

X5 Retail Group FY 2013 Financial Results Conference Call Transcript¹

**7 March 2014
Moscow, Russian Federation**

Operator: Ladies and gentlemen, thank you for standing by and welcome to the X5 2013 financial results call. At this time, all participants are in a listen-only mode. There will be a presentation, followed by a question and answer session, at which time if you wish to ask a question, you need to press star one on your telephone. I must advise that this conference is being recorded today on Friday, the 7th of March, 2014. I will now turn it over to your first speaker today, Gregory Madick. Please go ahead, sir.

Gregory Madick: Hello. And thank you for joining today's call. Before we begin, I would like to refer you to the disclaimer statement in the financial results press release 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 will now turn the call over to Stephan DuCharme, CEO of X5 Retail Group. Stephan?

Stephan DuCharme: Thanks, Greg. And thank you all for joining us to discuss X5's fourth quarter and full year 2013 financial results.

Before we discuss the 2013 financial results, I would like to update you on the ongoing transformation of our business and where we stand in that process. I feel that we have made important progress in 2013. That being said, and as

¹ This conference call transcript was prepared by InterCall.

you know, we have a full agenda also for the current year of change initiatives that we aim to complete in order to establish the robust platform we need for sustainable growth.

In terms of our progress, there are a few areas in particular that I would like to highlight today.

First, the team. Looking back at 2013, I am pleased not only with the level of talent and leadership we were able to attract to X5 over the course of the year, but equally important with how this new executive board has developed and worked together, supporting one another to tackle the various change initiatives and operational initiative we rolled out during the course of the year.

Equally important, this teamwork and cooperation, along with a sense of responsibility has also developed within each of the formats, resulting in better execution, especially in regards to our back-to-basics retail initiative.

Nowhere was this more evident than in the fourth quarter, where planning and communication played a key role in maintaining a high level of product availability at our stores and operational execution in all areas of our business.

We are starting to see signs of a renewed corporate culture at X5, an ownership of our objectives, and a responsibility for our performance, as well as sense of pride in the work we do to satisfy our customers. This is being reinforced by regular internal communications on our change initiative and transparency regarding the signs of progress we are witnessing in our operations, both at the levels of the formats and at X5 in general.

Finally, we are committed to moving management and central office administrative services closer to the stores to better understand and support our retail objectives.

As an example, our X-Pyatnitsa initiative that we initiated in the fourth quarter enabled more than 1,000 central office employees, including all senior management, the opportunity to work in our stores, and we plan to continue this program into 2014.

Not only did this provide additional manpower during the high season, but much more importantly, it was a boost for morale and reinforced the idea that we are one team. It was also an excellent opportunity to collect valuable feedback on our operational activities and a forum to share experiences that ultimately will contribute to improvements in operations.

Second, the transformation. In terms of the X5 transformation, I believe the rollout of our new operational model was an important and necessary step to reinforce our multi-format strategy and to provide each format with the operational autonomy and tools to operate as separate business units.

In light of this, when we assist our operations and where we stand in the overall turnaround, I think it is appropriate that we talk about the formats individually.

Starting with Pyaterochka, I am pleased with what Olga Naumova, the format's general director, and her team have accomplished in 2013. We've improved the management of day-to-day operations by creating a new, cluster-based organizational structure that provides better visibility, accountability, and speed of reaction across the scale of Pyaterochka's operations.

Also, Pyaterochka's new dedicated, category management-based commercial structure and mono-format logistics pilot in the Moscow region have resulted in improvements to assortment, promotions, and customer communication, as well as improvements to service levels, all of which Pyaterochka's customers are beginning to react to positively.

These improvements have been supported by the implementation of SAP auto-ordering, which also had an impact on fourth quarter availability, as well as freeing up store directors so they can focus on operations and customers.

These initiatives combined with the new Pyaterochka re-branding and refurbishment program have improved the quality of the shopping experience and were key contributors to Pyaterochka's fourth quarter results.

In 2014, Pyaterochka will consolidate the gains achieved in 2013 and will continue to focus on back-to-basics retail, the store re-branding and refurbishment initiatives, as well as intelligent expansion in our current regions of presence – in our current regions of presence, excuse me.

It is important to remember that in 2013 Pyaterochka's selling space increased by 18.7 percent and we plan to start accelerating growth. This is in line with peer group growth rates for economy-class stores.

Moving onto Hypermarkets. In 2013, Svetlana Volikova, Karusel's general director, made further significant progress in stabilizing Karusel's operations. We focused on putting the right assortment and pricing strategy in place, which we are communicating to customers, as well as the necessary employee structure to support in-store processes and routines.

The format is also demonstrating its innovation by the introduction of self-checkout in one of its Hypermarkets in December.

The Karusel team successfully opened a flagship Hypermarket in Moscow's Metropolis Mall, after a complete refurbishment carried out according to our new brand book, assortment, and merchandising guidelines.

This store and the other regional stores we opened in the fourth quarter will help us determine the right model and mix of stores for further expansion of our Hypermarket format, as we work to improve the development strategy for Karusel in the first half of 2014.

Finally, at Perekrestok, I believe we are more or less in the same position as Pyaterochka was last year at this time in terms of the structural and operational issues we plan to address in 2014. However, we do benefit from the experiences we've gained in category management and the support of our new operation model, as well as having the format's leadership in place already since last September.

