X5 RETAIL GROUP

Local everywhere

Annual Report
2017

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All sections under Part 1 ‘Strategic Report’ and Part 2 ‘Corporate Governance Report’, with the exception of the Chairman’s statement, Supervisory Board Report and Remuneration Report, together form the Management Report (“bestuursverslag”) within the meaning of section 2:391 of the Dutch Civil Code.

Local everywhere

This year's report includes symbols that represent each of Russia's republics, illustrating our commitment to meeting the needs of Russia's diverse population.

›01 Strategic report

Overview

About this report

In this report, we aim to inform our readers about material issues that have the potential to impact our business and to explain how this influences our strategy, our operations, our financial performance, the long-term sustainability of our business and the value we seek to create for our stakeholders.

This report aims to answer key questions such as:

In the following sections of this report, we provide our insights towards answering the following core questions:

- What does X5 Retail Group do, and what are the circumstances under which it operates?
- How does X5 Retail Group's governance structure support its ability to create value for stakeholders in the short, medium and long term?
- What is X5 Retail Group's business model, why did we choose this model and what makes it unique?
- What are the specific risks and opportunities that affect the Company's ability to create value for stakeholders in the short, medium and long term?
- What are the Company's key strategic goals, and how does it intend to achieve them?
- To what extent did the Company achieve its strategic objectives for the reporting period, and what was the effect on the value of the Company for stakeholders?
- What are the key challenges and uncertainties that the organisation is likely to encounter in pursuing its strategy, and what are the potential implications for the business model and future performance?
- How does the Company determine which matters are worth including in the annual report, and how are such matters quantified or evaluated?

Corporate responsibility

In order to secure the long-term sustainability of our business model and our operations, we are constantly reviewing and monitoring our interaction with stakeholders and the material issues that could affect our business.

We discuss our investments in human capital, health and safety, reducing our impact on the environment, and the local communities where we operate. We provide details on how our governance systems have been adapted to the changing business environment, and how we maintain relationships with our key stakeholders.

For more details, please refer to pages 134-155

Corporate governance and risk management

X5 continues to implement robust corporate governance practices that meet or exceed the requirements of the UK, European and Russian regulations that govern our activities. As a large and rapidly expanding business that is at the forefront of innovation in its sector, the sustainability of our success is due, to a significant degree, to the proper and smooth functioning of our governance and risk management systems.

For more details, please refer to pages 156-191

Determining our material issues

We have determined the material issues to include in this report based on management's understanding of our business model, risks and opportunities, and stakeholder interests. Management uses a variety of tools to remain informed about the material issues facing the Company, including regular internal analysis and reporting mechanisms, market research, external polling and research products, as well as feedback received directly from key stakeholders. While no formalised polling of stakeholders has been conducted for the purpose of determining material issues, it is the belief of management that this report addresses how we interact with and create value for stakeholders in a comprehensive manner.

Mission, vision and values

X5 Retail Group is Russia's leading food retailer. We create, develop and manage a portfolio of retail formats with distinct value propositions and brands that together target all categories of Russian customers.

We are a large business with a sustainable track record of more than 20 years. The Company has evolved from its roots as an entrepreneurial initiative to build a leading Russian retailer that is committed to adopting international best practices. Today, X5 is a business that draws on its entrepreneurial nature to drive growth in the food retail sector. It is a client-oriented business that strives to create value for its customers, shareholders, employees and other stakeholders.

Mission

X5 believes that it should offer all of its customers in all regions, regardless of income level, accessible food products and modern retail services. X5 is a company capable of delivering this by leveraging its scale and the value proposition of its portfolio of retail brands.

We aim to fulfil our mission by:

- Satisfying the food needs and desires of the Russian consumer
- Acting as a reliable partner for national and regional food producers
- Investing to expand Russia's modern food retail infrastructure

Vision

On a sustainable basis, X5 aims to become the recognised leader of the Russian food market and the #1 food store in the hearts of Russian consumers.

Our goal is to be #1 in the hearts of Russian consumers

Values

In order to achieve our mission and our strategic goals and to make our vision a reality, we adhere to a set of values that we believe are best suited to our business:

Customer orientation:
in addition to excellence in every store, we leverage technology and innovations to better adapt to changing demand and to make it possible to bring each of our customers a more personalised shopping experience in an efficient manner.

Innovation:
technology is changing our industry with ever-greater speed, and we intend to be at the forefront of this technological transformation, developing and implementing new ways to increase efficiency and better meet our customers' shopping needs.

Strong leadership:
our management team consists of experienced and highly qualified professionals, and we have implemented long- and short-term incentive programmes to align management interests with our goals of sustainable, long-term, profitable growth for the business.

Effective operating model:
X5 aims to decentralise its operations by giving each of its retail formats significant responsibility for the success of their segment of the business.

Intelligent organic growth:
we expanded our selling space by more than 1 million sq m in 2017, and 87% of our growth was organic. We are constantly optimising store opening procedures.

Efficiency:
we are always seeking ways to improve the efficiency of our operations, optimising business processes to enable us to do our job better and more efficiently.

Key highlights

Stable, sustainable growth

In 2017, we strengthened our position as Russia's leading food retailer, expanding our truly multi-format business model and accelerating our pace of growth, while continuously innovating to improve efficiency and enhance our customer value proposition.

We strengthened our lead as Russia's #1 food retailer. We extended our lead over the other largest players in 2017, as we maintained our focus on sustainable and high-quality growth, and by consistently providing customers with a high-quality value proposition in every one of our stores in Russia.

2017 operating and financial highlights

Revenue increased

by 25.3% year-on-year

to RUB 1,295 billion primarily due to organic growth

Selling space grew

by 27.4% year-on-year

by 1,178 ths sq m

Like-for-like sales

improved by 5.4%

year-on-year increasing across all major formats

Our rapid expansion continued in 2017, and we ended the year with a total of 12,121 stores, having added 2,934 stores throughout the year. With a consistent focus on innovation, efficiency and quality, we aim to deliver on our strategic targets of sustainable and rapid growth of our multi-format food retail business, creating value for our customers to the benefit of all of our stakeholders.

Like-for-like traffic

increased by 3.0%

year-on-year, the highest level since 2009

Net debt/ EBITDA

was 1.73x

the lowest level in X5's public history

Adjusted EBITDA margin

was 7.7%

maintained at the same level as in 2016

Selling space expansion

* The area of Red Square is approximately 23,100 sq m

The 1.2 million sq m of selling space we added in 2017 is equivalent to around 50 Red Squares.

This represents a new all-time record for X5 Retail Group, and the first time we have added more than 1 million sq m of selling space in a single year.

In 2017, our revenue reached a record high of RUB 1,295 bln

We delivered strong growth
of 25.3% year-on-year


RUB 1,295 bln
RUB 1,034 bln
2016
2017

Strategic highlights

Russia’s #1 food retailer expanding our lead in terms of market share:

25.3% year-on-year revenue growth, faster than the top 10 players, and the sector as a whole.

Rapid expansion:

