X5 RETAIL GROUP

X5 Retail Group N.V.
Q4 and FY 2020 financial results
Conference call held on 19 March 2021
Edited transcript

Speakers:
- Igor Shekhterman, CEO
- Svetlana Demyashkevich, CFO
- Natalia Zagvozdina, Head of Corporate Finance and IR
- Andrey Vasin, Head of IR

Participants asking questions:
- Henrik Herbst, Morgan Stanley
- Kirill Panarin, Renaissance Capital
- Elena Jouronova, JP Morgan
- Alexander Gnusarev, VTB Capital
- Maxim Nekrasov, Goldman Sachs
- Marat Ibragimov, Gazprombank
- Maria Lukina, BCS Global Market
- Artur Galimov, SOVA Capital

Operator:

Ladies and gentlemen, thank you for standing by and welcome to the X5 Retail Group Q4 and FY 2020 financial results conference call. At this time, all participants are in listen-only mode. After the speakers' presentation there will be a Q&A session. To ask a question during this session you will need to press "*1" on your telephone. I must advise you that this conference is being recorded today, Friday, 19 March 2021. I would now like to hand the conference over to our first speaker today, Head of Corporate Finance and IR Natalia Zagvozdina. Thank you. Please, go ahead.

Natalia Zagvozdina:

Thank you very much. Good morning and good afternoon, ladies and gentlemen. Let me welcome you today to X5 Retail Group Q4 and FY 2020 results call. The speakers today from our side will be CEO Igor Shekhterman and CFO Svetlana Demyashkevich. You can find the disclaimer on the last page of our press release, as usual. Distribution of the results was carried out through the usual channels this morning. Without further delay, I am passing the floor to our CEO. Igor, please.

Igor Shekhterman:

Natalia, thank you. Good morning and good afternoon, ladies and gentlemen. Thank you for joining our call today. I would like to begin by concentrating on our response to the COVID-19 pandemic and the impact that it had on our business last year. I will then give a brief overview of some of X5's main achievements in 2020, as well as our priorities.

Let me start with how we handled the pandemic and how consumption patterns in Russia changed with the onset of the coronavirus. The COVID-19 pandemic presented X5 with multiple challenges. Food retailers across the world faced many of the same challenges in 2020. The Russian national lockdown in May–July proved the resilience of our internal processes, risk control and decentralised management model. It also tested our capacity to keep up with growing consumer demand. At the start of the pandemic, we introduced new measures to boost workplace health and safety. For example, we provided emergency personal protective equipment for all of our employees. We arranged for 95% of our office personnel to start working remotely over the course of just two weeks. We introduced new mobile teams for our stores and logistics operations. These teams could quickly replace a full shift or team that needed to quarantine if a worker tested positive for COVID-19. This enabled us to keep our logistics network and stores fully operational throughout 2020.

Our online and express delivery channels saw a rapid rise in demand in 2020. To capitalise on this, we invested heavily in our online platform and express delivery services. We expanded our infrastructure by opening two new dark stores and increased our express delivery service area to fully cover the city of Moscow. Today our online delivery services are already available in 25 Russian regions. Across both Perekrestok Vprok and express delivery, we delivered 7.9 mln online orders to over 1.4 mln customers. We now expect express delivery's contribution to X5's digital sales to continually surpass that of Perekrestok Vprok, having seen that short delivery time and attractive pricing can help us gain traction among our customers.

LFL sales increased by 5.5% in FY 2020. This was driven by a higher average ticket, our constant focus on the quality of goods in our stores, attractive pricing, as well as the new store concept. Over 12% of our stores were operating under the new concept by year-end. In 2020, we added 1,500 new stores, and our trading space increased by 8.3% y-o-y to 7.8 mln sq m. Approximately half of these openings replaced less efficient food retail operators who were unable to continue running effectively in the pandemic. As a result of positive LFL and network expansion, we increased our offline market share to 12.8%, growing our revenue at an accelerated pace compared to the previous year.

We continued to consolidate our position in the offline food retail market in both proximity and supermarket formats. In the proximity segment, Pyaterochka demonstrated particularly strong performance between late March and mid-July in the context of lockdown and limited public mobility. The chain attracted new customers from traditional retail, as well as hypermarket and supermarket formats. Because of this, we are even more confident in our strategic decision to concentrate on expanding the proximity segment.

Over the course of the year, customer loyalty continued to grow. Our loyal customer base increased by 16.5% and reached 47.3 mln [people] by year-end. This growth was fueled by new customer feedback features across our loyalty programme and our new enhanced mobile app. This helped us to gather over 120 mln customer ratings of products in our stores. Customers that actively use loyalty cards generate higher value and are typically more profitable for the Company. So, this puts us in an excellent position for the year ahead.