Janusz Lella, the general director of Perekrestok, is putting his team and organizational structure in place, including the creation of a commercial

department based on category management principles, which will complete a full-fledged category review exercise by the end of the second quarter.

The format's new team is addressing issues regarding positioning, assortment, and pricing, as well as the right store concept to support future growth, all of which we wish to surprise you with during the second half of this year.

Finally, I would like to add a few words on our new operational model. Our decision to further decentralize our operations has given the formats the tools and resources to deliver on their stated value propositions and we are beginning to live up to those propositions and meet customer expectations.

While we saw improvements across all formats in 2013, in regards to a better-defined and relevant assortment with improved communication, I think this was especially the case at Pyaterochka. Working under category management principles, Pyaterochka surprised our customers with not only a more modern assortment, but also a more interesting one, with better promotional offers and communication.

Our mono-format logistics pilot in the Moscow region, which has been in operation since the end of the second quarter, has demonstrated the efficiency of our new operational model. As we advised you at our capital markets day, based on a detailed plan and implementation schedule, we will continue to roll-out this model to other regions in 2014.

While we do not expect any significant disruptions from this process, we do acknowledge the challenges inherent in it and we will be executing the decoupling efficiently to ensure continuity of supply to our stores.

This decoupling process is also intimately linked with the execution of the respective supply chain strategies of the formats and will dovetail with the opening of various distribution centers in the second half of this year and continuing into 2015.

In this context, it is important to note that the separation is not expected to cause a material increase in Capex, as we planned to add capacity regardless.

Now this new capacity will come in the form of mono-format distribution centers.

In terms of our results in 2013, we feel that many of our initiatives began to crystallize in the fourth quarter. As we had said on previous occasions, we have an ambitious change plan in 2014 that we will have to execute properly.

That being said, with the right people and operational model in place, we have demonstrated that we are starting to execute against our strategic initiative. I am confident that we will continue to execute on these initiatives in the current year and the outstanding change initiatives required to complete our turnaround.

I will now hand the call over to Sergey Piven, X5's CFO, to comment on the key drivers of our fourth quarter results.

Sergey Piven: Thank you, Stephan.

To begin, I would like to make a few brief comments about the macroeconomic environment before we get into the 2013 financial results. Judging from the economic data in Q4, January 2014, and some preliminary February numbers, it is clear that we are seeing a softer consumer environment in regards to both sentiment and key consumer metrics like slower growth in real disposable income and real wage increases.

This has manifested itself in lower year and year growth rates for retail sales for the industry and especially food retail during this period.

However, we did not see any material impact from this in our results in the fourth quarter or in the start of 2014. This may be due to the fact that our back to basics initiatives supported by the new operating model started to gather momentum in the fourth quarter and negated the effect of negative consumer trends.

Also, although some metrics are slowing down, unemployment levels are still low and real wage is growing. We are not seeing any deterioration in our

check, which may suggest improvements in basket composition as a result of expanded assortments and no trading down trends by the customer.

And the decline of ruble, which has been exacerbated by the events in the Ukraine, has not directly impacted our operations yet. This will impact our cost to some degree, as there is a foreign currency-based component to our cost base. However, we believe this will eventually be passed through to the customer.

In terms of the impact on inflation and food inflation, we think it will be difficult for the government to meet its stated targets of five percent plus or minus 1.5 percent. Our debt portfolio is 100 percent denominated in rubles, with 70 percent with a fixed rate, so our balance sheet is not exposed to the currency risk.

We will continue to monitor the macro situation, however, at this time, it has not caused us to make any changes in our strategy as regards to pricing or expansion.

I think it is also important to remember that one retail penetration is still relatively low in Russia, and that this and the inelasticity of food demand would support continued growth.

Moving on to revenue. So I would like to talk briefly about the drivers behind the revenue and LFL improvements we saw in the fourth quarter.

There were a number of factors which are sustainable and broadly apply to all of the formats, but I think they were most prevalent and had the biggest impact at Pyaterochka and were driven by a balanced marketing equation comprise of three key elements.

First of all, I would like to touch on prices. We did not increase prices in December. For several years this had been part of our holiday – this increase has been part of our holiday strategy based on the assumption that the consumer does not know, care or notice high prices during the holiday season.

This may be true on the 29th, 30th, or 31st of December, but the consumer definitely notices earlier in the month. By not increasing prices, consumers did not experience any negative surprises in our stores and we maintained consistency in terms of our price strategy positioning and consumer perception, and we are going to continue with that.

Second, the effect of promo. Our promo offer was a bit more aggressive in the fourth quarter, but also it was well planned. We think it was interesting and effectively communicated.

By working more closely with our suppliers, we were able to optimize the cost of promo actions, which, in turn, resulted in increase volumes of product sales. This win-win situation is a direct result of better communication and cooperation with our suppliers, which we will continue to focus on.

Third, the increased advertising. After analyzing our advertising spend, especially in Pyaterochka, we concluded that we were spending significantly less than industry norms. As a result, we increased the frequency and effectiveness of our campaigns to inform customers about the changes that are taking place.

At Pyaterochka, this was especially well timed to coincide with the new Pyaterochka re-branding program and all the initiatives launched by the new Pyaterochka team.

Other factors which were no less important related to improvements in availability and assortments. We think we were well prepared for the fourth quarter and the seasonal demand increase.

Stephan has discussed this in the earlier remarks, but it is important to note that this planning allowed us to maintain strong availability at our stores, not only throughout the holiday season, but also in the beginning of January of 2014.

