in the cities of presence. While at X5, we piloted both models. And we decided to develop delivery using our own stores because we saw that in terms of a rollout, CapEx, additional OpEx, such as overheads, we believe it is more efficient to work from own stores. The working capital features, and the ability to sell our own inventory from the stores faster make this model a lot more financially resilient and robust.

We will continue developing in regional cities, and we'll see what it will be like there. But right now, our main focus is on this type of development. Moreover, a significant part of the results we showed in Q1 hinged on the access to the X5 customer base data with about 40 million active loyalty card users. There are even more loyalty card holders, but for different reasons they stopped buying from us. Access to the loyalty program database enables us to speed up the development of our services and offer exciting, innovative services to inactive and new customers, which would help us to increase monetisation of existing customers and expand the interaction with those customers, who for different reasons stopped buying.

As to CapEx, definitely, our model has an advantage. The integration in existing business processes in the stores will give us an advantage in OpEx. Access to the customer base, customer knowledge, along with the fast rollout of this service using the existing network are, definitely, our competitive strengths against the other players in the segment.

Andrey Vasin:

Dear Colleagues, I would like to remind you that you can download the presentation from the Investor Relations section of our website. Let's move on with the questions from the participants. Could you provide a comment on the forecast about the redistribution of market shares in different segments of the online market? Do you think that the online marketplaces will grow

significantly? And how can you explain such a significant change in market shares between different segments? Vladimir Kholyaznikov, this is a question to you.

Vladimir Kholyaznikov:

The market has already established itself and online hypermarkets are dominating, but we can say that all the key online marketplaces that are out there have shown interest in e-grocery, and express delivery has been developing quickly since last year. Our estimate, which is shared by different analysts, is that this market will balance itself; the key players, those that are building their ambitions in the market, will occupy a certain niche in the market, resulting in market share redistribution.

The increasing share of express delivery and online marketplaces probably has to do with the fact that they are at a very early stage, and in the next two-three years their volumes will go up significantly.

Natalia Zagvozdina:

Leonid Dovladbegyan also wanted to add something to this.

Leonid Dovladbegyan:

The ongoing redistribution of the shares has to do with the growth of express delivery, in particular, during the lockdown. And we don't see marketplaces taking over the market share, because marketplaces are primarily about stocking up; while we see increasing demand for express delivery, we don't see dramatic growth in online marketplaces.

Andrey Vasin:

Thank you very much. And the next question: can you cover how the pricing policy in express delivery is different from the online hypermarkets and offline and how much more attractive is X5 versus the competitors?

Natalia Zagvozdina:

Probably Vladimir Kholyaznikov can start answering this and then Leonid will add something about the online supermarket.

Vladimir Kholyaznikov:

If you look at the prices of X5 in express delivery, they are based on the shelf prices in our supermarkets. So we are one more service of our chain for existing and new customers looking for access to our service. We don't have separate pricing online, although we do have some promos and additional perks within the loyalty program in this new service, but overall the online prices and assortment are in line with those of X5 brick-and-mortar stores.

Leonid Dovladbegyan:

Building up on this – similarly to the express delivery service of omnichannel retailers, Perekrestok Online covers a somewhat different mission of stocking up, and so it has separate pricing. We have Everyday Low Pricing (EDLP) for Known Value Items (KVI) online. In practice, it means that we are pricing our top selling and most attractive products for the users against direct online competitors. We strive to be the cheapest online against our direct competitors, so we use different systems for price comparison, this is quite a big pricing system. We can afford doing this because most of the time we work directly with the suppliers. So a significant share of goods is delivered by the suppliers directly to the dark stores, while the other part goes through distribution centres of Perekrestok, with the use of our own category management. For the remaining basket of top products which are markers of the position online, we use the high-low pricing model. It means that our pricing is flexible, this is our strength, and we are very market-driven, fighting against our direct competitors, tracking the customer wishes. We see how our customers are buying from Yandex.Market and from our competitors, so our pricing is built somewhat differently.

Andrey Vasin:

Thank you. A few questions to Vladimir Kholyaznikov about the express delivery. What potential do you see for expanding the assortment in express delivery? Do you have a plan to move to your own courier services? What are the advantages and disadvantages for working in-house and using a partnership model?

Vladimir Kholyaznikov:

In terms of the assortment, yes, we do see the potential for expanding. And just as in our retail chains we see interest in various ready meals. So it is highly likely that we will expand this segment using our existing infrastructure, our kitchen factory and cooperation with existing suppliers. So we are definitely going to test ready meals.

