

Market

Overview

The market environment in the Russian retail sector remained challenging throughout 2020, for both retailers and consumers. However, despite the overall economic decline both globally and across Russia as a result of the COVID-19 pandemic, food retail was one of the least affected sectors. Moreover, the leading players in modern retail, especially focused on the formats of convenience stores, were able to significantly increase their sales and strengthen their position in the market.

Macroeconomic Environment

In 2020, Russia's real GDP fell by 3.1% due to the economic slowdown amid restrictions related to the COVID-19 pandemic. According to the Ministry of Economic Development forecasts for 2021, real GDP will grow by 3.3%. Similar to 2020, in 2021 the state plans to stimulate the recovery of economic growth through assistance for the most affected sectors and investments in a number of projects.

In 2020, large-scale measures were taken to support various demographics, including families with children, pensioners and the unemployed.

In particular, in the middle of the year, monthly payments were introduced (which is about half of the regional subsistence level, or average RUB 5.5 thous. per child per month) for low-income families with children aged 3-7 years.

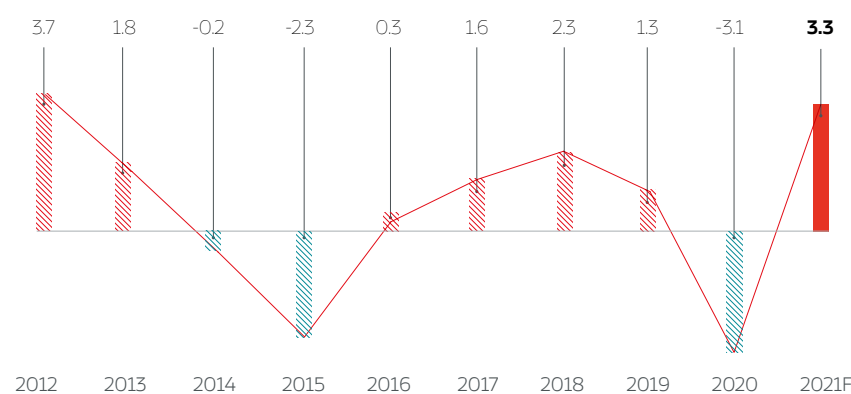
3.3%

Forecasted real GDP growth in Russia for 2021

3.0%

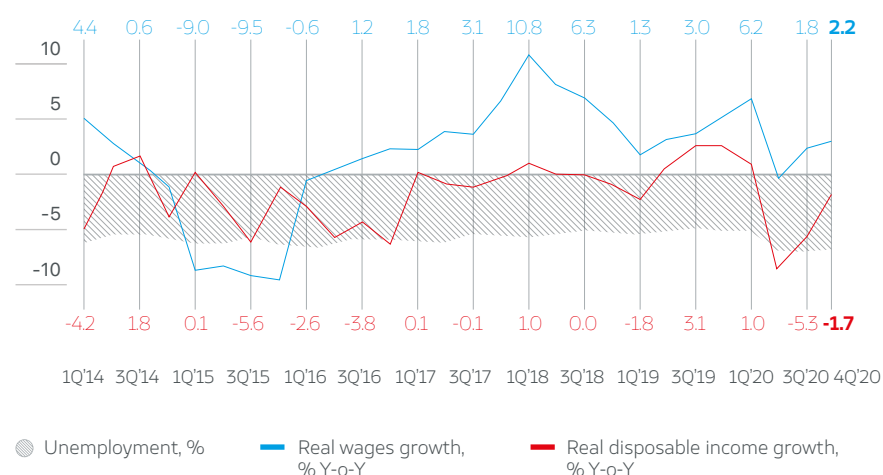
Forecasted RDI growth in Russia for 2021

Real GDP Change in Russia in 2012-2021F, YoY, %



Source: Federal State Statistics Service, Ministry of Economy Development of the Russian Federation

Real Wages, Real Disposable Income change and Unemployment Rate in Russia in 2014-2020, %



Source: Federal State Statistics Service, Ministry of Economy Development of the Russian Federation

Russian Food Market at a Glance

14%

sales growth of Top-10 in 2020

22%

share of traditional retail in Russia

34%

share of top-5 Retail Chains

8th

largest in the world

At the same time, payments for children under 3 years of age (RUB 11 thous. per child per month) continue for low-income families from 2018. In addition, various single payments were made to all families with children aged 0-3 and 3-16 years, directly related to the period of the COVID-19 pandemic in April and July. In addition, in December 2020, the President of Russia signed a decree on a one-time payment to families with children in the amount of RUB 5 thous. per child under the age of 8.

