

X5 Retail Group Q4 & FY 2012 Trading Results Conference Call Transcript ¹

Presentation

Operator

Thank you for standing by and welcome to your X5 Q4 and fiscal year 2012 trading results call. At this time all participants are in listen-only mode. There will be a presentation followed by a question and answer session (Operator Instructions). I must advise you that this conference is being recorded today, Wednesday, January 23rd 2013. I would now like to hand the conference over to your first speaker today, Mr Gregory Madick. Please go ahead, sir.

Gregory Madick - X5 Executive IR Director

Hello and thank you all for joining our call to discuss X5's recent announcements and fourth quarter and full-year 2012 trading results. Before we begin with the specific conference call details, I would like to refer you to a disclaimer statement in the trading results press release and presentation regarding forward-looking statements. During this conference call we may make reference to forward-looking statements by using words such as, "plans," "objectives," "goals," "strategies," and other similar words, which are other than statements of historical facts. Actual results may differ materially from those implied by such forward-looking statements due to known and unknown risks and uncertainties, and reflect our views as of the date of this call. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements in light of new information or future events.

I'd like to start the call by introducing our speaker, Stephan DuCharme, X5's CEO nominee, who will review recent developments and host a brief discussion on the Q4 results.

Stephan DuCharme – X5 CEO nominee

Thank you Greg. Before discussing some of the recent developments at X5, I would like to take this opportunity to wish everyone on the call a very Happy New Year. As most of you are already aware, I have been nominated by the Supervisory Board of X5 to become the statutory CEO after shareholder approval at the Annual General Meeting in April. Just to remind everyone, I was delegated by the Board in July 2012 to assume the functions of CEO after the resignation of Andrei Gusev, X5's CEO at the time, and have now agreed, with the support of the Board, to

¹ This conference call transcript was prepared by InterCall.

legally become the Company's CEO. In doing so, I have also officially resigned as X5 Board Member. Over the past six months I have been working very closely with the Senior Management Team, travelling to our stores in the different regions, and talk with employees at various levels. This has given me a better understanding of what is going on with the business, including at the store level, what the issues are that we face and what is and is not working.

What I discovered is that X5 has an exceptionally strong asset base not only in terms of the stores, but in terms of the people running them. It was this realisation that helped me in my decision to accept the nomination for CEO and the challenge and develop and lead the team in this next phase of X5 development. Over the past six months, taking a closer look at the operations and getting a better understanding of the team leaders going forward, has resulted in a number of personnel changes at the Senior Management level. These changes have been based on my initial focus of team building and improving the working relationships and execution among the Senior Management Team. Initially my focus was on Hypermarkets, as this format had been showing the weakest results up to that point in 2012. As you may remember, in August 2012 the Board accepted the resignations of both the Head of Hypermarkets and Logistics, and we filled those positions through internal appointments, which also necessitated a change of leadership in the Supermarket format.

As we stated in previous calls, we are very pleased with the working relationship that the Hypermarkets' new Senior Management Team has established with one another, as well as with the Directors and employees at the store level; the improvements to an employee motivation and the focus on better in-store operations have allowed the format to begin reconnecting with its customer base.

We are also seeing encouraging numbers from Supermarkets, as the new General Director has been emphasising a focus on service, quality, and accountability that is supported by improvements in how employees are led and incentivised. The positive working ethos at both these formats has enabled the teams to improve operations, which has translated into better results and which is clearly supported by the Q4 2012 numbers. Recently, there have been some additional changes to the Senior Management, affecting both administrative and operational positions, which have come about directly and indirectly from our continued focus on the centralisation.

Moving to the administrative changes, we announced last week the resignation of X5's CFO and the nomination of X5's Deputy Director of the Commercial Department, Sergei Piven, to become the new CFO. Kieran will work closely with Sergei during this period to ensure an orderly and

smooth transition. This move is, in part, a result of the decentralisation and stabilisation of the finance function under Kieran's tenure and the recognition of the overall changing focus and needs for the position under the new CEO. Kieran has been instrumental in the development of our financial and operating reporting systems and teams, which have allowed us to report faster and provide the transparency into the business necessary to better understand our operations.

The expectation has always been that Kieran would rotate out once the finance function was successfully cascaded down to the formats and the integrity of the reporting structure was secured. Sergei was brought on in 2011 and has been learning the business from an operational perspective as first Finance Director for the Commercial Department and later Deputy Director of the Department. This experience has provided a solid understanding of the format and logistics operations at X5, and combined with his many years of experience in finance and retail operations, both internationally and in the domestic market, should provide a unique perspective for the CFO role.