Before I move on to the X5 2020 results, I want to briefly touch upon the main market trends we saw in 2020. Last year, consumer behaviour continued to shift towards even greater confidence. The total online grocery market in Russia increased by 260% to RUB 155 bln. Competition between online players grew, and express delivery from proximity stores became even more popular. Overall, offline food retailers grew by 1.8% in 2020, helped by higher stay-at-home consumption. This was also reflected in an estimated 30–40% reduction in the HoReCa market. Food inflation began to rise significantly towards the end of last year. It was 6.7% in December due to high global inflation in fruit and vegetable prices and the weakening rouble. During the first 9M 2020, it averaged 3.3%. Hard discounters did extremely well in 2020 compared to higher-end supermarkets and specialty stores. This market segment doubled in value between 2018 and 2020. Consumer spending last year focused on staples like food, pharmaceuticals, utilities, health, and pet products. The stay-at-home trend also led to higher spending on selected durable goods, such as consumer electronics, DIY and home and garden products. The food retail industry continued to consolidate. The share of the top-5 retailers rose from 29% in 2019 to 32% in 2020. Offline retail continued to be dominated by X5 and Magnit. Another trend we saw last year was that almost all offline players either expanded or launched their own online delivery services.

Now, I want to summarise our key achievements of 2020 and the progress of our online business in 2021. We maintained leadership in revenue growth against our main peers and further expanded the absolute revenue gap with each of our five closest competitors in online grocery. The vast majority of our stores remained fully operational during the COVID-19 lockdown and even managed to increase their sales and delivery volumes from our supply chain. We achieved revenue growth above our internal budget targets and profitability in line with our budget. We managed to offset COVID-related costs of RUB 3.5 bln thanks to increased efficiency and the positive effect of our business digitalisation. This enabled us to deliver a solid EBITDA margin of 7.3%, which was in line with our strategic objective to remain above 7%.

We grew the GMV of our online businesses faster than the e-grocery market and achieved market leadership in e-grocery. Our estimated market share is 12.6%. The GMV generated by express delivery from Pyaterochka and Perekrestok stores and the Okolo delivery aggregator totalled RUB 2.1 bln in February 2021. By the end of February, our express delivery services were handling around 50,000 orders per day. Vprok handled between 12,000 and 15,000 orders per day during February. The online marketplace Perekrestok Vprok, which is primarily for stock-up shopping, reported a GMV of RUB 1.7 bln in February this year, up by 122% y-o-y. The share of digital sales in X5's total revenue exceeded 2% during the second month of 2021 and reached 4.5% in Moscow and the Moscow region in the same period.

We delivered stability and successfully sustained the quality of our in-store operations during the pandemic. We fully understand that the vast investments we have made into our new businesses and their development are currently having a negative impact on our consolidated margin. This is why we are in the process [of finding] the best structure for our digital businesses and will come back with a solution later this year. There are several options. We may consider attracting new investors or strategic partners when new businesses are set up as a separate company. This should enable us to continue investing accordingly in the development of our digital business in line with more aggressive actions by our peers in the e-grocery segment, and also to reduce the stress on our consolidated financial results from new businesses, which we consider strategically important for us.

We sustained positive momentum in personnel turnover and labour productivity. Turnover declined by 11 p.p. to 38% and our average labour productivity improved by 3.3%. Our investments in price in 2020 were in line with our plans. We supported our customers throughout the pandemic with additional price investments and promos, even when demand at our stores peaked. It was the socially responsible thing to do, given the impact of the COVID pandemic on consumer income. We continued to roll out new concepts and CVPs in our proximity and supermarket formats. We refurbished 583 Pyaterochka and 45 Perekrestok stores. By the end of the year, 13% of Pyaterochka and 12% of Perekrestok stores were operating under the new concept. LFL performance in the new concept stores is around 10% higher than it was in the previous concept, while NPS is 50% higher in new concept stores.

We continued to transform X5's hypermarket format. We reduced the number of Karusel stores by 35 in 2020, and transferred 25 stores to the Perekrestok brand as large supermarkets. As of year-end, 56 stores still operated as Karusel hypermarkets.

We launched stores in the promising market segment of hard discounters under X5's new Chizhik brand. The average area of Chizhik stores is about 250 sq m and each store has around 660 SKUs. We opened our first four pilot stores last year, and one more in February this year. Initial results have been very promising. Our long-term target for Chizhik is to have a 60% share of private labels in the assortment. This year we plan to introduce around 300 private-label SKUs to the format. During the year, we also plan to open up to 50 stores in this format.

We launched express delivery mobile apps for Pyaterochka and Perekrestok, with a total of 3.8 mln downloads last year. We launched Okolo, our FMCG delivery aggregator. We will develop Okolo further this year as we sign up HoReCa and non-food FMCG retailers to the service.

5Post, our e-commerce delivery service, successfully completed the year as a standalone business. It delivered 6.8 mln e-commerce packages. In December alone, 5Post handled 1.5 mln parcels. By year-end, its network had over 4,500 parcel lockers plus nearly 12,000 delivery points in X5 stores. By February this year, 5Post had already achieved positive EBITDA performance.

We continued our digital transformation, which had a positive impact on last year's EBITDA of RUB 7 bln. This year, we expect its impact to be RUB 20 bln. We strengthened our focus on ESG by producing new medium-term goals to be achieved by 2023 as well as longer-term ESG aspirations for 2030. Among other things, we aim to become carbon-neutral by 2050, decrease food waste and expand our Basket of Kindness food drive while improving our disclosure of ESG metrics.