The minimum wage in 2020 increased by 7.5% to RUB 12,130 per month.

It is assumed that in 2021 the minimum wage will increase further by 5.5% to RUB 12,792 per month. There was also a temporary increase in the minimum and upper limits of unemployment benefits in 2020. At the same time, non-working individual entrepreneurs began to receive unemployment benefits at the upper limit.

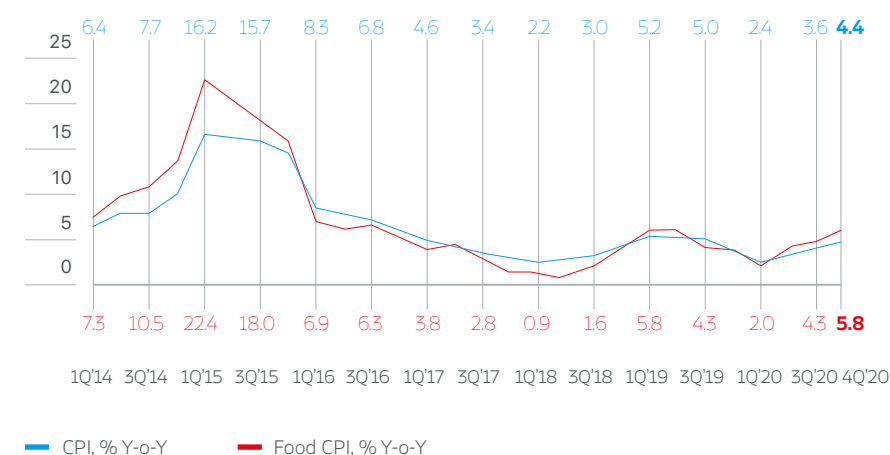
In some regions (for example, in Moscow), special payments were introduced for people over 65 and for those with chronic diseases. Furthermore, separate payments, both at the federal and regional level, were made to veterans of the Great Patriotic War.

Assistance was also rendered to small and medium-sized businesses. For companies in the most affected sectors, partial tax breaks were provided in Q2 2020, including income tax, employee national insurance contributions and others. Moreover, starting from the Q2 2020, the employee national insurance contributions rate for all small and medium-sized businesses was reduced from 30% to 15%.

The Central Bank of Russia played an important role in supporting the economy with a further reduction of the key rate from 6.25% in early 2020 to 4.25% by year-end. The government also launched various preferential programmes for loans, mortgage loans in particular. Opportunities were introduced to provide repayment holidays for individuals and individual entrepreneurs for a period of up to 6 months in the event of a decrease in monthly revenue by 30% year-on-year or more.

In 2020, average real wages remained almost unchanged (+2.5% year-on-year), while real disposable income (RDI), amid restrictions due to the COVID-19 pandemic, showed the most rapid decline in the last years (-3.5% year-on-year). The average unemployment rate grew to 5.8%.

CPI and Food CPI in Russia in 2014-2020, %



Source: Federal State Statistics Service

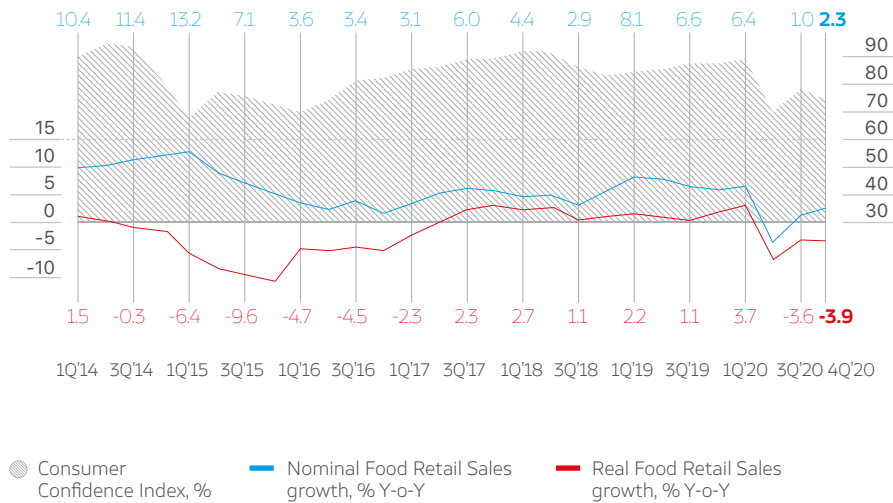
Market overview (continued)