We also expect the authorisation to sell alcohol online, maybe it will happen this year, and we will get ready to launching this category. As to courier services, the existing online market in Russia has created quite a competitive offering in third-party courier logistics (3PL). We see that in different segments there is a wide choice of players, offering highly specialised services. There are national and regional players both in regional centres and metropolitan areas. So near-term we don't see significant differences in quality of services between in-house and outsourcing. As an IT platform, developed in-house to provide express delivery from our stores, we are using the power of crowd-sourcing with around 10 different courier delivery partners, who are co-creating the service with us and for us. Leveraging open competition, they are doing this quite efficiently. Going forward, definitely, we will look at different options and scenarios of developing the delivery service, and we are going to adapt to market conditions. Right now, the dynamics are such that the supply in the courier service market is increasing, not going down. During the COVID outbreak, we have seen that every single service and taxi aggregator has entered the

market of last mile delivery. So it looks like the competition there is high, which means we can get good terms from them. Going forward we will adapt.

Andrey Vasin:

The next question is to Vladimir Salakhutdinov and Vladimir Kholyaznikov. Can you tell us about Perekrestok Bystro? How is it different from delivery from Pyaterochka? And why do you want to develop 2 brands?

Vladimir Salakhutdinov:

I will start and then Vladimir Kholyaznikov will continue. Like we said before, the delivery from our chains is the expansion of the CVP of a particular chain in the digital space. Both Pyaterochka and Perekrestok offer this service. And it is built on a single platform, with the same operating principles and metrics. Vladimir can probably provide more colour on that.

Vladimir Kholyaznikov:

As to our approach, at the headquarters of X5 we are building a centralised IT platform that integrates our chains. As to operations and additional IT CapEx, we increase utilisation of what we have already invested in by connecting our own chains. Businesswise, both of the chains are giving the customers a vehicle to add-on to the main purchase. So express delivery covers the mission of fast, additional purchase. We believe, Pyaterochka express delivery covers the main mission – the core purchase, while express delivery from Perekrestok supermarkets, covers, to a large extent, the mission that is normally fulfilled at the offline Perekrestok stores – excluding traditional stocking up.

We believe that the express delivery is a very good fit for both chains. We are planning to develop the service leveraging the existing customer base of 40-plus million. We see that in consumption and understanding of the service offers by the customers, we have been able to differentiate these service offers quite well at the times when the clients are ready to buy through one of the apps. Both apps use the prices and assortments of the chains. Pyaterochka offers a narrower assortment of a proximity store for express delivery. At Perekrestok there is quite a wide assortment with a significant share of ready-to-eat assortment, primarily in-house produced with some coming from our suppliers.

The single centralised operating platform and a near-single operating model enables us to offer customers yet another customer journey and more services under the brand of each of those chains.

Andrey Vasin:

The next question is about cannibalisation of offline services by online services. And separately, in terms of the express delivery, we said that there isn't much cannibalisation between express delivery and proximity stores. Some people find it a bit odd. Could you comment on that?

Svetlana Demyashkevich:

Let me start with the overall principles. Since we operate several formats, we always track all types of cannibalisation very closely. We always address cannibalisation in the initial financial modelling, when we approve the model, and pilot it, we measure this effect. In express delivery, and before that in Perekrestok Online, this is one of the areas we track very closely. We measure this, and with the Big Data, we try to assess the effect of cannibalisation before the rollout.

In our offline store openings, before opening a new offline store, we always factor in additional cannibalisation that we calculate according to our statistics. We use it as an input for our store opening model, and we always make sure that we meet the IRR requirement for both the old and the new store. On a stand-alone basis the operations should ensure the right return including a cannibalisation effect that we measure regularly. This is an overall approach, and Vladimir can elaborate on that.

Vladimir Salakhutdinov:

There are 2 things you've got to account for: first, there's a broader philosophical question. This is what you see in many industries, for example, in telecom, where the digital traffic is cannibalising the voice services, this doesn't mean they should impede new developments. This is our approach to development too. We view digital as a strategic area and develop it accordingly. When we look at cannibalisation, how do we know it's not that high? We did research on it. We saw that when we add express delivery service from the store, the biggest users are non-loyal, non-regular (ad-hock) customers. And customers who regularly come to our stores don't use the express service as much as those who either did not buy from us at all, or bought something very rarely. So most of the traffic we are getting through online services is new traffic for us, and our research confirms that.