Historical level store sales were not always well stocked after the holiday rush, but this year was different and we can see this in our sale results. In terms of assortment, we saw improvements across all our formats in many key

categories like fruit and veg, meat, poultry, fish, culinary, and non-food, to name a few.

However, at Pyaterochka, we also expanded the assortment to some extent and launched a weekly rotation of up to 50 items as part of the new Pyaterochka re-branding program. Based on empirical evidence, we have increased our assortment at Pyaterochka, we have seen a corresponding increase in sales, while decreasing the assortment historically has resulted in the opposite.

Finally, the improved motivation and morale of employees. During the quarter, we addressed imbalances in our compensation packages for certain store employees to bring us in line with the market and improve employee motivation. Also, the X-Pyatnitsa program provided operational support and improved morale in our stores.

As you can see, there was no one silver bullet that drove the improvement in our fourth quarter results, but rather a series of initiatives that came together as a result of our planning during the quarter and were supported by the right model and management team.

I think it is also important to recognize that these initiatives are all based on sustainable principles, and as long as we remain focused on execution and retail basics, we expect to see the improved results.

Moving onto margins. I think our gross margin result in the fourth quarter and for the full year demonstrates that we did not change our pricing strategy and confirms the effectiveness of our promotional activities, assortment decisions, and improvements in operational execution.

I believe there is still room to improve supply conditions, and based on the results of our recent negotiation campaign, we will see improvements this year.

However, the market will determine to what extent this will need to be reinvested into the customer.

In terms of EBITDA, I'm pleased to announce that we met our guidance for 2013 in terms of percentage, primarily due to our strong gross margin and continued efforts to control cost and SG&A level.

The two main components of our SG&A expenses are staff costs and lease expense. Regarding staff costs as a percentage of sales, we were able to remain in line with the previous year despite increased salaries for some positions and the addition of new stores. This was primarily due to our ability to optimize work schedules and the number of employees per store, as well as improved productivity and reduced our staffing levels.

In terms of lease expenses, we did see an increase and we should expect to see inflation of this expense in future periods based on changes in market conditions and general inflation.

Turning to our balance sheet, at the end of the year, our net debt to EBITDA ratio improved to 2.68 times as compared to 3.15 times at 31st of December 2012. We are still well within our covenant limit and access to capital is not a constraint on the growth of our business.

We generated much stronger cash flows from operating activities in 2013 than in 2012, primarily due to growth in EBITDA and a decrease in income taxes paid and the positive contributions from changes in working capital.

Working capital is one of our key sources of financing and an area where we are very focused on. We are managing this aspect of our business, but I think there is still room for improvements, most notably in our inventory and receivables management.

In terms of capital investments, we invested approximately 23 billion rubles, or just slightly below our guidance of 25 billion rubles, in 2013. And most of this went to expansion of our store base.

We increased selling space by approximately 13 percent in 2013, which was ahead of our guidance of 11 percent.

In October, we guided approximately 1,100 Pyaterochka refurbishments in 2014. We expect to do the audit for the full number of Pyaterochkas, but the actual number of refurbishments will be most likely lower than what we previously guided.

During the fourth quarter we determined that the key to successful refurbishments was ensuring that they were done properly, and this takes time and management attention. However, with each new refurbishment, we are improving the process.

The number of stores to be refurbished will be evenly paced throughout the year, and adjustments to the schedule do not pose any operational difficulties.

We will continue to provide updates on our process in this and other areas during the year. That concludes our discussion of the results.

Operator, we are ready to begin the question and answer portion of the call.

Operator: Thank you. If you would like to ask a question, then please press star one and wait for your name to be announced. If you wish to cancel a question, please press the pound key. Again, that's star one to ask a question. Your first question comes from the line of Brady Martin from Citibank. Please go ahead.

Brady Martin: Yes. Good afternoon. Thanks for the presentation. I have three questions.

First is on depreciation. We just noticed that depreciation charge Q on Q was down quite significantly in rubles. It looked like it was down about 15 percent. It was down 27 percent year-on-year. I'm just wondering is there an accounting change there? Is there something that I'm just not aware of in the business?

Second, this question is on Kopeka. Surprised to see the resurrection of this brand. I didn't know that you still had stores that were branded. I think a year ago you told us you had written that brand down to zero. There was an impairment charge. So jus wondering is there something – is that part of some new strategy?

And then, finally, just some more detail on Capex. You gave the guidance at 40 billion rubles. I'm wondering if you could actually give us a breakdown of how much of that is new stores, refurbishment, maintenance, et cetera – whatever breakdown you typically give.

Thank you.

Sergey Piven: Thank you for your questions.

On the depreciation charge, the differences are mostly related to impairment. There is an impairment movement every quarter, sometimes up, sometimes down. So all the – there were no accounting changes there.

If you want to have more detail on this particular item, I suggest you contact Greg at a later time. He will provide full details on our depreciation impairment.

On Kopeyka, we do in fact have 39 of these stores. They are part of our Express retail small format. So this is not the Kopeykas you knew before the acquisition. This is a small – a small store which is – which is part of the Perekrestok Express retail chain.

We have always disclosed them as part of our convenience stores.

In terms of Capex, the details on the Capex are in our presentation, but just to refresh them, for 12 months of 2013, we spent on new stores about 63 percent of our Capex, about a quarter of our Capex went to reconstruction and maintenance, and the rest went to IT and logistics.