We adopted and updated our dividend policy that envisaged an interim dividend payment in 2020 and paid the first interim dividend based on our 9M 2020 results in December. X5's Supervisory Board has just recommended that payments of the second 2020 dividend be in the amount of RUB 30 bln. Together with the interim dividends paid in December 2020, total dividends for the year will amount to RUB 50 bln.

To conclude, let me highlight our priorities. In 2021, we will work on maintaining our market leadership, while developing ourselves as a client-centric and technologically-advanced retailer. We will expand our retail footprint further in 2021 by opening up to 1,500 new stores. The majority will be proximity stores and the rest will be supermarkets and hard discounters. We will continue testing various aspects of the hard discounter format and its performance in relation to competitors. Given the recent success of our online businesses, we will develop a variety of new digital initiatives. This will include a media platform, which is already under development by our in-house team. We aim to launch an FMCG marketplace based on Perekrestok Vprok. We will open a subscription service for our customers this year. Alongside this, we will continue to expand our express delivery offering and broaden our customer engagement to increase the span of the customer journey. Speaking more broadly, in 2021, we will continue to build the foundation for X5's eco-system. We will increase our media capability as well as offer financial services to our customers. We will work on expanding our ready-to-eat segment and have set specific targets to grow the share of the ready-to-eat assortment at both the Pyaterochka and Perekrestok formats. Another key area of focus in the coming year will be sustainability. We will continue to work towards the goals of our sustainable development strategy for 2023 and 2030. We will also publish our first standalone sustainability report in line with GRI standards. Our focus on operational efficiency and our discipline in capital allocation will support our annual dividend payments, which we expect to grow steadily.

Now I would like to hand over to X5 CFO Svetlana Demyashkevich. Thank you for your attention.

Svetlana Demyashkevich:

Thank you, Igor. Good morning and good afternoon, ladies and gentlemen. Let me start with the external environment, after which I will give an overview of our financials and provide you with some insight on our key quarter-to-date results.

In Q4 2020, food inflation accelerated noticeably and averaged 5.8% y-o-y compared to 4.3% in Q3 and 3.9% in 2020. In February, food inflation reached 7%. Periods of high food inflation volatility tend to be rather short and so we expect this to stabilise over the year. High food inflation resulted in regulatory actions and price monitoring for socially important goods. The latter started in December 2020 and will remain in effect until the end of March. Socially important goods account for just under 5% of X5's turnover and given our pricing for these products has always been very competitive, we see low regulatory risks in this area.

In Q4 2020, real disposable income improved slightly but still remained in the negative area at around negative 1.7% y-o-y. It goes without saying that weak consumer income will continue to impact the sector in 2021, strengthening demand in the low-cost market segment.

Now a few words about X5's financial performance in Q4 and FY 2020. Q4 revenue increased by 12.7% y-o-y on the back of solid LFL sales, increased selling space and ongoing store refurbishments. Refurbished stores continued showing LFL well in excess of comparable stores still operating under the old concept. The net sales of our digital businesses (Perekrestok Vprok, express delivery and 5Post) rose by 362% y-o-y to around RUB 20 bln, and comprise 1% of consolidated FY 2020 revenue. Total revenue growth in 2020 exceeded our expectations and the budget. In Q4 2020, the LFL sales composition by traffic and basket continued to reflect the impact of COVID-19 with less frequent customer visits to stores and larger purchases per visit. On balance, X5 saw consumers trading up across all retail formats, which can be partially attributed to a lower share of wallet going to the HoReCa segment as well as ongoing improvements made to the variety and quality of assortment across all our formats. However, in Q4, we did feel the need to support customers suffering from the rapid growth in food inflation. As you remember, our financial results for 9M [2020] were very strong and noticeably above our budget. This is why, in Q4, we decided to invest in our consumers and personnel. Our investments were tactical and measured, and included price investments in October and November, additional marketing expenses as well as bonuses to operating personnel, mostly in Pyaterochka. Why did we do it in Q4? High food inflation began affecting customer confidence and we decided it was a good time not only to support our loyal customers by offering more attractive pricing but also to attract new clients in order to grow our market share. Marketing is vitally important as we aim to grow our market share through initiatives such as express delivery and the smart positioning of our proximity format. Our additional employee bonuses are in line with our strategy to dramatically increase engagement and the productivity of our line personnel.

In total, these three components of our investments in Q4 resulted in an additional 86 b.p. being spent with equal 25% shares coming from commercial margin and marketing, and 50 b.p. coming from bonuses to store and logistics personnel. Once again, it was our conscious decision to make these investments and our financial results allowed for it. Without these investments, our Q4 margin would have been 7%.

Another comment I would like to make is about the impact of our new digital businesses on our profitability, which Igor touched upon earlier. We see investments into these new businesses as strategically important. They contribute positively to our growth, adding about one additional percentage point and they impact our margins. In Q4, our EBITDA margin would have been 21 b.p. higher if we had no new businesses in 2019 and 2020. Compounded with the additional investment made in Q4, we have a total EBITDA impact of over 100 b.p. on our quarterly margin, which implied 7.2% normalised profitability for the quarter, excluding online. For FY 2020, the impact of new businesses on the margin was 38 b.p. and our annual EBITDA margin would be close to 8%, if we had no digital business investments and no technical investments in Q4. One-off COVID-related costs also had an impact on our EBITDA in 2020. We estimate the amount to be around RUB 3.5 bln. At the same time, there was a positive impact as consumers traded up. This was especially visible at our Pyaterochka format as the HoReCa sector declined and we saw a more profitable category mix.