Andrey Vasin:

And the next question probably is to you, Svetlana. What is the EBITDA in the online operations when they ramp up? And for getting the positive EBITDA after 3 years, what would be the investments?

Svetlana Demyashkevich:

As to the investments, I have already given you the numbers. We have different levels of investments in different areas. In Perekrestok Online, the CapEx is for building dark stores and buying trucks, while in express delivery, it is primarily about OpEx and the biggest cost item is courier delivery. You've got to understand here that in terms of how we see the target margin for these businesses, the approach is somewhat different. Express delivery is a part of the existing offline businesses and their economics, both costs and revenues. We are definitely making sure that the additional extension of the CVP and services wouldn't dilute the margins of our existing businesses.

As to Perekrestok Online, it's about the model, and since the model is more developed, we see very positive dynamics. This year, for example, we saw that for the old dark stores, the unit

economics are positive. And it's not due to the pandemic alone, but also the successful development of the services. We have overshot some of the forecasts that we put into the financial model last year.

Leonid Dovladbegyan:

If I could add a few words to what Svetlana said: in Q1, we saw that 2 dark stores had positive unit economics. The third dark store achieved positive unit economics before COVID-19 and COVID-19 has not even influenced that. So only the new dark store that we launched a month ago is not yet fully utilised, while ramping up it has not yet reached positive unit economics.

Andrey Vasin:

And the next question is to Vladimir Kholyaznikov. We know that express delivery in Moscow operates through dark stores, not just operating stores. What is the advantage of this model? Can you assume that instead of ordinary Pyaterochka stores we will open dark stores and operate through them?

Vladimir Kholyaznikov:

Thank you for this question. Yes, in Moscow, at this point, we have 7 dark stores. Developing the new business model, we are actively piloting different concepts that we see in the market. Right now, our oldest dark store is 8 weeks, others are even younger. In our development so far, we do not set ourselves the task of moving a significant part of deliveries to dark stores. But we are ready to look opportunistically at our own network. And wherever we see high order density, in these situations, sometimes, it would make sense to use dark stores.

Right now this is a pilot model, we have not fully analysed it yet and we are currently refining it. As of yet, we do not see evidence that could make us change the existing strategy. We will continue piloting new models and concepts that could be in-built into our brick-and-mortar stores as well as dark stores, so as to define the express delivery model for the next 5 years.

Svetlana Demyashkevich:

I would like to add just one more thing. I believe that it's important to understand the advantages of the fact that we have multiple formats. We can use components of our other businesses and infrastructure. For example, when we open dark stores for express delivery of Pyaterochka, those are Pyaterochka stores that we were planning to relocate. Every year there is a small typical percentage of stores that under-perform and we turn them around. Now we can experiment with them as dark stores. Or for example, a dark store for Perekrestok Online will be opened in a former Karusel hypermarket facilities. We are also leveraging other strengths, including data on our customer base, which is a huge advantage.

Andrey Vasin:

Thank you, Svetlana. And now a few specific questions to Leonid. How many dark stores in Perekrestok.ru will we see by the end of 2020, 2021?

Leonid Dovladbegyan:

Now we have 4 dark stores: 3 in Moscow and 1 in St. Petersburg. The fifth dark store will be opened on the 30th of May, very soon, in Nizhny Novgorod. And we are looking at the opportunities of opening more dark stores, in Moscow, St. Petersburg and yet another city.

The final decision hasn't been made yet, and so far, I cannot provide a comment on the number of dark stores - it is too early. Because of COVID lockdown we are revisiting our plans; the latest dark store in Moscow was opened 6 weeks earlier than initially planned. According to our pre-COVID plan, we expected to open 5 dark stores both in 2020 and 2021, but most likely these plans will be revised upwards.

Andrey Vasin:

Thank you. One more question about Perekrestok.ru. Are you going to extend the assortment in Perekrestok? And what will happen with an average ticket? Leonid could start and probably Vladimir Kholyaznikov would add something here from the express delivery aside.

