

August 24, 2010

# Magnit (MGNT LI)

## 1H10 IFRS results: margins suffered, but do not be upset!

Natalia Kolupaeva n.kolupaeva@tkbc.ru

**Margins came below forecasts, but will be recovered in 2H10.** Today Magnit has disclosed its 1H10 IFRS financials, which came below our and market expectations in terms of margins: 2Q10 gross margin dropped to 21.1% vs. our forecast of 21.8% that reflects that company's price investments turned out to be more aggressive than we projected. Thus, 1H10 gross margin totaled 21.5%. In its trading update, published earlier, Magnit showed spectacular 3.4% y-o-y jump in 2Q10 discounters LFL traffic growth, which came as a result of investments into prices and has turned 1H10 LFL traffic dynamic to a positive area for the first time since 2008. Magnit's SG&A expenses in 2Q10 remained under control but was slightly higher than our projection (at 16.5% of total sales vs. 16.1%). All this has pressured operating margin in 2Q10 to 4.7% (5.1% in 1H10). EBITDA and net margins in 2Q10 came at 6.6% and 3.7% (in 1H10 they were at 7.1% and 3.8%, respectively).

**Focus on management comments.** During today's conference call (see the details) we believe the management to shed more light on the expected recovery in 2H10 margins. In particular, we assume upcoming 3Q10 to deliver further strong sales as more than 30% of Magnit's stores are located in the Southern District of Russia and thus will experience a seasonal inflow of traffic from vacationers. Moreover, we underline the progress in gaining more efficiency of operations through logistics development – as of the end of June, Magnit's centralization ratio totaled 79% vs. 73% in 2009 with the long-term target of up to 90%.

### Today Magnit stated the following targets for this year:

- **To reach 35% y-o-y top line growth (in ruble terms).** We see this to be consistent with our current valuation model, which assumes this year ruble-based revenue to grow by 32% y-o-y.
- **New 2010E EBITDA was set at 8.0-8.5% vs. initial estimate of 8-9%.** Our current valuation model implies 2010E EBITDA margin of 8.8%, which looks above the high end of the management forecast. During today's conference call we expect Magnit's management to provide us with more details on the expected recovery in 2H10 EBITDA margin.
- **Discounter store openings expanded to 650** (vs. 450-550 initially planned), **hypermarkets openings will total 30** (vs. 25-30 range). We estimate this to cost additionally about \$225 mn, thus the company also has **enlarged its CAPEX forecast to \$1.1-1.3 bn vs. previously estimated at \$1.0 bn.**

#### Key financials

IFRS, \$ mn	2Q10	% to 2Q10E	2Q09	Change y-o-y	1Q10	Change q-o-q	1H10	Change y-o-y	2010E	2009	Change y-o-y
Revenue	1,808	0%	1,250	45%	1,640	10%	3,448	45%	7,649	5,355	43%
Gross income	382.0	-3%	291.4	31%	358.6	7%	740.5	34%	1,759	1,257	40%
- gross margin,	21.1%		23.3%		21.9%		21.5%		23.0%	23.5%	
Operating income	84.4	-18%	88.1	-4%	92.4	-9%	176.8	5%	542.9	393.9	38%
- margin, %	4.7%		7.0%		5.6%		5.1%		7.1%	7.4%	
EBITDA	118.6	-13%	111.7	6%	124.6	-5%	243.3	14%	676.2	497.0	36%
- margin, %	6.6%		8.9%		7.6%		7.1%		8.8%	9.3%	
Net income	66.6	8%	64.8	3%	64.6	3%	131.2	11%	347.3	275.2	26%
- net margin, %	3.7%		5.2%		3.9%		3.8%		4.5%	5.1%	

Source: company data, TKB Capital

Magnit	Common	GDR
Ticker	MGNT	MGNT LI
Recommendation	BUY	BUY
Price, \$	105.0	22.2
Target price, \$	122.0	24.4
Upside/downside, %	16%	10%

#### SHARE DATA

Bloomberg	MGNT RX
Reuters	MGNT.MM
	Common
# of shares outstanding, mn	89.0
EV, \$ mn	9,388
MC, \$ mn	9,346
MIN 12 mnth., \$	46.6
MAX 12 mnth., \$	107.1
	Common
Shares per GDR	1/5

#### SUMMARY FINANCIALS, \$ mn

IFRS	2009	2010E	2011E
Revenue	5,354	7,648	10,673
EBITDA	497	676	990
Net income	275	347	503
EPS, \$	3.09	3.90	5.65
Rev. growth, %	0.1	42.8	39.6
EPS growth, %	46.4	26.1	44.9
EBITDA margin, %	9.3	8.8	9.3
Net margin, %	5.1	4.5	4.7

