X5 Retail Group N.V.
2021 CMD held on 27 October 2021
Edited transcript

Speakers:

- Peter Demchenkov, Chairman of the Supervisory Board
- Igor Shekhterman, CEO
- Vladimir Salakhutdinov, Director of Strategy
- Sergei Goncharov, General Director of Pyaterochka
- Vladislav Kurbatov, General Director of Perekrestok
- Ilya Yakubson, Head of Chizhik Hard Discounter
- Vsevolod Starukhin, CFO

Moderator:

Elena Konnova, Head of Corporate Communications

Elena Konnova

Good afternoon! On behalf of X5 Group I would like to welcome you at the annual Investor Day.

Just like a year ago, we hope that very soon we'll be able to meet without restrictions. But so far we're happy this online format allows us to have a bigger number of participants: our circle of investors has grown to 200,000 people, and today we have over 700 people registered.

First of all, I would like to draw your attention to the disclaimer on the screen.

In the first part we're going to discuss the strategy with our CEO and Director of Strategy, and then have a deep dive into our formats. We'll start with Pyaterochka's General Director, and after the break we will have presentations of the heads of Perekrestok, Chizhik discounter chain, and our CFO will recap.

There will be a Q&A session at the end. Please write your questions in the field below the player on your screen.

This year X5 celebrated its 15th anniversary. To mark the occasion, we updated our brand based on the feedback of our customers. We asked our customers about the options, and they have selected the one you see on the screen. And we also invite you to give your feedback and assess it after our video.

I hope this video has set the right mood, and now I would like to introduce our first speakers: X5 Group CEO Igor Shekhterman, Head of Strategy Vladimir Salakhutdinov, and the General Director of

Pyaterochka, Sergei Goncharov.

Online with us is also Peter Demchenkov, the Supervisory Board Chairman. Peter, the floor is yours.

Peter Demchenkov:

Ladies and Gentlemen, welcome to our Capital Markets Day, and thank you for joining us today. I will start by saying that the food retail industry has learned important lessons during the pandemic, and the main ones are on speed and flexibility. Through its willingness to adapt fast, X5 has created a safe environment in stores and distribution centres, maintained efficient supply chains and ensured food supply in all the regions of our country. I sincerely thank all our employees for their selfless work during the pandemic.

On behalf of the Supervisory Board members, I would like to stress our commitment to the strategy announced at the CMD a year ago. We are confident in the management team's ability to achieve its goals despite tougher competition in both the offline and online segments.

We also expect the company to continually strive for improvement and development of our business model, and adapt to ever-changing external environments. It is crucial for us to remain the best choice for our guests, suppliers and investors. Today, the management will elaborate on the changes that will take place in the near future

The Supervisory Board also keeps the company's sustainability efforts in focus. We warmly welcome the progress made in reducing our environmental impact, supporting social initiatives, as well as efforts to improve working conditions for our employees. We will continue to further improve our corporate governance structure. Both the Supervisory Board and management are convinced that the ESG agenda will be an integral part of the company's strategy and everyday operations.

An example of our commitment to sustainability values is the inclusion of ESG indicators in our management LTI programme KPIs. In September we also set up a Sustainability and Innovations Committee at the Supervisory Board level to coordinate and introduce best practices in sustainable development at X5. I would also like to thank both our institutional and retail investors for being our shareholders.

Now I am giving the floor to Igor Shekhterman, Chief Executive Officer of X5 Group.

Igor Shekhterman:

Thank you very much, Peter. Welcome to our traditional Capital Markets Day. Thank you for joining us. It's our second time online. It's another wave of the pandemic, and the safety of our customers and employees are our main focus. The level of vaccination among our people in Moscow is 63%, and it is over 50% across Russia. Yesterday we managed to arrange visits for some of you to

Pyaterochka and Chizhik stores in Moscow. Many Russian retail investors have joined us, and we're happy that they are interested in X5 shares, and today we're going to discuss the status of our Strategy adopted in 2020.

The main area of our Strategy is leadership in the food market. X5 is leading with a 13% market share. We have a comparable market share in online grocery. Our sales in digital channels have grown 2.7 times to RUB 35.2 billion for the nine months. Half of the adults in Russia, that is 60 million people, are active users of the loyalty cards in our formats. The ticket penetration is 65% to 81% depending on the format. The sales densities are still high, exceeding the indicators of the main competitors. Achieving technological leadership for several years, we've been doing a digital transformation programme, and the outcomes are visible. The effect from internal digitalisation will come up to RUB 20 billion at the end of the year.

We pay special attention to building up effective digital contacts with our buyers. The main tool is our application. The MAU (monthly number of users) of applications and websites has grown by 37% against last year and exceeded 17 million people.

It is very important for us to create value for shareholders, and our financial indicators allow us to perform up to the promises. Revenue for 9M 2021 was RUB 1.6 trillion, up 10.2% y-o-y. ROIC is expected to be above 15% for 2021; the three-year TSR in roubles is over 93%.

At the end of last year, we updated our dividend policy and started paying an interim dividend. The new policy better reflects the performance of the business, the Company's expectations for future growth and cash flow, and our planned investments. In doing so, it balances these factors against the leverage and allows X5 shareholders to receive more regular returns during the financial year. We are planning to pay dividends for 2021 at or above last year's level, which maintains a high dividend yield that is above the global sector average.

Sustainability and social responsibility are in our focus. We were the first Russian retailer to publish an audited sustainability report for 2020 in accordance with international GRI standards, reflecting our progress in achieving our goals. The new Sustainability and Innovation Committee at Supervisory Board level further underlines the Company's commitment to our ESG goals. In the last 12 months, we have created over 13,000 jobs.

There are no major changes in our strategy, but there is a clear focus on the performance of our mature businesses, Pyaterochka and Perekrestok, and expanding our presence at all stages of the customer journey.

In implementing our strategy, we rely on macroeconomic trends. I would like to focus on the assumptions that will be laid down in our budget for 2022. After a strong economic recovery this year, we expect GDP growth to slow almost twice, to 2.3% in 2022. Private consumption and external demand for commodities will remain the main growth drivers. Consumption will be financed by wages, social payments and credit expansion. Next year, the food retail market will continue to recover. The physical volume of food retail turnover growth could be just under 2%. Growth will be supported by recovery of real disposable incomes. Wages will continue to rise at a slower pace, and the main focus of government support will shift to pensions. Inflation remains the main threat to real disposable income growth. We expect the food inflation in 2022 to be at or slightly above 5% on average. Prices will rise, especially in the first half of the year, due to supply chain disruptions, labour shortages and rising production costs, as well as energy issues in Asia and Europe that will also have an impact on price dynamics in Russia.

Now let us talk about the Russian food market and its trends. The market continues to change rapidly, with some trends accelerating. Food inflation remains above the forecast level, at 8.1% in Q3, peaking at 9.2% in September. Price increases for some food products outpaced the rate of inflation. This is caused by labour shortages in a number of regions under quarantine restrictions; as well as higher commodity prices globally, which over this year have risen by a third and exceeded a ten-year high. In general, players in the food retail market are gradually adapting to the new realities of the pandemic. In the food retail market, we can see the same trends as last year. The market is consolidating, the total market share of the major three retailers is 27%, and this trend will continue. Almost all federal food chains started their online sales and are actively developing this area. The volume of the online grocery market in 2021 will be around RUB 380 billion, increasing 2.5x y-o-y, and in 2023 it will be at least a trillion roubles. But there is a market segment that is growing at a comparable rate to online – the hard discounter segment, where we expect the next big battle for leadership to unfold. We are fully prepared for this and will discuss it in more detail today.

But federal chains and discounters are not the only threat to our leadership. We are seeing an unprecedented increase in pressure on the segment from ecosystem players and marketplaces, for which food is the main tool for increasing the frequency of purchases. Digital players' shareholders are ready to finance their negative cash flow and billions in shrinkage. We expect it to continue in the near future. But our infrastructure capabilities, scale and tens of millions of loyal customers allow us to compete in the digital race at a much lower cost than our competitors. The market also expects a number of offline players to launch IPOs.

Another trend is the declining well-being of population in Russia, which is extremely determining their purchasing behaviour. There is more emphasis on the value for money, which we should certainly take into account in our strategy.

These trends pose three key challenges for retail and us, which we at X5 are ready to respond to by offering new opportunities for our customers and for the company's business.

First of all, the decline in household incomes and the increasing trend to trade down lead to the rapid growth of value formats, primarily hard discounters. The constant adaptation of our formats' CVPs to changing market conditions allows us to remain competitive on the price–assortment mix. This is primarily the case for Pyaterochka. Our aim is to maintain the right balance between the emotional content and costs of our stores, on the one hand, and a pragmatic approach to pricing and the price perception, on the other. Today we see opportunities to improve this balance.

The new concept of Pyaterochka demonstrates really good results in major cities. For development in other regions, we will adapt our stores, keeping the core values of our CVP, to provide the best value for money and the assortment. The update to Pyaterochka's CVP will include operational and capital cost cuts as well as deeper assortment analytics using big data. Sergei Goncharov will talk about that in more detail.