Brady Martin: OK. And actually on Capex, this question is for 2014. Is this breakdown going to be significantly different?

Sergey Piven: I think we will update our understanding of Capex as we move towards finalization of our refurbishment program, which of course is a big driver.

But we do indeed continue to open new stores, so the major portion of our Capex will go there, for sure.

Brady Martin: Thank you.

Operator: Thank you. Again, it's star one if you wish to ask a question. The next question comes from the line of Maria Kolbina from VTB Capital. Please go ahead.

Maria Kolbina: Yes, good evening. Once again, thanks for the presentation. I have a few questions. First of all, can you comment on January and February sales growth numbers, at least tell us about the trends that you see in the beginning of the year? That's the first question.

And the second question is on your refurbishment program. How many stores have you refurbished year-to-date? And if you can provide some details on how good improvement and like-for-like sales growth was for these stores?

Sergey Piven: OK. First of all, about January and February, we will comment in detail when we have a conference call for the first quarter. But we – what we can say about the conditions in January and February, we see that there is increased competitive activity there, for sure. Our competition increased promo activity.

On the other hand, we also see that the measures which we have taken, which I just described during my presentation, the effect of these actions also continue, so the result will be in the balance of – somewhere in the balance of this two. Precisely we will comment at a later stage.

In terms of refurbished stores, we have currently 19 stores which are in the process of refurbishment. Twelve are already finished. For 12 stores, we finished the refurbishment this year. And there are many more on what we call the audit, which is part of our process for selection the store to refurbish. So the program continues.

As per result, they are going in line with our expectations in terms of sales. And we also think that we spent about the – we spent about the amount which we previously informed you about. So, the program we think is making progress.

Maria Kolbina: And any details on the sales uplift that you see for these refurbished stores?

Sergey Piven: They are in line with our expectations.

Maria Kolbina: And for 2013, how many stores did you refurbish?

Sergey Piven: About 100 stores.

Maria Kolbina: Thank you. Again, also, like I didn't see any presentation on the website for 2013. Will you be making any? I just see it for nine months and 2013, and you just made the reference to the presentation.

Sergey Piven: Maria, the presentation for the fourth quarter and full year 2013 financial results, as I am told, is in the financial results section of our website. It is accessible.

Maria Kolbina: OK, thank you.

Sergey Piven: Please try again. Thank you.

Stephan DuCharme: Maria, to add – this is Stephan. To add one comment to what Sergey just said, is the results of the 90 plus stores that we did in the fourth quarter that has allowed us to make this decision to proceed with stores in the first and second quarter.

Maria Kolbina: Thank you.

Operator: Thank you.

Our next question is from the line of Victoria Petrova from Credit Suisse.

Please go ahead.

Victoria Petrova: Thank you very much for this closure. I would partially repeat Maria's question. What is the likelihood for uplift from refurbishment you expect?

And I also would like maybe you to be able to comment what was the base effect in 2013 – in fourth quarter 2013 uplift in sales? And what was the contribution of your initiatives?

And my third question is related to your guidance. You are, Stephan and also Sergey, are naming a lot of very, in my view, sensible initiatives which actually should improve the results versus the dynamics you have here in the fourth quarter, now for 2014. But your guidance actually suggests lower margins than in 2013, and quite moderate growth.

Do you expect some extra-strong course of integration? And if you could be able to maybe give us some assessment, that would be very helpful. Or are you giving just initially quite conservative guidance, which would be relatively easy to meet, even in the environment of weaker ruble?

And could you reconfirm, 30 percent of your debt has a floating cost of debt rate, and how are you affected by the current market environment in this respect? Thank you very much.

Sergey Piven: If I may start from the last part of the question about – we do confirm that we have 30 percent of our debt is floating. But the increase in the interest rate is timed for certain periods. So these periods are not over. So, so far, we are not affected by this in our actual results, and we will see how the interest rates will move. So then we will be able to determine the final effect.

About integration, we do not have any integration costs because we do not have big acquisitions. So there is no...

Victoria Petrova: I mean the integration of your back to basics program or strategy. That's what I meant.

Sergey Piven: OK. Back to basics program is not a separate program, which is put on top of regular activities of the company. It is actually what we, as retailers, do. So there is no integration cost of that.

In terms of guidance, of course, when we do the guidance, we intend to meet it. That's the point. But I would remind you that we had – we are in the

beginning of the way. I would put it this way. We have seen first results in quarter four. We are very pleased with these results, but there is much more to be achieved, much more. This is a marathon; this is not a sprint. And that's why you have also to run very fast to be in line with competition.

So the end result is always some sort of a balance between our efforts to improve the internal efficiency and growth, versus the market and versus the competition in the market. So I would not be too optimistic about us beating our guidance. I think we gave a sensible focus and we stick to it so far.

Victoria Petrova: Thank you very much. And like-for-like uplift from refurbishment, could you give any – I don't know – idea for us?

Sergey Piven: Well, since you repeated Maria's question, I can only repeat my answer to Maria, which is it is in line with our expectations.

Victoria Petrova: OK. Thank you very much.

And the last, maybe, comment. Did you account for base effect yourself? How important was it in the fourth quarter? Because when I look at fourth quarter of 2012, there was some slowdown, which of course would be helping you also in the base of 2014, at least for the nine months. But have you looked at it somehow separately? Should we do the same?

Sergey Piven: Well, if I understood the question correctly – and correct me if I'm wrong – but like-for-like assumes usually that there is some base effect. So like-for-like results, they reflect the base. And of course, we take into account the previous year like-for-like growth for the period when we make our internal focus for like-for-like of our sales growth.