We note a moderate impact on the population of Russia's incomes and unemployment level compared to developed countries. Russia has a small share of small and medium size enterprises in its economy (around 20% of Russian GDP versus 50-60% of GDP in advanced countries). The relatively high proportion of the Russian population working for the public sector (around 25% of the Russian workforce versus 15% in developed countries) provided further stability. Finally, about 36 million pensioners had their pension indexed by 6.6%, which is higher than the inflation rate (CPI growth). Looking ahead, in 2021, pensions are set to be increased by 6.3%.

The Ministry of Economic Development of Russia expects RDI growth of 3.0% in 2021 driven by the rebound in incomes from property and business after a significant decline this year. The unemployment rate is forecast to decline to 5.2% in 2021.

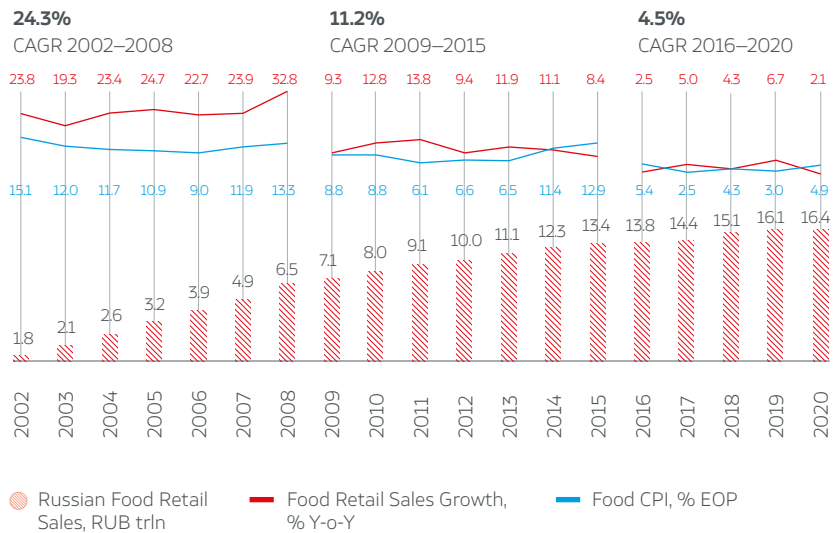
In 2020, the Consumer Price Index (CPI) grew by 3.4%, while Food CPI increased by 3.9%¹. According to the Ministry of Economic Development of Russian Federation, CPI is expected to grow by 3.7% in 2021, as planned fiscal consolidation will have a restrictive effect on the CPI growth, which will only be partially offset by the mitigation of monetary policy. In the future, the growth rate of CPI is expected to return to the target level of the Bank of Russia (4%).