Other admin changes included the resignation of Tatiana Kozhevnikova, our Director of Human Resources, which also is in line with the continued decentralisation of our operations. Since Tatiana arrived in early 2011, we have been working to transfer the HR responsibility to the individual formats and, for all intents and purposes, this work has been completed.

My acceptance of the nomination for CEO and the assessment of our needs for the next phase of the Company's evolution signals the right time for Kieran and Tatiana to rotate out. They have delivered on what was asked of them and we thank them for their contributions.

Moving to the operational change, the Board has agreed to accept the resignation of Frank Mros, the General Director of the Soft Discounter format. Frank had been with us since June 2012 and I think the expectations were high for both him and ourselves based on his CV and operational background. Unfortunately, when you are dealing with a multinational Management Team and cross-cultural assimilation it is difficult to manage and predict how people will integrate and develop in a new top management position. Russia is, as we know, a difficult environment to work in both culturally and organisationally, and this was affecting Frank's ability to assume the leadership role, which the Board and I felt was necessary for the Soft Discounters to improve results, which had been deteriorating in the second half of 2012. Ultimately, this is what led to the Board's decision to accept Frank's resignation. That being said, there is no management crisis at the Soft Discounter format. We have a Management Team in place, who will continue to run the day-to-day activities at the Soft Discounter under my direct supervision, and I'm being supported in this task by both the new CFO and our Head of Strategy.

As we've discussed on earlier calls, we developed a three-point initiative in fall for the Soft Discounter format that focuses on shelf availability of the 500 best selling items in the assortment, increased focus on fresh fruits and vegetables to ensure quality, and also increase the footprint of the category in these stores, and a focus on store appearance, which the team will continue to roll out. We also will continue with the plans to increase the number of regional supervisors, so that they have fewer stores to monitor and can provide more support to store directors and improve accountability.

During past calls we have also identified an underinvestment in store refurbishments in core regions, as part of the decrease in X5's competitiveness in these regions, and we still plan to address this as part of our capital investment programme for 2013.

This concludes my comments on the recent announcements. Now, I would like to address some general points regarding the Company's strategy and future plans.

As we have stated in the previous trading update call, there is no change in the Company's multi-format strategy. The Board recognises that this presents the best opportunity to capitalise on the opportunities in the Russian market. Our Supervisory Board has reiterated its support of the strategy and their commitment to developing a national champion in the Russian retail market.

In terms of 2013 guidance, I think it would be more appropriate to wait until our Q4 and full year 2012 financial results release and conference call to update the market on our plans for this year. This will give Sergei, our new CFO, a chance to assume ownership of this new brief and for both of us to lay out in more detail some of the initiatives that we see as fundamental in delivering the growth we have planned for the year.

Now, regarding the Q4 results, I think overall the results were in line with our guidance for net retail sales growth. We did a slowdown in the 10% run rate we posted for net sales growth in Q2 and Q3, primarily due to the Q4 results of the Soft Discounter format.

Regarding our expansion, we delivered 800 net stores in line with our guidance; however, our net selling space grew by 14%. The main reason for this was a decrease in selling space as a result of having closed two hypermarkets and the downsizing of a third, which amounted to an approximately 20,000 square metre reduction and materially affected the net selling space growth.

Looking at the individual formats, as I've stated earlier, we have seen positive momentum at the Supermarket and Hypermarket formats in the second half of 2012. In Supermarkets we have seen positive trends in sales growth since August 2012 and like-for-like sales results were positive in Q4, the first positive quarterly like-for-like results this year for Supermarkets.

In Hypermarkets the positive results are visible in the reduction of the year-on-year decline in total net sales and like-for-like sales results, which are much improved from double digit declines in the first nine months to low single digit in Q4 and, as you can see from the presentation, the monthly trends look very positive. As we commented earlier, we have seen a deterioration in the results of the Soft Discounter during the second half of 2012.

The year-on-year monthly sales results have been declining from 21.8% in June to 8.1% in December. Like-for-like monthly sales dynamics have been in decline after peaking in June and they are now in negative territory for November and December. This is primarily due to an increase in competition in our core regions, the aging of our store base in the core North West, St Pete's, and Central Moscow regions, and operational issues with logistics leading to poor service levels in select regions. We will continue to address these issues through the format's three-point plan focused store refurbishments and improved accountability, which I discussed earlier in the call.