Another response to this challenge is our pilot hard discounter Chizhik. We have built a hard discounter model based on a prevailing share of private labels, minimal process costs and decent quality at low prices. The pilot demonstrated excellent results, and we plan to open around 2,000 Chizhik stores by the end of 2023, and around 300 Chizhiks will be opened next year, which will strengthen our competitive advantage in the market. Ilya Yakubson will shortly tell you more about it.

As to rising costs of resources and the pressure on the margins, we know how to deal with that, and we see opportunities for improving our commercial margins, further shrinkage reduction and further cut of logistics costs.

A balanced and reasonable approach to investing in new businesses allows us to maintain the company's margins at the current levels by improving the efficiency of existing businesses. We expect the EBITDA margin of our mature businesses to exceed 8% by 2024 and see no risk of decline in margin in the medium term. We will reduce our CAPEX for both new store openings and refurbishments.

The pressure from digital players is a threat, but we also see it as an opportunity. The market is actively investing in creating habits of buying online and using apps. We use these changing habits for growth of our online services. We have built up our own online technology expertise over the last two years, which allows us to be as flexible as possible and adapt to changing trends. Our unique infrastructure of over 18,000 stores allows us to expand our express delivery services fast and efficiently. X5 currently is a leader in the e-grocery market. We will continue to develop digital services around our customer journey, starting with the search phase, adding financial services, ready-to-eat food delivery and additional services, such as subscriptions, parcel lockers and in-store pickup points.

We are consistently building vertical integration of production and sales channels in our ready-food business. We added a dark kitchen segment to our own kitchen factory this year. This segment currently accounts for 5% of the ready-to-eat food delivery market, but its growth rate outpaces other online HoReCa segments and, according to our forecasts, this format will become increasingly popular. The revenue of our Mnogo Lososya is expected to triple in 2022, and in 2023 we expect the business to reach positive EBITDA.

What are our competitive strengths that will help us face those challenges? Strong, recognisable brands that rank among the top Russian brands, of which Pyaterochka ranks first. The active development of our online services and express delivery are proof of the flexibility of our business in a rapidly changing market environment.

Despite all of X5's strengths, we also see areas where there is potential for further growth. That includes adapting our CVPs to changing market conditions, focus on operational excellence and CAPEX optimisation, the corporate governance model which will allow faster decision-making.

A very important aspect of our strategy is sustainable development, and that's one of the priorities in our strategy. You know that we have defined strategic areas for our contribution to solving global problems, set ourselves specific goals and organised processes in the company to achieve them. First and foremost, it is our contribution to solving the climate change problem. We reduced greenhouse gas emissions per square metre of selling space by 9% last year and began the transition to renewable energy sources. The share of recycled solid waste in our own operating processes reaches up to 85%. Already 48% of our private labels are produced in sustainable packaging. We are increasing the share of healthy lifestyle products, with the share of fresh, fruits and vegetables already at 45.5% year to date. The well-being of our employees is always at the centre of our attention. We are targeting an increase in engagement; it has already reached 77%. We are focused on the safety and health of our employees during a pandemic and ensuring a safe work environment. In 2020, the company switched to a permanent hybrid format for office employees. We have actively developed social programmes for local communities, including a charitable programme for missing people and food assistance programmes. Here is a video with major initiatives in the key areas of X5's sustainable development. (The ESG video)

And now I would like to move on to our plans and targets for 2022. We expect to maintain a revenue growth rate of over 10% per year. We expect to open at least 2,000 stores next year, including about 300 hard discounters. At this pace, we are confident that we can deliver both double-digit revenue growth and steady ROI. Preliminary pilots show that the level of cannibalisation between Pyaterochka and Chizhik stores within a 500-metre radius is in the 1%–5% range. CAPEX is expected to grow below the revenue growth rate, and that includes investments in all the new businesses. We expect the profitability to be at least 7.2% in 2021.

The Company expects to continue the dividend payout in line with the approved dividend policy, while maintaining the net debt/EBITDA ratio below 2.0x. We plan to maintain the level of dividend payments irrespective of the tax treaty denunciation. Based on 9M results, the management plans to recommend to the Supervisory Board the payment of an interim dividend at last year's level.

Thus, the main tasks facing X5 in the near term as part of our three-year strategy are:

- Ensuring efficient management and development of existing formats and businesses;
- Diversifying the business by growing shares of other businesses. One of the key priorities is the expansion of our new hard discounter format Chizhik;
- Ensuring that X5's business model and infrastructure are prepared to respond quickly and efficiently to digital and traditional disruptions;
- Embedding sustainability practices into the company's business model.

As you know, in a number of major cities our share is close to the 25% threshold. It will be possible to compete only on efficiency. The main growth should come from the LFL growth of the stores that are already operating today. Our priority is the LFL sales growth and maximum focus on reducing operating costs. And that should be the main focus as early as next year, and we are making it part of our budgeting for next year.

Achieving these goals is supported by an LTI programme. It ensures consistency in X5's long-term goals and serves as an efficient mechanism for retaining management, whose work is a major part of our long-term success. The LTI also focuses on sustainable development for future generations.

The programme targets are:

- Leadership by EV/EBITDA multiple among public players in the Russian food retail market;
- Leadership in market share in the Russian food retail market;
- ESG indicators aiming to reduce CO2 emissions, increase the share of recyclable waste and use of sustainable packaging;
- In addition, the programme provides for minimum EBITDA margin and leverage.

Elena Konnova

Thank you, Igor. Now I would like to give the floor to our next speaker, Vladimir Salakhutdinov, Director of Strategy and Business Development. Has our strategy changed, and how is it implemented?

Vladimir Salakhutdinov

First of all, I would like to go back to the market where we are playing. Igor has already said that we have a strong composition of formats: that is proximity, Pyaterochka; supermarkets, Perekrestok;

and hard discounters, Chizhik. But we also have the e-grocery, which is part of all our formats, as well as a stand-alone online hypermarket format, Vprok. This is the segment we are playing in. Altogether this segment covers 47% of the Russian market, and in the next three years this will be 60% of the total market, and five years from today it will be 64%.

Right now we are focusing on the most promising, exciting and fastest-growing areas of Russian food retail, and we will continue to focus on them. Does it mean that in the next five years we'll only have the very same formats? The answer is no. We are closely following what is happening in the Russian market, what promising formats emerge, and we are ready to pilot new solutions.

And another important point Igor mentioned. Our colleagues often ask us about how much Chizhik and Pyaterochka will cannibalise each other. The answer is that there will definitely be customer flows between these two formats, the way it is now happening between Perekrestok and Pyaterochka. But both the proximity and the hard discounter segments will grow, and both will get the inflow of new customers. And we will grow with them both in Pyaterochka and Chizhik formats.

Let me go back to the slide on our challenges. Here I would like to dwell upon the second and the third challenge. We are going to cover in detail our core business and our efficiencies there later, but let us talk briefly about efficiency now. As was rightly mentioned, the competition nowadays is shifting towards competition in efficiency. There are many factors there, and one of them is digitalisation based on innovations. We have a lot to be proud of here. We have done a huge homework on that, and we have developed a wide spectrum of innovative solutions that ensure our efficiency and will do so in the near future. Let me give you an example – a self-checkout. We have developed our own solution, and right now we already have 11,000 self-checkouts that we have created ourselves. If you look at the traffic flow, 30% of all the checks are processed by them. Could it be more? Yes, sure; we have stores where over half of all the traffic goes through self-checkouts. It means that in the near future the cashiers will only service customers if the age control is needed – that is for buying alcohol, for example. For other cases self-service can handle most of the traffic, and we are completely ready for that. That is not the only solution. Let us watch the video about innovations at X5.

(The Innovations Video)

All of these solutions are already working at X5, and importantly the upside is still there, because some of them have been only recently implemented and have not as yet been rolled throughout the chain. So, we expect a major breakthrough in the next few years through these innovative technologies.

And now let's talk in more detail about the third challenge – that is, the pressure from ecosystems and other digital players, as well as our response to them. A year ago, we presented the strategy which included focus on strengthening the businesses of our chains. But we also looked at the customer from a different angle; we looked at the customer journey. We said that most of the time our customers already know what they want to buy, so they have already made their choice, and we were thinking about how we can support the customers end-to-end, and this is exactly what the ecosystem players are doing now, by offering a set of services and managing their relations with the customers in different segments.

We have announced a similar approach, and let me tell you about what we've done so far. I believe we have done quite a lot. We said that the customer's first step, the first contact with information on food is the media space; this is where they get their information. A year ago we said that the audience of ten biggest sites on food was equal to that of Channel 1 of Russian TV. We understand we have to build our relations with the customer once they start thinking about food, before they come to us. This is why we have built our media platform food.ru – that is, to become the first touchpoint for interacting with X5 in the media space. This is an exciting area, and we will show the video to you which will tell it all.

(Food.ru video)

Importantly, food.ru platform was created to strengthen our main business, to attract customers to our chains, to meet them at the very start and accompany them throughout their customer journey. For the platform itself, our goal is to become a number one food-related resource in the Russian Internet, and we seek to achieve that as early as next year.