CCI and Real Food Retail Sales growth in 2014-2020, %



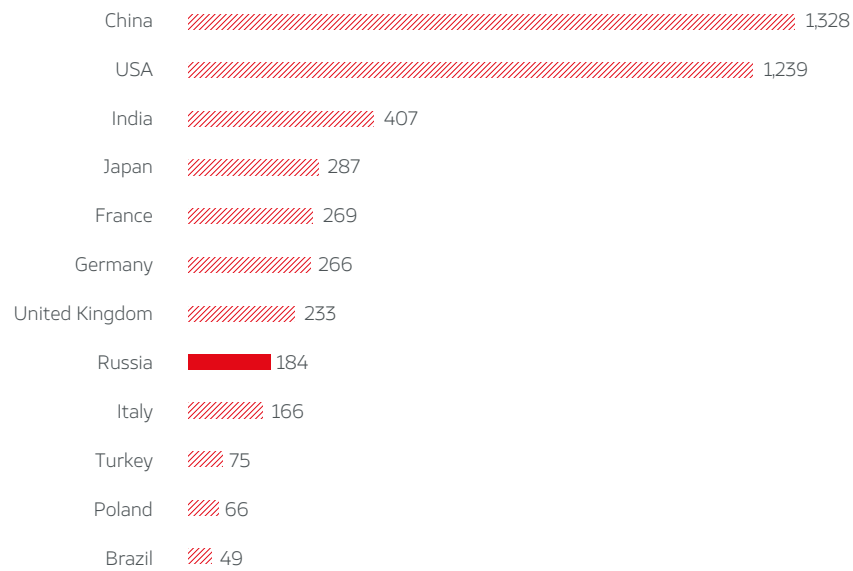
Source: Federal State Statistics Service

Food Retail Sales in Russia in 2002-2020



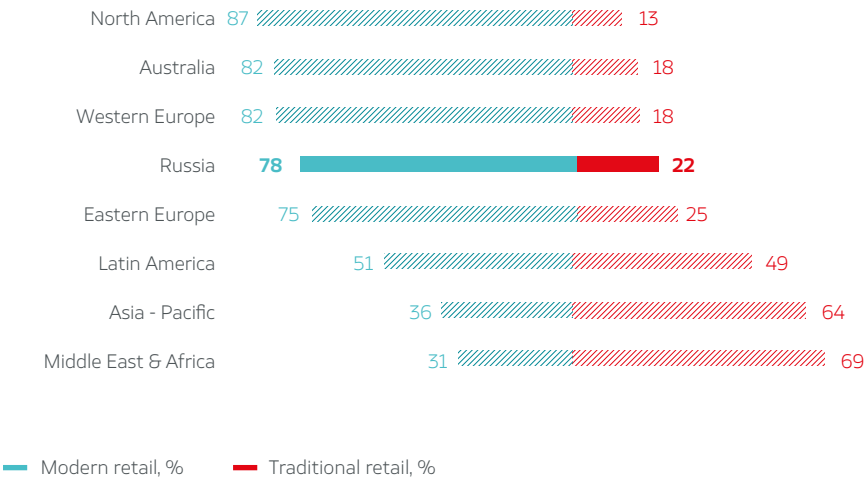
Source: Federal State Statistics Service, Ministry of Economic Development of Russian Federation, Magnit analysis

Grocery Retail Market in 2020, USD bln



Source: Euromonitor, 2020

Share of Modern and Traditional Retail in 2020, %



Source: Euromonitor, Infoline, 2020

The Russian Retail Market

The real growth of food retail sales in Russia in 2020 was negative (-2.6%)². The decline was primarily due to a sharp drop in sales in traditional grocery retail and big box formats associated with restrictions and changing consumer behavior due to the COVID-19 pandemic. At the same time, sales in modern convenience stores have grown significantly. Despite both decreased RDI and consumer confidence index (CCI) having a negative impact on the whole industry, in some large retail chains, such as Magnit, customers tended not to decrease their spending.

On the contrary, customers spent more on food while cutting their spend on travel, entertainment, services, etc. The statistics clearly reiterate that grocery retail is among the least affected industries by the COVID-19 pandemic in Russia. In 2020, the Russian food retail market remains the eighth largest in the world in terms of revenue, ahead of countries such as Italy, Turkey, Brazil and Poland.

The modern Russian food retail market has solid potential for further growth and strong players are gaining market share. The share of modern retail in 2020 in Russia was 78%, behind the markets of North America (87%), Australia (82%) and Western Europe (82%). The Russian retail market remains underpenetrated.

