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FMCG RETAIL CHAINS IN RUSSIA 2012

Leading Retail Food Chains:
General Business Characteristics
Lines of Activity



Analytical Review

Tenth Edition

Demonstration version

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Moscow, 2012

ABSTRACT

The tenth edition of the market survey "FMCG Retail Chains in Russia 2012" is dedicated to analysis of the development of Russian retail food chains in 2011-2012. The survey describes the current market situation, analyzes key mid-term trends in retail development, assesses the market volume and provides possible scenarios and forecasts for its development in 2012-2015, considering macroeconomic forecasts and trends in consumer demand.

This survey includes an analysis of changes in retail chain formats (supermarkets, hypermarkets, discounters, convenient stores) and key characteristics of Russian chains (average check, average selling space, assortment size, sales per square meter of selling area, etc). In addition, the survey analyzes current strategies employed by Russian and foreign food retailers, their advantages and disadvantages.

An analytical review of the market includes a description of basic parameters of, and trends in, Russia's food retail sector, strategies and business models adopted by major companies, as well as development forecasts for retail chains and the market as a whole to 2015.

Methods

The survey was conducted using the following approaches and methods:

- A questionnaire survey among retail chains
- A desk study
- The desk study was based on the following sources:
 - Data from printed and electronic media
 - Materials of conferences
 - Investment reports by banks
 - Financial reports of companies

The survey was conducted during April - July 2012. The Report consists of 82 pages.

The Report includes 31 tables and 39 charts and diagrams.

Report language: Russian. The report is provided as a PDF file.

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ECONOMIC TRENDS OF THE RF IN 2011 AND JANUARY-MAY 2012. FORECAST FOR 2013-2015¹

The key tendency of 2011 was further revitalization of economic activity and, for the most part, completion of recovering growth after the economic crisis of late 2008 and 2009.

At the end of 2011, many key economic indicators, such as industrial production index, consumer spending and commodity export and import, exceeded the maximum pre-crisis values of mid 2008. The situation in the labor market has improved; the upward trend is demonstrated by real earnings which were higher as early as in 2010 than the pre-crisis figures. However, real disposable income added only 0.8% as compared with 2010, which is connected with increased compulsory payments and the growth of the consumer and mortgage lending segment.

On the part of production, GDP trend is conditioned, first of all, by the growth of manufacturing activities, construction and extremely high pace of growth in agriculture.

On the part of demand, the economic growth is connected with the growing share of consumption and investments and recovering growth of inventories. GDP trend was negatively influenced by net exports, as the growth rate of imports remained high while the growth rates of exports were slowing down.

Key Development Indicators of the Russian Economy, 2009-2011, % from the Same Period of the Previous Year

| | 2009 | 2010 | 2011 |
|---|-------|-------|-------|
| GDP | 92,2 | 104,0 | 104,3 |
| Consumer price index (period on period) | 108,8 | 108,8 | 106,1 |
| Industrial production index | 90,7 | 108,2 | 104,7 |
| Manufacturing activity index | 84,8 | 111,8 | 106,5 |
| Agricultural production index | 101,4 | 88,7 | 122,1 |
| Fixed capital investment | 83,8 | 106,0 | 108,3 |
| Construction works | 86,8 | 103,5 | 105,1 |
| Commissioning of residential housing | 93,5 | 97,6 | 106,6 |
| Real disposable money income | 102,1 | 105,1 | 100,8 |
| Real wages | 96,5 | 105,2 | 104,2 |
| Retail turnover | 95,1 | 106,4 | 107,0 |
| Paid public services | 97,5 | 101,5 | 103,0 |
| Commodity exports, \$ billion | 303,4 | 400,6 | 522,0 |
| Commodity imports, \$ billion | 191,8 | 248,7 | 323,8 |
| Average Urals oil price, \$/barrel | 61,1 | 78,2 | 109,3 |

Source: Rosstat of the RF, the Ministry of Economic Development of the RF

¹ This section was prepared based on data of the RF MED.