During our Q4 and full year financial results conference Sergei and I will provide you with more details on the initiatives we will be implementing operationally to improve results. We will not be providing specific details on these during this call, so please take this into consideration during the Q&A session.

Finally, in the process of closing the Company's 2012 accounts, we have determined that we will record a non-cash property plans and equipment impairment charge in the fourth quarter of 2012. The impairments will be carried out in accordance with IAS 36 impairment of assets and comprises impairments to certain non-performing assets, equipment, and the Kopeyka brand. Initial estimates are that the impairment charge will be up to RUR 16 billion. The impairment charge is a non-cash item, which will not affect X5's EBITDA or the Company's key credit metrics. The impairments also have no impact on the bank's credit arrangements, covenants, or bonds.

Operator, we are now ready to start with the Q&A portion of this call.

Questions and Answers

Nick Ashworth – Morgan Stanley

Hi, good afternoon, everybody. Thanks for the opportunity to ask questions. I guess my question is around the Soft Discounters and looking at the numbers that you provide on the website and, in particular, if you could provide a little bit of colour. You talk about the logistics issues and the low service levels at the distribution centres. Can you provide a little bit of color around what's happening and why those service levels are down, and what the historic problem is? And then does this impact your ability to grow that part of the business through 2013 if the focus is very much on trying to turn around that business?

Gregory Madick - X5 Executive IR Director

Yes, I think we won't be going into detail about the initiatives that we will be implementing to turn or to address issues of logistics. That's something that we will be talking about on the Q4 and full year financial results conference call once Sergei has, as we said, time to look at and develop his brief as the CFO, so this is also for all of the other listeners who are waiting in line to ask questions. We won't be providing much detail on those types of initiatives during this call, sorry.

Nick Ashworth – Morgan Stanley

All right, understood, so will you be able to provide any sort of guidance for 2013 now, or, just to be clear, you're going to give nothing and then we wait for the call in March for the first – for the guidance for '13?

Gregory Madick - X5 Executive IR Director

Yes, that's correct. As we said during the conference call, we won't provide guidance on 2013 estimates now.

Nick Ashworth – Morgan Stanley

Okay, perfect. I'll let other people jump in. Thank you.

Maria Kolbina – VTB Capital

Yes, good afternoon. I have a few questions. First of all, you saw some improvement in the traffic in Hypermarkets and Supermarket business. Do you think you are on a recovery track and trend and you think that these results are sustainable? So that's the first question. The second question basically in the same territory; what has happened to the Discounter business in the fourth quarter this year, because traffic is down as low as 5% in the [minor] zone, and overall why have we observed such declining trend in December compared to October? Was it because of some lower marketing activity, because inflation seems to be at the same level? And the third question, can you once again elaborate on the nature of the impairment loss that you plan to record in the fourth quarter account? So that's it, thank you.

Stephan DuCharme – X5 CEO nominee

In terms of the Hypermarket and the Supermarket formats, yes, we are pleased with the results so far. We are taking it one month at a time. Looking forward, as we said, we're not going to give any guidance, but we are hopeful that things will continue,

Maria Kolbina – VTB Capital

So you see it as quite a sustainable – the sustainable trend?

Stephan DuCharme – X5 CEO nominee

As I said, one step at a time, but the trend is definitely in the right directions...

Maria Kolbina – VTB Capital

And with regards to the Soft Discounters, then?

Stephan DuCharme – X5 CEO nominee

Yes and as regards to the Soft Discounters, none of us is pleased with the results. We are looking in more detail into them, including myself personal and Sergei Piven, the new CFO. It may be down to a combination of factors, including our competitiveness position in the two core regions. It could be related to the somewhat aged asset base in those same regions. There may have been an issue with communication towards the end of the year. We are analysing all of

that. Once we have completed our analysis we will tie that into a programme that we're already in the process of defining for this year and we will come back to you with more results in March.

Maria Kolbina – VTB Capital

Okay.

Stephan DuCharme – X5 CEO nominee

Regarding the impairment charge there is no link whatsoever between that and the Discounter performance in Q4. This is a technical matter that does in some ways relate to the less than satisfactory overall performance in 2012, but is not specifically linked to the Q4 Discounter performance.

Maria Kolbina – VTB Capital

No, that's – that I fully understand. I just want to get – to understand the nature of this impairment. It's PPE, or – so can you – I understand there is no link between Discounters and impairment.