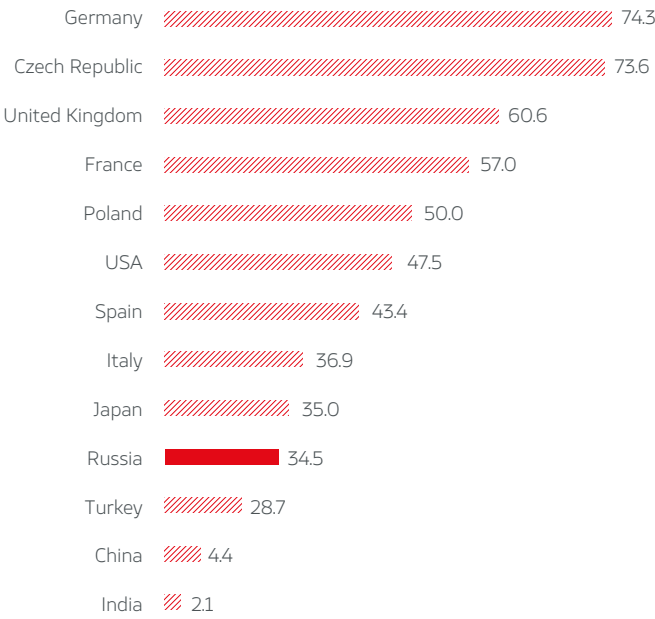
The retail market in Russia remains fragmented with significant potential for further market share growth for the top players, especially Magnit, which recorded robust results. At the end of 2020, the share of revenue of the top 5 retail chains was 34.5%, up 3.5 pp versus 2019.

¹ Average annual inflation rate is given based on the average quarterly CPI changes year-on-year. Inflation rate at the end of December 2020 since December 2019 was 4.9%.

² According to Federal State Statistics Service.

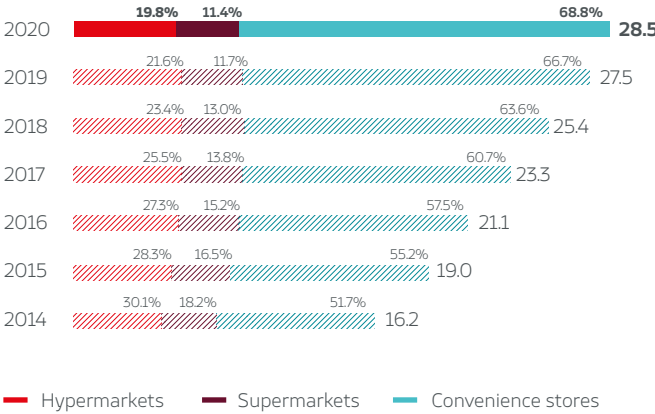
Market overview (continued)

Share of Top-5 Retail Chains by Countries in 2020, %



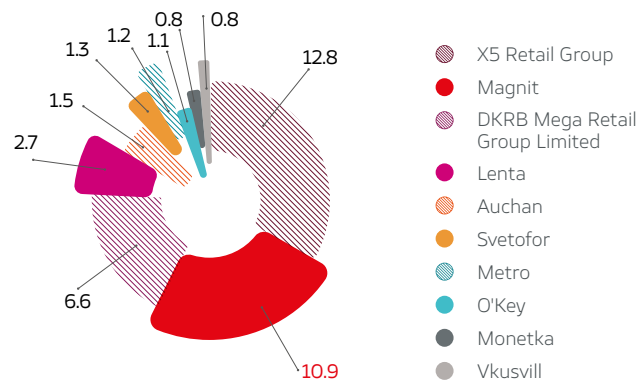
Source: Euromonitor, Infoline, Magnit analysis 2020

Total Selling Space in Russia for modern retail in 2014-2020, mln sq. m



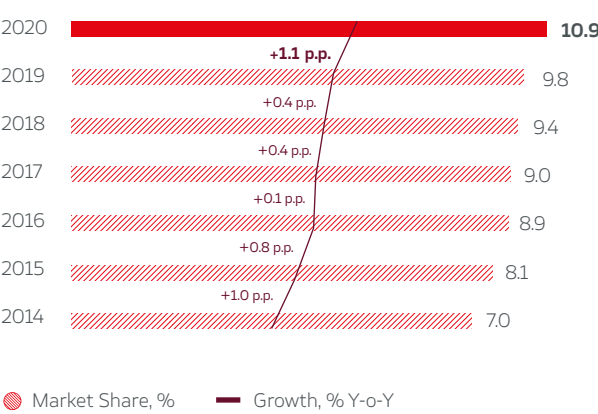
Source: Infoline, Magnit analysis, 2020

Top-10 Retail Chains Market Share in Russia in 2020, %



Source: Infoline, Magnit analysis 2020

Magnit Market Share by Revenue in Russia in 2014-2020, %



Source: Federal State Statistics Service, Magnit analysis 2020

Magnit is

#1

in Russia by number of stores and geographical footprint¹

#2

retail chain in Russia by revenue



In this respect, Russia remains behind developed countries, where the top 5 players account for 50% or more of the market.