Now let's talk briefly about our digital businesses. We have discussed them a lot over the past few months, and we have discussed how we view our strategy, and we have said there are no major changes in it. We are also saying that the digital component is probably the most important part of our future and the development of our business, and we are continuously developing it. Within digital we have several businesses. And one of them is 5Post. That is the last-mile logistics, a very promising and exciting project growing at accelerated speed. This year it will achieve a positive EBITDA, fully in line with our guidance. We view it as an important part of our portfolio, which also generates traffic for our stores because all of the 5Post pickup points are within X5 stores. Can we consider partnerships in this business? Yes, we can, but generally speaking we see how we can develop this business over the next few years and generate positive financial results for X5.

There is also an online hypermarket called Vprok. We said before that this format has a future only if we extend its categories and build a multi-category marketplace. An important thing to stress is that we do not have an ambition to invest in building yet another marketplace. We do not want to become a number five or six in the race among Russian marketplaces. So, we are looking at various partnership scenarios for Vprok. We are currently in negotiations, and in the near future we will decide upon our partner the way to go there.

As to express delivery, as we said before it is an important component of our chains' CVPs, and in essence it is their extension because the same customers, depending on the situation, would buy both online and offline, and we believe that we have to develop express deliveries within X5, but we want it to be a stand-alone business unit with clear, transparent economics. We will develop it as a business, and right now thanks to our infrastructure, technologies, scale and purchasing terms, we can do deliveries more efficiently than our digital competitors. We understand how to build this business with a positive financial result, and this is key to us, and we will continue to compete quite aggressively for a position in the digital sector to ultimately become a leader in this area.

And now a couple of words about a number of other services that we have added since we last spoke.

The first one is the bank. As you can see in the slide, very soon we are going to launch financial services – that is, X5 bank. What exactly are we doing on this front? On the one hand, we do not want to start a banking business and start playing on some field there. We are building the tool to enhance loyalty to our chains. It will be an institution that will enable all the customers to cover their main food needs at X5 and get unique offers for key bank products as well as a convenient payment service.

Besides, this will help us optimise acquiring activities in the stores. We have significant expectations for this project; we will develop in this area, and we are confident this will be an important impetus for higher loyalty and purchase frequency at X5 stores.

I would also like to cover subscription services. We believe that they will grow. We are testing different combinations of subscriptions. So far it is a limited test mode, but next year we will have a full-size offer within X5 formats.

And by way of finalising this part of the presentation, I would like to note that those are the services around the customer journey which are primarily aiming at the higher purchase frequency and loyalty of our customers. Each of these services have a very clear role within our model. We know which services generate additional traffic, revenue or loyalty.

But generally speaking our ambition is to have at least 40 million active users in these digital services. This will make us one of the biggest digital companies, and we also do this to improve our financial results, first of all our revenue. We expect additionally up to 200 billion of revenue from these initiatives around the customer journey. That is it from my side.

Elena Konnova

Thank you, Vladimir. Now on this optimistic note I would like us to move on to discussing our key business, Pyaterochka, and invite Sergei Goncharov to speak about it in more detail.

Sergei Goncharov

Good afternoon. I will start with the results we have achieved this year.

In our traditional offline business, we continue to demonstrate stable financial performance despite all the challenges in the market.

- At the end of September, Pyaterochka had 17,600 stores.
- Revenue for 9 months exceeded RUB 1.3 trillion – that is, almost 11% growth y-o-y.
- In the middle of the year, we had temporary logistical challenges which affected the entire Russian retail industry.
- We managed to stabilise the situation quickly; we decentralized the logistics function and empowered the regions more.
- As a result, by mid-August we had an uninterrupted supply and were ready for the high season.
- LFL sales growth for 9M 2021 was 4.1%, but as the logistics issues were getting resolved, we trended towards better LFL numbers – 7% in September and 10% in October. The sales growth in September was 12% and in October 17% y-o-y.

A few other key numbers:

- The share of private label in our sales grew to 20%.
- Pyaterochka shows high business efficiency. EBITDA in H1 2021 grew by 11% y-o-y, while EBITDA margin rose by 7 b.p. y-o-y to 8.4%.
- The EBITDA margin improved by 80 bps over the past three years.
- As you probably remember, back in 2018, we set ourselves a goal to improve EBITDA margins in the regions, and as a result, 9M 2021 to 9M 2018 EBITDA more than doubled to RUB 44 billion.
- The shrinkage in H1 2021 has improved by another 20 bps thanks to our efficiency measures.
- Labour productivity increased by 6.4% y-o-y due to initiatives we are undertaking to further optimise processes both in our stores and DCs.
- Despite staff shortage, we enjoy quite a healthy staff turnover rate, which we achieved by improving working conditions and expanding compensations with our employees' interests in mind.
- The number of active loyalty card users rose by 3% y-o-y.
- Our NPS today is at an all-time high.

Let me tell you more about our private labels (PL):

- Today PLs include over 2,600 products in over 150 brands.
- The PL margins in most cases are higher than the category average.

- Understanding the strategic importance of private labels, we are going to raise their share in our sales to 28% by the end of 2024, and make them a key competitive advantage for Pyaterochka.

To this end, we are changing our approach to private labels:

- We accept zero compromise between price and quality, and offer the best price to value in our stores.
- Development of innovative products based on consumer research.
- One supplier per product for local supplies within a region.
- We expect PL to contribute 20 bps cumulatively to our margins over 2022–2024.

Now let us see a short video about work with private labels in our company.

(A PL video)

Pyaterochka's digital services have opened up additional development opportunities for our business.

- In 9M 2011 the GMV for the express delivery service of Pyaterochka grew 4x y-o-y in GMV and 4.6x in orders.
- Express delivery service currently is a stand-alone vertical within our chain.
- The number of orders per day is over 40,000; the average ticket is around RUB 1,400, which is several times higher than the average ticket in conventional offline stores.
- Some reduction in the average ticket is due to our regional expansion. The service covers almost 800 chain stores and 15 dark stores.
- Twenty-five per cent of express delivery customers are new to Pyaterochka. Our current customers are starting to use delivery and continue to visit our offline stores as well, and their overall monthly turnover grew by over 30%. The plan is to go from bigger cities to smaller ones, to test the demand for this service. By the end of 2021, we expect to cover all the cities with populations above 500 thousand, and next year we are planning to enter cities with populations between 250,000 and 500,000. Our goal is to make each order cost-effective, while we are continuously improving the quality of services and cutting delivery time to the customer by streamlining processes in the store and in the courier service.
- Over this year, the pickup CPO went down by 30%, and delivery CPO by 18%. We expect to reach positive EBITDA in 2023. In Moscow, we see positive unit economics, and other regions are improving their efficiency while expanding rapidly. We launched this line of business in time, and during the pandemic we were able to offer guests this service along with offline shopping. As a result, for the second year in a row, Pyaterochka was named the most loved brand among all categories in Russia during the pandemic. We beat not only our format

competitors, but also local and international giants from other industries such as Sber, YouTube or Yandex.

In 2021, Pyaterochka also climbed to number 6 in the ranking of most expensive brands on the Russian market according to BrandFinance.

We continue to develop our mobile app as the key online channel for communicating with our guests. Today we are the market leaders in terms of MAU in absolute terms and growth dynamics. We get feedback from our guests via our app, and based on this feedback we have rotated or refined with the producers over 3,000 SKUs, and the average rating, for example for our private label products is 4.8 out of 5.

We use the app to rank the quality of the services, their experience in our stores, and we also leverage it to engage guests in our Spy Club initiatives.

The mobile app also serves as one of the channels for communication through the CVM system. We launched these analytical models for personalised offers and communications last year with the goal of translating mass promotions into personalised benefits for guests with loyalty cards.

Today the project has positive EBITDA; we reach out to 23 million people monthly with personalised communications through over seven channels, including in-store, such as checkouts, price checkers, etc. We expect the effect from reducing mass promos as early as 2022.

Now a couple of words about our new concept. We continue to roll out the new Pyaterochka concept; today it’s over 4,000, or 23% of the chain. The LFL revenue growth rate in stores with the new concept is double-digit. The NPS in the new concept is 1.4x higher than the network average. We continue to optimise our CAPEX. To date, the cost per 1 square metre for both new openings and refurbishments has gone down by over 30% against the costs in the pilot projects implemented in 2019. This is our key focus, and in order to optimise CAPEX and uplift the return on investment, we carry out complete renovations of stores with significant location upside and tough competitive environment, as well as in cases of significant wear and tear of floors, walls, utility lines. In other cases, we replace obsolete equipment without stopping the store operations. The economic situation in the country changed, the cost of materials and equipment went up, and the pandemic affected the economy and disposable incomes. Therefore, we are not seeking to renovate all of our stores by some particular date; instead, we are trying to keep the balance between the long-term investments and sustaining the target profitability. We are planning to reduce the cost of upgrading to the new concept by another 10% per square metre.

This year highlighted the key challenges that Pyaterochka faces today: to ensure LFL sales growth, reduce our CAPEX and OPEX, strengthen our logistics capacity in line with further business growth, cope with the labour shortage for both our stores and DCs as well as lower consumer purchasing power amid a general weakening of the economy.

These challenges have defined our strategic priorities for the near future. Our main focus remains on accelerating the pace of LFL sales growth through higher sales density.

We will deliver business efficiency through operational excellence and process automation, which will give us higher productivity and reduced need for operational staff. This includes our in-store process optimisation initiatives, new operating model and implementation of tools like WFM, ASMS, headcount calculator, development of additional payment channels such as SCO (self-checkouts), express scans, and etc.