Stephan DuCharme – X5 CEO nominee

It's property, plant and equipment including, for example, the Kopeyka brand, writing that down to zero for the obvious reasons that we are currently not using that brand anymore.

Maria Kolbina – VTB Capital

And it means that this was reflected as investment property on the balance sheet that you have now for the [free valued]? So it's...

Stephan DuCharme – X5 CEO nominee

I'm not in a position to answer that. Sergei is here, but I'm not sure he's into the detail of that at this point, but it's an adjustment to PT&D.

Maria Kolbina – VTB Capital

Okay, so if you can come with more details on that maybe in an email form that would be very useful. Also, the last question with regards to the monthly to four months in the fourth quarter, so can you provide any comments why sales were that much [down], from 10.1% to 6.8% in December, and December of 2011 doesn't seem to be the very high-base effect, so any comments on that front?

Stephan DuCharme – X5 CEO nominee

Can you repeat that please?

Maria Kolbina – VTB Capital

Can you provide any comments why sales growth for the Company in the fourth quarter in between the months have slowed down from 10.1% in October to 6.8% in December? So can you provide any justification for that; less aggressive marketing campaigns with the customer and some other reasons like weak operational performance? So can you talk more on that front?

Stephan DuCharme – X5 CEO nominee

Most of the impact of that is obviously coming from the Soft Discounter performance and that is something we are looking into more closely at this point.

Maria Kolbina – VTB Capital

So you think you were a bit unprepared for the Christmas sales in December?

Stephan DuCharme – X5 CEO nominee

I wouldn't state that as a specific reason, no.

Maria Kolbina – VTB Capital

Okay, thank you very much.

Patrick Shields – Wood & Co.

Yes. Well, I guess I'm going to follow on what Maria has been focusing on and looking at. I think we all applaud the measures that have been taken in Hypermarkets and we're seeing some real positive turnaround there, and clearly Supermarkets has been performing better in the fourth quarter, but I think the problem that we have is – the market community, looking at you guys, is that the issues of Pyaterochka have been known for some time and it's not as if this is just a fourth-quarter manifestation. On previous conference calls, both prior to your assuming the CEO's role and subsequently, we've talked – whether under Frank Mros's stewardship or, more generally, about what needs to be done at Pyaterochka, and I just wonder whether, given the acceleration and the rather precipitous acceleration in terms of negative traffic numbers, is there – we need some help in trying to understand that. To say that you've got an aged – you've got – it's an aged store base and there are still some issues in terms of stock availability, we're seeing a real acceleration in traffic attrition, which is a disturbing trend in itself. At the same time, and this has been the subject on previous conference calls, [where] there should be at least some positive like-for-like benefits accruing for the Soft Discounter format from the fact that those old Kopeyka stores are now running on better sales density, so surely you have some view on what your customers are saying. Presumably, at the store level and the regional level you're in touch with some of your customers, so what is it that is still misfiring, given the fact that for at least the last three months you've been trying to focus on some short-term measures to support the performance of those stores, because, minus 8% traffic like for like for December, in what should be a pretty good month for you, is a pretty significant negative trend? Have some of the issues that you were trying to address [audio] even more problematic? Has it been shelf-availability that's been proving itself more problematic? Where are the bottlenecks in the performance of Pyaterochka?

Stephan DuCharme – X5 CEO nominee

Patrick, I appreciate that some of these matters have been taken up on previous calls, and we've talked through during those calls what we felt some of the issues were. We brought someone on board in June to tackle those issues and other issues. We were not satisfied with the performance in tackling those issues. We cannot exclude that that contributed to the performance in addition to having tried to address those issues. At this point unfortunately I would not be comfortable laying that out in anymore detail, because I don't think it would be fair to previous participants, nor to those who are trying to tackle this issue at this point.

Patrick Shields – Wood & Co.

Okay. I'm happy to accept that, but I guess I accept it under the circumstances. In terms of given how central this is to the performance of the Group overall, what do you want to do in terms of repopulating the management team of Pyaterochka? Are you looking for a new GD? Do you feel that the existing team is capable of driving the business forward? Obviously, Frank brought in a couple of guys to support him in his efforts. Have we come to the end of management change there, or do you expect to be able to try and find somebody to run that business this year?