According to Rosstat, the growth of **industrial output** reached 4.7% in 2011 compared with 2010. The contribution of the manufacturing sector with the output growth of 6.5% into the total growth of industrial output was 90.5 percent. From this sector, 35.7% of total growth was ensured by "manufacture of transport vehicles and equipment" (output growth by 24.6%). From this sector, the growth of extraction of commercial minerals in 2011 was 1.9% accounting for 9.2 percent contribution into the total output growth.

According to Rosstat, in 2011 the growth of **capital investments** was 6.2% as compared with the level of 2010. By the end of the year, the growth of investments became significantly faster and in the IV quarter was 7.3% as compared with 1.7% in the III quarter with the exception of the seasonal and the calendar components.

Investment activity is supported by growth of lending to legal entities and self-employed individuals. Although the average weighted rate on ruble loans to non-financial organizations for a term of up to 1 year increased by 0.2 percentage point in November as compared with October (to 8.8% - the maximum value over eleven months of the current year), the aggregate amount of granted loans of this kind, according to the Bank of Russia, increased by 11.8% and reached 22,480.9 bln rubles. Moreover, October 2011 triggered increasing growth of accumulated earnings of companies and organizations (from 20.6% in September to 22.4% in October and 23.5% in November).

Growing capital investments of 2011 were accompanied by the growth of business in the "**Construction**" sector. In 2011, as compared with 2010, the growth of business volume in the "Construction" sector was 5.1 percent. In 2011, 62.3 sq m of housing was put into use (by 6.6% more than in 2010). Over the year, 788.2k new apartments were built, among them 244.9k – in December 2011 (31.1% of the year-to-date quantity). The situation with the completion of residential buildings in December was positively influenced both by the traditional end-year peak of housing completion by construction contractors and by continuing improvement of residential mortgage conditions.

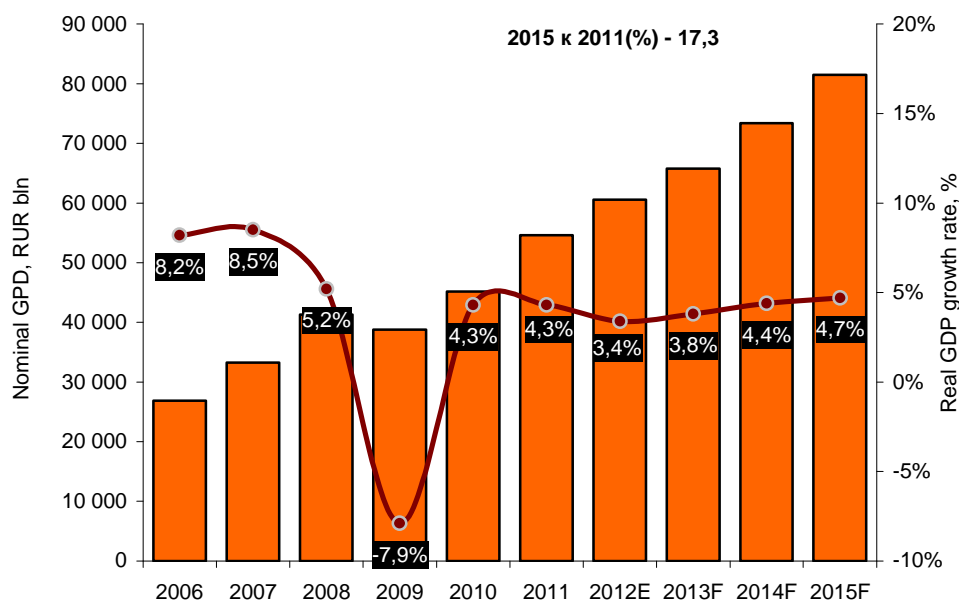
Consumer demand remains one of the key factors of economic development. In 2011, the turnover rate of **retail** became considerably higher in the second half of the year – from August the growth rates (in comparable prices as compared with the same period of 2010) were steadily above 8% promoted by fast decline in inflation in the second half of the year. According to updated information of Rosstat, the growth of retail turnover was 7.0% in 2011, which is by 0.6 percentage point higher than the level of 2010.