Leonid Dovladbegyan:

The average ticket is growing year-on-year. It is RUB 4,500 and it tends to go up. The assortment is around 30,000 SKUs, 33,000 SKUs right now. We are planning to get to 50,000, and next year, we expect to further increase in line with the target model. So far, ultimately, we are looking at the cap of 100,000 SKUs. It's not so much about the numbers but about how the categories will expand. They are categories of a food hypermarket, which means adding more fresh groceries; non-food, such as household goods, making a strong entry into the children's' goods category, professional pet foods, house care, and cosmetics. These are the main categories for growth. So it's not about the number of SKUs but rather about making sure that we have good positions in all of those categories growing vertically, not just horizontally.

Vladimir Kholyaznikov:

And a short comment for express delivery. For us, the ticket is at an attractive level. It is RUB 1,900 in May. In April, it was more than RUB 2,000. And we are not planning to promote the increase of the average ticket. Our initiatives will be more around ensuring that we have higher frequency of interactions with the customers and increasing our target audience. We believe that one of the differentiators of express delivery is a lower ticket, and as a result a bigger addressable market and we are going to develop along these lines.

Andrey Vasin:

Thank you. The next question is about our financial forecast. How significant can the share of online sales as a percentage of revenue be in the next 5 years?

Vladimir Salakhutdinov:

Right now, we are at the stage of formalising our new strategy and looking at various scenarios, so we are not going to provide guidance. But in April, for Moscow alone, where the digital businesses are developing most actively, their share exceeds 2 percent.

If you look at some of our stores for express delivery, we see many examples where online traffic or online sales contribute about 30 percent to the total store performance. We are looking at all of these numbers, and in the near future, we will be able to refine our forecast.

Svetlana Demyashkevich:

Let me add to this. We said before that we are looking at our ambitions. And our ambition is to generate 20 percent of our revenue in new online businesses in the next 10 years, so we are keeping to this. And probably, it means 10 percent of revenue could be generated by the new businesses in the next 5 years. And with the existing acceleration rate, this could be quite realistic. We are going to refine and finalise that, and we'll get back to you on this.

Leonid Dovladbegyan:

Very briefly, yesterday, Perekrestok Online represented 8 percent of the total Perekrestok business in Moscow, and 10 percent in St. Petersburg.

Andrey Vasin:

And the next question is to Vladimir Kholyaznikov. And Vladimir Salakhutdinov probably could add something here.

In Russia, overall, will express delivery service be in demand in Russia long term? And post-COVID, most likely the demand will shift more towards evening deliveries when people get back from work. And so deliveries will have to be done during the prime evening hours. What do you think about that?

Vladimir Kholyaznikov:

Let me start answering this. We assume that any service that is convenient for the customer will be in demand. And the convenience there is about the platform used, and we see that the retention rate here is one of the highest among all services, even among those unrelated to food retail.

And why do we know that? We see that from our statistics, and we also make the conclusion that it is positive experience for our customers, and they will continue using the services post-COVID. As to the frequency and time distribution, Vladimir can provide more commentary.

Vladimir Salakhutdinov:

As to the retention rate, I believe this is a good illustration of what is happening. According to our own data and according to experts, we have one of the best retention rates in our customer base. And we also see that this retention was comparable before and during the lockdown. We see that

the pandemic actually accelerated the processes, helped increase the average ticket, while the behaviours of the customers have not changed.

What has changed is the addressable market - in March and April it became significantly larger. And it became so big that all the growth in the express delivery of X5 came from the organic inflow of customers. We believe that this is due to convenience and the fact that express delivery is an organic addition to the existing services, and this is an alternative to going to a proximity store. This will not change long term.

And as to uneven distribution of deliveries throughout the day, the COVID outbreak changed the situation somewhat. Before the lockdown, the distribution of orders mirrored the peak hours of our offline stores. Peak hours are not just evenings, in Moscow, we also see a big work load for the proximity stores during lunch hours too and there is a small morning peak too. Express delivery mirrored that, because express delivery is the mirror of our retailer business. It's not a stand-alone business, it's the extension of the retail market using the same missions and scenarios shoppers have when they come to a store.

So these scenarios are part of our long-term planning and the operating model of express delivery, we are going to adjust to those peak hours that we know very well for every single location. Every store connected to the delivery service has statistics, and we use these data to plan every process of express delivery, including order assembly and courier delivery. So we don't expect to see a dramatic change in the situation post the lockdown.

Andrey Vasin:

Thank you very much. The next question is quite comprehensive: For X5, what 3 areas are the most challenging in developing food delivery services?