Stephan DuCharme – X5 CEO

On that point, Patrick, we built a team around Frank over the last six months. We give Frank credit to certain initiatives that were launched over the course of the period. We think some of them are beginning to bear fruit. We have not nominated anyone to assume that position for now, because we want to give the full team a chance to work together on a day-to-day basis; three Operational Directors, a Marketing Director, and eight Regional Directors. We will take this forward one step at a time. We think it would be highly risky given...and we are as aware of the fact that this is the biggest part of our business as you are, we do not want the risk of bringing in someone immediately. We think that is a higher risk than letting the current operational team taking forward under the guidance of Sergei and myself.

Patrick Shields – Wood & Co.

Okay, and maybe one last question on Pyaterochka. You have prevailing food inflation, whether you believe that Rosstat is the right number that reflects a basket or not, but it certainly looks as if your basket development compared to other convenience store operators around the Russian market was trending very significantly below inflation. How do we interpret that? Do we interpret that that you've been aggressively investing in prices across the assortment in Pyaterochka? Is there something specific in what you were trying to do with promotions in the fourth quarter? And given the fact that it doesn't seem to have had a particularly positive impact on traffic like-for-likes, are we to assume that you feel that your promotional campaigns have been misfiring?

Sergei Piven - X5 CFO nominee

Our Soft Discounters maintained the lowest price in the market and our Supermarkets are still the most affordable Supermarkets in the country, and in our Hypermarkets we also try to be very competitive on prices. We do invest in price and we...you may say that we are holding the price inflation down, which we also try to do it with our suppliers, so, yes, we do manage the price and we try to stay competitive in terms of pricing.

Patrick Shields – Wood & Co.

But do I understand...

[All talking]

Sergei Piven – X5 CFO nominee

Yes, I'm sorry, we also ran some very interesting promo campaigns, some of them we just introduced this year, which they were not there before, like for example average days in our Discounter formats, which was effectively buy one get the other one free campaign, which, of course, affects also the aggregate pricing level which you can see and our basket size.

Patrick Shields – Wood & Co.

Do we interpret from what you are saying that you are doing this therefore with the full support of the supply chain?

Stephan DuCharme X5 CEO nominee

Yes we try to do it, and to the extent possible we also manage our supply prices.

Boris Vilidnitsky – Barclays

Good afternoon, a quick couple of questions from my end. First of all following Patrick's questions regarding the ticket prices that you mentioned and it does look like you are raising it slightly below inflation. Does that imply that we should expect some margin pressure over the near term as these marketing campaigns continue. That is the first question.

Gregory Madick - X5 Executive IR Director

Hi Boris, I think in terms of our margin guidance we don't see any need to change or update the guidance that we have provided on the margins.

Boris Vilidnitsky – Barclays

Fair enough, and in terms of competition, you notice that competition is accelerating in your two core regions. Could you elaborate maybe a little bit on that, is that in terms of pricing, is that in terms of marketing, is it in terms of finding locations, is it a battle for new potential customers or existing customers.

Stephan DuCharme - X5 CEO nominee

I would make two comments on that, one particularly in St Petersburg in terms of the battle for store openings, as you know we are not able to participate specifically in the city of St Petersburg, so we are coming under increased competitive pressure there and the city of St Petersburg is probably the most competitive market in the country. More generally I think we're just seeing competition on all fronts with different formats having repositioned, reinvested themselves and something that is forcing us to make sure we stay on our toes and do the same.

Boris Vilidnitsky – Barclays

What about the central region?

Stephan DuCharme - X5 CEO nominee

My personal assessment would be that the central region is not as tough for us as St Petersburg, first of all because of our ability to continue opening which we are at a rapid pace.

Boris Vilidnitsky – Barclays

There are some talks about cancellation of the 25% market share rule, how do you see your strategy changing if that rule changes, do you see yourself becoming more competitive again in St Petersburg because that would essentially allow you to open more stores there.

Stephan DuCharme – X5 CEO nominee

We will tackle that if and when that happens.

Victoria Petrova – Credit Suisse

Hello everyone, thank you for the call. First of all given the major changes in your management team, could we expect some sort of an analyst day, or some sort of communication with the market, opportunity for us to see these people, to ask them questions any time soon? I remember you were planning before in the different era an analyst day in spring. Is it still on? Does new CFO and CEO plan to talk to investors maybe at an NGR. I personally find it important given the lack of clarity regarding what is going on in the company right now. Could you first elaborate on that please?