In 2011, **headline inflation** attained its minimum in the contemporary Russian history – 6.1% and lost 2.7 percentage points against 2010 (8.8 percent).

Forecast of Russian Economic Development in 2012-2015

The growth path of the Russian economy over the forecast period will in many respects be connected with the situation in the global raw material and capital markets. Expected recession in the Euro zone will definitely have an adverse effect on the pace of the Russian economic development in the midterm. First of all, this will affect Russian foreign economic activity; this tendency already manifested itself in January-May 2012 when the growth rates of imports and exports nosedived in comparison with the same period of 2011. According to the Federal Customs Service of the Russian Federation, in January-May 2012 the growth rates of imports were 106.9% against 143.0%, exports – 110.4% against 128.7% in the same period of 2011.

Nominal GDP of Russia, bln rub., 2006-2011, Forecast for 2012-2015



Source: RF MED

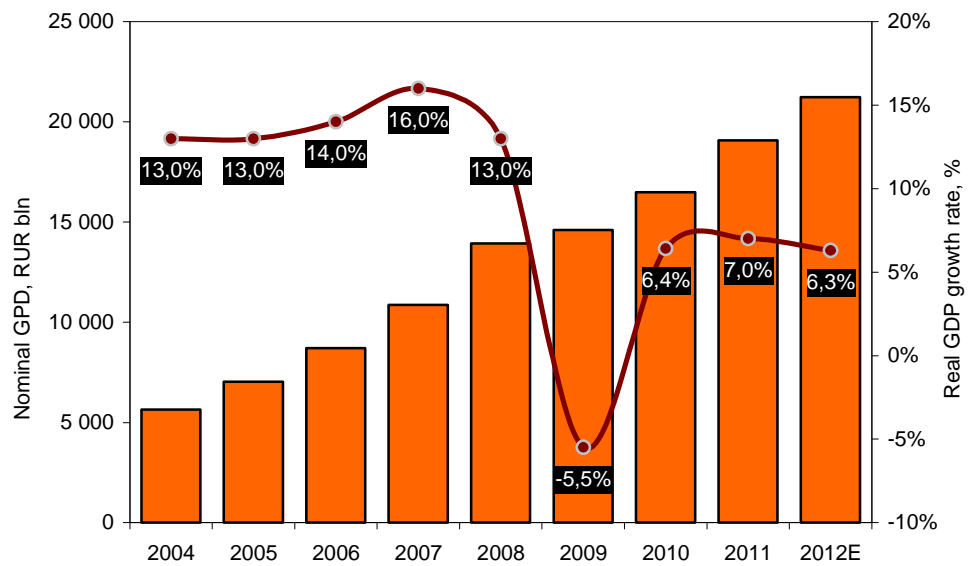
According to forecasts, GDP growth will be around 3.4% in 2012, which is lower than the December forecast of the MED (3.7%). The slowdown in GDP growth rates, according to the RF MED, will be conditioned by decreasing gross accumulation, as estimated capital investment growth figure goes down to 6.6% against 7.8% in the December forecast. Besides, another cause of decelerating GDP growth in 2012 will be decreasing growth of net exports associated with the imports growth estimate rising to 12.5% against 11.4% and the concurrent ruble rate strengthening. The exports growth was increased by 0.3 p.p. to 2.3 percent.

Development of Retail in 2011 and Expected Development in 2012-2015

Retail is one of the most dynamic sectors of the Russian economy which develops faster than other industries. In 2011, the growth rate of retail turnover was considerably higher than the forecast values of early 2011 (3.8%) and reached 7.0 percent in spite of the sharp slump in real disposable household income (0.8% in 2011).

The key growth factor of retail was the slowdown of the headline inflation to 6.1% in 2011 (2010: 8.8%). According to Rosstat, the retail growth rate increased in the second half of 2011 promoted by fast decline in inflation during that period.