As the Company delivered higher than budgeted financial results in 2020, both KPIs for the 3-year LTI programme that ended in 2020 were met. To remind everyone, these KPIs were related to our leadership in revenue and the EBITDA multiple against sector peers. In Q4, the reversal of accruals for LTI and share-based payments amounted to RUB 1 bln due to the actualisation of the LTI fund for participants who withdrew from the LTI programme in recent years. As part of the programme, 50% of the total award is paid in 2021 subject to maintaining the achieved target until the end of 2020, while the other 50% is deferred to 2022 with the profitability threshold as a condition for the deferred pay-out. The remaining accruals related to the second payment of the previous programme will continue until Q3 2022, and will total around RUB 1.5 bln.

Depreciation, amortisation and impairment costs decreased as a percentage of revenue by 16 b.p. to 3.7% in Q4. This was due to the positive impairment effect largely caused by by Pyaterochka's improving results. This is partially balanced by impairment related to Karusel, which is undergoing transformation. Karusel's share of X5's revenue as well as its number of stores are decreasing driving down their negative impact on overall margins.

In Q4 2020, net finance costs decreased by 20% y-o-y due to a decline in the weighted average effective interest rate on X5's total debt to 6.78%. This comes as a result of declining interest rates in the Russian capital market as well as actions taken by X5 to minimise interest expenses.

In Q4, income tax expenses grew by 36.6% as a result the Group's subsidiaries distributing their first interim dividend of RUB 20 bln in December, an increase in the accrual of deferred tax liability as well as higher free-tax profit, which reflected overall business growth.

The Company's net profit in Q4 increased by 221% to RUB 2.8 bln, while its net profit margin increased by 34 b.p. y-o-y to 0.5%. In 2020, net profit margin improved by 49 b.p. y-o-y to 2%.

At the end of Q4 2020, our net debt/EBITDA ratio was at 1.67x. Going forward, we aim to keep this ratio under 1.8 while continuing to pay dividends.

Now a few comments about our cash flow. In Q4, net cash flow generated from operating activities was RUB 20.4 bln due to the Company paying higher dividend-related taxes. In 2020, net cash flows generated from operating activities increased by 26.9%, reflecting both the Company's business expansion and its positive working capital trends. The smaller positive change in working capital in Q4 2020 compared to Q4 2019 was mainly due to the calendarisation of procurement and sales during the year driven by changes in customer behaviour, with a higher share of total purchases in Q2 and Q3 and a lower share in Q4 compared to 2019. On balance, the Company continued to operate with negative working capital which supported cash flows as the business continued to expand.

Turning to capex, net cash used in investing activities increased to RUB 25.6 bln in Q4 2020, slightly up y-o-y. This reflected higher investments in store refurbishments and our digital transformation, including the development of digital businesses, and lower investments in new openings compared to 2019. Approximately 33% of capex in Q4 went towards expanding our store base, the remaining capex went towards refurbishments at 9%, logistics at 12%, IT at 8%, maintenance at 15% and other investments. Total capex in 2020 increased by 10.9% y-o-y to RUB 89.9 bln with increased shares of spending on refurbishment and development of digital businesses, and decreased spending on new openings as the number of new stores was lower. However, we managed to bring capex per new store in line with the capex per store of our previous concept. On the back of strong profitability, good cash flow and a solid balance sheet, the Supervisory Board proposed to pay a final annual dividend in the amount of RUB 30 bln. Together with the interim dividend paid in December, the total dividend for the year will amount to RUB 50 bln. This is 67% higher than in 2019 in rouble terms.

And finally, I will give a short update on the quarter-to-date results before we go to the Q&A session. YTD trading is strong and is exceeding our expectations. Pyaterochka and our digital businesses remain the core drivers of growth. Growth in net retail sales from the beginning of January to mid-March was over 11%, while LFL sales have risen by around 6%. At the same time, LFL sales in Pyaterochka accelerated from 7% in January to 7.4% in February and our online sales are up 365% y-o-y. With that, I would like to conclude the discussion of our results. Thank you very much for your attention.

Operator:

Thank you very much. Ladies and gentlemen, we will now begin the Q&A session. If you wish to ask a question, please press "*1" on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the "#" key.

The first question comes from Henrik Herbst of Morgan Stanley. Your line is open, please ask your question.

Henrik Herbst:

Thank you very much. I have three questions.

You have mentioned your pricing activity and your reinvestment in consumers in October and November. I was wondering if you could tell us more about your LFL figures. Maybe you could talk a bit about the return on your price activity. More specifically, about what you did and whether it was about cutting headline prices or more about promo activity. And what do you think about price elasticity on the back of that?

Secondly, I was wondering if I heard it right. You were saying that, excluding the digital investment, your EBITDA margin in Q4 would have been around 8%. I am not sure if I heard that correctly. Maybe you could confirm that.