Stephan DuCharme – X5 CEO nominee

Yes we have talked about an investor day here in Moscow in the past. We would be delighted to host one. We will be coming through with a specific date very soon. This is most likely to be after we have released our Q1 results. I am looking at Greg here which would mean hosting this type of a day second half of May. Yes, and we will come back to you with that specific date very soon and clearly both Sergey and myself would be part of such an investor day here in Moscow, and we will involve to the extent necessary desirable other members of the senior management team.

Victoria Petrova – Credit Suisse

Thank you very much it would be very helpful. My second clarification question, you were talking about decentralisation processes and this is what X5 has been talking about for a while now, how does this idea correspond to the fact that discounter format is going to be run by you.

Stephan DuCharme – X5 CEO nominee

Very interesting, very good question, actually it is being run on a day-by-day basis by the operational team. Furthermore we are including in those discussions the eight regional directors, because I think it is very important for us to hear from them directly what is happening in each of their respective regions and what they need in each region to improve performance. While there is some supervision and guidance from me for a limited period of time and we don't know how long that will be, we're actually maintaining that idea of decentralisation, both in terms of the team here out of Moscow that is running the discounters and the regional senior management. One of my main objectives as part of doing this is also to get a much better feel for that top management team here in Moscow and in the regions.

Victoria Petrova – Credit Suisse

Thank you very much, and my last question is related, have you identified the key problem in soft discounters. As Sergey mentioned you are the cheapest discounter on the street from the market data and some studies we get, consumer is price sensitive. Still you have one of the worst traffic on the street, so there should be something which basically keeps your customers from coming back to the stores. Have you identified this problem and do you think the worst times for X5 are over. It is more of a philosophical question, thank you very much.

Stephan DuCharme – X5 CEO nominee

If we start with the philosophy, we have more work to do. We have mentioned on previous calls that we thought we were halfway through a type of turnaround programme. I believe that that continues to be true. That doesn't mean we don't have work cut out for ourselves. We are taking it one format at a time. We are pleased with the initial reaction of both the hypermarket and the supermarket formats to decisions we have taken. We are displeased with the performance in discounters. There are a myriad of reasons that we are looking into. I tend to start in general when there is the problem with two very basic things and that is people and execution. My general experience is that if there is an issue with people or with execution that accounts for a large part of the problem, so this is one of the things we are looking at. We will come back to you and I can assure with more granularity of what we are doing in the discounter format in March on the call.

Patrick Shields – Wood & Co

Sorry to come back, you said right at the beginning of your comments that the supervisory board, the general statements are that you very much back the multi-format based approach, but you have also emphasised decentralisation and that [unclear] departure, that other departures have been related to the fact that process of decentralisation has come to an end. Does this also suggest that we are now talking about rather than integrated, a disintegrated series of businesses and does this suggest that at some point in time you will think about divesting one or other of the minority businesses in your portfolio. If the answer to that is no, where do you see the rationale or why are you so supportive of the multi-format based approach, given the fact that you have struggled with it hitherto.

Stephan DuCharme – X5 CEO nominee

We won't necessarily agree that we have been struggling all the time, we have been struggling more recently, but that is I guess a point for discussion. I can no longer speak for the supervisory board in that I resigned from it about ten days ago. What I can say is that at no time during the four years that I was on the supervisory board was there any discussion of divesting any part of the business. There has been and there is clear support for the multi-format strategy.

Point number two, when we say decentralisation we are not saying disintegration which I think is the word you used. I think what we are saying is we want four stronger operational formats, led by strong individuals who are closer to the customer, with strong execution in those formats which can take different forms depending on the type of the format, with strong operational controls run from the centre under the new CFO.

Patrick Shields – Wood & Co

This is a more difficult question and I hope you don't think I am being rude in asking it, but I am interested to hear your perspective. Clearly your appointment to the CEO comes after what we had understood had been a search to find a replacement for Andrey Gusev and that I think the market and I think some of the comments that we heard from you when you were in the interim position suggested that you were looking for a retailing man, somebody with a kind of industry and operational experience that could be brought into help drive what is obviously a very challenging project forward. My comments are made not to be disparaging of you, but just I wonder why the decision was made or what led to the decision to say well we don't need to bring somebody, from inside and instead you have decided to take on the mantle of responsibility.

Stephan DuCharme – X5 CEO nominee

Patrick your comments are not at all taken as being disparaging and there is no issue there whatsoever. Let me give you two answers, we brought in for two formats very strong experienced retailers to take charge of them. Unfortunately for a myriad of reasons it didn't work out in both of those cases. Making a more general comment the board in appointing me initially felt there was an important job to be done in terms of stabilising the team, in terms of getting a better understanding of the situation. In appointing me earlier this month a sense what I continue with that work of building the team, that I focus on people, that I focus on execution and I will of course be bringing in the right retailers into the right position as this develops.