Russia's nominal GDP in billion rubles, 2004-2012, and forecast for 2011-2014



Source: The RF MED, the RF Ministry of Industry and Trade (update)

According to Rosstat, in 2011 retail turnover was 19,083 bln rubles having added 7.0% in comparable prices against 2010. In 2011, the percentage of food products, including beverages, in the retail turnover structure was 47.8%, the percentage of non-foods – 52.2% (in 2010 – 48.6% and 51.4% respectively). The decreasing percentage of food products in the aggregate retail turnover implies the return of the pre-crisis consumer behavior model. In many respects this was promoted by the sharp slump in the headline inflation in respect of food products in 2011 (3.9% against 12.9%).

RECOVERY OF THE CHAIN FOOD RETAIL MARKET

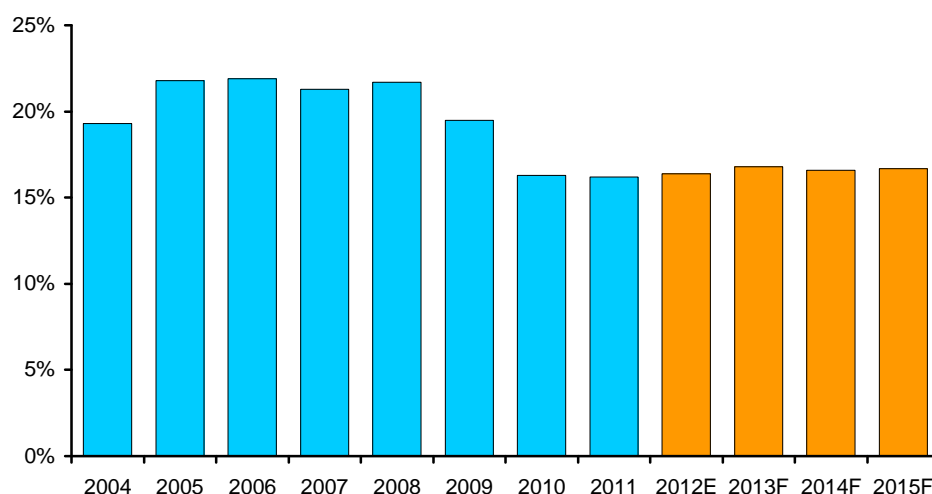
In 2011, the Russian market demonstrated the highest revenue growth rates after the downfall which means that the post-crisis period is over. The favorable environment of the Russian economy in 2011 contributed to the growth of retail indicators. However, the Russian market entered the phase of maturity which implies gradual slowdown of growth and increasing competition in the future

So far the consumption level is considerably higher than in the mature markets of Europe and the USA, as the Russian buyers have reduced their savings and increased their expenditure on consumer goods and payments for credits. Ongoing reduction of savings and low interest to the securities market and other investment instruments shall be attributed to extremely low supply in this sector and low customer confidence. As a result of this situation the Russians spend more than people in Europe or the USA

Regional chains managed to overcome the negative consequences of the crisis and in 2011 their development pace became faster. Besides, they managed to improve their LFL figures and outperform federal companies by a number of indicators. In Siberia and the Far East, regional companies have leading positions owing to still low level of logistic development. In the Urals the positions of federal chains are becoming stronger, their market share increases.

In 2011, the lending activity of the Russian banking sector significantly increased; in spite of the growth of average weighted rates on credits, in 2011 the amount of loans granted to non-financial institutions increased by 26 percent. For banks, retail is one of the key sectors as it demonstrates steady development rates.

Contribution of Retail Sector to Russian GDP, %, 2004-2011, Forecast for 2012-2015



This indicator includes wholesale and retail turnover, repair of motor vehicles, motorcycles, household appliances and personal demand items

Source: the RF MED

In 2011, the contribution of the retail sector to GDP remained without significant changes as compared with 2010, notwithstanding the growth rate. In 2012-2015, this indicator is expected to increase; however, it will remain within the limits of 16-17 per cent.