Over the past few years, leading Russian retailers have recorded a significant increase in their respective market shares, primarily due to the rapid growth of convenience stores. The COVID-19 pandemic has accelerated continued market consolidation by industry leaders due to the weak performance of traditional retail and inefficient players. Both small players and ineffective retail chains are leaving the market, which provides good opportunities for large effective players to occupy well-located vacant retail premises not only individually, but also in large quantities. In 2020, the Top-10 companies in Russian retail demonstrated sales growth by 14% year-on-year. According to Infoline, the growth was primarily driven by inflow of customers to federal retail chains. Magnit's market share in 2020 increased by 1.1 pp (the highest growth in the last 5 years) to 10.9% primarily due to the changes in CVP leading to higher sales densities.

In recent years, one of the major trends has been an increase in the number of convenience stores while the average selling space has decreased. The COVID-19 pandemic has only accelerated this trend due to restriction of movement. Magnit has benefitted from the restrictions thanks to its multi-format business model and dominant share of local stores.

Our CVP is continuously evolving. We are building our offering in each format depending on the preferences of customers in different areas to become a store of choice. For instance, this year Magnit launched Metropolitan Convenience store tailored for customer preferences in larger cities as well as started piloting discounter "My Price". We are developing our online expertise and plan to undergo a full digital transformation to be even more transparent and accountable for our stakeholders and shareholders.

Magnit is focused on profitability of every project, while piloting new formats and adapting our value proposition to spearhead the market trends and changing customer preferences.

In 2021, we will continue our smart growth strategy. With improved sales density and attractive returns on new store openings, we will accelerate our organic expansion and continue to closely monitor the opportunities that the market provides.

See more at [Strategy](#) (p. 46.) and [Operational Review](#) (p. 58.)

Key Trends in the Retail Market

Key trends in consumer behavior and preferences

Trend	Description
Consumer behavior	<ul style="list-style-type: none">— The COVID-19 pandemic significantly increased the trend towards shopping in convenience stores— Customers began to visit stores less often, but at the same time they began to make larger purchases, which led to a simultaneous decrease in traffic and an increase in the average ticket— The trend to shop online has skyrocketed due to the COVID-19 pandemic, especially in large cities such as Moscow and Saint Petersburg. The e-grocery market in Russia in 2020 grew by 229% and reached RUB 148 bln, which is 0.9% of the total food retail market volume— From consumers leaving large hypermarkets, there is an increasing demand for more expensive products in convenience stores
Consumer preferences	<p>Despite the COVID-19 pandemic restrictions and the economic environment, consumer preferences are still shifting towards:</p> <ul style="list-style-type: none">— Healthy and safe food— Simple and convenient service— Quality and fresh products, especially fruit and vegetables— Unique and local products— Responsible consumption— Technologically friendly and omnichannel services— Awareness about products and shops from the media

¹ Federal State Statistics Service, public disclosures, Magnit analysis 2020.

Market overview (continued)

Key trends in Russian retail market

Trend	Description
Accelerated industry consolidation and growing availability of real estate	— The pandemic has strengthened the trend towards consolidation of the industry by leading players due to the withdrawal from the market of some more traditional retailers, HORECA, and small regional and ineffective players
Rapidly evolving technologies	— Actively emerging digital ecosystems (e.g. Yandex, Mail.ru Group, Sber, Amazon, Wechat, Alibaba Group) erase the borders of traditional sector based thinking — Digital experience has become an essential part of today's lives including shopping
Migration to big cities	— Migration to big cities strengthened after COVID-19 pandemic, which drives changes in customer needs
Aging population	— The population of Russia is in decline and the proportion of people receiving state support in various forms is increasing
Moderate inflation rate	— Healthy inflation rate allows for more comprehensive planning of relationships with suppliers and supports retailers
Growing interest in sustainable development	— Increased interest in sustainable development among stakeholders — Growing attention to responsible waste disposal — Increased focus on relationships with suppliers — Higher investor expectations
Political factors	— Sanctions by the US and the EU — Counter-sanctions — Continuous support of local suppliers and manufacturers by government — Regional protectionism