Vladimir Salakhutdinov:

Let me start maybe – this is Vladimir Salakhutdinov. Probably the hardest thing for us is putting together the traditional off-line businesses, and disruptive rapid online technologies. It's not just about organising dedicated units and functions, but it is a major transformation of the whole organisation. So we are undergoing a digital transformation, which fundamentally changes the approach to organising, value creation and how we create new processes, products and services. And to a large extent, it also changes what we demand from our people. And we want to make sure that those areas could develop at the same speed inside the big organisation, as they would develop outside. We have come a long way in transforming ourselves over the past 6 or 12 months, and we see that so far, this has been quite a successful journey - we're happy with the results.

Yet another very important factor is that on the one hand, we see that as one of the biggest retailers, we have a lot of contacts with our off-line customers, 15 million customers come to our stores daily, but this is not digital traffic. And converting this traffic into digital is a challenge. We know how to deal with that. We see very fast growth in the use of our mobile apps, we are

setting very ambitious goals and definitely, we are going to see in the next 3 to 5 years most of our loyal customers - tens of millions of people - providing the online traffic for the online businesses. So we are at the beginning of a long journey.

Andrey Vasin:

Thank you very much. Svetlana, the next question is probably for you. What is the CapEx planned for online in 2020 and beyond in the next few years?

Svetlana Demyashkevich:

As I said before, the CapEx is primarily for Perekrestok Online and – as Leonid said – this year, apart from the dark stores that we already opened in April and the ones we are going to open at the end of May, most of the investments have been made. Right now we are looking at whether there are ways to open additional dark stores in 2020-2021. And we'll make a decision once we see if it makes sense, if the model works as expected. So in the budget for 2020 we are not allocating significant investments for this.

One dark store is around RUB 600 million, depending on the number of SKUs. It could come to 700-800 million with a wider assortment. So far, the development has been highly successful. This is an exciting segment for us, and we have invested around RUB 3 billion CapEx over the past 3 years for a company of our size. The total CapEx of X5 last year was RUB 80 billion. If the model works, if we see interest and if it works for the segment, we will continue doing that.

Andrey Vasin:

Thank you very much. A few questions to Vladimir Kholyaznikov about Pyaterochka express. What about unit economics in Pyaterochka express? What is the break-even average ticket for Pyaterochka express? And how long will it take you to achieve positive EBITDA in Pyaterochka express?

Vladimir Kholyaznikov:

Thank you for the question. With the current ticket, we are operationally profitable. Long term, we believe that the ticket of RUB 1,500 plus is enough to show good economics. And, generally speaking, we see that in April and May we will overperform in economics in key geographies and in Moscow.

Generally, we adhere to this promise to our shareholders: all our businesses should become operationally profitable in 3 years and ensure the required IRR. We are getting there, and the situation currently works. But even with conservative forecasts for the market development, even if you assume conservative development here, express delivery will go ahead.

Andrey Vasin:

Thank you very much. The next question is probably to Leonid Davladbegyan and Vladimir Kholyaznikov. To the extent that we are ready to disclose numbers for this business, how much does it cost to acquire a client in Perekrestok Online and Pyaterochka?

Leonid Davladbegyan:

We do not disclose this for Perekrestok Online, because if you look at the market, this is quite a competitive market. Courier services work as a bidding market, operating in real time. We wouldn't like to disclose our costs. We believe, though, that these numbers are efficient, we have excellent customer retention rates, so we can say that these numbers are good. Every year the customer retention costs are going down per customer year-on-year and quarter-on-quarter.

Vladimir Salakhutdinov:

Dear colleagues, in express delivery, all the growth was from the organic traffic. We have just started experimenting with paid-for marketing. Primarily the marketing is integrated into the existing marketing campaigns of our chains. And in May you will be able to see marketing campaigns in traditional channels, including online performance advertising.

We don't know as yet what the customer acquisition costs will be. What we do know is the behaviour of our customers. We have some cohorts of customers with quite a long history, and new cohorts – those that we acquired during the lockdown – perform even better. When we see how the market develops and what the lifetime value will be, we will understand the share of lifetime value we are ready to spend on customer acquisition. So far, the growth has been organic. In complicated geographies like Moscow with a high level of service and high competition, we were able to build organically quite a big business, which already creates significant value for X5 and for our customers.

Andrey Vasin:

Thank you very much. The next question is about unit economics and the cost structure. Once again, we are not ready to disclose any specific numbers. Leonid and Vladimir, could you speak about the costs for each of the businesses, starting from bigger items? What are the key costs for each business, what are their key components and what has less impact on the overall cost structure?