We will optimise our CAPEX by reducing the number of costly refurbishments and cutting the cost per square metre. Given changing market conditions, in particular rising inflation and falling household incomes, we are optimising the cost of openings in the regions.

For our stores in the regions, we have developed a flexible format matrix with different sets of services, refurbishment and construction depending on a number of factors, such as their locations, traffic and guest needs.

Thus, the store CAPEX is based on a set of services, which are determined by the macro-regions. This will allow us to adapt the format to the changing market conditions as much as possible.

Elena Konnova

Thank you very much, Sergei. I would like to remind you that after the break we are going to talk about Perekrestok and Chizhik, as well as our financial performance. I would also like to answer one of the questions which was asked about the recording. Yes, we are doing the recording, and it will be posted on our website, and you will be able to see it.

Elena Konnova

Now we are on live, and I would like to introduce the team of our second block, and to remind you that after it we are going to have the Q&A session. Today in the second block we have General Director of Perekrestok, Vladislav Kurbatov; General Director of Chizhik, Ilya Yakubson; and Financial Director of X5, Vsevolod Starukhin. Let us start with Perekrestok. I would like to invite Vladislav Kurbatov. The floor is yours.

Vladislav Kurbatov

Good afternoon, ladies and gentlemen. Today my colleagues have told you a lot about what we were doing, what we are planning to do, and where we are going to as X5 and Pyaterochka.

Allow me to talk about Perekrestok. It is a Russian supermarket chain. According to the supplier survey by Advantage market research agency, for the second year running, we were awarded as the best partner among the top 15 food retailers.

Presently, we have over 980 stores; we added 75 new ones this year. During the pandemic, with all the restrictions, lower disposable incomes and crazy inflation rates, we have somewhat adjusted a number of new openings, but still Perekrestok is moving ahead.

We maintained positive LFL growth for the seventh year running. Especially so, we are happy about the positive dynamics of the traffic, and we are developing organically, and according to our guests, we are getting better in their perception.

Despite all the difficulties we faced over the past two years, our NPS is still growing. First of all, it happens thanks to our new emotional concept that allows us, on the one hand, to meet the demand of our consumers in ready-to-eat food, fresh produce, to provide more emotions and to make the lives of our customers easier and better.

Almost 20% of our stores are operating under the new concept, demonstrating 8p.p. higher LFL growth against comparable stores in the legacy concept. For over a year all new stores have been opened in the new concept.

EBITDA in absolute terms in the new stores exceeds the EBITDA in the old concept, reflecting both the increased sales density and the higher EBITDA margin, primarily thanks to redistribution of shares in the categories.

We're improving the assortment mostly focusing on high-quality private labels and introducing changes aimed at lowering CAPEX in openings and renovations, without losing attractiveness. Thanks to the introduction of functional solutions in our stores – for instance, self-service checkouts, electronic price tags, mobile workplaces – we can increase efficiency of our personnel and reduce the headcount. We are looking for new opportunities to satisfy the demand of a bigger number of customers.

Taking into account that one of our main competencies today is the category of fresh and ready-to-eat food, as well as in-store cafeterias, we are considering an opportunity to enter the proximity store segment with emphasis on fresh food, ready-to-eat and cafés. This will allow us to be closer to our clients and better meet their everyday needs. Our attention really matters for the customer. We are getting closer to the customer in a direct and indirect sense of the word.

Express delivery is an integral part of our CVP. We are delivering over 20,000 orders every day, and the number is growing. Last Sunday we delivered 30,000 orders. Today, express delivery is available in 576 supermarkets all over Russia. Before the end of the year, we're going to expand the delivery and click-and-collect services to over 100 cities and towns.

The positive EBITDA is expected in 2023, but Moscow and St Petersburg showed positive economics in September, which makes us quite optimistic.

Personalisation and feedback are now everyday attributes of our communication with customers. The assortment of healthy food and private labels is a differentiating factor, which distinguishes Perekrestok from other chains. We do not only offer an assortment of healthy lifestyle food, but educate customers through our communication about healthy habits.

The atmosphere and services in the stores facilitate shopping. Dedicated healthy-lifestyle zones in stores allow everybody to find what they want, saving time. We are striving to be the best store for a healthy lifestyle. Green Line is our main healthy lifestyle brand in private labels, and it is successfully scaled up in all regions. Besides, we are increasing the private label share in the turnover, and by the end of the year it's going to be 18%. We are also introducing the assortment and quality management based on the feedback from our customers. We received over 3 million customer ratings and reviews on products that we sell. Our plan is to increase the private label share to 27% by 2024. Within the private label assortment, we intend to develop high-margin products in the mid- and high-price segments; we also aim to outperform the competition in terms of private label NPS.

Ready-to-eat food is what makes us stand out among competitors, and you can buy both our own products and products from famous restaurateurs, such as Arkadiy Novikov. We are developing production utilising our existing kitchen factory (Smart Kitchen) and opening sushi and pizza points in our stores in partnership with Mnogo Lososya.

We intend to raise the ready-to-eat category share from the current 3.9% to 8.4% in 2024. The ready-to-eat category grows y-o-y over twice as fast as the chain overall.

This year the key challenges for Perekrestok are LFL sales growth; reduction of CAPEX and OPEX; traffic recovery, which is now lower than expected, especially in shopping malls; lower buying power against the backdrop of the weakening economy, and growing popularity of discounters and proximity stores; competing with online players, especially in express delivery; rising salaries due to labour shortages.

Operational efficiency remains one of our big priorities, and we realise that we should become even more mobile and efficient, and our value proposition should be clear-cut, reliable and emotionally attractive.

The speed of decision-making is the most important factor for us. Our new flat and decentralised management model that we developed and launched this July will allow us to be more effective than we are today.

In conclusion, I would like to dwell on the key strategic priorities for Perekrestok for the near future. Certainly, the main focus is on accelerated LFL growth driven by higher sales density. We maintain our focus on operational efficiency and digitalisation. Our goal is to be the first choice for ready-to-eat categories, private labels and healthy lifestyle products.

Thank you.

Elena Konnova

Thank you, Vladislav. Now I would like to give the floor to Ilya Yakubson, Head of the Chizhik project, by now, Head of the Chizhik retail chain.

Ilya Yakubson

Thank you very much, Elena. Good afternoon, good evening. I'm honoured to present today this new format; it's a hard discounter, Chizhik. In the past 10 to 15 years, the hard discounter image in Russia has been that of a dirty outlet, poor infrastructure, low-quality service and food products. Chizhik was created to break these stereotypes. However, it's better to see once than to hear a thousand times, so let's have a look at the new store.

(Chizhik Video)

Ilya Yakubson

A couple of words now as to what our format is about. Chizhik is a store with a floor space of 250 to 300 square metres; the total area is 400 square metres, where one SKU covers one need, with 750 SKUs across the assortment, and we think this is going to be the same in one or two or even five years. Fifty per cent are in-out products; 75% is the share of our private labels we are planning to achieve by the end of next year.

The CAPEX per store is RUB 7 to 9 million depending on the infrastructure we lease; the ROIC is up to 50% higher than major players' average. The productivity at our stores significantly exceeds that of other players. Sales density is 1.5–2 times better than at the best proximity stores. We have a seven-person team for up to RUB 550,000 of turnover, and EDLP – "everyday low prices".

A very important factor of our CVP is the price. Needless to say, we have low prices every day. Thus, we also say that the food basket of similar quality will always be 20%–25% cheaper than that of our competitors.

Another crucial feature is convenience. Our shop is not only convenient because it is small in size and allows you to shop fast, but thanks to one-SKU-per-one-need approach, the choice of a buyer is very simple, and we got very positive feedback from our buyers on that component of our value proposition. From the point of view of assortment, Chizhik covers 50 to 60 main customer needs, and we intend to keep it that way going forward.

The atmosphere of our shop includes a young team, a very simple but emotionally charged environment, and I would say it's quite a lively store. We considered social responsibility. We experimented and bought products in Chizhik for RUB 1,500 and spent the same amount at one of our competitors, and we had 35%–40% more goods bought in Chizhik, which means that we really are saving a lot of money for our clients, and not only money, but their time, too.

A couple of words about our private labels. We want our private labels to become our private brands at some point, because our goal is to make our private brands the market leaders in their categories. In three or five years, for instance, we want to make our Grinola number one green peas in Russia, or Karusel number one biscuits. We would like our private labels to be brands number one on the market according to Nielsen.

The way to achieve it is to cover three areas of development: number one is products. If we are to create a brand, this brand must have the quality of the market leader. The system of blind tests, which are conducted by the best marketing companies of the country, allows us to achieve this kind of quality.

Number two is packaging. One hundred per cent of our products should have shelf-ready packaging, which is very important from the point of view of saving on OPEX, and for creating an image of an emotionally charged and attractive shop. We also use batch packaging so as to have two to three SKUs of different flavours in the same logistical unit. Thus, we provide a choice for our buyers exceeding 750 SKUs.

Number three is the price. As I said about everyday low prices, we expect that the price gap between Chizhik basket and key market players will be at least 25%–30%. In the long run, we want private labels to be the key part of our differentiation. We want people to come to Chizhik not only because they will not find a lower price for this quality but also because they really want to buy this particular brand available only at Chizhik.