And then, I was wondering how you consider that investment and its drag on margins going into 2021.

The last question is about LFL sales or trends so far in Q1. It is quite encouraging to see your LFL sales accelerating in February, but maybe you could give us some thoughts on how margins progressed in Q1 and also how you think about the comps. I guess from mid-March, comps are getting a little bit tougher from stockpiling as well.

That is it. Thanks very much.

Svetlana Demyashkevich:

Thank you for all your questions. I will start by discussing the price investments we made in October and November, mostly in Pyaterochka, and, as I have mentioned, not only price investments but also some marketing activities. As you probably know, this is in line with our typical strategy for any Q4 period. It is high season for us, and provides us with the best opportunity to attract new customers and significantly increase our market share. We usually take advantage of this opportunity in Q4 if we have good results in the beginning of the year. 2020 was a good example of this – we had very strong results in the first three quarters, so we had the opportunity to invest. This resulted in us growing our market share above expectations. As you see, it grew by 1.5%, above the usual pace of our annual market share growth, which is typically around 0.8-1.0%. This year, the pandemic, online development and the ability to invest and consolidate the market allowed us to increase our market share at an accelerated pace. We achieved this through increasing our promo activities and introducing price corrections in line with the market. Starting in January, our promo activities returned to normal levels and now remain even lower than at the beginning of last year.

As regards the LFL trends in January and February, we have seen the results of all these activities, including price investments, marketing activities and investments in our personnel. In January and February, we saw not only rising LFL trends in Pyaterochka, but also increased productivity and higher than forecasted EBITDA margins. It is hard to predict how this trend will play out in late March, as we will have to compare it with a one-off and unusual period from last year, i.e. the start of the pandemic. I think this will be the case for the entire market, and we can come back to this point during our call in April when we will be discussing the results of Q1 2021.

On additional expenses in our digital businesses, yes, you are right. I would say that taking into account adjustments made for investments in marketing, prices, employees and our digital businesses, our normalised EBITDA margin would be around 8%. If we are only talking about our digital businesses, the overall impact on the margin is about 38 b.p. You are right that we look to our strategy to understand and forecast the impact of our digital businesses going forward. That is why we focus on the efficiency of our core business, as we are able to increase our investments into new lines of business if we can first improve our operational efficiency. We have so far made significant improvements in our shrinkage, logistical costs and personnel productivity. Our digital transformation has also boosted our efficiency, improving internal processes and decision-making. All of this gives us an opportunity to invest more into our digital businesses and is perfectly balanced in our budget for 2021. We do not have any concerns here. We are operating in line with the expectations of our three-year strategy – we have an EBITDA margin well above 7%, increasing ROI, leverage below 1.8x, and offer continued payment of dividends. I would say that this framework, which we discussed on our Capital Markets Day in October, is working perfectly for us.

Igor Shekhterman:

I would like to add that we are very focused on efficiency and we had very good results in terms of shrinkage efficiency. And when we discussed the budget for this year, we had even better metrics than last year.

Henrik Herbst:

Thank you very much. Just a quick follow-up. When you say that margins were above expectations in Q1, do you mean year-on-year margins? I guess we still have a few weeks.

Svetlana Demyashkevich:

It is difficult to talk about Q1 in its entirety because of the abnormal nature of the last two weeks of March 2020, but performance at the beginning of this year was pretty much in line with that of last year.

Henrik Herbst:

Thanks very much.

Operator:

The next question comes from Kirill Panarin of Renaissance Capital. Your line is open, please ask your question.

Kirill Panarin:

Hi everyone. Thanks for taking my questions. Two questions, please. First, a follow-up on the previous question about pricing investments in Q4. To be honest, I have still not fully understood what the return on those extra investments was. You mention market share growth of 1.5%. But what would Q4 growth be without those extra 50 b.p. investments? And how do you quantify how much to invest in Q4? Should we assume that every time you show strong results in 9M, you reinvest all the gains into prices? How do you find a balance between growth and margins? That is the first question.

Svetlana Demyashkevich:

Of course, we have very complicated and detailed operational processes in place. Most of them are now fully digitalised. For example, we rely on a state-of-the-art algorithm for measuring price efficiency and deciding on the price of a particular SKU in a particular basket and a particular store depending on the data we get from our loyalty cards. We then analyse performance using big data collected by our data team. When we look at the sensitivity of our price investments, we can use it to estimate the effect of additional LFLs and customer acquisition. Frankly, when we started discussing these price investments back in October, we used an LFL revenue growth forecast to year end. The actual results were even better than our expectations. That is why we, as management, are very happy internally with the Company's performance in 2020. And our Supervisory Board recently confirmed that they are also happy with our results, confirming that they had exceeded expectations.

Also, we are not just talking about the same month or the month following the investment, but about a longer period. We still see the effect of this investment in January, February and March, and continued to consolidate the market and gain additional market share past that. When you look at our LFLs, you should also bear in mind the fact that we have had a very high base for the past several years and have never had a decline in LFLs or negative LFLs like some of our competitors. It is very important to take this into consideration. I think it is very encouraging that we are still able to demonstrate LFLs like these, despite having such as high base. This is driven by our efforts to improve our stores' CVP, the performance of our new concept stores for Pyaterochka and Perekrestok, the operational productivity of our stores, as well as our efficiency in logistics and shrinkages, etc. It is complex work and it remains the focus of the entire management team.