Leonid Dovladbegyan:

For us, the main costs are OpEx: the fulfilment costs which are split into a darkstore placement and assembly cost and the last mile delivery cost. Our marketing costs are quite high. There are office costs, staff costs. This is the structure of our OpEx. As for the CapEx, since the business requires infrastructure development we have quite a sizable CapEx. Once again, we already have positive unit economics at our facilities level. And as Svetlana said, we are ahead of our business plan and we are on track to a positive EBITDA at the business level next year. As for specific OpEx figures, we don't disclose that.

I will just add that, for example, the pick rate numbers look good not just for Russia, but globally, too, against the benchmarks in the U.K. and the U.S. And additional cost-contributing metrics like the number of stops per trip also look decent. We track those metrics globally, and we believe that we are on a par with our peers.

Natalia Zagvozdina:

If I can add something so that everyone understands. Does that mean you spend roughly the same amounts on order assembly and order delivery in absolute numbers? Which is bigger now?

Leonid Dovladbegyan:

The assembly is a little bit more than the delivery. But in the delivery, we see good potential for improvement because the stop economics is changing. When we open a new dark store, we have a shorter delivery distance, more stops per trip, and this improves our economics.

And we also have plans for further improvement of our back-end, back-office systems. We have lean projects for the improvement of dark stores and back office, but even without those projects the figures look quite attractive now.

Natalia Zagvozdina:

Vladimir Kholyaznikov, could you say something about the express delivery, covering the same categories?

Vladimir Kholyaznikov:

Yes, for express delivery, the key cost item is the cost of delivery. Right now, we ask the customers to pay for that delivery. We charge them RUB 99 per delivery, and it doesn't fully cover our cost of delivery. So far, we are subsidising the cost of delivery – the direct cost of delivery. And we hope that as the volume of this business picks up and we use the courier service resources more efficiently, and as we see more delivery partners, we will be able to subsidise this less.

The second important cost item is picking cost. And right now, in terms of its weight in P&L, it is similar to the previous item. And what is different for the express delivery is so far lower-marketing and corporate centre costs, because the business is built with a small mobile team. It is a business model with a very low CapEx, because we focus on using our own infrastructure, we are using existing stores. In terms of OpEx, to a large extent, we integrate the service of express delivery, and express delivery control into existing staff KPI and business processes. We integrate them into the KPIs of store managers, regional supervisors and so on all the way up to the operational directors (исполнительные директора) of Pyaterochka. So we are creating a fully-fledged service at Pyaterochka, and this is happening also in the express delivery of Perekrestok. So the model focuses on a relatively low CapEx on the one hand, and smaller additional overhead OpEx to ensure the right quality of the processes, on the other.

Natalia Zagvozdina:

Can I ask a follow-up question that I sometimes get? In Pyaterochka stores, where you do express delivery, do you have to hire new employees, or is the order assembly done by the existing store employees?

Vladimir Kholyaznikov:

The operating model for the picking personnel is as follows. Whenever we launch a new territory, a new city, the picking is initially done by the existing store personnel. Once we go above a certain threshold of deliveries within 1 day from 1 store, we start adding additional FTEs to do the picking. The target model is using dedicated staff with a pre-set required productivity per 1 order-picker. So yes, the long-term model is to use additional full time staff.

Andrey Vasin:

And the next question probably is to Svetlana and to Vladimir. Can you assess the further investments in infrastructure that you would need to make sure that you take over 20 percent of the online market (dark stores, transportation, IT, etc.) ? This is probably about our slide from the Capital Markets Day presentation at the end of last year.

Svetlana Demyashkevich:

You understand that we cannot give you a specific number right now. The situation is evolving in the market and in the competitive environment too. This is an ongoing process of refining and fine-tuning the models. But let me show to you how we look at this. We have a 10-year model. And within that model right now we are working on a 5-year model, including the development of the existing and all the new businesses. We also have some limits we set ourselves that we are not planning to change. One of those is our leverage, we plan to keep it at two times, while the target is 1.8. And we don't want to decrease our return on investment, ideally we would like to increase it, so for the new businesses the IRR remains the same: 19 percent.