A couple of words about our key priorities. Our goal before the end of next year is to finish the first stage of building up a family of our private labels. By the end of next year, we intend to have about 450 to 500 SKUs of our private labels, which will be 70% to 75% of our sales.

The next area of our development is to create the necessary logistical infrastructure to support the rollout of 3,000 Chizhiks throughout the country in the next three years.

Elena Konnova

Thank you very much, Ilya, and we really believe in Chizhik. Now I would like us to make the financial recap and give the floor to Vsevolod Starukhin, our CFO.

Vsevolod Starukhin

First of all, I would like to welcome and greet all the participants of our today's videoconference, and particularly I would like to say thank you to investors and analysts that managed to join our visits to Pyaterochka and Chizhik yesterday. I think it was quite an interesting visit we had; thank you very much for your involvement and feedback.

Now let me briefly cover our 9M 2021 performance. We are really content with how our mature businesses continue to sustain double-digit growth and show high efficiency. Sales in Q3 grew by 11.7%; LFL sales, by 4.8%; EBITDA margin came to 7.7%. During the first 26 days of October, we can see high sales growth rates at 14.8% and LFL growth at 8.9%.

The 9M sales grew 10.2%, and the EBITDA margin was 7.6%. The 9M CAPEX growth was 5.2% y-o-y, and mostly it was spent on expanding the store chain and store renovations. For 2021, we confirm the guidance for the revenue growth of 10+%, and the EBITDA margin after LTI over 7.2%.

Let's now discuss the growth drivers and financial highlights of X5 for the coming three years. I will start with drivers of revenue growth. Revenue growth of mature businesses will be brought by the positive growth of like-for-like and new retail spaces. In the graph, you can see that like-for-like is the main driver of the revenue growth. Our sales density has the best growth potential in regions.

Pyaterochka will be the main driver and contributor to space growth. The discounter Chizhik will make a notable contribution to space growth after 2022.

In addition to strengthening its leadership in the moderately growing offline retail segment, X5 will continue to build its presence in the fast-growing online retail segment. The e-grocery segment capacity in 2024 will reach RUB 1.4 trillion, according to projections, or around 6.5% of total food sales in Russia. Based on 9M results, X5 is the leader in the e-grocery segment, demonstrating 2.7x y-o-y growth in online sales GMV. We intend to maintain our position among the top three players in the online segment by the end of 2024.

We estimate that the share of digital sales channels, as well as other businesses such as 5Post, X5 Bank, will increase to 5% of revenue in 2024, up from the current 2%, and we also aim to make this segment profitable.

The focus of our company is to continually improve efficiency. New technologies offer great opportunities to automate decision-making processes. In X5 stores, we rely on digital technologies for automating pricing and assortment. We are actively developing the automation of personalised offers for customers based on big data. We are also improving our CVM system to develop high-quality communications with our customers and personalised offers.

Efficiency is also being improved through changes in ongoing operations. Key operational efficiency initiatives include the digitalisation of in-store processes through the introduction of electronic price tags and self-service checkouts. Staff management initiatives will allow us to have the right staff in place at the right time, while delivering cost savings. Changes in in-store acceptance processes will reduce labour-intensive processes.

Our focus on these improvements allows us to actively meet the challenges of the market. For the 9M 2021 staff costs remained flat y-o-y, despite the strong growth in salaries in the market overall.

The use of modern digital tools for transportation and warehouse management ensures the efficiency and reliability of the Company's logistics operations. In 9M 2021 we managed to reduce logistics costs by 0.1p.p. We continue to digitise our supply chain with the implementation of world-class IT systems (WMS, TMS, replenishment, forecasting) using machine learning.

We expect further margin improvements through centralisation of recyclable materials handling, logistics services for suppliers, shrinkage reduction through supply chain straightening and end-to-end temperature controls.

An important factor in improving the margins of our operations at the individual format level is the Company's market share in various regions. We showed you these figures before, and they were updated, but the trends remain unchanged: regions where the Company's market share exceeds 10% have significantly higher sales density and EBITDA margins compared to regions where X5's market share is still insignificant. This is due to improved operational efficiency, in particular logistics optimisation, as a result of increased store density in the region, increased brand awareness and a better knowledge of the local market, tastes and preferences of local consumers, which enables us to expand local sourcing at more attractive prices.

In our relatively new regions – Urals, South, Siberia – our market share grew by 1% over the last 12 months, while EBITDA margin increased by 1%–2%, which confirms the thesis about the positive impact of new regions. In the course of the next three years, we intend to open over 7,000 stores including Chizhik. We expect 10% of these openings to be in Moscow, with the remaining openings in the regions, where the market share gains will translate into higher sales density and profitability.

Basically, our EBITDA margin is made up of a mix of formats. Pyaterochka has been and remains the most profitable one. Over the next three years, we will continue to work on efficiency improvements in each of our key formats with expectation of generating over 50 bps EBITDA impact from operational efficiency measures as well as measures to optimise in-store processes.

We expect a separate positive effect from digital transformation initiatives, increasing the digitalisation of in-store processes and eliminating human manual involvement. We also expect to benefit from the focus on increasing the share of private labels and direct imports. New businesses, such as 5Post, show impressive performance dynamics and will contribute positively to our overall profitability as early as in 2022. The 5Post target profitability is expected at above 30% of EBITDA margin. Other digital and new businesses will also deliver positive EBITDA, enhancing X5's profitability after the third year of operation in line with our targets.

These effects will also be partially reinvested in our prices taking into account expectations for macro and slowdown in disposable income growth, as well as supporting X5 CVP in the competitive environment. We separately highlight the impact of the new Chizhik hard discounter format, which is set to become profitable after 2024. The opening of around 3,000 stores will have a negative impact on profitability at 80 bps for the next three years.

Given the growth in online sales and the improving unit economics as well as the dynamic development of Chizhik, we target an EBITDA margin for the X5 Group in 2024 above 7%. In 2020, we demonstrated the results that showed that we were able to maintain high levels of efficiency despite the structurally challenging environment due to competition with online players and hard discounters.

Let us talk about the approach to managing our investments in the next few years. In mature businesses, we aim to improve our CAPEX, freeing up capital to invest in new business areas. Improvement of the CAPEX efficiency coupled with ambitious revenue growth will also allow us to reduce CAPEX as a percentage of X5 revenue overall, and we are on track to reach less than 4.5% in 2024 considering Chizhik openings.

In our CAPEX, about 60% will be spent on store openings and upgrades, including the maintenance CAPEX and renovations. We are actively working on optimising the unit cost of one store, especially Pyaterochka stores, and we are optimising our CVP to fit customer needs and geographic specificities, thereby achieving a cost per store reduction of approximately 30%.

We are also changing our approach from a full refurbishment for stores to more efficient store maintenance and repairs based on sales densities and traffic. This new approach will save up to 20% CAPEX over the long horizon. These measures, as well as the fact that the cost of opening one Chizhik is about half of that of Pyaterochka, will allow us to efficiently relocate capital expenses, maintain active expansion and increase capital efficiency.

Both mature and new businesses will definitely require investments in logistics and transportation. In the next three years, Pyaterochka and Chizhik will open a total of 10 DCs, and in transportation we need to gradually renew and expand the truck fleet in line with business growth. Traditionally, 15% of our investments are in efficiency projects and process upgrades, as well as digital transformation projects. In the nine months of this year, we invested in over 500 diverse projects, including about 25 digital transformation projects. Notably, ROIC on the completed projects or digital products has exceeded 100%. The efficiency projects should bring us around RUB 38 billion in 2021, including RUB 20 billion from digital transformation.

We continue to use our operational cash flow on investments and dividends. Business growth, efficiency of working capital, and reduction of CAPEX as percentage of revenue and maintaining high business margins will help us to improve dividend coverage with free cash flow both against the free cash flow and the net profit.

We consider three factors when determining the dividend payout. First of all, we make sure that our leverage is below 2.0x net debt/EBITDA, then full coverage of CAPEX by operating cash flow and at last the retained earnings from previous years. In 2024, we intend to increase net profit to the level of dividend payout, and net cash flow will cover at least 70% of dividend payout. According to this year's results and development plans for 2022, we cannot exclude that we will recommend to the Supervisory Board to raise the dividend payout to over RUB 50 billion.

Now by way of summing up, I would cover our financial goals for the next three years. We would like to raise the guidance for the annual revenue rate from 10+% to 12+%. The guidance for target EBITDA margin stands at 7% with the mature businesses at least 8%. We intend to exceed 15% market share in food retail in 2024, and our leverage cap will stay flat at 2.0x net debt/EBITDA. We will be more conservative and look at 1.8x. We expect to maintain a stable level of dividend payout in line with the growth of business profitability and strategic initiatives. We expect that dividend payments in 2024 will be in line with a net profit and will no longer create a pressure on equity.

We also expect our ROIC to go up over the next three years by at least 3%. We hope that such guidance will add confidence to the investment community that X5 intends not only to maintain its leadership but also has a potential in the business improvement and investments in new strategic areas of X5.