My personal very strong preference is to work with internal people that we have in the company at the senior and the middle level. Part of the work that I am doing is identifying the right people for the right positions. Experience in general and over the last few months at X5 has shown that when we put especially the right internal people into the right positions we tend to see results more quickly. I wouldn't disagree with you at all that I do not have a long track record in retail.

Patrick Shields – Wood & Co

That is very helpful, thanks for being so open.

Suhail Suleman – Coronation

I know you are not wanting to provide any guidance for this year, but just as a broad overview do you see the prospect of store growth while the existing store base is being sorted out, as being more muted for the next little while, or do you still expect to continue with your long term store target that you have previous disclosed to the market.

Stephan DuCharme – X5 CEO nominee

Without giving specific items I would say not necessarily. We continue to see continued growth and we intend to participate in that growth.

Kalim Aziz – Armajaro Asset Management

Thank you very much for taking the time out today. I understand this is not an easy time for you. I am sure you have a lot more things to do. I wanted to focus a little bit about one of the major shareholders of the company, the main sponsor of the business as such, and trying to get a little bit of a handle on and understanding of how his involvement is now given the state of affairs that the business is today, not necessarily because of all the activities done by the management but because of market structure and the market competitive environment as well. What do you think or what is the opinion about the performance from an operational perspective of X5 as it stands today.

That is the first bit. The second bit I think I am trying to probably paraphrase some of the comments made earlier is that the problems or the difficulties or the issues that surround X5 are not as such scientifically difficult or scientifically difficult to find or resolve. They appear to be tedious, and things that are mundane but take a long time to implement. I don't seem to

understand the time it has taken to realise these issues and time it is still taking to come up with a fully-fledged plan that you can disclose to the market or we can see for ourselves through implementation.

The first question is related to the sponsoring shareholder and what is his view, what are the thoughts about the company as it stands today. The second is a little bit of colour on why is it taking so long to come up with a robust enough plan to see things or maybe it is a communication issue that we didn't understand the extent to which the problem was.

Stephan DuCharme – X5 CEO nominee

Thank you for the question. In terms of the, as you call it, I think sponsoring shareholder and in terms of the major shareholder, Michael Friedman is on the supervisory board. We are in regular contact with all supervisory board members. We have active support and involvement where we ask for it from all of those individuals; they visit us from time to time. I would not agree with the hypothesis that any of them are involved in operational management of the company.

Kalim Aziz – Armajaro Asset Management

Sorry sir, I didn't make that comment at all. I just wanted to understand how is he looking at it and what are his opinions.

Stephan DuCharme – X5 CEO nominee

In terms of the opinion of any member of the supervisory board, all I can say at this point is that the full supervisory board stands behind their strategy and stands behind the senior management team of this company.

Kalim Aziz – Armajaro Asset Management

I don't want to sound obtuse but the management has been changing quite recently, so which management team is the supervisory board supporting, the current one, or the one which was changed, which we also thought was being supported by the supervisory board. I am a bit confused here.

Stephan DuCharme – X5 CEO nominee

I fully understand the question, and someone who has moved from a board role to the CEO role I would say that I serve until the supervisory board decides that I do not serve. Any senior management serves at the request of a supervisory board. The team in front of you today has the full support of the supervisory board.

Kalim Aziz – Armajaro Asset Management

Thank you for that and regarding the issues that we are dealing with at X5 and...

Stephan DuCharme – X5 CEO nominee

I couldn't agree with you more, retail involves a lot of tedious issues, day to day, store by store, region by region, format by format, it is not rocket science, but it is an accumulation of lots of little things across a network of 4,000 stores in a fast growing environment, and a situation where potentially... I think it is best left at that. We are tackling a lot of those things in a decentralised way. we are launching certain experiments across the network, and as we see those results coming through on a more consolidated basis, we will know what is working and what is not working, and as I said earlier I think it will come down to a large extent to people and execution.

Kalim Aziz – Armajaro Asset Management

I understand – just a little bit more – I understand the concept of decentralisation. It is a good way of managing things if you have adults running businesses who are prepared to take responsibility, but there is also a concept of ownership, who owns the change, who is eventually responsible to make sure that things happen. As you mentioned there have been personality clashes with some part of, I have a great idea but when I want to implement it appears that I am hitting a break wall or I am not able to communicate type scenario has happened. Is there anybody in the company today who wants to own the change in the business, change for the better and who will that be?