Then we also have the requirement about achieving profitability, a positive EBITDA after three years of operation. And – not to be ignored - we are planning to continue paying dividends. Many of you know that we are increasing the absolute dividend amount every year, and we still have a very comfortable leverage. We are also very well positioned to invest in new businesses and digital transformation, which is pivotal not just for the new businesses, but also for the core business. As a result, we create long-term competitive advantages.

Vladimir Salakhutdinov:

I would like to add here, that we are not making any statements about the target share of online businesses, because primarily we are driven by the wishes of the customer. Because what you see is in metropolitan areas this share can be quite sizable, while in some regions, this service will probably be less in demand. And there are also some limitations Svetlana has mentioned. It is really important to us that the company value and shareholder income go up with the development of new businesses, and this is what we are focusing on in the long term.

Andrey Vasin:

Thank you very much. The next question is for Leonid Dovladbegyan. In the presentation, you spoke about the target model for Perekrestok.ru, and you looked at Ocado. Are you looking at using robotics in the warehouses for online delivery?

Leonid Dovladbegyan:

It is a very good question. Yes, we do look at Ocado as a target model. Right now, we already have quite a high level of warehouse automation for Russia. We use automated WMS, employee terminals, warehouse alley navigation, built on gravitation, APC analysis of the categories, and efficient software for replacements.

As for robotized warehouses, we have calculated the economics repeatedly. The labour costs are different in the U.K. and Russia, and this is the cornerstone for robotics. Right now, it's not economically efficient to have a fully robotized warehouse. We know how it works in Ocado, and we know the payback period in the U.K. and we are not sure we should go that way, given the difference in labour cost and legislation in Russia and the U.K. So robotics is potentially interesting, we are looking at it, but we do not need it right now.

Natalia Zagvozdina:

A repeated question about cannibalisation is for Leonid and Vladimir Kholyaznikov. So could you talk a bit about the profiles of the e-customers? Are they the same online and offline? And Vladimir Salakhutdinov said you have a lot of new customers in the Express Delivery. Can you add anything to that? Is offline business cannibalised by online?

Leonid Dovladbegyan :

Since it has come up time and again, let me explain. I would not even talk about cannibalisation, because we are one company, and one and the same customer could shop online with Pyaterochka and Perekrestok, both online and offline. Our customers, guests want a particular convenient service. It's just a question whether they will get it at fX5 Retail Group, or somewhere else in the market. So it doesn't make sense looking at it through the lens of cannibalisation. Once again, this is not right. We are not looking at the competition from the express delivery, because we at Perekrestok online fulfil a stocking up mission. It's like talking about the competition of OZON and a restaurant, or between OZON and a museum. People choose between going to a museum or spending money buying in OZON. Can we talk about cannibalisation here? No. These businesses hinge on different missions. And if it is convenient for a person to drop in and grab an ice cream while they are walking, it is very different from stocking up at Perekrestok online or buying something additionally at Pyaterochka express.

So I wouldn't talk here about cannibalisation, but rather like Vladimir said, how do we ensure the consistency in customer journey between different formats and platforms. Our figures show that the customers that are using Perekrestok Online are not becoming less loyal to Perekrestok brick

and mortar stores, we know that from our big data and the ratings we are getting from customers. And in Perekrestok Online, we get new customers who then go also to brick-and-mortar Perekrestok stores, so it works also in the opposite direction. So we are providing new digital services to the established customer base of X5 Retail Group. It's not about cannibalisation, but rather complementing a consistent customer journey.

As to the customer profiles, for the stocking up mission they are primarily family people who plan their consumption ahead. Svetlana talked about our thinking when starting the service. Many consultants told us that online clients would be busy professionals, but then we understood that our customers are people who are planning to stock up ahead, parents with children, who cook at home, who make grocery lists. They buy food for two weeks. and along with that a basket of low involvement goods from different categories like diapers, household chemicals, dog foods or drinking water. They buy everything that they don't want to carry from the store, so it is a big purchase of low involvement goods. This is the essence of a stocking-up purchase. They are people who are planning on stocking up ahead, families with children who cook at home. And primarily, our customers are women, the median age is 39, and this is 1.7 online orders per month.

Vladimir Kholyaznikov:

I would like to add a few things. I fully support the idea of Leonid, that we as the management of X5 have the shared commitment to expand the range of services that enables the customers to meet their needs along the fluid customer journey. If we don't do that, others will. These services should be developed within X5 and become an integral part of our company. And so we are learning, and thanks to our digital transformation, we already see a lot of data that are customer-centric rather than format- or business-centric.