Kirill Panarin:

Okay, thank you. And just one more. Could you comment on your new LTI programme that was submitted for approval in the Annual General Shareholders Meeting? That is it from me. Thank you.

Igor Shekhterman:

We have three main metrics in our LTI programme. Two of them are practically the same as those used in the previous programme. We have market leadership as one of our metrics. The second is leadership in value multiples relative to our peers. The last metric is related to ESG.

Kirill Panarin:

Thank you.

Operator:

The next question comes from Elena Jouronova of JP Morgan. Your line is open, please ask your question.

Elena Jouronova:

Good evening, ladies and gentlemen. I have a follow-up question likely for Svetlana. If I look at your FY 2020 results, it seems that you did not have any margin expansion. Is that right? So, if we strip away the effects of LTI accruals and reversals and the Carousel one-offs, your EBITDA margin was broadly the same as it was previously, at around 7%. And that was in the year of COVID-19 when food retailers generally had positive EBITDA margin dynamics, give or take. I am just wondering how to read this. Is the consumer and competitive environment actually more difficult in Russia than we understood it to be, meaning you basically end up reinvesting all the efficiency gains that the management team has worked on into prices to sustain high LFLs? Or was it simply the COVID-19 unwind? I just want to hear your thoughts on this because, to be honest, on a FY basis not achieving any EBITDA margin expansion in a year like 2020 was a bit of a surprise to me.

Svetlana Demyashkevich:

Hello. Thank you for your question. First of all, we have experienced positive growth in terms of our EBITDA margin for FY 2020. It improved by 27 b.p. compared to 2019. If we add to that the negative effect of investment in digital businesses on EBITDA, which almost doubled vs 2019, then you can see that the actual margin improved significantly. That is why during this COVID-19 year, with this improved result based on higher revenue due to COVID-19 and HoReCa trends, we were able, and indeed felt it was a good idea, to invest back into our customers and our relationship with them. As you know, this is our usual strategy and is how we have kept an edge on our competitors for many years. It is also one of the reasons why we have become, and still remain, the leader. We have actually increased the gap with our competitors in absolute terms and in terms of market share, because we are ready to invest back into the development of our CVP, services, customers, price perception, etc. We think that in the long term this stimulates very good results.

Elena Jouronova:

Yes, I appreciate that. But, with your business developing in a more digital direction and your commitment to fostering long-term relationships with your consumers, is it even possible for X5 to achieve an EBITDA margin that is meaningfully above 7% in the current environment?

Svetlana Demyashkevich:

Yes. If we stop investing in all kinds of new businesses and in our growth ahead of the market, then the EBITDA margin could be 8% or even higher. But that is a conscious choice we have made in line with the Company's longer-term strategy, because we understand the importance of being with consumers and fulfilling their expectations in terms of our new concepts, personnel, brands and services that we provide both offline and online.

Elena Jouronova:

OK, I understand, thank you. One more clarification question on LTI. I think you mentioned in your speech that the condition to pay the second threshold of LTI in 2020 was maintaining profitability at a certain level. Are you disclosing this level?

Svetlana Demyashkevich:

We are not disclosing this level but it is in line with the previous programme. We have always kept this constant as it is a comfortable level for us.

Elena Jouronova:

OK. And, finally, on the new LTI programme, you no longer have that EBITDA margin KPI. Is that right? Because Igor mentioned the market share leadership, multiple leadership and ESG. On the multiples leadership, can you clarify how you are calculating that? Can you share some mechanics? Are you trailing multiples with EBITDA, P or anything else? And what time period are you measuring that over?

Igor Shekhterman:

Thank you for the question. We definitely have a trigger depending on our EBITDA margin and profitability but regarding the details on the multiple, we are still developing the mechanics. We have just confirmed this metric with the Supervisory Board and will develop the mechanics on how to calculate it later this year.

Andrey Vasin:

Elena, the EBITDA margin trigger is actually in line with the previous programme.

Elena Jouronova:

Understood. The final question is on hard discounters. I am sorry if I missed that from the presentation speech, but can you share with us the latest results for that format and your thoughts about its possible roll-out?

Igor Shekhterman:

As we mentioned earlier, we have just opened five stores. We will open an additional 45 stores in different regions this year. I think, as we have only opened five stores [so far], it is quite early to give any results or metrics, but the final decision regarding the roll-out will be made in December 2021 by the Supervisory Board based on the results of the model in development this year. I hope it will be approved by the Supervisory Board and we can start the roll-out next year.

Elena Jouronova:

Thank you very much and good luck.

Operator:

The next question comes from Alexander Gnusarev of VTB Capital. Your line is open, please ask your question.

Alexander Gnusarev:

Greetings, everybody. I suppose many of my questions have already been answered. I have the last one. Speaking about your year-to-date sales [growth] of 11%, could you break this down by month, if possible? Thank you.

Svetlana Demyashkevich:

Overall growth stood above 10% each month and was in line with our expectations. I can't give any more details here.