The investment climate in Russia can hardly be characterized as favorable; in 2011 capital outflow from Russia became more intensive, now it is around 10 bln US dollars in a month.² Low confidence of business in Government and the desire to drive it away from Russia are conditioned by many reasons: high level of bureaucracy, violation of laws, frequent changes in the taxation system, absence of free competitive

² Information from the Saint-Petersburg International Economic Forum, June 2012

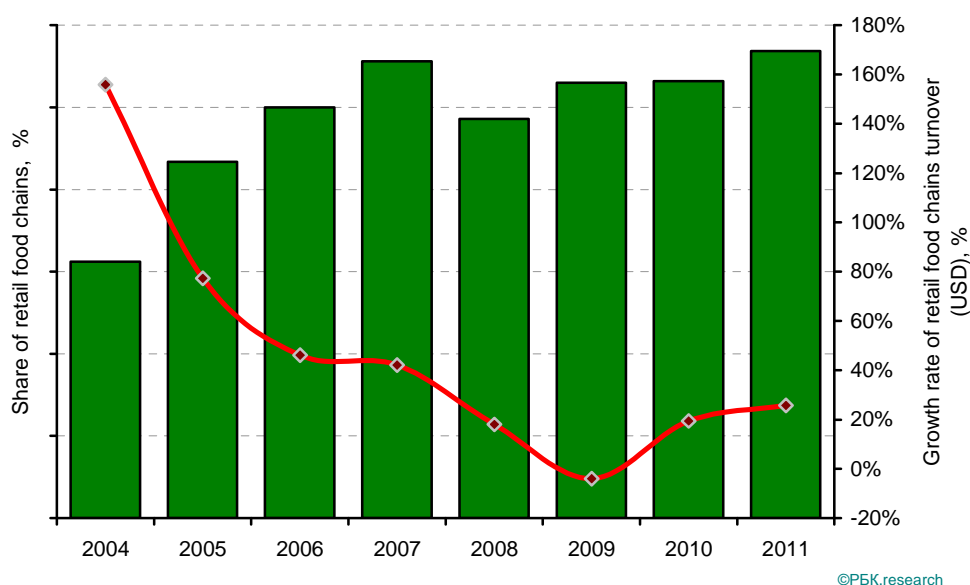
market, etc. This obstructs the influx of foreign investments in limiting the growth rates of the Russian economy.

Development Indicators of Food Retail Market in 2011

In 2011, the sector of food retail chains has completely recovered after the crisis, on the whole retail growth rates were higher than predicted by the MED at the beginning of the year, while consumer behavior gradually returns to the pre-crisis model, especially in the cities with high level of incomes.

Although the environment in the retail market has improved, in 2011 the revenue growth rates of the largest retailers were multidirectional by nature. It shall be noted that in 2011 the revenue growth rates of the global networks ranking among the Top-10 were significantly below the revenues of X5 Retail Group, Dixy and Magnit. The revenues of the Real hypermarkets demonstrated a slower growth rate than in 2010.

Growth in the share of retail food chains in total food retail turnover in Russia (USD), 2004–2011



Source: RBC.research

According to RBC.research, in dollar terms the turnover of food retail chains rose by ...% in 2011 as compared with the same indicator of the previous year. We estimate the turnover of chain retail in food products in 2011 as \$... bln (... bln rub.).³

...

In 2011, the market consolidation process became significantly faster due to the amalgamation of the leading companies. According to RBC.research, at the end of 2011 ten largest companies of the food chain retail sector accounted for ...% (in 2010: ...%) from the total food retail turnover and ...% (in 2010: ...%) of the aggregate turnover of food retail chains in Russia. The largest retailers managed to achieve considerably high revenues, which influenced the trends of aggregate performance indicators of the Top 10 in 2011.