During the lockdown in express delivery, it is hard to assess any effect of cannibalisation, just because we definitely saw a significant traffic shift towards express delivery. We saw organic inflow into all apps, just as many other online formats in the market, because people had concerns about going out to the brick and mortar stores. So we cannot talk about cannibalisation in such an environment. We can say that we provide services according to the acute needs of our guests, and we provide the service on behalf of our brands, and we consider this a competitive advantage. And before the lockdown, when we were in peaceful times, we saw that in terms of the target audience for Pyaterochka express delivery, they were very similar to that of Pyaterochka brick and mortar, but with fundamentally different purchase needs, different "moments" for a purchase.

A lot of customers, about one third, are people who have limited mobility, or relatives buying for people with limited mobility, like retirees or disabled people. A sizable share of our customers are mothers who have children, with an average age of between 30-35. Because of their life situations, maternity leave and geographies, they cannot go to the brick and mortar stores or

carry heavy bags of 12-15 kilos on top of a stroller. It's not what they want, so they are actively adopting this service.

Before COVID, 90 percent of Express service customers in Pyaterochka came from among the non-frequent shoppers of Pyaterochka, judging by their loyalty cards. Right now, 75 percent of orders (in Q1, 80 percent) are done with loyalty cards. So we can see where people spent the money before and what their total spend was and what share of wallet we see at X5.

We saw the significant inflow of the customers who before were not active segments at Pyaterochka. They are customers who, for whatever reason, were not our chain active shoppers, and we saw the increase in the total spend between online and offline formats.

As to how the situation will change post lockdown, we will follow it closely, looking ahead and adapting to the needs of our guests. But in express delivery and stocking up, we are separating the formats less and less, looking at how we can best serve our guests on behalf of the company.

Andrey Vasin:

Thank you very much, colleagues. We will take 2 more questions because we have so worked for more than 90 minutes. And you can probably answer them very briefly.

The question is to Vladimir Salakhutdinov and Vladimir Kholyaznikov. How is the delivery service going to compete with aggregators? And where do you see the advantage of Pyaterochka as compared to the aggregators like Yandex.Lavka, for example?

Vladimir Kholyaznikov:

OK, let me start with that. Probably, now I wouldn't draw a line between the services and the aggregators, because in digital the ability to aggregate several services is a natural wish. But even inside an aggregator, a customer selects a particular supplier or service. I believe this is going to be a single space, a single market and competition will happen along the lines of service quality, assortment, loyalty to the brand. In our case, it will be a brand of a chain, as well as the customer experience, privileges and benefits that we will create within the service.

Andrey Vasin:

Thank you. And the last question to Svetlana and Vladimir. Do I understand correctly that the online business has a higher gross margin because of the higher share of non-food in the ticket, but the OpEx is higher because of staff and transportation costs?

Natalia Zagvozdina:

Probably Leonid could take this.

Leonid Dovladbegyan:

As to the understanding, the highest-margin categories are bakery and ready-to-eat. As to higher OpEx - I don't know what we should compare it to. Probably, if we compare it to a standard model of non-food, like consumer electronics, then our costs are maybe higher, because we use

refrigerators and refrigerator trucks. But if you look at oversized non-food, then probably our business is less costly because we have standardised boxes. So it is a difficult question to answer, but non-food definitely is not the highest-margin business.

Natalia Zagvozdina:

Thank you very much, Leonid. Now I would like to ask Svetlana and Vladimir Salakhutdinov if they have any final remarks.

Svetlana Demyashkevich:

Thanks a lot for being with us, and thanks for the continued interest in tracking the success of our businesses. We are very grateful for your support in this. I would also add that there is a lot of excitement in the team about the success of these businesses.

Vladimir Salakhutdinov:

Today we had a lot of questions around cannibalisation, competition, and different market shares. What's very important here, and I would like to emphasize that right now: the digital, online businesses are still at the very early stages in food retail. There is enough room for many big players there. It is in our best interests to see the overall development of the market, the right set of customer needs developing, so it will be easier for all of us to develop and grow in this market. Thank you very much.

Natalia Zagvozdina:

I would like to thank once again all the speakers of X5 who found the time to be with us. I want to thank all the call participants. As to the questions from the analysts and investors that we were not able to answer, we are ready to answer them in the off-line mode. Goodbye, and stay well. Thank you.