So yes, it was taken into account. But maybe I understood the question.

Victoria Petrova: No, no. It's fair enough. It's fair enough. Thank you.

Stephan DuCharme: Victoria, if I could add one general point to what Sergey has just said, all of the initiatives that we undertook last year and that we're undertaking now

are aimed to when they come together deliver sustainable, long-term growth and profitability.

We're not aiming to achieving one-off effects in any given quarter. And that is also why we've provided the guidance we have provided.

Victoria Petrova: Thank you very much. It's very clear.

Operator: Thank you. Our next question is from Nick Ashworth from Morgan Stanley. Please go ahead.

Nick Ashworth: Hello. Good afternoon. A couple of questions, if I may.

Firstly, I'll start with distribution centers. And I think, and I might have gotten a little bit confused, but I think it was during your talk, Stephan, you talked about the distribution centers coming on, mono-format type ones from the second half of this year. How many are you looking to open?

Stephan DuCharme: Do you want me to answer that or do you want to go through all of your questions?

Nick Ashworth: Maybe if you answer it and then we can – because there are separate issues.

Stephan DuCharme: OK. Well, in terms of distribution centers, and I'll start and Sergey will pop in when necessary, we have two mono-formats distribution centers currently in the pipeline for the second half of the year.

That applies to Pyaterochka. We have further in the pipeline for the next year, going through the course of next year, five based on memory. That does not include additional smaller DCs we may bring online for our bigger stores.

But for the second half of this year, a minimum of two, potentially three, and then more going into next year.

Nick Ashworth: And how many of the DCs that you already operate are you changing? Or are you – have you done what you wanted to do with those DCs that you're already operating?

Stephan DuCharme: In terms of the ones that we're operating, and you're right to combine the two question because it's definitely part and parcel of a larger plan, as you know, we started last summer with five in Moscow. That was the pilot project, which has demonstrated positive results.

At the beginning of this year, we have done a separation of DCs in the Samara region where we now have one operating for Pyaterochka and one for Perekrestok and Karusel.

Furthermore, we have transferred responsibility for five distribution centers in the larger Urals region, being Yekaterinburg, Chelyabinsk, and Perm, to Pyaterochka. They continue to serve the limited number of Karusel stores and Perekrestok stores in that region, but they are considered to be Pyaterochka warehouses at the moment.

Nick Ashworth: So the process is still ongoing for those?

Stephan DuCharme: The process is ongoing. It is a process which will continue through September-October, at which point, we will stop it, given the high season in the fourth quarter. Anything we are not able to do by the end of September we will push into next year.

Nick Ashworth: And then, has that caused disruption or are you doing it in such a way that it sort of – one at a time and you're just trying to limit?

Stephan DuCharme: We're doing it region by region based on the resources that we have and often the constraint is human resources. It's not a – there's no restraint in terms of financial resources. We simply want to manage this process carefully.

There will always be minor disruptions here or there, but we have spent two months, if not three months, planning this process quite carefully. But business is business; there will always be minor disruptions. On the other hand, we expect it to deliver good improvements in terms of service availability very quickly.

Nick Ashworth: OK. And then in terms of the IT, I think you mentioned that SAP was broadly done, if I understood you correctly, in the Pyaterochkas. Am I right in thinking that you're still going through the IT upgrade – I think it's JDA – in the Karusels and Perekrestoks through the course of this year? Or is that also done?

Stephan DuCharme: That is correct. And that will be happening in parallel with the rollout of the Perekrestok-Karusel supply chain strategy.

Nick Ashworth: OK. And then, finally, just on rubles. And I can't remember if you talked about this. There was a talk – someone said there was an impact on your cost base through the ruble depreciation. And I just wanted to get a little bit more color on which parts of the SD&A or the cost lines that that goes through, and how we should think about this.

Stephan DuCharme: On the ruble, I will hand it over to Sergey.

Nick Ashworth: Thank you.

Sergey Piven: Yes. There are two ways how we are affected. By far, the most significant effect would be through the cost of our purchasing. It's basically we know that we do sell and we do have on our shelves a lot of goods which are imported. Although X5, we ourselves do not import a lot. We import really a small fraction of what we sell.

But we do sell imported goods, which are brought into Russia by distributors and by importers. And, of course, there will be some pressure as Euro and dollar strengthen, and the ruble weakens, there will be some pressure on our purchasing terms and on invoice prices from our suppliers.

The second element, which is much smaller and it's probably not even material, is we have a certain portion of our rental contracts which have some clauses related to some triggers in exchange rate. That is a smaller – much smaller risk. We have it under control. We identified all these contracts and we watch it very closely. The biggest risk, as I mentioned, is from purchasing terms.

Nick Ashworth: OK. But I guess in terms of that risk, is it small in that you are buying things and selling things – I mean, the turnover of the good is quite quick, I guess.

Sergey Piven: Yes. Since it's affecting the whole market and the whole industry, we do not have the structure of our assortment any different from our competition. We think that eventually it will be passed onto the consumer by the industry. That's it.

Nick Ashworth: OK. And just in terms of the leases, how much of your least cost is linked to exchange rates, hard currencies?

Sergey Piven: We do not disclose this information particularly, but I assure you that the risk is not going to affect our result significantly if we don't have some major movements in the currency. In fact, it's in small double-digits, the number of the contracts which we have with this or that kind of currency clause.