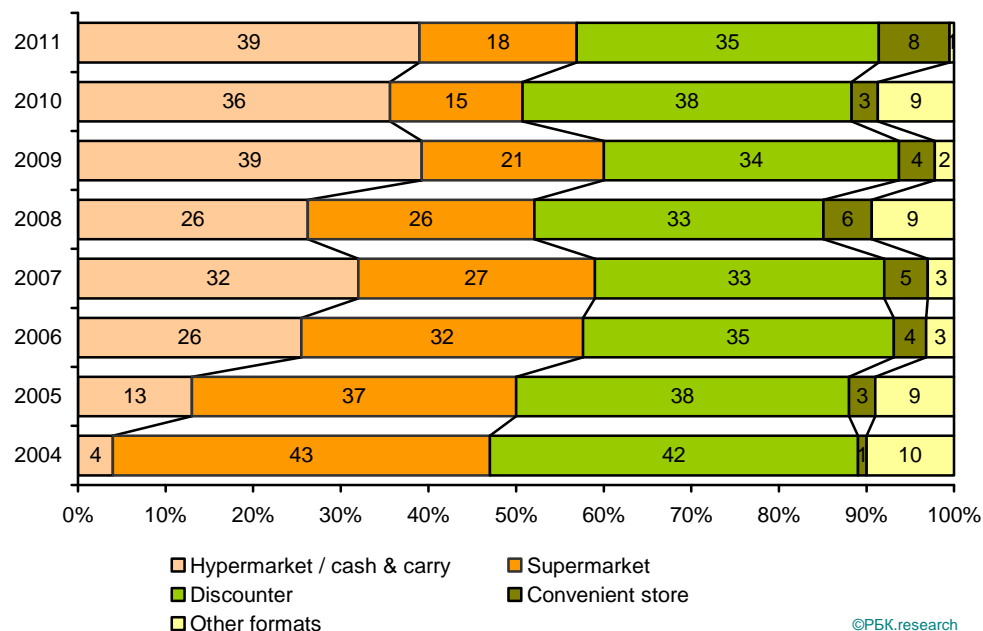
In general, 2011 was a successful year for the Russian food retail; however, in 2012 its growth rates may be lower because of the inflation that increased in the second half of the year. Among positive factors one should mention the ban to sell alcoholic beverages and beer through mobile outlets which will have a positive effect on the revenues of retail chains that will be able to occupy this niche.

³ Calculations were based on the official annual average exchange rate of US dollar against the Russian ruble – 29.36 RUB. / US dollar

Retail Format Structure of Food Retail Chains in 2011

In 2011, the dominant positions of discounters in the Russian FMCG retail market have become obviously weaker. In spite of maintained key positions in the format structure, the share of discounters at the end of 2011 decreased by .. p.p. and was ...% of aggregate revenues of chain food retail.

Structure of Food Retail Turnover by Retail Chain Formats, 2004-2011



Source: information from companies, estimate by RBC.research

Key Features of Russian Chains

Based on the information received during the survey of the companies operating in the Russian food retail sector and the published data open to public, the analysts of RBC.research prepared a list of key business features and parameters that reflect the performance of retail chains. The tables below contain the maximum, the minimum and the average values.

General Characteristics (average sales area, number of personnel and traffic of chain stores)

Average Sales Area, Distribution by Formats, sq m, 2010-2011

| Format | Min, 2010 | Min, 2011 | Max, 2010 | Max, 2011 | Average, 2010 | Average, 2011 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies, estimate by RBC.research

Personnel per Store, Distribution by Formats, people, 2010-2011

| Format | Min, 2010 | Min, 2011 | Max, 2010 | Max, 2011 | Average, 2010 | Average, 2011 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies, estimate by RBC.research

Daily Customer Traffic per Store (Number of Cash Receipts), Distribution by Formats, people, 2010-2011

| Format | Min, 2010 | Min, 2011 | Max, 2010 | Max, 2011 | Average, 2010 | Average, 2011 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies, estimate by RBC.research

Range of Food and Non-Food Products

Total Product Line, SKU, 2011-2012

| Format | Min, 2011 | Min, 2012 | Max, 2011 | Max, 2012 | Average, 2011 | Average, 2012 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies as of April 2011 and 2012, estimate by RBC.research