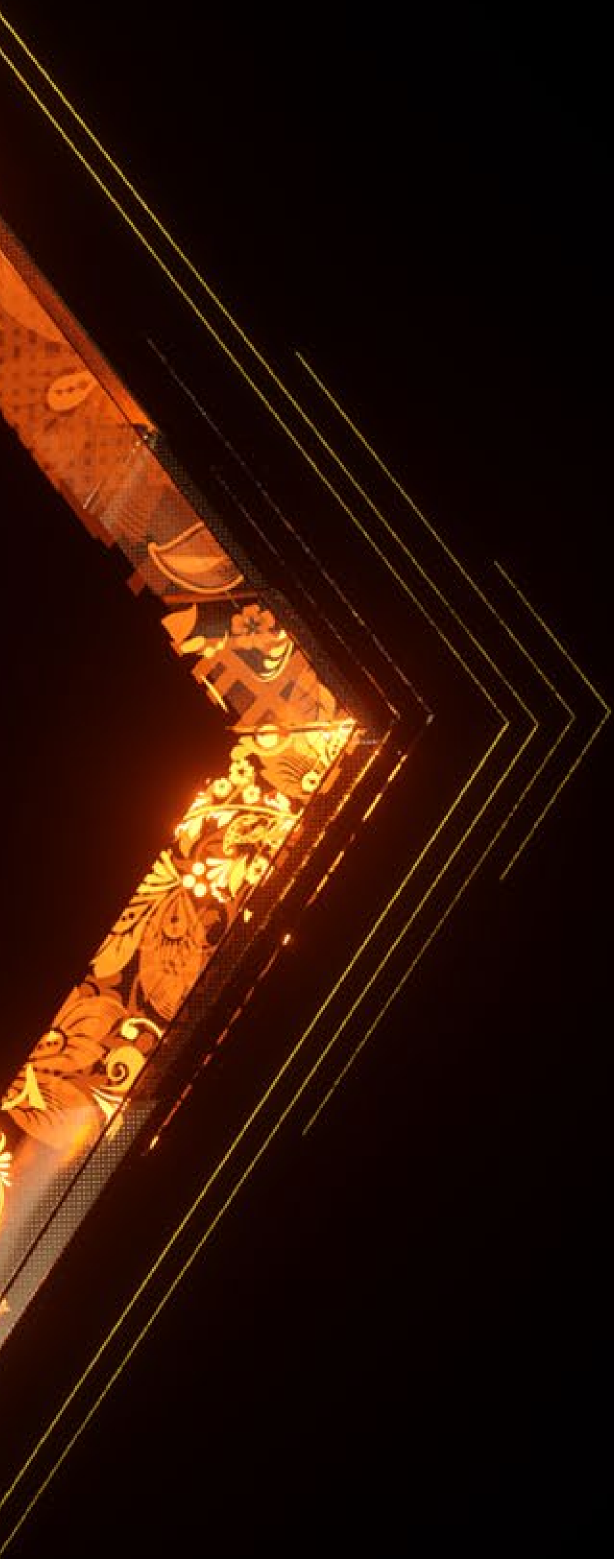
2,934 new stores added; 1.2 million sq m of new selling space added, expanding our regional presence and increasing the diversity of customers served across Russia.

Refurbishments and day-to-day improvements:

almost all Pyaterochka stores and more than 73% of Perekrestok stores are now operating under their new concepts as of 31 December 2017. Elements of our new concept and operating model for Karusel are being trialled in a new store.

Preparing for the future of food retail:

we are developing innovative projects using big data analytics for personalised offers and measurement of targeted marketing campaigns. This will enable us to increase customer activity by better addressing consumer demand in the future.



Developing omni-channel business model:

we have successfully launched Perekrestok Online in Moscow, which complements our offline offering, but with an average basket several times higher than brick-and-mortar stores, an exceptionally high 73% NPS score, and strong customer loyalty.

Constant focus on operational efficiency and cost optimisation in every line:

adjusted SG&A (see APMs information on pages 104-107) declined to 16.8% of revenue, the lowest since 2010, as well as successful efforts to improve supplier terms, close down inefficient logistics operations, and automate manually intensive high-volume and routine tasks.

Enhanced logistics:

10 new distribution centres across Russia and an additional 1,231 new trucks, bringing our total fleet to 3,144 as of 31 December 2017.

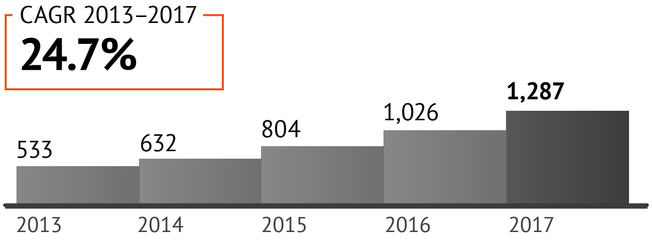
Approved dividend policy:

the Supervisory Board approved a dividend policy for the Company, with a target payout ratio of at least 25% of X5 Retail Group's consolidated IFRS net profit in case of a consolidated net debt/EBITDA ratio of below 2.0x. Based on the Company's 2017 financial results, the Company's Supervisory Board has put forward a recommendation to pay dividends in the amount of RUB 21,590 million / RUB 79.5 per GDR, subject to related fees and taxes.

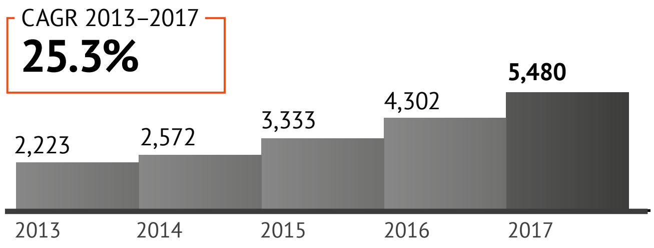
Operational highlights

Our omni-channel and personalised approach enabled us to continue to improve customer experience both in-store and online, while boosting operational efficiency supported by smart logistics and big data.

Net retail sales, RUB bln



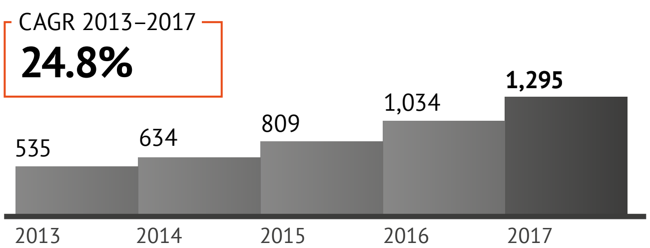
Selling space, ths sq m



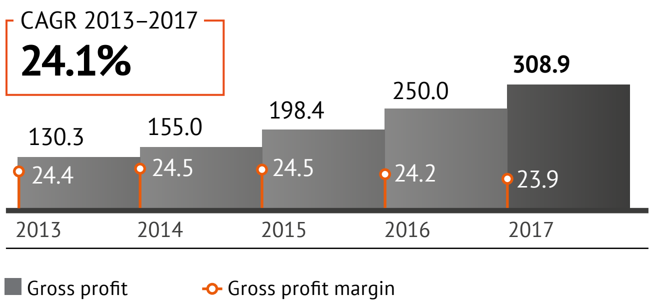
Financial highlights

X5's strategy calls for growth faster than the market and competition while at least maintaining margins.

Revenue, RUB bln



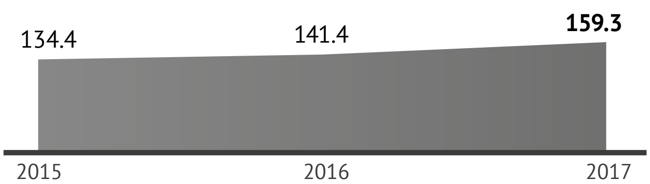
Gross profit, RUB bln / Gross profit margin, %



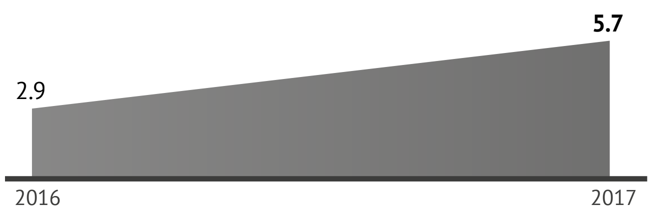
Sustainability highlights

We measure our performance by more than just operational and financial metrics. In this report, we discuss in greater detail our integrated approach to building a sustainable business.

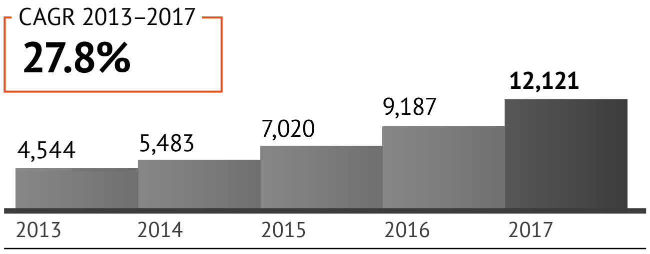
Income from the sale of recyclable waste per store, RUB ths