Elena Konnova:

Now we are moving on to the Q&A session. It will last for an hour. I can see a lot of questions in the chat. If you have not asked your question yet, please use the question line under the player. You can write either in English or Russian. We have very different questions about our strategy, our operations, as well as our chains' tactics. We will try to answer as many questions as we can in the time we have.

For the Q&A session we are joined again by Igor Shekhterman, Vladimir Salakhutdinov and Sergei Goncharov. The whole team is here on the stage now. The first question is: what are the top-management strategic priorities for the next 12 months and further?

Igor Shekhterman:

Let's start with a longer term. By the end of 2023 we expect to have at least 15% market share. What are we going to do in the short term to achieve this? First of all, as my colleagues and I said, we're going to adapt our current CVPs to the current economic situation. We expect to reduce CAPEX as much as possible for both the store opening and refurbishment; this will be our focus. We also see opportunities in optimising our OPEX, primarily through the digital transformation projects that we have launched over the past years. Both Sergei and Vlad spoke about this. Through adapting our CVPs we also see the potential for improving our LFL growth. That is the main task for the next year. What is also important is to improve the efficiency of our digital businesses. As Vladimir said, the express delivery will be a major enabler for our development in the digital segment. Notably, 5Post will have a positive EBITDA for 2021.

As to express deliveries from our chains, around 70,000 orders are delivered daily, and our delivery model is more efficient than that of our digital competitors because it enables the company to increase the EBITDA. Another important focus for next year is piloting and rolling out our Chizhik discounter chain. These are the main priorities for next year.

Elena Konnova:

Thank you very much, Igor. And the next question is to you, Vladimir. How do we view our position in the online market given the tough competition and emergence of multiple strong and well-financed players? The question is whether we are still targeting a 20% share of the e-grocery market by 2023? Are we going to step up investments in these initiatives? Are we planning an IPO in digital businesses and when exactly?

Vladimir Salakhutdinov:

A lot of questions coming in one. Now let's start step by step. Now how do we view our position in the online market? We believe that we are one of the leaders there. The market itself is quite small; it is just 2% of the total food market, but it is growing at three-digit rates. Probably comparing the positions of the top three or four companies is not so important. It is important that we are among the leaders, and we are also growing at a three-digit pace. As we said at the beginning, we target to stay among leaders long-term. Within the next five years, we strive to stay one of the market leaders.

As to the other players, Igor mentioned that competition is tough, and they live in somewhat different conditions, including financial ones. But we see our advantage in our infrastructure and an efficient operating model. I believe right now we are probably one of the only players that has implemented express deliveries from our stores on its own. We have a very high quality of order pickup and high utilisation rate of couriers. We know how to achieve profitable economics, play long-term and get sustainable results within a few years, and we'll definitely do that.

As to the market share of 20%, the guidance for the market growth has been updated three times this year and raised by almost a factor. We definitely adhere to our targets regarding the share of digital services in our revenue. As to what we will look against the market, it will depend on the market itself as well as the decisions we will make on the partnerships. But the scenario of 20% market share is also there.

As to planning the investments and the IPO, like we said earlier, we are not going to invest just to participate in all the segments. Speaking about marketplaces, we do not want to participate in the current race of marketplaces. But we will continue investing in the development of our digital channels. As to the IPO, we have various businesses; we have 5Post, and probably at some point this business could be monetised. We also have Vprok, which is a stand-alone format. Here we do not consider the IPO as the next step. Right now we're thinking more about a partnership with one of the players who is implementing the strategy of creating a general purpose marketplace.

As to our express delivery, we do understand that this is an integral part of our CVP. This is a part of X5, and it is becoming part of our DNA, because we are playing in the digital field; we are living in a different reality, and the main task for the express delivery is to solidify the long-term value of X5. We're going to create the hybrid infrastructure relying on our stores, but also we're creating the networks of drugstores wherever it is needed for the efficiency of the operating model.

Igor Shekhterman:

Let's talk about express delivery. It's very important for us to develop express delivery. This is the key component of our current business. We believe that our 18,000 stores, our strong position in procurements and our loyal customers enable us to make express delivery really efficient.

Elena Konnova:

The next question is to Ilya Yakubson. Our shareholders and investors mentioned the growth of the players in the discounter format. Can X5 withstand this competition in the hard discounter segment, and what are the plans for the geographic expansion of Chizhik?

Ilya Yakubson:

Let's start with our geographic expansion. In the next two years, we have to be in all the cities of Russia with the population above 1 million, apart from those where we have reached the Federal Antimonopoly Service ceiling, but we are planning to be in 10 to 12 regions on top of Moscow and Moscow region where we are operating now. Time will show if we can counter the competition, but we believe we have created a solid format that has all it takes to become one of the market leaders.

Elena Konnova:

Sergei, the next question is to you, and it is pretty specific. It's about the pricing strategy of Pyaterochka. What is the pricing strategy to maintain the price leadership on the market, and how it can affect the profitability of Pyaterochka? And specifically, are you going to invest in prices in the next few quarters?

Sergei Goncharov:

Let's start with the second question. Right now we see that we do not really need to invest in prices in Q4, but the situation might change because of the market dynamics and because of the anti-COVID measures. So if needed, we'll be ready to respond.

Low prices are key for Pyaterochka CVP, and to drive our attractiveness we focus on pricing. We are doing a lot to maintain the long-term attractiveness of Pyaterochka. For example, we have invested in digital tools, which helps us define the prices depending on the locations, family budgets and competitive environment. And we can adjust prices accordingly for many locations.

We closely monitor the first price and KVI baskets. KVIs are the goods most popular with our customers. There we are on par with competition or even below because this is the key aspect of our attractiveness. And these things are the basis for the long-term development of the company and for maintaining the right price perception.

Elena Konnova:

Thank you. Vsevolod, the question is to you about the dividends. The 50 billion you mentioned, is it a base case scenario, or could it be more depending on the results for the year? If so, then by how much? And what should be the dividend expectations for 2022?

Vsevolod Starukhin:

Right now, I would just repeat what I said before. We do not rule out that depending on the results of the year and how aggressive our development programme will be next year, we will decide on the optimal dividend payout, making sure that the yields are attractive for the investors. We cannot rule out this higher dividend payout scenario, but it is still too early to provide more specific guidance.

Elena Konnova:

That already sounds rather promising.

Another question is to Vladimir. It's about online businesses coming to positive EBITDA. Can you tell us more about the performance of express delivery in the regions as well as prospects for higher profitability of the business?

Vladimir Salakhutdinov:

Thank you. As to digital businesses, some of them are already in the positive EBITDA area. But as to the express delivery in the regions, this is the business that is definitely promising for the regions and not just for cities with populations above 1 million, but in smaller ones as well. And right now over 50 towns and cities have express delivery. And we have significant growth points apart from Moscow and St Petersburg – for example, Kazan and Ekaterinburg. As to the economics, importantly, express delivery is an integral part of our stores' operating processes. For our key stores where we have a substantial volume of express delivery, we see that express delivery has a positive impact on their economics. So this is what Igor said today. Our infrastructure, commercial terms as well as the density of our network in the cities, as well as our additional work to create the dark stores where our stores are overloaded, enable us to achieve positive economics. In the next few years, we expect that most of our main express delivery businesses will be in the positive area in terms of their financial performance.

Elena Konnova:

The long-term profitability for Vprok and express delivery. Could you specify those?

Vladimir Salakhutdinov:

I have already covered express delivery. As to Vprok, the online hypermarket, we said before that a big purchase not delivered within an hour or two is only topical if the assortment is bigger. So in essence it means becoming a marketplace. Here we have somewhat adjusted our views. We are not going to create a marketplace. We are looking at a partnership with those who will create that. Vprok could be complementary to their business. In our models we see how a partnership with a marketplace could be efficient, and the specific economic parameters will depend on the partnership structure. We are currently in talks with potential partners.

Elena Konnova:

The question is to Vladislav on Perekrestok. Some of our investors believe that the supermarket segment will not really grow over the next few years. And in this context, the question is, How are we planning to build up our market share? And how many supermarkets do we expect to open in the next two or three years? What is a mid-term and long-term forecast for the store count?

Vladislav Kurbatov:

Let's start with the store number. Next year we expect to open 80 to 85 stores. And our goal is to grow LFL sales by 10%–12% per annum in the next three years. Based on this, we will set targets for opening new stores. As I said before, we're going to work with sales density, which will allow us to have a bigger sales growth with less investment.

Possibly, in the current economic environment, it is difficult for supermarkets to grow organically, but there are a lot of other opportunities for them to develop. The winners will be the ones closest to the customer, and the most efficient. We can see an opportunity to grow at the expense of hypermarkets, because supermarkets cover major part of the customers' needs. We also expect to gain market share from unconventional retail and local players.

Elena Konnova:

Thank you. A question to Igor, and possibly Ilya because it's about Chizhik. Why are you opening just 300 Chizhik stores next year? Maybe you should accelerate the rollout or redistribute the investments from Pyaterochka and Perekrestok because some of our investors think that the profitability is higher in hard discounters.

Igor Shekhterman:

There are two main enablers for effective rollout of hard discounters. First, as Ilya said, it takes quite a big share of private labels (PL). This is the essence of the model. PL should represent 75% of the assortment. Unless you have this many, it makes no sense rolling out the hard discounters. We're going to have about 35% at the end of this year and about 70% at the end of next year. So the full-fledged hard discounter rollout will be possible when we have at least 70% of PLs. So we will start the rollout in 2023.