Igor Shekhterman:

We will publish the Q1 2021 results in the middle of April, so you will be able to see the monthly dynamics then.

Alexander Gnusarev:

OK, that is clear.

Operator:

The next question comes from Maxim Nekrasov of Goldman Sachs. Your line is open, please ask your question.

Maxim Nekrasov:

Good afternoon. Thank you very much for the presentation. I have a couple of questions. The first one is on your capital allocation. Could you remind us what your capex expectations are for this year and the medium term?

Svetlana Demyashkevich:

In the long term, we do not plan to see our capex grow faster than our revenue. As a framework, we also intend to hold our debt/EBITDA at no more than 1.8x, maximum 2.0x. In terms of openings, we are planning a total of 1,400 Pyaterochka, 90 Perekrestok and 50 Chizhik store openings in 2021. In terms of capex structure, we are going to spend around 40% of capex on new store openings, with refurbishments accounting for around 15–20%, logistics – around 10%, maintenance – around 8–10%, IT and innovations – 19%, and the rest will go on other items. We are still going to pay dividends, which, as you know, increased in 2020. So we intend to maintain high levels of both absolute numbers and dividend yield.

Operator:

The next question comes from Marat Ibragimov of Gazprombank. Your line is open, please ask your question.

Marat Ibragimov:

Thank you very much. I have a question on SG&A costs. Third party service expenses went up by almost 50% in Q4 2020 y-o-y. What is the reason for this and how are they forecasted to change in the future (in percentage of sales, probably)? Thank you.

Svetlana Demyashkevich:

Two of the major driving factors behind this growth were the rapid expansion of our express delivery courier services and the increase in popularity of express delivery. I think we will soon be disclosing more and more information about our new businesses – you can already find a lot of disclosures on their unit economics in our Annual Report. We are also planning to hold an event that will provide information about our new businesses sometime in May. So we will be able to talk more about them in terms of their unit economics and increasing costs then. Additionally, as I have mentioned before, we have increased our marketing expenses for Pyaterochka in line with the price investments in Q4 2020 as a strategic move to increase our market share in LFL.

Marat Ibragimov:

OK, I got it. Another question on LFL in supermarkets. Perekrestok LFL sales ventured into negative territory once again at -0.2%. What is the reason for this? I understand that in Q2 2020 some shopping centres were closed. But what is causing this negative LFL? As we can see from the breakdown, it is largely driven by an outflow of customers. This seems quite surprising given your heavy investment in prices. Can you please elaborate on that? Thank you.

Svetlana Demyashkevich:

We should look separately at the trends in supermarkets and proximity [stores]. They are very different and this has been the case throughout the year. In Pyaterochka, we grew above expectations and had an inflow of customers due to the pandemic and a weakened HoReCa market. Through additional price investments, we were even able to further accelerate this growth. [Meanwhile,] Perekrestok stores, supermarkets and hypermarkets are mostly located in shopping malls and therefore suffered from zero traffic in Q2 due to their forced closures. Traffic partially returned in August and September, but in Q4 we unfortunately had a second wave of infections and, as you know, people were afraid to go to shopping malls. That is why we saw further decreased traffic in supermarkets. As you can see, the performance of supermarkets not located in shopping malls was much better. We have already seen some positive trends in January, February and March 2021 in Perekrestok – positive LFL sales – both in shopping malls and separate locations. Of course, we look at the trends across all of our big formats. Because of that, we are accelerating the development of Perekrestok and Bystro, Perekrestok's express delivery service, which is very popular with customers and has exceeded our growth expectations in both 2020 and 2021. We are very happy with the performance of this new service for our customers.

Igor Shekhterman:

I just wanted to remind you that practically 50% of our supermarkets are located in Moscow and the Moscow region, with half of them situated in shopping centres. Most of them were struggling until mid-January 2021 because people did not come back to shopping centres. We had very negative traffic. Only at the end of January and the beginning of February did results indicate that traffic had started to turn positive.

Marat Ibragimov:

OK, thank you. My last question is about your hard discount stores. I understand that they are currently in roll-out mode and you do not have the final numbers yet. What is your planned IRR or ROI for this particular format? Thank you very much.

Svetlana Demyashkevich:

Actually, it is higher than the ROI that we have recently seen for Pyaterochka, which has the leading ROI among our other formats. We expect that Chizhik, if its pilot is as successful as we planned in our financial model, will have a higher ROI than all of our other formats. That is due to its smaller store area (sq m), capex, and higher turnover and sales density. We already see that general discounters, even in Russia, have higher sales densities than proximity format stores and we want our hard discounters to be leaders in terms of sales density per sq m.

Marat Ibragimov:

But you have not disclosed the absolute number. I am guessing it is around 20%. Am I right?

Igor Shekhterman:

At the moment, we are not disclosing this information as we are just starting to look for the most relevant operational model. When we make a decision regarding the roll-out we will discuss it in more detail.

Marat Ibragimov:

OK, thank you. That is it from my side. Thank you.

Operator:

The next question comes from Maxim Nekrasov of Goldman Sachs. Your line is open, please ask your question.