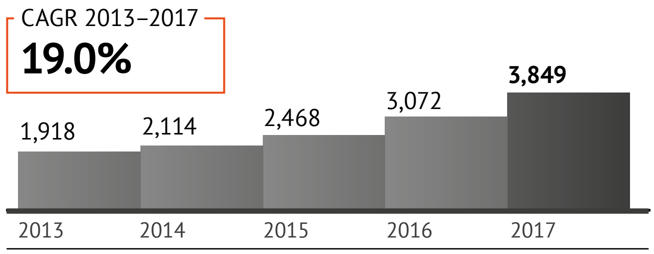
Training hours, per person per year



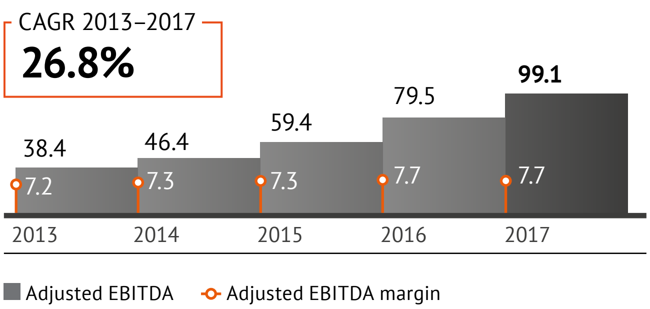
Number of stores



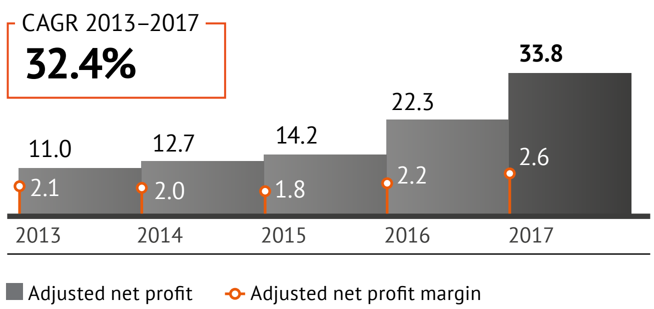
Customer visits, mln



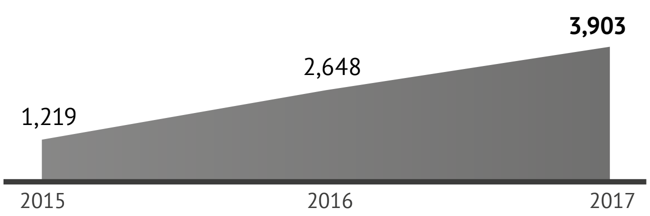
Adjusted EBITDA, RUB bln / Adjusted EBITDA margin, %



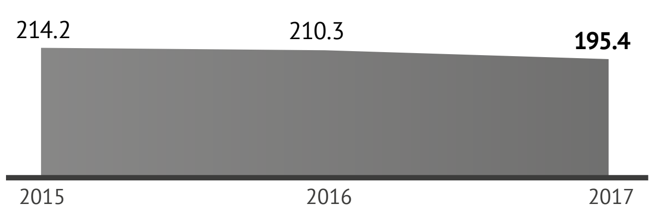
Adjusted net profit, RUB bln / Adjusted net profit margin, %



Number of in-store quality audits



Average monthly utilities costs per store, RUB ths



Chairman's statement

Dear stakeholders,

As I look back at 2017 and our outlook at the beginning of that year, I am pleased to note that X5 Retail Group has delivered on its strategic targets, and the Company achieved strong operational and financial results: selling space increased by 27.4% year-on-year, while revenue rose by 25.3% year-on-year and adjusted EBITDA margin was maintained at 7.7%. These results show that X5 is delivering sustainable growth despite continued macroeconomic challenges.

X5 has reinforced its leadership position by expanding its operations and attracting more loyal customers, seeking to offer the best value propositions on the market. We are the leading Russian public food retailer in terms of growth, increasing our overall share of the food retail market to 9.5% in 2017. Our focus on rapid and sustainable growth requires us to constantly adapt, with the economic situation, competition and consumer behaviour continually evolving.

X5 will continue to pursue its strategic objectives with its balanced, multi-format business model, which enables us to capture growth in the three largest segments of Russia's food retail business: proximity stores, supermarkets and hypermarkets. We will also further increase our standards for quality and efficiency across our operations. I believe we will continue to deliver sustainable value with a corporate culture focused on achieving long-term strategic targets.

Going forward, technology and big data analytics will play an important role in value creation, and the Supervisory Board supports X5's increased focus on technology, innovation and an omni-channel offering for its customers.

Stephan DuCharme

Chairman of the Supervisory Board

Strategic continuity and adaptability

Our successful strategic transformation and customer-centric approach, which I wrote about last year, have delivered strong results and enabled us to regain market leadership. Meanwhile, we must continue to adapt as consumer behaviour evolves and the retail industry becomes increasingly technology-driven.

With a balanced operating model that enables each of our formats to adapt their distinct value propositions to the needs of their customers, we have managed to achieve rapid, efficient and sustainable growth. At the same time, the Corporate Centre has developed as a hub for innovations, pooling resources in areas like purchasing and logistics, and with overall strategic oversight.

Throughout our businesses, the customer remains at the centre of our decision-making. We are engaged in ongoing analysis of consumer behaviour and demand, always seeking new ways to enhance the data and improve the outcomes. We are innovating to find new ways to meet consumer needs, for instance through data-driven personalised loyalty programmes. At the same time, we continue to refurbish Perekrestok supermarkets and introduce day-to-day improvements across our operations in order to ensure a consistent and high-quality shopping experience at every single store X5 operates. We also remain focused on continuous improvements in efficiency, which ultimately benefits the customer as well as other stakeholders. In terms of logistics, 2017 was another year of strong progress, with 10 new DCs opened as part of the implementation of our recently-approved Logistics and Transportation Strategy.

Another key to successful strategic continuity is the strong management team that we have assembled. The Supervisory Board continues to view motivation as a key element in the long-term success of X5, and we believe that the LTI programme is essential to keeping management interests aligned with those of shareholders and other stakeholders to achieve rapid and profitable growth aimed at sustainable long-term value creation. After the first LTI programme was approved by shareholders in 2015, an updated version of the programme will be subject to AGM approval in 2018, with the aim of further aligning management interests with shareholders', and including an even greater focus on sustainable value creation.

These foundations of our approach to building X5 Retail Group have consistently proven themselves year after year, giving the Supervisory Board confidence in the Company's ability to achieve strong and sustainable results while continuing its rapid growth. Furthermore, this has enabled us to adopt X5's first-ever dividend policy in 2017, and the Board will consider regular dividends in line with this policy.

Creating value across the chain

We recognise our responsibility as a major business in Russia and as a large employer to take a responsible and sustainable approach to our business.

In line with this, the Supervisory Board and management focus not only on financial and operational results to measure our performance, but also on non-financial metrics ranging from occupational health and safety, environmental impact, employee satisfaction and customer satisfaction, to how we can have a positive impact on the communities where we operate.

We aim to create value for our stakeholders at every stage of our business, starting from the food producers and suppliers whose goods stock our shelves, all the way through to our customers, who are looking for a convenient shopping experience with fair prices for high-quality goods.

This approach has led X5 to support local suppliers across Russia with training seminars at our DCs that help them interact more efficiently with us. The Company maintains healthy and safe workplaces for employees, and offers a growing array of career training and development opportunities.

We give back to local communities through food aid programmes like the Basket of Kindness, which, in partnership with Rus Food Foundation, was rolled out across more than 800 stores and collected more than 77 tonnes of produce that was provided to more than 6,000 families in need in 2017.

We have introduced and, where necessary, improved our internal policies to ensure that we hold ourselves and our suppliers to high standards of business conduct, with procedures in place to prevent corruption, discrimination and other unacceptable or unlawful practices.

Within the Company, we communicate these developments, conduct training for employees and maintain feedback mechanisms including a whistleblower line for reporting any type of misconduct and irregularities. With suppliers and other counterparties, X5 is currently in the process of introducing new contracts that require compliance with high standards of business conduct as well.

Corporate governance

X5 has a robust system of corporate governance that draws on international best practices and serves to ensure that the interests of all stakeholders are duly represented and taken into account. The members of our Supervisory Board come from a variety of backgrounds and bring to the table different skills and knowledge from across retail, finance, strategy and governance.

With an understanding of the importance and benefits of diversity, including but not limited to gender, the Board developed a diversity policy in 2017. Whilst the Supervisory Board is currently not balanced with regards to gender, X5 recognises the benefits of diversity and is fully committed to achieving this. We acknowledge the importance of diversity, including gender, at all levels of the Group, and the Company has a very strong track record of developing female business leaders at the executive level, as demonstrated by the gender balance within the Executive Board and senior management team.

The Board is committed to constantly challenge and improve its own functioning and performance. The in-depth board evaluation performed by an external evaluator in 2017 helps us to ensure that members of the X5 Supervisory Board are “fit for tomorrow” and able to support management in being prepared for disruption and change.

Corporate culture that is prepared for the future

The Supervisory Board and I believe that we must lead by example and set the tone, together with the management team, to create a culture of long-term value creation across X5’s entire business. We view corporate culture as the key to instilling a systematic and sustainable approach to growing our business in every employee. In fact, we aim to move from the traditional notion of strategy to the notion of culture as the key to achieving sustainable growth and profitability.