Key Changes in the Regulatory Environment in 2020

Change	Regulatory Document	Effective Date
Lower VAT rate on import and sale of fruit and berries in Russia (including grapes), down from 20% to 10%.	Federal Law "On Amendments to Article 164 of Part Two of the Tax Code of the Russian Federation".	4 January 2020
Increase in excise tax on the sale of alcohol	Federal Law of 29 September 2019 No. 326-FZ	1 January 2020
New legal regulation of domestic viticulture and winemaking	Federal Law of 27 December 2019 No. 468-FZ	26 June 2020
Monthly cash payment for a child aged 3 to 7 years	Federal Law of 20 March 2020 No. 199-FZ	1 January 2020
The official publication of the amended Constitution of the Russian Federation, in particular including a policy ruling that the minimum wage cannot be lower than the subsistence minimum.	Decree of the President of the Russian Federation No. 443	4 July 2020
A ban on the production and import of unlabeled drugs	Federal Law of 27 December 2019 No. 462-FZ	1 July 2020
Organic products and their manufacturers are introduced, along with the norms for their production, storage, transportation, labeling, and regulated sales	Federal Law No. 280-FZ	1 January 2020

Key Changes in the Regulatory Environment in 2020 (continued)

Change	Regulatory Document	Effective Date
Experiment in receiving consumer packaging in retail outlets.	Instruction of the Deputy Prime Minister of Russia dated by 20 July 2020	Q4 2020 - Q3 2021
Resolution on the approval of the Rules for the provision of catering services, according to which restaurants and cafes from 2021 will not be able to include any payments that do not relate to the cost of ordered dishes and selected services.	Resolution of the Government of the Russian Federation dated by 21 September 2020 No. 1515 "On approval of the Rules for the provision of public catering services"	1 January 2021
Decree for manufacturers, suppliers and retailers on setting price caps for sugar and sunflower oil	An agreement between market participants.	14 December 2020
Increase in minimum retail prices for spirits, including vodka and cognac.	Order of the Ministry of Finance of Russia dated by 7 October 2020 No. 232n	1 January 2021
Establishing the size of the state duty for the provision or renewal of the license for the retail sale of alcoholic beverages.	Draft Law "On Amendments to Article 333.33 of Part Two of the Tax Code of the Russian Federation	1 January 2021
An experiment on labeling beer and other low alcohol drinks, including mead and cider.	Draft Decree of the Government of the Russian Federation "On conducting an experiment on labeling beer, beer and low-alcohol drinks with identification means in the territory of the Russian Federation" dated by 6 November 2020	From 1 April 2021 to 28 February 2022
Transition to piece accounting of alcoholic beverages.	Orders of the Federal Service for Alcohol Market Regulation pursuant to Article 10.2. Federal Law of 22.11.1995 No. 171-FZ "On state regulation of the production and circulation of ethyl alcohol, alcoholic and alcohol-containing products and on limiting the consumption (drinking) of alcoholic products"	1 November 2020
Extension of the anti-tobacco law to all nicotine-containing products.	Federal Law No. 303-FZ of July 31, 2020	28 January 2021
Increase of excise taxes on cigarettes and other tobacco products in Russia by 20% in 2021	Federal Law of 15 October 2020 No. 321-FZ	1 January 2021
A variety of changes that affected trade were linked to the coronavirus pandemic and approved by Rospotrebnadzor both at the federal and regional levels (provision of PPE, introduction of preventive measures, disinfection, etc.)	At the year end, Recommendation for the Prevention of the Novel Coronavirus Infection (COVID-19) in Trade (MR 3.1/2.3.5.0191-20) approved on 21 April 2020 – became mandatory in accordance with the sanitary and epidemiological rules SP 3.1.3597-20, Prevention of the Novel Coronavirus Infection (COVID-19)	On 21 April 2020, it was decided to extend the term of the rules until 1 January 2022