Nick Ashworth: OK. Thank you very much.

Operator: Thank you. Your next question comes from the line of Natasha Zagvozdina.

Natasha Zagvozdina: Thank you very much. I'd like to ask a question regarding your personnel cost because it was one of the biggest drivers behind your profitability in the fourth quarter and for the full year actually. If I got it correctly from your numbers, in ruble terms, your overall personnel cost went up 6.3 percent. And from your annual report, we see that the head count, excluding outsourced personnel, went up like 2 percent.

Could you maybe split the drivers into efficiency improvements, which you mentioned, on the schedule in the stores, and what's happening with this outsourced labor? It comprised 21 percent of the total personnel count in 2013. How does that compare with the previous year of 2012, and how we should think about the personnel costs going into 2014? Thank you.

Sergey Piven: OK. There's a lot of calculation you've done. More generally we can comment that – I can just repeat what we said, that there were some improvements in number of employees per store and improvements in the efficiency. And if you need more detailed information, I suggest you contact

Greg with all this calculation. We'll update you exactly on the comparison versus 2012.

Natasha Zagvozdina: Thank you. I will do that, your advice. But still, the question is how much of this improvement on per store basis and builds efficiency? And kind of improving scheduling of labor you still see for yourself to add during 2014 it's pretty much done?

Sergey Piven: I'm sorry. Could you repeat the question? How much of these efficiencies we expect in 2014?

Natasha Zagvozdina: Yes. Do you expect this to continue – this scope for improvement of things?

Sergey Piven: Speaking about improvements, it's quite hard now to speak about that because there is obviously a pressure on labor costs, on salaries, for us. So the end result of our personnel expense as percent of revenue will be the balance between our efficiencies and the inflationary pressure from salaries.

So of course we'll do our very best to offset that. But I can't now commit that we have any improvements in our personnel costs as percent of revenue for this year.

Natasha Zagvozdina: What do you think you will be required to do with the wages to stay competitive versus the market in 2014? What will be the wage inflation?

Sergey Piven: We do not forecast that directly, but I think you can expect the wage inflation to continue as there is no indication that – about any sort of cuts in the government. So we just expect that the wage will continue to grow.

Natasha Zagvozdina: And I would also like to ask a few questions on the rent . It's 56.3 percent of our total selling space in 2013 that you had under lease agreements. Shall we expect that number to continue climbing higher as you open new stores in 2014?

Sergey Piven: I'm very, very sorry, but I have difficulties hearing exactly what you're saying. And again, I will just repeat the question as I understood it. I heard

that you are interested in whether the share of our lease space will grow this year. Am I correct?

Natasha Zagvozdina: Yes. Yes, thank you. I apologize for the line.

Sergey Piven: We expect it to grow slightly, as we – as it was – as it was in the previous year. The reason for that is, as you noticed, our fastest-growing format is Pyaterochka. And this is the format where it is quite easy to find rental space.

And where the payback from rental space is quite good. So just mathematically, Pyaterochka grows faster than other formats, then the amount of rental space is going to grow over, so is the owned space.

Natasha Zagvozdina: OK, thank you.

Operator: Thank you. Your next question is from the line of Patrick Shields from Wood & Co. Please go ahead.

Patrick Shields: Thanks very much.

Can I start off with a question about your working capital? If I look at fourth quarter movements, it seems as if you had a very big expansion in payables. That was partially offset by a bigger draw into inventories than last year was the case. And I think last year you characterized it as an assortment or inventory miss.

So I just wonder if you could comment on inventories in the fourth quarter?

But there was also a pretty significant expansion of receivables in the fourth quarter, as well. Net-net, you did very well out of working capital. I just wonder whether the big movements that we saw reflects a change in terms of trade?

I mean, clearly there was increased promotional activity. I wonder whether the movements in working capital reflect a more aggressive stance by your suppliers to want to do more promo business with you. And can you comment how that will evolve into 2014?

Sergey Piven: Thanks, Patrick, for the question. As I commented in the previous communications, the working capital is a balance of many things which are moving against each other quite fast.

In terms of inventories, as I mentioned, we were quite well stocked here in the high season. And for the first time during maybe several years, we had enough stock to cover the sales. And that was a conscious decision.

In terms of payables, it's also basically a math – if you buy more stock, you have more payables, because the working capital is negative. So we experienced that as well.

And in terms of receivables, there were various movements there, but you have to remember that part of our receivables are coming from the back margin. And if we have a compensation for our promo, then the back margin grows and you can expect some movements in trade accounts receivable.

I do not – I will not connect these movements with some sort of change in our strategy or with changes in supply strategies. I think it's just a reflection of the situation for quarter four 2013 and does not mean any significant changes in the future.

Patrick Shields: OK. And sticking with cash flow, I mean you've obviously made the point very clearly that generating cash is an important part of what you're trying to achieve within all of the changes that you're trying to make. I mean obviously the year-end net debt to EBITDA number was quite good.

But if I take your guidance at face value, which is relatively modest sales growth and flat, at best, margins – although it seems that you're low-balling so you don't spend the rest of 2014 guidance – in order to be able to not have to increase your gearing again, you're going to have to work hard to generate more cash out of working capital this year to be able to cover what is a doubling in Capex, if I understand your guidance.

Do you think you'll be able to do that – cover your Capex out of operating cash flow this year?