The second component is how we are going to enter the biggest cities. We have to create a logistical chain of its own for Chizhiks. Next year will be spent organising this logistical chain. So, the rollout is about creating enough PLs and logistical chains, and we expect to have them in place for the active rollout starting from 2023.

Elena Konnova:

Thank you very much. Quite an exhaustive answer.

Vladimir, the question to you about one of our enablers, about X5 Bank.

Vladimir Salakhutdinov:

Colleagues, maybe I will give you some more information than in the presentation. Importantly, X5 Bank is a project we are creating in partnership with Alpha Bank.

And this is not a full-fledged credit organisation but a technological platform, a front with its own product initiative and management. It's a separate organisation with a separate management team which will embed the banking and financial services into X5 digital and in store customer journeys.

What is its role? Payments and maybe the need for loans or saving products is an inseparable part of our clients' lives. Everybody needs financial and banking services, and, taking into account competencies we totally have in our Group and Alpha Group, we know how to offer convenient and attractive banking and financial services in exchange for their loyalty to our retail chains. This is the essence of the project.

Timewise, we are planning to launch first projects before the end of this year, and, according to the results of the pilots in 2022, to come up with a final vision, strategy and product line to start systematically [developing] it on X5 infrastructure.

Elena Konnova:

Right away another question to you about additional innovations that we are planning to introduce for offline business. We already mentioned in our video the innovations we have in our stores but our colleagues are interested in the eye-tracking payment, unmanned stores that we are already piloting. Are we going to implement anything else?

Vladimir Salakhutdinov:

The short answer is yes. Because at X5 we are absolutely convinced that innovations are a very powerful factor for both enhancing customer experience and driving our strategy to increase efficiency.

Indeed, we have a dream or maybe an outlook. We really want you to be able to walk in our stores without your iPhone or wallet. Just take a product off the shelf and just pay because we will recognise your face through our recognition system. We do have such projects already. We have a face recognition system and face payments, but so far it's being done on a very limited scale. We are going to roll it out.

We do believe in automation. Needless to say, the substantial cost item is payroll. Whatever is related to an opportunity to automate a process, and the self-checkout lane is one of these processes, as you saw in the video, as well as automation of DCs' procedures, and automation of some other processes unrelated to providing services. Of course, we are thinking about that. I would say again that we do believe that the number of people in our stores – I mean the number of staff – will be reduced first of all, and secondly the staff will be involved more in creating more value such as talking and communicating with clients, monitoring availability of items on shelves and helping our customers to make choices, while all the routine work at the checkouts will be fully automated. And we have a very clear concept of it in our minds. In the coming year or two, we are going to talk about new innovations; we're going to introduce in our retail chain.

Igor Shekhterman:

We have an innovation laboratory where we really pilot and review quite a big number of innovations. But we scale only those products where costs and CAPEX investment for such products will be paid back fast in terms of reducing our OPEX. For instance, the self-checkout zones and Scan&Go, which are quite effective because we can see OPEX reduction per each store.

Elena Konnova:

Right away a question to Sergei. What about self-service checkouts? How do you evaluate this effect? Do self-service checkouts increase shrinkage? Are there any issues with that? And later I will ask about Pyaterochka and Perekrestok. And a question for Ilya: Are you going to introduce such self-checkouts in hard discounter stores?

Sergei Goncharov:

Well, first of all, self-checkouts are installed in about 35% of our stores. And we can see quite a big improvement in the labour productivity in those stores. The idea was to deploy more of these self-checkouts since it boosts labour productivity. The methodology that we showed yesterday, and I mentioned it today, express scan, is a system enabling our guests to pay for their purchases without using cashiers or even self-checkouts just by using their mobile phones and mobile application. This is operational now in about 1,000 Pyaterochka stores. So we're going to scale it up next year. And generally speaking, those initiatives, among the many we are introducing and implementing in our stores, are aimed at increasing productivity and, as a result, business efficiency.

Vladislav Kurbatov:

Self-checkouts indeed allow us first of all to save on payroll. When we install six self-checkouts, we need just one cashier-administrator. As you've been asking about theft and shrinkage, of course at self-checkouts we have a bit more theft issues than, say, at conventional checkouts, but that's not a critical number. And all in all, it's still more profitable than keeping cashiers at the checkouts.

I agree with Sergei that the popularity of self-checkouts is gaining momentum, as all the smaller tickets are processed by self-checkouts, and we have stores where the self-checkouts account for over 50% of all tickets. It's especially true for smaller stores, where the average purchase size is not very big.

Also, self-checkouts are used by shoppers who buy mostly ready-to-eat food or coffee and things like that. And I'm sure that self-checkouts are the future. We are fine-tuning those self-checkout areas. We are developing a software that will show that, for instance, someone pays a small amount or just imitated payment, and this will be immediately flagged. So, answering your question, I will say that self-checkouts are indeed very efficient.

Ilya Yakubson:

Throughout one year we've been piloting self-checkouts in four of our stores. And this week, we have dismantled the last self-checkout. There are two main reasons for this. Chizhiks are smaller shops, so when choosing between using physical space for self-checkouts or for a more legacy checkout area, we prefer legacy checkout areas, as they are four times faster. The second reason, which is no less important, is theft, because my colleagues have among their staff designated store managers, and they can exercise visual control over self-checkout areas. We cannot afford to have such a visual inspector in the staff of Chizhik stores. This is why the theft issue is very burdensome in our case. That's why we made a decision to forego self-checkouts.

Elena Konnova:

Well, we are all different, and our customers are all different, and this could be our main competitive advantage, since we have various formats.

Vsevolod, a question for you now. It's quite a painful topic, I think. You've mentioned labour shortage on the market now, which is a factor of growing costs. Everybody is talking about it, as it seems to be a common issue. Do you think the problem could be aggravated in the years to come, and how do you forecast its impact on our cost and profitability in the mid-term?

Vsevolod Starukhin:

Look, if we take some macroeconomic categories, needless to say that increased inflation and inflationary pressure, be it in product or service categories, one way or another translates into on-shelf prices. Add to this higher salaries, which also manifests itself in higher on-shelf pricing. In the long term though, this situation more or less balances itself out, while in short term, and this is what we faced this year, it was a perfect-storm situation, with globally high inflation, which also affected our domestic market, on the one hand, but, on the other hand, we've had difficulties in logistical chains and COVID situation coupled with migrant labour crisis – all of those did impact the inflationary pressure and high salaries this year.

But, generally speaking, as we were saying, we are coping with inflation. And what helped us was that for about some time we have been investing in efficiency gains projects. It was not our first year on this path. For a number of years already, we have been building a culture of creating digital projects, searching for ways to support intrapreneurship to initiate different ideas to identify inefficiencies in our costs, and physical activities for improving them. And we are willing to keep supporting it. And as I said, there are about 500 projects in the pipeline, and many of them have already been implemented, while others are still underway. And we continue allocating quite a weighty part of our CAPEX, of about 15%, to support the efficiency projects aimed at reducing inflationary pressure of working hours.

Sure, we cannot pay workers below the market, while in some cases our target levels – as this is a common story in logistics in Moscow – are even above the market levels. But what we can do using digitalisation and process efficiency is to cut down on the number of working hours needed to perform standard tasks. This is the main goal – that is, to mitigate this pressure through the efficiency projects and speed of their implementation by prioritising them and even trying to be ahead of inflationary pressure to have some partial competitive advantage so that we can offer our clients best prices despite inflationary pressure, which all retailers are feeling right now.

Elena Konnova:

Yes, it makes sense regarding staff costs adjusted for inflation. And our audience also wants to communicate with Sergei and Vladislav on efficiency gains of Pyaterochka and Perekrestok. What are the top three to five factors of a higher efficiency for Pyaterochka and Perekrestok in the near future?

Sergei Goncharov:

Speaking about Pyaterochka, we can split it into several key factors. Those are the growth of private labels and imported goods. The implementation of initiatives I've mentioned already in implementing efficiency processes. Such processes are further broken down into sets of metrics, such as checkout areas, working on the trading floor, work with price tags, work with the merchandise and moving goods from storage areas onto the trading floor, managing staff time within the store and automation of staff management practices. We build special products for that such as WFM (workforce management) and automated task manager and so on. Next, speaking of other factors and categories: efficiency gains of express deliveries, where we have quite big plans on boosting unit economy. And also investing in higher efficiency of logistical processes and operations related to logistics. Those are the main factors.

Vladislav Kurbatov:

Well, Sergei has enumerated them all.

Elena Konnova:

So in Perekrestok it's almost the same.

Vladislav Kurbatov:

Yes, we are going to work more efficiently with our assortment, which will allow us to improve the efficiency of working with staff in stores. We are also going to implement a lot of new technological initiatives, which have been or are being developed at the moment.

We think we will improve the indicators in logistics thanks to improved efficiency inside distribution centres. Another important factor is working with private labels. As I said already in my presentation, we're going to focus on high-margin products in medium and high price categories, which will also be a factor to improve our margins. We have already launched a pricing project which allows us to work with current margins; we expect that it will also impact overall efficiency.