We aim to establish a learning culture that rewards innovation and is receptive to the disruption caused by technology, for example, in order to benefit from emerging opportunities to leverage data that will enable X5 to become a smarter, quicker and even more customer-centric retailer.

Innovation has become a core area of development for X5, and the Board expects management to focus on this area to ensure that we lead the sector in developing from a traditional modern food retailer into a next-generation omni-channel retailer that can effectively and efficiently use data about its customers to constantly refine and adapt its business model.

At the same time, we will continue to focus on expanding our decentralised operating model that has successfully brought us where we are today: a truly multi-format food retail business with a constant focus on efficiency and adapting our value propositions to customer needs.

The Russian food retail market remains highly attractive, with significant potential for overall growth, consolidation and increasing the share of modern retail. I will be working closely with the other members of the Board and with our management team to ensure that X5 continues to remain at the forefront of Russian food retail, the employer of choice for our employees, and that our value proposition to customers remains the most compelling regardless of trends in the market.

I would like to extend my sincere gratitude to everyone who made 2017 a successful year for X5 Retail Group and to thank our investors for their continued belief in our story.

Stephan DuCharme

Chairman of the Supervisory Board

Our business model

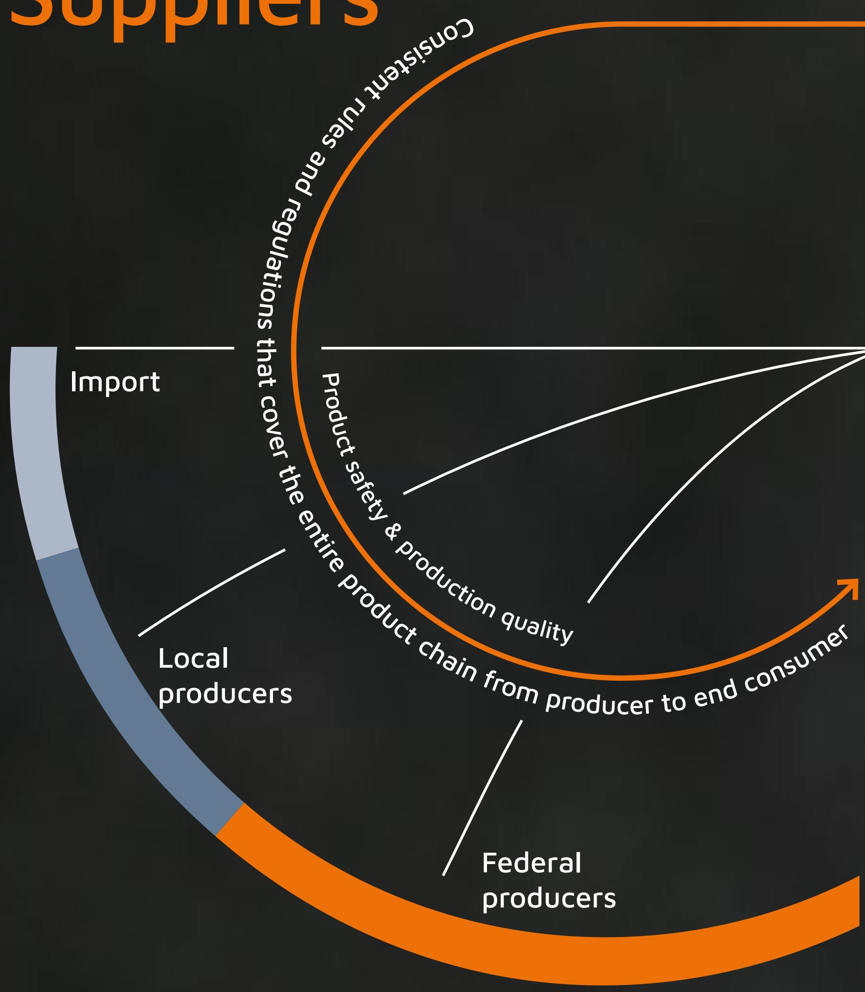
X5 RETAIL GROUP

X5 Retail Group is Russia’s largest food retailer, with three national food retail formats: Pyaterochka, Perekrestok and Karusel. While each of the formats functions largely autonomously, the Corporate Centre centralises certain activities when coordination and pooling resources improves efficiency across the Company.

Corporate Centre

The Corporate Centre provides strategic support to the retail formats and aims to create synergies that support efficient, sustainable growth. X5 Corporate Centre’s key responsibilities include implementing big data analytics programmes, facilitating the development and launch of innovative projects (X5 LAB), business planning and control, promoting a unified corporate culture that is aligned with the Company’s strategic goals, pooling of purchasing power, managing strategic partnerships with suppliers, and supporting the exchange of best practices within X5.

Suppliers



Supply chain infrastructure

Logistics
39 DCs
as of 31 December 2017

Transport
3,144 owned trucks
as of 31 December 2017

Retail formats

Each of retail formats is largely autonomous, running its own operations, marketing, category management, logistics, distribution and expansion operations.

Pyaterochka
proximity stores

11,225
stores

Perekrestok
supermarkets

638
stores

Karusel
hypermarkets

93
stores

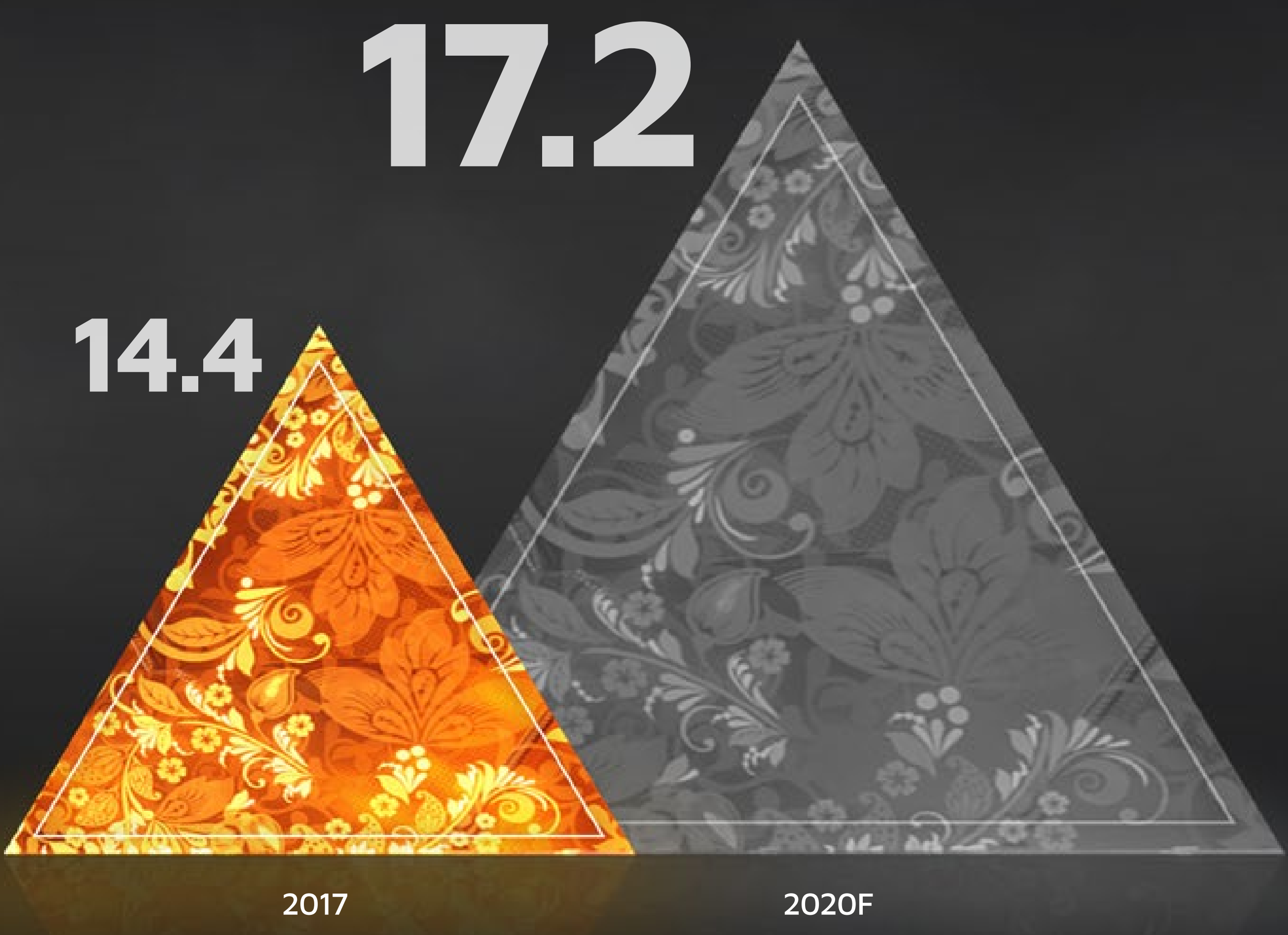
As of 31 December 2017

Our brands

Each of our brands offers a unique CVP and targets key parts of the Russian consumer population. This multifaceted strategy enables X5 Retail Group to capture a significant portion of the growth that is forecast for each of the three largest segments of Russia’s food retail market.