Sergey Piven: What we will do, for sure, is watching very carefully and matching – and managing Capex and working capital so that the company remains within the limits of sensible financial policy.

And Capex is a guidance up to, it's not a number which is cast in stone. So what I can promise is we will manage the financial position of the company so that it adequately meets the situation in the market.

And another thing is the market now and the economic situation is quite uncertain, so we will do our best to be prepared for that.

Patrick Shields: OK, clear. I think in your comments you talked about space growth at Perekrestok and desire to accelerate. I think you used the word accelerate.

If I look at your current guidance for 2014, I think you're talking about space growing about 10.5 percent. If you only replicate, if you don't grow Perekrestok and you don't grow Karusel, but you just replicate the amount of growth you achieved in Perekrestok in 2013, I think you get to about 12 percent space growth.

So can we assume that that 10.5 percent is a very low-end number?

Sergey Piven: What we have to remember is that we will keep the balance of growth from new stores versus the like-for-likes. And part of the like-for-likes are coming also from refurbished stores and refurbishment is still an important program for us. And frankly speaking, refurbishing a store is the same more or less in terms of management, resources, and operations as opening a new store.

So we are quite careful about focusing large growth in new stores because we want quality growth and we want quality reconstructions of our stores. So together we would see probably the similar number as for 2013, but I would not say that we have some very conservative guidance about the area growth.

I think the guidance is well thought through and you should take it.

Patrick Shields: OK. And then maybe just coming back to your employee numbers, which seem a bit of a mystery. Well, certainly they're a mystery to me how many people the Group actually employs.

I noticed on page 47 to your report accounts that you put in a note that you've updated the methodology on how you calculate the number of employees you've got, and we have the question of how many part-time or contract employees you employ.

Can you give us an idea of what the number of full-time equivalent employees are within the Group? And what do you expect to happen to that number in the current year? Because on the numbers that you presented in the report and accounts, your employees, average employees, have been flat for three consecutive years, but you've grown significantly.

I mean, how should we look at – I mean, this obviously has very important implications for how we look at productivity and how we look at your cost line expansion. But how many people do you actually employ? And is it going to rise in 2014 or not?

Sergey Piven: The number of people we employ is of course going to rise in 2014, as we continue with our expansion and re-opening new stores.

The numbers of X5 head count are given in our presentation. Page 22, exactly. For the end of 2013, it's 102,000. We also give the number of employees per store. Where you can see also the split, the average split between the home personnel and the outsourced personnel. And we give it by format, as well.

So if you refer to the presentation, you'll find the answers to these questions.

Patrick Shields: OK, thanks. And then, finally, if I may, sorry to take up so much of your time, on the store refurbishment program – again, this seems to be a little bit shrouded in mystery about how many stores you're actually going to be able to refurbish this year. And you've been running pilot projects on this program for some time.

I just wonder what the issues are in regards to being able to sort of target a specific number. I think there was a discussion at one point of over 1,000 stores to be refurbished in 2014. But there seems a little bit of reluctance to pin your – to pin guidance to a particular number. What's the impediment to having a clear idea of how many you're going to – how many you're going to refurbish this year?

Sergey Piven: When we were speaking about the number of stores to be refurbished next year, we were talking – yes, you're right, we were talking about that we do a pilot program in 2013. And we were mentioning the number of stores. And the number of stores in the pilot program has been about 100.

We were also giving some sort of a stretch target, mostly to ourselves, about 1,100 stores for 2014.

When – but as we all move forward and we gain the experience, we realized one very, very important thing for us was that the quality of reconstruction or the quality of refurbishment is much more important than the quantity. In fact, one of the learnings from our pilot program was that the results were very different from store to store, depending exactly on whether it was a quality prepared refurbishment or it was done less – in a less quality way. That was – that made very clear this difference.

So because we do the reconstructions not for reconstruction's sake but to achieve the results, we focused on what drives the results, which is the quality of planning, the quality of selecting the store, the quality of preparing and designing the process of this – and the quality, what's important also, of allocating the management resource to that and having the right management in place, including the store director.

So that's clearly the focus in 2014 and that's why you can expect, for sure, the number of refurbishments to be lower than what we told you in October during the invest today. The exact number remains to be seen because we actually put every candidate store for refurbishment through a series of filters and there are no guarantees that this or that store will pass the series of filters because we are actually quite picky.

But for you, I think, as analysts and investors, it could be the comfort, in fact, because we are not going to dig a lot of money blindly. We are very, very careful about shareholders' money and shareholders' funds in our Capex. So you can expect from us a quality refurbishment program, not just the program focused on pure numbers.

Patrick Shields: OK, clear. And I think you said that the cost is about the same as a new store, a rented new store. What is the average cost of a quality refurbishment net?

Sergey Piven: The average is about \$360, but it's also very – \$360,000, sorry, of course – but it varies a lot from store to store. Also because each store undergoes the inspection and the audit before we start the refurbishment in a store, and we take some modular approaches. So some modules in some stores we do, some modules in some stores we don't do.

So – but the average number is what I mentioned.

Patrick Shields: OK. And I promise you, the very last one for me. I mean, for once, certainly I'm responding to it in the presentation, you have given the monthly like-for-likes across the Group for January and February.

I think you said back in October that same-store sales improvement, like-for-like improvement, is like the canary in the coal mine of evidence that all of the work that you guys have done to get the Group and all of the banners back on track is going to be the demonstrable evidence.

Are we still in positive like-for-like territory in January and February?