Maxim Nekrasov:

Thank you very much. Sorry, I got disconnected [previously]. I wanted to follow-up on capital allocation and dividends, in particular. What is your dividend outlook and do you see any possibility to increase dividend payments in 2021 despite their high base? My second question is more of a technical one. What are your tax rate expectations, given rates have been quite high in recent years?

Svetlana Demyashkevich:

Regarding dividends, at the moment it is too early to say. Our current dividends were recommended by the Supervisory Board at the General Shareholders Meeting in 2020. Based on H1 2021 results, we will have a discussion with the Board on further interim dividends for 2021. I think we will be ready to share our expectations regarding these closer to Q3 2021 after Q2 results. Onto tax. As I mentioned earlier, several factors affected the rate, the largest of which was probably the payment of interim dividends at the end of 2020. It was the first payment of interim dividends for the year. That is why it impacted the comparatives and our tax rate. In addition to that, increased net profit, as a natural rule, also affected the overall tax rate. We also had some accruals on our tax cases in line with our usual practice.

Maxim Nekrasov:

Should we assume a similar tax rate going forward, as you will probably continue paying dividends?

Svetlana Demyashkevich:

No, I expect the tax rate to fall, because in this case we had some one-offs.

Maxim Nekrasov:

Ok, thank you.

Svetlana Demyashkevich:

And it is always better to look at the full-year performance, not just…

Igor Shekhterman:

Not just Q4 separately.

Svetlana Demyashkevich:

Yes.

Maxim Nekrasov:

Thank you very much.

Operator:

The next question comes from Maria Lukina of BCS Global Market. Your line is open, please ask your question.

Maria Lukina:

Hi, thank you for the presentation. Sorry if I missed it, my question is on Q1. Can you please once again comment on sales dynamics and LFL performance? What is happening with the traffic at the moment, what trends do you see, and what is happening with the level of shrinkage? Thank you.

Svetlana Demyashkevich:

Overall, LFL sales are very positive. For example, as I mentioned earlier, Pyaterochka experienced [growth of] 7.0% in January and 7.4% in February. We still see trends related to COVID-19 persisting, with lower traffic offset by a higher ticket. We still see trading up in all of our formats, driven by a higher ticket and stronger category mix. That was on LFL sales, and the second question was on shrinkage. Actually, even after last year's very strong results, we saw a further decrease in shrinkages in Pyaterochka in January and February and stable or decreasing shrinkages in Perekrestok, where the shrinkage level has been very low for several years in a row. I think our management team is doing a very good job of decreasing shrinkages. They have implemented many projects focused on freshness, optimisation of logistics, and operational efficiency and these all help to decrease shrinkage.

Maria Lukina:

Thank you very much.

Operator:

The next question comes from Artur Galimov of SOVA Capital. Your line is open, please ask your question.

Artur Galimov:

Good afternoon, everyone. What is the estimated impact of digital businesses on your full-year EBITDA margin in 2021, and what will the impact of increased payments to employees and price investments be even though you mentioned these price investments were mostly completed by this quarter?

Svetlana Demyashkevich:

We have already balanced all these factors during our budgeting process for 2021. We are expecting and forecasting our overall EBITDA margin to be well above 7% for both our core and digital businesses as well as for some of the investments we do depending on the needs of a particular year. As we indicated in our strategy, we want to keep our EBITDA margin either stable or growing so we can continue investing in all business lines that we find to be strategically important. We also believe that our market share should grow above the competition and the market. That is our expectation and has been part of our business model for many years. We are ready to invest more in terms of capex and opex in order to grow faster and sustain our long-term market leadership both in the offline and online segments.

Artur Galimov:

Thank you very much. Could you possibly give the breakdown of how you think the EBITDA margin should develop for different parts of your online businesses, mainly Vprok and express delivery, this year? Thank you.

Svetlana Demyashkevich:

Vprok, the oldest of our online services, is forecast to have a positive EBITDA this year. At the same time, we are developing other parts of our online businesses, one of them being our marketplace. We consider it a new business. It is part of the Vprok brand but brings in additional GMV and works with a large number of partners to significantly increase the number of SKUs it offers in non-food categories. This part of the business will put additional pressure on the EBITDA margin, which is natural for the first year following launch. The express delivery service is also still developing and is only in its second year. That said, its unit economy is improving and we expect 5Post to become positive this year as initially planned in our financial model.

Igor Shekhterman:

We are also piloting a Pyaterochka-based dark store this year. We started doing this last year to improve profitability and unit economics. After the pilot ends, we will decide on whether we should transform some Pyaterochkas into dark stores for express delivery.

Artur Galimov:

Thank you very much.

Svetlana Demyashkevich:

Just to add. Unlike many of our online competitors, we focus on improving our performance and efficiency while ensuring the positive development of our unit economics. At the same time, we are conscious of the fact that in order to compete in such environment, we need to be quite aggressive in terms of growth. So far, we have been able to achieve both.

Operator:

No questions at this time. Please continue.

Natalia Zagvozdina:

With that we will end our call. Thank you very much for participating. If you have any follow-up questions, please address them to X5 through the usual IR contacts. Thank you very much and have a good day.

Operator:

That concludes our conference call for today. Thank you for participating. You may disconnect.