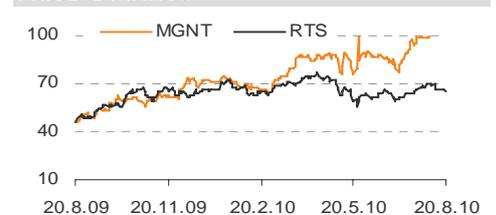
#### SUMMARY VALUATIONS

	2009	2010E	2011E
P/E	34.0	26.9	18.6
EV/EBITDA	18.9	13.9	9.5

#### SHAREHOLDER STRUCTURE

Sergey Galitskiy, CEO	44%
Labini Investments Ltd.	4%
Management & BoD	5%
Other	46%

#### PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

#### CONFERENCE CALL DETAILS:

**DATE: 24 August, 2010**

#### TIME:

**8 am New York,  
1 pm London,  
4 pm Moscow**

#### TELEPHONE:

**+44 (0)20 7162 0025 (International),  
+1 334 323 6201 (USA)**

Operating results	6M10	6M09	y-o-y, %	June 10	June 09	y-o-y, %	3M10	3M09	y-o-y, %
<b>Number of opened stores, net</b>	<b>264</b>	<b>226</b>		<b>68</b>	<b>45</b>		<b>90</b>	<b>94</b>	
- discounters	260	222		66	42		89	94	
- hypermarkets	4	4		2	3		1	0	
<b>Total number of stores</b>	<b>3 492</b>	<b>2 808</b>		<b>3 492</b>	<b>2 808</b>		<b>3 318</b>	<b>2 676</b>	
- discounters	3 464	2 790		3 464	2 790		3 293	2 662	
- hypermarkets	28	18		28	18		25	14	
<b>Selling space, sqm</b>	<b>1 156 118</b>	<b>905 215</b>	<b>28%</b>	<b>1 156 118</b>	<b>905 215</b>	<b>28%</b>	<b>1 092 610</b>	<b>854 260</b>	<b>28%</b>
- discounters	1 065 025	840 500	27%	1 065 025	840 500	27%	1 009 047	797 895	26%
- hypermarkets	91 093	64 715	41%	91 093	64 715	41%	83 563	56 365	48%
<b>Net retail sales, RUR mn</b>	<b>103 638</b>	<b>78 461</b>	<b>32%</b>	<b>18 612</b>	<b>13 406</b>	<b>39%</b>	<b>48 992</b>	<b>38 168</b>	<b>28%</b>
- discounters	94 500	73 212	29%	16 850	12 440	35%	44 840	35 707	26%
- hypermarkets	9 138	5 249	74%	1 761	966	82%	4 152	2 461	69%
<b>Net retail sales, \$ mn</b>	<b>3 447</b>	<b>2 373</b>	<b>45%</b>	<b>597</b>	<b>432</b>	<b>38%</b>	<b>1 657</b>	<b>1 125</b>	<b>47%</b>
- discounters	3 143	2 214	42%	541	401	35%	1 517	1 052	44%
- hypermarkets	304	159	91%	57	31	81%	140	73	94%

Source: Company data, TKB Capital estimates

LFL growth, y-o-y	1H10	2Q10	1Q10	FY09
Average ticket (excl. VAT), RUR	3.6%	3.9%	3.4%	5.8%
Number of tickets	1.3%	3.6%	-0.6%	-1.5%
Revenue, RUR	4.9%	7.6%	2.8%	4.1%
<i>In particular by store format:</i>				
<b>Discounters</b>	<b>1H10</b>	<b>2Q10</b>	<b>1Q10</b>	<b>FY09</b>
Average ticket (excl. VAT), RUR	3.3%	3.6%	3.2%	n/a
Number of tickets	1.2%	3.4%	-0.7%	n/a
Revenue, RUR	4.6%	7.2%	2.4%	n/a
<b>Hypermarkets</b>	<b>1H10</b>	<b>2Q10</b>	<b>1Q10</b>	<b>FY09</b>
Average ticket (excl. VAT), RUR	3.0%	3.1%	2.7%	n/a
Number of tickets	10.8%	11.6%	9.2%	n/a
Revenue, RUR	14.2%	15.0%	12.2%	n/a

Source: Company data, TKB Capital estimates

### Revenue growth, % in RUR terms

	1H10	2Q10	1Q10	FY09
<b>Magnit</b>	32%	36%	28%	28%
<b>X5 Retail Group</b>	19%	18%	20%	25%
<b>Dixy</b>	15%	18%	13%	12%