POTENTIAL TOTAL MARKET GROWTH
RUB trillion

+2.8



Source: Rosstat, Infoline

Pyaterochka

Pyaterochka is our largest retail format, with 11,225 proximity stores serving customers in convenient locations in around 2,500 cities and towns across Russia. The Pyaterochka CVP appeals to a wide swath of the Russian population, with a large assortment of fresh goods and a recently launched loyalty programme that offers personalised promos based on each individual customer's shopping behaviour.

Perekrestok

The Perekrestok supermarket format is Russia's oldest and largest. Now undergoing a large-scale refurbishment and expansion programme, Perekrestok offers a wide assortment of high-quality goods, including a growing range of exclusive and private-label lines.

Karusel

Karusel focusses on compact hypermarkets located within city limits that appeal to rational shoppers and customers looking to stock up their household in one shopping trip. With a significant offering of in-house production, private-label and non-food goods, every Karusel aims to meet a wide array of customer needs.

As of 31 December 2017 / In 2017	Pyaterochka	Perekrestok	Karusel
Number of stores	11,225	638	93
Selling space thousand sq m	4,427	637	385
Net retail sales RUB bln	1,001	187	89
Percentage of X5's net retail sales	77.8%	14.5%	6.9%
	Proximity/discounters	Supermarkets	Hypermarkets
Potential market growth of segment RUB trn	+2.1	+0.9	+0.4
2017	4.9	3.4	2.1
2020F	7.0	4.3	2.5

Source: X5 data, Rosstat, Infoline

Russia's food retail market

Highlights

The world's
8th-largest grocery market

Market growth forecast for 2017–2020 (Infoline):
RUB 2.8 trillion

CAGR 2012–2017:
8%

Market share of modern retail in 2017:
70%

Market share of top five players in 2017:
24%

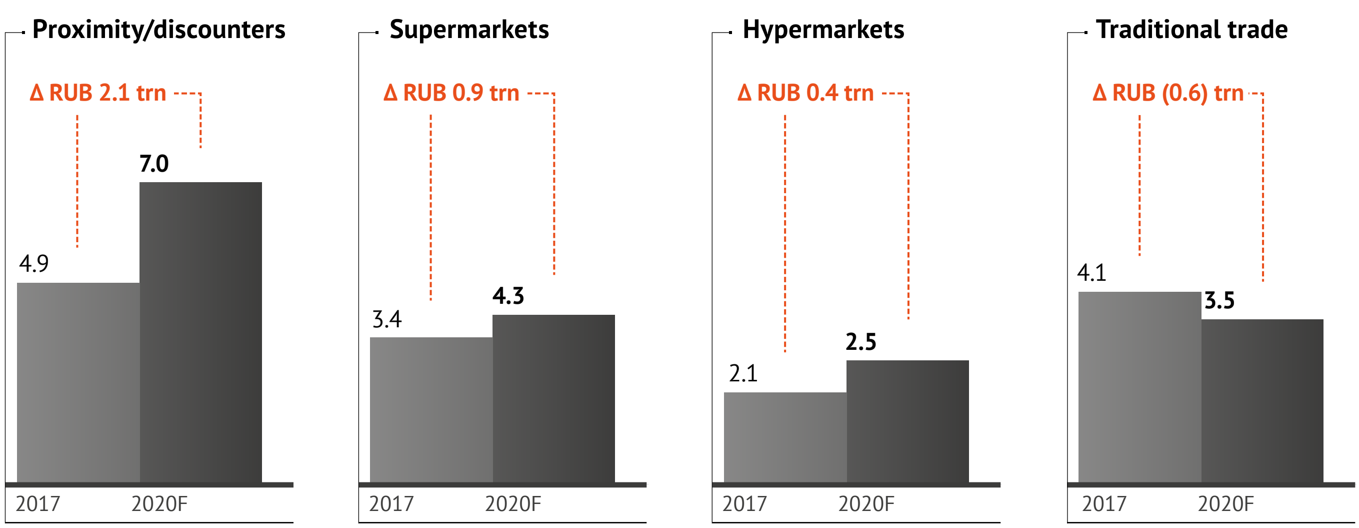
Market overview

Committed to the three major food retail formats, RUB trn

Total market size:

2017:	RUB 14.4 trn
2020F:	RUB 17.2 trn

Substantial mid-term growth potential for all major formats.

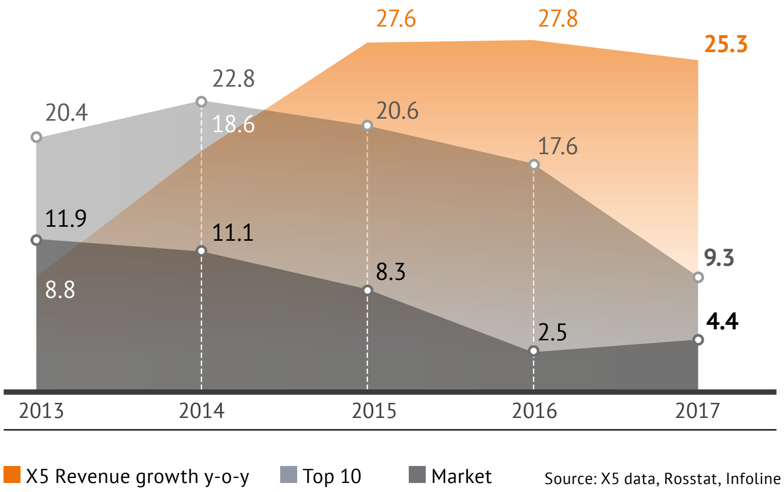


Source: Infoline

The Russian food retail market holds significant potential, especially for the largest players with the ability to expand rapidly and take market share in a growing market. We are Russia's largest retailer with an established presence in the three largest formats: proximity/discounters, supermarkets and hypermarkets.

In 2017, X5 continued to outperform the overall market, maintaining its #1 market position and extending the strong momentum that has outpaced major competitors since 2015.

X5 vs. Russian food retail in top-line growth, %



Source: X5 data, Rosstat, Infoline

X5 compared to peers

While the Russian food retail market grew by 4.4% overall in 2017, X5 managed to increase its share from 8.0% in 2016 to 9.5% in 2017, in line with the Company's strategic goal of expanding faster than other players in this growing market.

Top 10 Russian food retailers

#	Company	% of total market 2016	% of total market 2017
1	X5	8.0	9.5
2	Magnit	7.4	7.5
3	Lenta	2.1	2.5
4	Auchan	2.9	2.2
5	Dixy	2.4	2.1
6	SPS Holding	1.2	1.8
7	Metro	1.6	1.4
8	O'KEY	1.2	1.2
9	Monetka	0.6	0.6
10	Globus	0.6	0.6
	TOTAL TOP 10	**28.0**	**29.4**

Source: Infoline

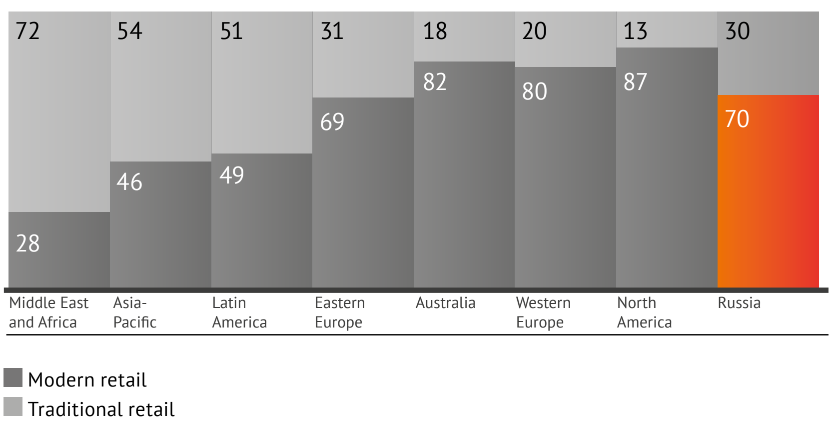
Russian food retailers vs. global peers

2015	2016	2017
1 Wal-Mart	1 Wal-Mart	1 Wal-Mart
2 Kroger	2 Kroger	2 Kroger
3 Schwarz Group	3 Schwarz Group	3 Schwarz Group
4 Carrefour	4 Carrefour	4 Carrefour
5 Tesco	5 Aldi	5 Aldi
39 FamilyMart	33 Whole Foods Market	21 Mercadona
40 X5 RETAIL GROUP	34 X5 RETAIL GROUP	23 X5 RETAIL GROUP
41 Trader Joe's	35 Jeronimo Martins	26 AEON Group

Source: Euromonitor, Company reports, X5 analysis

While outgrowing the Russian market, we also continue to improve our ranking among global food retailers: in 2017, X5 was the 23rd-largest food retailer by revenue in the world, up 10 positions from 2016. Over the last three years, X5 has consistently improved its standing among its peers.