Sergei Goncharov:

I would also like to add, Vladislav was right speaking about working with our assortment. And for us, to a large extent, it's never-ending work to optimise what we're offering on our shelves. It means reducing the number of SKUs, but not reducing the number of clients' needs that we meet. So we can switch to SRP (shelf-ready packaging), when we get merchandise in certain packaging, which reduces labour costs for shelving, and we can see here a huge efficiency mechanism. It is not a very fast process but eventually we expect some tangible results.

Elena Konnova:

Thank you, Sergei. Igor, now a question for you about our competitors and risks.

Is expansion of our competitors, for instance, Krasnoye i Beloye (Red & White) and other discounters a risk for us and for the Chizhik chain? What is your perspective on this?

Igor Shekhterman:

The Russian market is very competitive, which is very good for customers and for the economy. All competitors are not risks, but challenges for us, which help us to be more attentive and adapt ourselves to what is happening on the market, and to what our competitors are doing. Of course, those are challenges.

Elena Konnova:

Do we recognise these challenges, and do we have plans of risk mitigation?

Ilya, do you want to add anything? It is about Chizhik.

Ilya Yakubson:

Every Chizhik store is about testing some hypothesis. In particular, it's about testing a location hypothesis and a competitive environment hypothesis. Before announcing the creation of this format, we tested the Chizhik against all types of competitors we have in the Russian market such as hypermarkets and our colleagues in the hard discounters. We do know how we are going to behave and what results we will get. We feel very confident in this respect.

Elena Konnova:

Igor, continuing this topic, what about major M&A deals you've mentioned in the market. Are you at X5 looking at major deals like that, and in general what do you think about M&A?

Igor Shekhterman:

For the last five years, we have been growing organically, and we think that organic growth provides twice as big a return on investments than M&A deals. If you look at our development in recent years, in about 85% of cases we open organically, and in 15% of cases we grow due to acquiring some smaller regional chains.

Our strategy will stay the same for the nearest time period. We expect to have more openings through organic development, because it means bigger return on capital. While in the regions, we will continue to look for smaller chains of 15 to 100 stores with good locations. Our strategy is unchanged, and it stipulates mostly organic growth.

Elena Konnova:

Vsevolod, a couple of questions for you. What are the plans to reduce CAPEX? If we can speak about a reduction.

Vsevolod Starukhin:

Yes, we are aiming at reducing it in relative terms as a percentage of sales. And there are several areas to look into. Needless to say, our main capital investments go to our mature businesses, namely Pyaterochka and Perekrestok. Our objective for the next three years is to substantially increase efficiency of those investments.

On the one hand, that means optimising the development of our CVP, which is aimed at optimally working on three challenges. Number one is getting LFL growth. The second challenge is to minimise our OPEX, and the third one is a minimal CAPEX. That's the triangle we are fine-tuning for balance. And it definitely impacts the level of investments in opening new stores. Our objective here is to reduce the impact of Pyaterochka, which has a lion's share in our annual openings: it's about 1,500 new stores, along with upgrading the existing stores. We want to reduce the cost of an average opening by 30% on average.

The second component is to support our chain and all the upgrades we have been doing until now. Basically, we refurbished a store by closing it down first, then we tore down everything in it and rebuilt the interior, which notably is sometimes more expensive than opening a new store. We have now adopted a new model of modular upgrading our stores. It enables us to shift from upgrading our stores every five to seven years with a huge upfront CAPEX, as well as losing sales because you have to close down the store, so you lose sales, to modular upgrades during the 10-year life cycle, when we change different components in the store, depending on traffic. So depending on the category by traffic, each store upgrade will include targeted modular replacements and refurbishments.

So we have certain standards for each component, and after appraisal we either change or keep those components, or even delay changing them. It is the second lever of boosting the efficiency, and in the long term it provides CAPEX reduction of up to 20% in our retail chains due to this factor.

And for improving efficiency in logistics, we will consider various options, not only buying more trucks, since we already have quite a big fleet of almost 5,000 units currently. And as our business will be expanding, not only will we have to replace existing vehicles, but also buy new ones, and we are talking about billions in expenses.

We have been actively working with our logistics partners and providers so that, together with them, following our logic of developing DCs – built to rent – we could also sign long-term contracts with them so they could buy trucks and replace or add them incrementally. It will also reduce the capital intensity of our investments. These are the key ideas, which cumulatively will result in reduction of our CAPEX as a percentage of revenue in three years from 4.7% to 4.5%, or even below 4.5% from the revenue, including multi-billion investments in Chizhik. If you take those away, we expect to reduce our CAPEX as a percentage of revenue below 4% of our current level.

Elena Konnova

Thank you, Vsevolod! And now I would like to ask you about growth of your gross margin and additional drivers for growing your gross margin. Could you please elaborate on Q4 – what can we expect?

Vsevolod Starukhin

We do not provide any guidance with such granularity. But I will say generally that we see gross margin drivers – on one hand, they are the drivers of digitisation projects which have been launched. It's about gross margin on top of positive product mix or some weather conditions, which have been very favourable for us and helped us to show good gross margins for the last two quarters.

But we do not discard such tools as dynamic pricing, stock replenishment, assortment management and the like – these are all digital tools we heavily invested in over the last couple of years. They definitely help our margin, and in part play as our competitive advantage. They also help to reduce shrinkage, as we have some unprecedented low level of shrinkage in our gross margin. And we see further potential of reducing our shrinkage. We envision potential of further improvement of assortment quality management through the development of these tools. We also see the potential of moving from mass promo campaigns to personalised offers, which are also driven by big data tools, which in turn should enable more personalisation and overall reduce our investments in mass promo campaigns. It will contribute more and more within the next three years.

On top of that we have private labels. Today 20% of our portfolio are private labels. In addition to locking up our customers to our stores due to great and unique products, private labels have higher margins. We plan to see some material growth of the share of private labels in our portfolio, and I will remind you that today they represent about 400 billion of revenue, which is comparable with the total business volume of Perekrestok. And this line of business will see double-digit growth in the years to come.

We also believe that the potential of direct import has not yet been fully explored. We have big plans of boosting direct import by eliminating some chains of middlemen suppliers, and in this way, we can increase margins of our business.

Our logistics and digital projects for improving logistics play a big role in the gross margin. It's about digitising logistics and increasing capacity utilisation of our fleet, boosting dispatching of the fleet and so on. For sure it is a driver of cutting unit costs in logistics, and sustaining and improving our gross margin. Effects of these improvements will be reinvested in prices to keep the loyalty of our clients as well as to attract new clients, and to maintain price perception leadership on the market.

Thanks!

Elena Konnova

Changing the subject, I would like to address my question to Igor and Vladimir. It's about the Mnogo Lososya company – quite a successful start-up, which enabled us to enter the dark kitchen segment this year. In your view, what are the outcomes so far? What are your plans for this segment? Would this company (Mnogo Lososya) be enough to set a foothold in this segment?

Igor Shekhterman

Like I said in my presentation, we entered this segment because we could see quite a big growth upside. In this segment of food deliveries, dark kitchens show the biggest growth potential despite the fact that today they are only 5% of the market. But the growth upside there is the biggest.

It was a complementary move on our part to enter this segment, because it's the ready-to-eat segment. In Perekrestok the ready-to-eat segment posts the biggest growth now, as we can see year-on-year growth of 25%. We are happy with the outcomes of the Mnogo Lososya company this year. We are planning further expansion. The company has already set its presence in St Petersburg, and before 2024 we are planning to come to some cities with a million-plus population. Currently the challenge is to achieve positive unit economy here in Moscow, and after 2023 this business should reach positive EBITDA. The average ticket in this business is quite good; they operate in the middle-price bracket, and their average ticket is RUB 1,800. Currently we are thinking about launching a more mass brand on this platform.

Vladimir Salakhutdinov

I would like to add to this that, just as in some other deals like that, not only did we acquire a business in a promising segment, we also got teams and competencies which we built into our other businesses. One example here is that using this company, Mnogo Lososya, we opened sushi stations in Perekrestok stores. They have been operating only for several months by now, but they are very popular already. They not only provide our clients with a better experience in Perekrestok but also additionally attract customers to our stores.

Elena Konnova

I believe it will be my final question today. We are seeing not so many questions, as recommendations, opinions, and at this Q&A session we would like to provide answers to some specific questions. The last question is to Vsevolod. Is it safe to assume that EBITDA growth can be projected on the level of revenue growth – that is, 12% per annum?

Vsevolod Starukhin

Generally, I will say yes. Looking into the next three years, I can see such a correlation between EBITDA and revenue growth. On one hand, we are increasing the margins of our current mature businesses from the current 7%+ to 8%+ within the next three years. And, on the other hand, a big part of it will be reinvested. Oftentimes it is not a negative EBITDA margin, but rather of diluting our

EBITDA margins in some low-margin businesses like Chizhik, which in three years will deliver about 10% of our revenues. At the same time, it will sustain our EBITDA margin on the same level, give or take. With the annual average growth of revenue at 12%, it is justified.

Elena Konnova

On this high-pitched note, I would like to conclude our Investor Day. Thank you very much, dear panellists; it was exciting and highly informative. I would also like to thank our audience today! I am grateful to those who will be watching this video later. Thanks for being with us today; we hope you've enjoyed this. Stay with us and goodbye!