### LFL stores performance, % in RUR terms

	1H10			2Q10			1Q10			FY09		
	Total	Traffic	Basket	Total	Traffic	Basket	Total	Traffic	Basket	Total	Traffic	Basket
<b>Magnit breakdown by format</b>												
Discounters	5%	1%	3%	7%	3%	4%	2%	-1%	3%	n/a	n/a	n/a
Hypermarkets	14%	11%	3%	15%	12%	3%	12%	9%	3%	n/a	n/a	n/a
<b>Total Magnit</b>	<b>5%</b>	<b>1%</b>	<b>4%</b>	<b>8%</b>	<b>4%</b>	<b>4%</b>	<b>3%</b>	<b>-1%</b>	<b>3%</b>	<b>4%</b>	<b>-2%</b>	<b>6%</b>
<b>X5 Retail Group breakdown by format</b>												
Hypermarkets	0%	-3%	3%	2%	0%	2%	-1%	-7%	6%	7%	-	7%
Supermarkets	-7%	-9%	2%	-8%	-9%	1%	-6%	-10%	4%	-	-4%	4%
Soft Discounters	14%	7%	7%	11%	6%	5%	17%	9%	8%	17%	10%	7%
<b>Total X5 Retail G</b>	<b>5%</b>	<b>2%</b>	<b>3%</b>	<b>4%</b>	<b>2%</b>	<b>2%</b>	<b>7%</b>	<b>2%</b>	<b>5%</b>	<b>10%</b>	<b>5%</b>	<b>5%</b>
<b>Dixy breakdown by format</b>												
Discounters	5%	n/a	n/a	-3%	n/a	n/a						
Supermarkets	7%	n/a	n/a	0%	n/a	n/a						
Hypermarkets	3%	n/a	n/a	5%	n/a	n/a						
<b>Total Dixy</b>	<b>5%</b>	<b>4%</b>	<b>1%</b>	n/a	n/a	n/a	n/a	n/a	n/a	<b>-2%</b>	<b>-2%</b>	<b>0%</b>

Source: Company data, TKB Capital estimates

## Research Department

---

Equity Research + 7 (495) 981 3430

**Maria Kalvaraskaia**

Head of Equity Research  
Banking, Transport  
m.kalvaraskaia@tkbc.ru

**Alexander Kovalev, PhD**

Commodity markets  
aa.kovalev@tkbc.ru

**Evgeny Ryabkov**

Metals & Mining  
e.ryabkov@tkbc.ru

**Artem Lavrishev**

Machinery, Database Management,  
Dividends  
a.lavrishev@tkbc.ru

**Julia Kryuchkova**

Translator/Editor  
y.kryuchkova@tkbc.ru

**Evgenia Dyshtyuk**

Oil & Gas  
e.dyshlyuk@tkbc.ru

**Natasha Kolupaeva**

Consumer & Retail  
n.kolupaeva@tkbc.ru

**Anatoly Vysotsky**

Real Estate, Infrastructure  
a.vysotsky@tkbc.ru

**Alexey Serov**

Utilities Sector  
a.serov@tkbc.ru

**Tatiana Zadorozhnaya**

Transport  
t.zadorozhnaya@tkbc.ru

**Natasha Yanakaeva**

Small Caps  
n.yanakaeva@tkbc.ru

## Structured Product, Equity & Derivative Department

---

Moscow + 7 (495) 981 3430

**Dmitry Romanov**

d.romanov@tkbc.ru

**Vladimir Kurov**

v.kurov@tkbc.ru

**Vadim Guglenko**

v.googlenko@tkbc.ru

**Denis Piskunov**

d.piskunov@tkbc.ru

**Pavel Shlyk**

p.shlyk@tkbc.ru

**Artem Ananyan**

a.ananyan@tkbc.ru

**Danil Olimov**

d.olimov@tkbc.ru

7, bld 3, Znamenka Street,  
Moscow 119019  
Tel. +7 (495) 981 3430  
Fax +7 (495) 783 3170

[www.tkbc.ru](http://www.tkbc.ru)

This document is provided to you for informational purposes only and does not constitute an offer to buy, sell or subscribe to investment products described herein. The sources used for this report are believed to be reliable, but TKB Capital makes no representation as to their accuracy or completeness. The views, advice and recommendations contained within represent the analyst's view as of the publication date. Such views may change without notice and may contradict previously expressed views and recommendations. TKB Capital is under no obligation to bring such previously held views to the attention of the reader.

This report is intended for market professionals and institutional investors capable of assessing the risks associated with the securities mentioned herein. TKB Capital shall not be held liable for any losses or other damages which may occur as a result of using this information or investment decisions made on the basis of opinions and recommendations contained in this report. Some Russian equities experience volatility which increases their investment risk, as their value may fall causing losses if the investment is realized. Many Russian equities are illiquid, and some investments are not readily or quickly realizable in good markets, and in times of market duress they may be impossible to realize. Many Russian equities do not trade on a daily basis and thus do not have a daily price quote, giving rise to questions concerning their true value. TKB Capital can give no representation as to the absolute volatility or liquidity of any Russian equity, nor can it give any representation as to the true value of an illiquid security. The value of all ruble-denominated Russian equities is also dependent on currency fluctuations in addition to equity market conditions. Investors should conduct their own investigation and research into a given investment and make their own assessment as to the risks involved with a particular investment in Russian equities.

TKB Capital may trade for its own account based on any short-term or long-term recommendations or trade ideas. It may also trade in recommended securities in a manner that is contrary to any trade idea or recommendation.

This report may not be reproduced, distributed or published without the written agreement of TKB Capital.