Traditional vs. modern trade in 2017, %

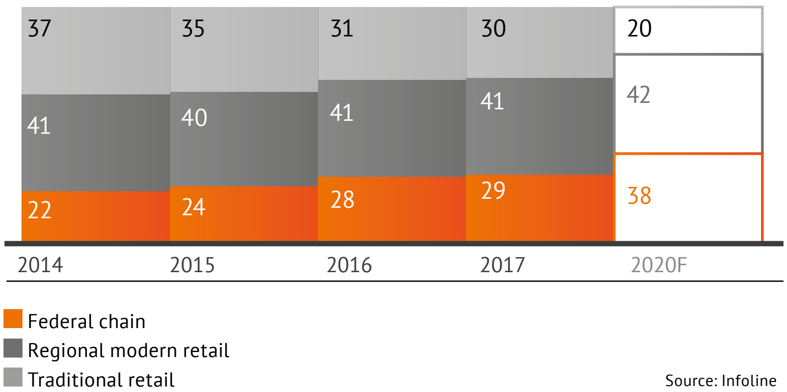


Note: All values used are nominal. All numbers are exclusive of VAT/sales tax
Source: Euromonitor, X5 analysis

According to Infoline, the top five players in Russia control just 24% of a fragmented market, compared to 60-70% in developed markets, indicating significant potential for growth. Further market consolidation is expected in the proximity/discounter and supermarket segments, meaning individual stores, small regional chains and informal trade will increasingly give way to leading players.

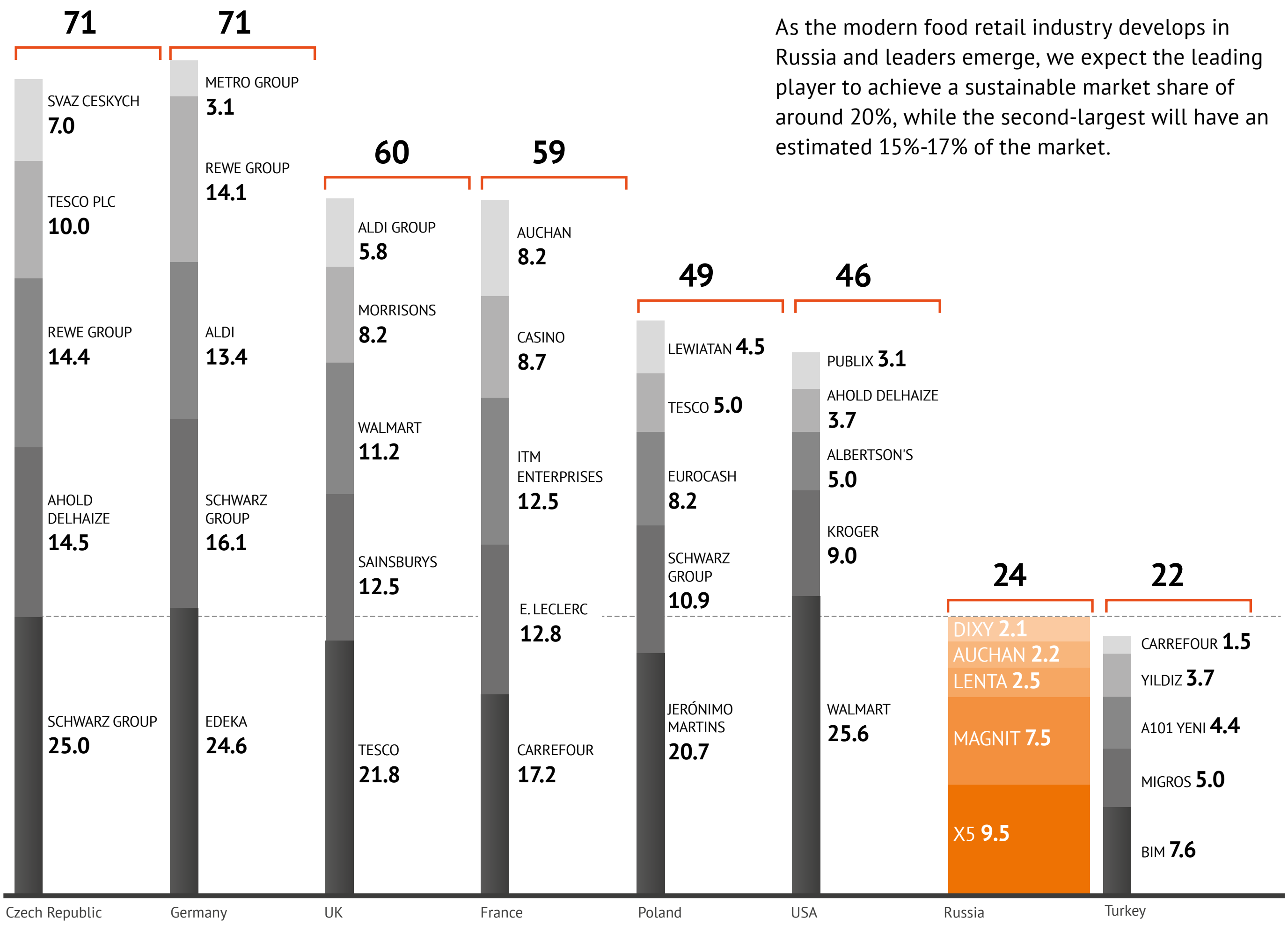
The continued shift towards modern retail will be the key driver for growth for the top players. The share of modern retail in Russia has grown significantly, from 48% to 70% over the last five years, but there is still potential for further increases compared to most developed countries.

Russian food retail market development, %



Despite the substantial level of modern trade penetration in Russia already, there is still potential for further growth.

Top five share of grocery retail globally in 2017, %



As the modern food retail industry develops in Russia and leaders emerge, we expect the leading player to achieve a sustainable market share of around 20%, while the second-largest will have an estimated 15%-17% of the market.

Source: Euromonitor, Infoline (for Russian market only). Company Reports, X5 analysis

Economic and consumer trends

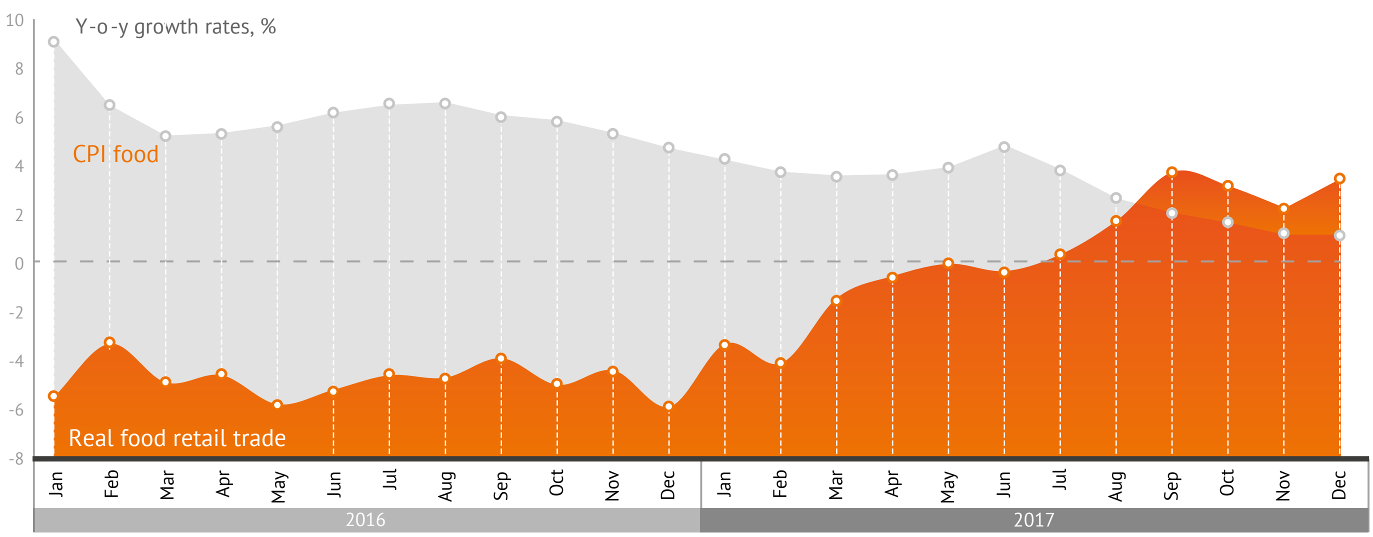
The Russian economy returned to growth in 2017, and a gradual recovery is expected to continue in 2018, but sufficient risks for the sustainability of this recovery still exist. Some of the key macro-trends that affected X5's performance in 2017 include:

- Personal consumption switched to growth on the back of steady growth in real wages, a decline in the unemployment rate and a recovery in retail lending
- Consumer confidence improved but still remained negative. Trading down started to decrease but was still high in absolute terms
- Inflation decelerated to historically record lows in 2017

Looking ahead to 2018, we expect the following macro-trends to influence our results for the year:

- Inflation is likely to stop decelerating in 2018, but the average rate for the year may still be lower than the CBR target of 4%
- Expected household consumption and real retail turnover growth will play an important role in real GDP growth of 1%-2%, according to the consensus forecast
- The key macroeconomic risks for the sustainability of the economic upturn are a weak recovery on the supply side and a decline in real disposable income on the demand side

Food retail trade and CPI dynamics

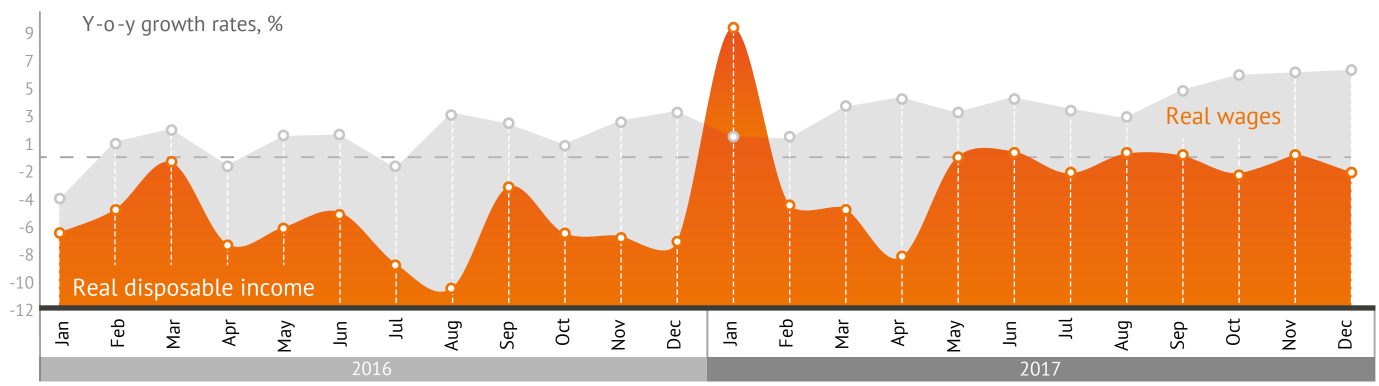


Source: Rosstat

X5 has proven its ability to adapt to the changing macroeconomic conditions and to lead a potential economic recovery, leveraging its scale, efficiency and flexibility to grow profitably while others have slowed their pace.

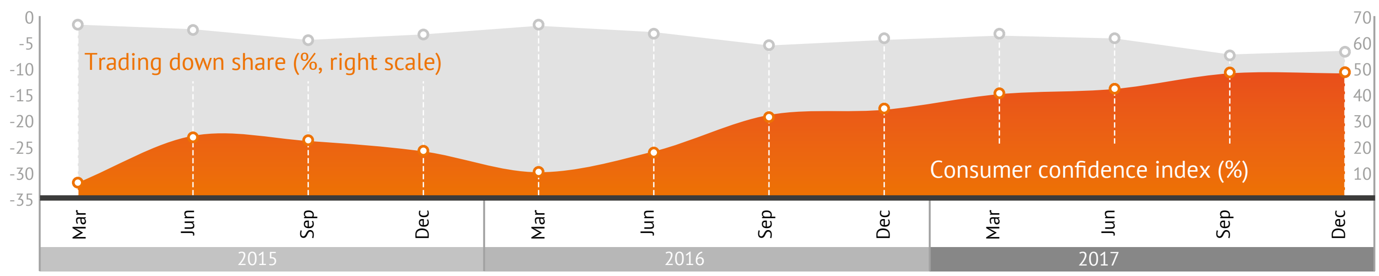
- The key factors affecting our market in 2017 were decelerating food CPI, which influenced nominal retail sales growth; negative real disposable income growth; and the slowdown in the recovery of consumption and consumer confidence towards the end of the year
- At the same time, the food retail market returned to growth in real terms, increasing by 0.5% year-on-year. In nominal terms, it increased by 4.4% to RUB 14.4 trillion in 2017
- In response to low inflation rates, the key to X5's ability to continue to deliver strong revenue growth was the increase in real consumption. Going forward, X5 will continue to concentrate on enhancing customer activity
- As consumers remained highly sensitive to prices, X5 focused on maintaining accessible prices with the help of promo activities and the development of strategic partnerships with both suppliers and private labels. To address these trends, X5 is also further developing its loyalty programmes and personalised advertising using modern data analytics. In private labels, we have introduced and are further developing offerings that compete with high-quality name brands at an attractive price point

Personal income dynamics



Source: Rosstat

Consumer behaviour indicators



Source: Rosstat, FOM

How we are responding to Russia's changing food retail market

X5 has identified the key trends that will drive Russia's food retail market in the coming years, and the Company has developed innovative methods to maintain its growth. X5's omni-channel approach, which improves customers' personal shopping experience both online and offline, is backed by smart logistics and big data analysis.

Innovation has been a core focus of our business since we completed our successful strategic transformation, and it affects all aspects of our operations, from automated recruiting software to big data analytics used to analyse customer behaviour to the GIS software we use to pinpoint locations for new stores. In innovating, our aim is not to adapt quickly to market trends, but to be the trendsetter and to lead the transformation of food retail into a high-tech business.

X5 has already launched Perekrestok Online for its customers in Moscow and aims expand the e-commerce platform to St Petersburg in 2018.

New retail

	Offline +	Online +
WHERE WE ARE NOW	• More than 12,000 stores • Presence in 63 of 85 regions across Russia • Market leader with 9.5% market share in 2017 (Infoline)	• Launch of Perekrestok Online covering all of Moscow
COMING NEXT	• Grow above the market and the competition • Defending core regions while profitably expanding in new areas	• Launch of Perekrestok Online store in St Petersburg • Omni-channel model to improve customer experience

We aim to build a next-generation food retail company, developing an omni-channel approach with in-store and online shopping, while implementing innovative solutions and big data to advance our smart logistics operations and better inform our value proposition.

Logistics + Data

Logistics

- 39 Distribution Centres
- 3,144 owned trucks
- Innovative IT solutions: JDA, GoCargo

- Implementation of a new Logistics and Transportation Strategy to 2025
- Up to 20 new DCs by 2020
- Up to 3,000 new company-owned trucks by 2020
- Development based on a long-term forecast of customers' demand
- Innovative approach

Data

- Focus on innovations and big data
- Strategic retail partnership with IIDF and Skolkovo
- Loyalty programmes across all three major formats

- Launch of personalised promotions in proximity format
- Deep analysis of customers' needs and habits
- Customer-centric approach and data-driven culture

CEO statement

Dear stakeholders,

By the end of 2017, X5 Retail Group had extended its lead as Russia's #1 food retailer, growing rapidly while maintaining a constant focus on the quality and sustainability of our expansion. We continued to deliver on our core strategic goals, maintaining sustainable profitability thanks to intelligent organic growth and a relentless focus on efficiency at every level of our operations.