Range of Food Products, SKU, 2011-2012

| Format | Min, 2011 | Min, 2012 | Max, 2011 | Max, 2012 | Average, 2011 | Average, 2012 |
|--------|-----------|-----------|-----------|-----------|---------------|---------------|
| | | | | | | |

| Format | Min, 2011 | Min, 2012 | Max, 2011 | Max, 2012 | Average, 2011 | Average, 2012 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies as of April 2011 and 2012, estimate by RBC.research

Range of Non-Food Products, SKU, 2011-2012

| Format | Min, 2011 | Min, 2012 | Max, 2011 | Max, 2012 | Average, 2011 | Average, 2012 |
|----------------------------|-----------|-----------|-----------|-----------|---------------|---------------|
| Discounter | | | | | | |
| Soft discounter | | | | | | |
| Supermarket | | | | | | |
| Hypermarket / cash & carry | | | | | | |
| Convenient store | | | | | | |

Source: information from companies as of April 2011 and 2012, estimate by RBC.research

Ratio between Food and Non-Food Products in Product Line, Format Average, %, 2011-2012

| Format | Food, 2011 | Non-Food, 2011 | Food, 2012 | Non-Food, 2012 |
|----------------------------|------------|----------------|------------|----------------|
| Discounter | | | | |
| Soft discounter | | | | |
| Supermarket | | | | |
| Convenient store | | | | |
| Hypermarket / cash & carry | | | | |

Source: information from companies as of April 2011 and 2012, estimate by RBC.research

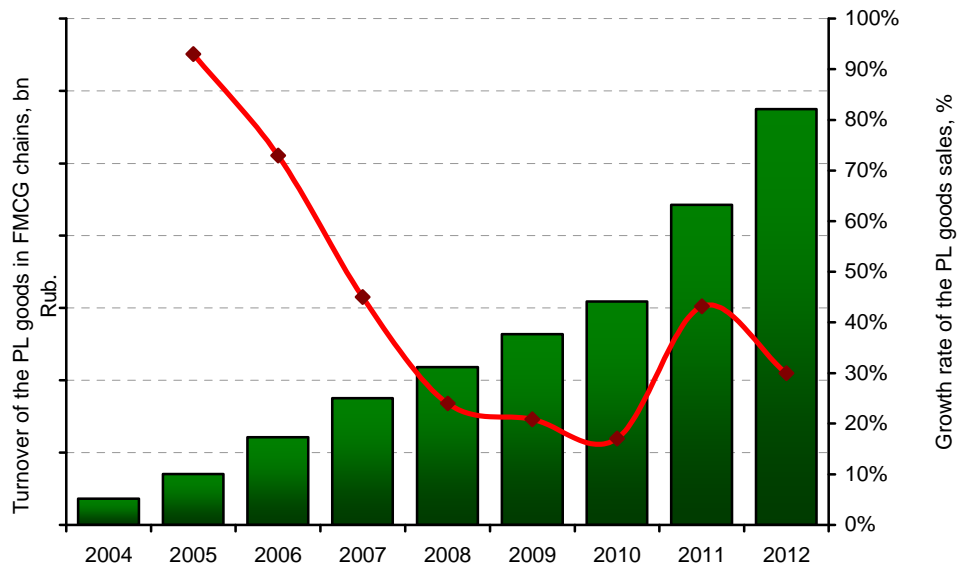
Private Label Goods

Private labels began to develop in 2007, and during the crisis this trend became one of the most promising in assortment policies. On average, the percentage of private label sales by federal and foreign chains was ...% from revenues in 2011.

The greater part of private label goods are food products which, actually, ensure the basic amount of sales. Currently no accurate data are available in respect of this fig-

ure, but by the estimates of individual chain data it may be assumed that the share of food products in the aggregate sales of private label goods may be around ... percent.

Turnover of Private Label Goods of Food Chains that Operate in Russia, rub., 2004-2011, Forecast for 2012



© RBC.research

Source: RBC.research

In the midterm, the market of private label goods will grow further, which is connected with the increasing share of loyal customers, improving quality and range of private label goods, as well as the outrunning growth of prices for branded products.