Sergey Piven: We consciously decided to publish and comment on like-for-likes during our quarterly updates. So I'd just ask you to be a bit patient and wait until then. Please understand us – we don't want to be under pressure from the investment community every month. We are here, as I said, long-term. We are running a marathon. So like-for-like is, for sure, on the top of our focus. We think it's a very important metric and maybe the most important for the situation the company is in. But please just wait until the quarterly results. We want to discuss it at that point in time.

Stephan DuCharme: This is Stephan. I'd like to support Sergey on that comment. We are clearly, as an organization, very focused on traffic and like-for-like. We think it's the most important sign of the various measures that we're implementing being successful and we'll be very pleased to comment on January, February, and March in detail once those results are out.

To come back to what you were saying about the store refurbishment program, just one more – one comment from me on that. I do not think – we're not shrouding anything in mystery on that front. We did a pilot program last summer, which was to test different ideas in terms of the hundred stores we did in the first quarter, it was a full-fledged roll-out.

We felt it was wise at this state to take a step back and measure the results of that rollout of 100 stores. We're generally pleased with those results. But as Sergey has said, one of the things we realized was key was in the preparation of the stores.

Our stores are very varied in terms of size and location and shapes and the condition they're in, so the better the preparation, the better the selection of the stores we do, including selection of store directors who are worthy of the investment we make.

And we're continuing with the program actively on that basis. It is no longer a pilot project. It's a real project that is live that we're doing, but we will be doing less than the 1,000 stores we initially thought we would do.

Patrick Shields: OK, very clear. And I shall be patient and wait for the like-for-likes. And thank you for being patient with my barrage of questions.

Stephan DuCharme: Thank you for your patience. We appreciate it.

Patrick Shields: Thanks.

Sergey Piven: Thanks, Patrick.

Operator: Thank you. Once again, as a reminder, it's star one to ask a question. Your next question's from the line of Irina Karacharskova from Renaissance Capital. Please go ahead.

Irina Karacharskova: Yes, hi. I have two quick questions. The first question is about your OPEX. I just wanted to know how much of OPEX on your estimate use in absolute terms you spent on store renovation in 2013?

And the second question, on your renovation for Hypermarkets, you said that your number of Pyaterochkas would be less than you previously expected. And I just wanted to ask, did you change your targets for Hypermarkets?

Thank you very much.

Sergey Piven: In terms of OPEX, we do not expect any effect on OPEX because of reconstructions. And in terms of Hypermarket renovations, we now completed three pilot stores for renovations. One mentioned by Stephan was in Moscow. Then the other two in the regions. And currently we've finalized a program of how many other – how many other Hypermarkets will be renovated during this year, but I do not expect the number to be more than 10.

Irina Karacharskova: But in terms of absolute number of renovation expenses is spent this year for renovation – do you have some approximate figure ?

Sergey Piven: I'm sorry. Could you repeat the question?

Irina Karacharskova: I just want to understand how much of SG&A or some other (inaudible) expenses was spent on store renovation or you think was attributable to store renovation this year? I mean these 100 stores you renovated.

Sergey Piven: We did not disclose this number because, in fact, what we spent on renovation usually is the Capex rather than OPEX.

Irina Karacharskova: OK. So it's tiny.

Sergey Piven: So the OPEX is in our normal numbers.

Irina Karacharskova: OK, thank you very much.

Operator: OK. Your next question comes from the line of Victor Dima from Bank of America. Please go ahead.

Victor Dima: Yes, hi, good afternoon. Thank you for taking the time to answer the questions. I have a question about your stores, the renovation of the stores. When you spend \$360,000 renovating stores, what kind of paybacks do you have in mind as a benchmark? And how does that compare to new stores?

Sergey Piven: In any way we do not approve the store renovation if it has payback higher than five years, so it's higher than 20 percent – lower than 20 percent. And it compares favorably to opening a new store, but it's in the same ballpark.

Victor Dima: OK. Thank you.

Operator: Just another reminder, star one to ask a question on the phone line. Your next question is from Elena Jouronova from J.P.Morgan. Please go ahead.

Elena Jouronova: Good evening, gentlemen. Can you please update us on your supply chain costs in Q4? We don't really see them since you don't break out them above the gross profit line. Any idea of how they developed year-in-year or quarter-in-quarter, or as percentage of sales would be helpful. Thank you.

Sergey Piven: What do – well, we do not disclose the costs exactly. So I can just comment on the – on some general impressions from our supply chain in the fourth quarter. First of all, cost is not, of course, the only metric. And for us, as we're so much focused on sales, the most important metric was, of course, the service level. And we observed a good improvement in service levels by the end of the year compared to, for example, second quarter. So we are very pleased with the performance of our supply chain, especially in December.

I think that contributed to our successful, as we think, quarter four in terms of sales.

In terms of cost, we do not see any cost increases. Everything is in line with what we planned. And of course, what we need to take into account is, for the future, that our transformation program for logistics continues. So as Stephan

said, it's a big program so there may be some deviations here and there from that, because it's a huge change for us. But so far, we think our costs for logistics are under control. And we will do our best for it to remain under control.

Elena Jouronova: OK, that's clear. Thank you very much.

Operator: Once again, star one if you wish to ask a question. There appear to be no further questions coming through at this stage. Please continue.

Gregory Madick: Well, that concludes the call. I'd like to thank you for participating. And we look forward to speaking with you again towards the end of April when we release our Q1 2014 financial results.
Thank you.