Stephan DuCharme – X5 CEO nominee

To be very direct, I own that, the CFO does and so does the team that we are putting together down to each format, and down to each region and down to each store. This is a key consideration in a turnaround, ownership is key and I would fully agree with you on that.

Julia Gerasimova – Goldman Sachs

Two questions left, both on the management, changes in the management team. I guess my first question is just to make sure whether Mr DuCharme plans any other changes in the management team or I think the current management team is more or less stable, and the only thing you need is just to find a director for the discounters. That is my first question. The second question relates to this director of discounter format. I understand that the changes were like a week or two weeks ago, but what is the progress with the search of the new director for this format and I just wanted to understand whether you have any internal deadlines to find the new director. Could it be someone from the current operational management team which runs the discounter format right now? Just lastly, or maybe what are the chances that this format will be permanently supervised by the group of people rather than just by one leading director. Those are my two questions thank you.

Stephan DuCharme – X5 CEO nominee

Thank you. In terms of management changes we have a core group of senior managers. We have been working together in one capacity or another for a period of six months now. As the company adapts to current market situation, one can never exclude a change. As I said earlier my intention is to work with the team, the larger team that is in place, and to determine which of them are most appropriate for what positions and challenges as we go forward.

In terms of specifically the soft discounter format, the format is being run day to day by a group of individuals. It is not an ideal solution long term. The silver lining of the cloud is that individuals like Sergey and myself get a much better understanding of what is happening at said format also in terms of people, but most importantly in terms of results and issues that still need to be resolved. We have started a search. I will be honest in saying we are not rushing into it. We cannot afford to bring someone into that position who would fail. There is a risk of that, there is always a risk of that, so that in making any appointments we want to ensure that the appointment is a success both for the individual and the company and we will make the right decision at the right time, taking that risk into account.

Patrick Shields – Wood & Co

Sorry to keep coming back, just to kind of pick up on I think part of the question that Kalim was asking. We have known that the operating performance of the business, particularly Pyaterochka, is not something that has only become manifest in the last couple of quarters. It has been something that we had the first warning flags went up in the third quarter of 2011 if I

remember rightly, which was the time when we saw some contracting like for likes. I just wonder and you characterised Frank Morose's difficulties in implementing changes cultural. I wonder, is that a smoke screen, is that really going to encapsulate everything. I am an Englishman so it is difficult for me to judge from the outside and I take onboard what you say about some of the challenges of doing business in Russia. Frank also joined a business that was in a process or change that moved from the most critical move from back margin to front margin, if you want to describe it like that or from a vendor driven to a customer focused type of retailing business etc. That seems to be a kind of a major and very important strategic change in the way that the business model runs, but it seems to be one where you have the most significant difficulties in executing, and I just wonder does that reflect the fact that there was resistance within the operations to that change, because presumably in a business that was very close to its suppliers, maybe that was something that people preferred working in an environment such as that. to me it has to be more than cultural, Morose came with a significantly hard nosed reputation certainly from what I know of his time as a manager of retail businesses in Germany. He wasn't, as I understand it a walkover, he was quite a tough man with an operational reputation. I just wonder where the kinds of points of resistance were and whether that reflects the fact that turning the business around, i.e. creating a new culture for the Pyaterochka business from the shop floor up is readily achievable.

Stephan DuCharme – X5 CEO nominee

I would argue Patrick that when change is well described, when there is guidance, when there is sufficient education on the necessary change, it is actually possible in Russia to implement such a change with guidance and with a bit of corporate discipline. I would not take it all as a given that there was a resistance in there was a resistance in the discounter format to some of the initiatives that have been introduced and that I guess were introduced as early as the beginning of 2012. If there was a resistance it may have been to individuals, but not to new ideas.

Patrick Shields – Wood & Co

You're quite hopeful that despite the fact that we still have manifestly very poor trading results, despite the fact that we don't seem to have made much progress over the last four or five quarters yet, that that change is achievable.

Stephan DuCharme – X5 CEO nominee

If I didn't think that I wouldn't be sitting here.

[No further questions]

Gregory Madick – X5 Executive IR Director

Thank you everyone for joining in the call and as Stephan had said earlier we look forward to providing more details and guidance in the call in March for the full year and Q4 financial results.

Thank you.