Some of the key 2017 achievements I would highlight include:

- Revenue grew by 25.3% to RUB 1,295 million, driven by a 27.4% rise in selling space and a 5.4% increase in LFL sales
- Pyaterochka's revenue exceeded RUB 1 trillion for the first time in the format's history in 2017
- Like-for-like (LFL) sales and traffic, which are some of the best indicators of our customers' reaction to how well we are doing, was one of our key achievements in 2017: LFL sales were positive across all three formats and grew 5.4%, while LFL traffic increased by 3.0%, which is the highest level the Company has seen since 2009
- Adjusted EBITDA margin remained stable at 7.7% in 2017, despite a challenging macro environment
- We adopted a dividend policy and recommended our first-ever dividend of RUB 21.6 billion (RUB 79.5 per GDR)
- We developed our omni-channel offering with the launch of the Perekrestok Online e-commerce platform
- We strengthened our focus on innovation, with the full rollout of Pyaterochka's loyalty programme, which leverages big data and machine-learning-based insights into promo impact on customer behaviour
- We adopted a new Logistics and Transportation Strategy to 2025, which aims to efficiently and effectively support X5's rapid growth across Russia, including in remote regions of the country

Igor Shekhterman

Chief Executive Officer

This year, we are also extending the way that we report on the value we create for a broader range of stakeholders in order to bring our reporting in line with EU Directive 2014/95 on non-financial information. This is our first step on the path towards a more integrated approach to how we measure and report our performance across a broad set of indicators.

Customer-centric approach

We put our customers at the centre of everything we do, and meeting customer demand is central to our decision-making. We continued to adapt our value proposition in response to changing demand and shifts in the market environment: our three different formats address different segments of the market and different cohorts of consumers. In addition to a constant focus on service and shopping experience quality, we launched a new, personalised loyalty programme at Pyaterochka in 2017 and expanded Perekrestok's loyalty programme through strategic alliances.

One of our core areas of focus has been on improving the in-store experience, and in 2017 we completed the Pyaterochka refurbishment programme, while continuing to update Perekrestok supermarkets in line with our new concept. Karusel, after approving its new branding and commercial model, began testing elements of the new concept for its stores at one of its locations in St Petersburg, with a new interior design and navigation and a varied food court. Even renovated stores are changing, as we introduce day-to-day improvements on a regular basis.

Our assortment is constantly being refined across all of our formats, with the introduction of private-label and exclusive-label products that offer a growing range of unique and high-quality goods at attractive price points at each of our formats, including a successful new line of exclusive dairy products under the Sarafanovo brand. Our focus in this area is on developing strategic partnerships with high-quality producers that allow us to sell goods at all price points. As we expand across Russia's diverse regions, we are also adapting our business processes to increase the share of locally produced goods in the assortments offered at our stores.

Another customer-centric priority is leveraging greater insights into our customers to help us do more, better and faster to ensure that our value proposition remains the best in the market. We are making increased use of big data to tailor our loyalty schemes and rewards cards, and we have also rolled out a new loyalty scheme that will use automatically generated personalised offers for Pyaterochka customers. We have also announced a partnership to integrate machine learning into marketing campaigns to improve suppliers' ability to effectively measure the impact of promo campaigns on consumers.

I believe that our results show that these measures have been successful: 5.4% LFL growth in 2017 across X5 Retail Group's formats was the fastest pace of growth among our public peers.

Smart and profitable growth

We continue to focus primarily on organic growth, which accounted for 87% of the increase in selling space in 2017, but we were also pleased to take advantage of several attractive M&A opportunities, such as the acquisition of O'KEY's supermarket business, which we agreed in late 2017. As X5 moves into new regions and adds market share where we already have a presence, our entire team remains focussed on ensuring the profitability and sustainability of this expansion, and we are leveraging all of the tools available to achieve this.

Through further refinements of our GIS system, we have improved our ability to select the most attractive locations for new store openings, including identifying locations where cannibalisation is likely from other stores. While primarily a tool for organic growth, the GIS system also helps us to more effectively analyse potential M&A transactions.

Moving towards innovative transformation

Technology is coming to retail, and at X5 we have started a new transformation into a technology-based company. Innovation and big data are now a core focus of our long-term strategy, and as a leader in the food retail sector we aim to be at the forefront of our industry's transformation using big data, automation, online sales channels and other tools to enhance our ability to meet customer needs while growing our business. Our aspirations in this area are also reflected in the IT roadmap to 2020 that was approved in the summer of 2017 and is now being implemented, with a focus on supporting rapid, organic growth and increasing the efficiency of IT processes.

The Company views big data as an important tool to boost the efficiency of business processes and as a source for developing potential new areas of business. X5 plans to refine its data analysis capabilities by integrating data from various internal and external sources, creating a portfolio of information products to enhance the Company's CVP and increase sales densities. This can be achieved by establishing detailed data on customers, making it possible to create more personalised offerings and tailor assortments to customers' evolving needs.

We are gearing up for a future where customers will demand even greater convenience and more personalised services, which will be made possible by emerging technologies and AI. Our ability to offer these services effectively and efficiently will play an increasingly important role in consumers' choice of where to shop and what to buy. X5 intends to be at the forefront of the AI- and technology-driven transformation of our sector, and we have established X5 Lab as a way to support, develop and manage internal and external innovative developments that can help us enhance our business.

Multi-format and omni-channel operating model

We remain committed to our multi-format operating model, which is designed to capture a greater share of wallet across the three largest segments of the Russian food retail market.

In 2017, we delivered 27.4% growth in selling space, adding a record 1.2 million square metres and 2,934 new stores, including our 12,000th store, a Pyaterochka in the Arkhangelsk region. We also announced plans to streamline our portfolio with the disposal of the Perekrestok Express format, which represented a narrow segment of Russia's modern food retail market, in order to further strengthen our focus on our three core banners.

A significant development in 2017 was the launch of Perekrestok Online, covering all of Moscow and due to launch in St Petersburg in 2018. X5's shift to an omni-channel model gives us additional possibilities to capture more customers and expand our share of wallet by increasing customer loyalty, meeting growing demand for online grocery shopping in key markets in Russia. While the development of online food retail is several years behind certain other markets, we see enormous potential for this segment to develop, with growing demand from customers and the opportunity to apply business models that have already proven themselves to be successful.

Operational efficiency

We reduced SG&A costs to just 16.8% of revenue, the lowest level since 2010. Our focus on efficiency in every single aspect of our operations is a key to maintaining sustainable profitability while we continue our rapid expansion. We regularly review all expense lines at our stores, logistics and transport divisions, as well as at the head office in an effort to minimise inefficiencies and cut costs.

In the last year, some of our key efficiency efforts included negotiating improved terms with suppliers, replacing old and inefficient logistics operations with new, state-of-the-art DCs, automation of high-volume and routine tasks, as well as across nearly all SG&A lines.

Several years ago, we recognised that our logistics operations failed to provide us with the competitive advantages needed to be #1 in Russia. Since then, we have made significant efforts to build a cutting-edge logistics and distribution infrastructure, using technology in our warehouses and trucks to improve efficiency, cut losses and make sure our operations are safe for consumers and for the environment. In the last three years, we have opened 23 DCs, and 10 in 2017 alone. Last year we also approved X5's Logistics and Transportation Strategy to 2025 and purchased 1,231 new trucks to add to our existing fleet. While X5's successful decentralised model has enabled each of our formats to grow rapidly, the new strategy represents an excellent example of how the Corporate Centre and three formats can work together to significantly improve efficiency and support growth.

A strong and diverse team

X5's results for 2017 again demonstrated the strength of the Group's management and the high calibre of people in key positions across the organisation, as well as our ability to get the best out of them. While retaining our core team, we welcomed Svetlana Demyashkevich as our new Chief Financial Officer. Svetlana completed a seamless transition into the role and has already contributed significantly to the growth and success of X5.

Operating environment

While we strengthened our leadership among Russian food retailers in 2017, X5 continues to operate in a highly competitive market with several well-developed players in each of the segments where we operate. X5 aims for each of its stores to be #1 in the hearts of Russian consumers by offering the best customer value proposition and best shopping experience to our customers.

While personal consumption began showing the first signs of recovery in 2017 along with Russia's economy, decelerating food CPI put a damper on nominal retail sales growth throughout the year, with inflation growth reaching its record lowest level in the fourth quarter. Real growth in disposable income remained negative in 2017, and the recovery in consumer confidence slowed towards the end of the year. In the current environment of slow economic growth, significant risks to the sustainability of the recovery remain, with consumption growth still weak, consumers' behaviour remaining rational, price-sensitive and promo-oriented.

We have responded to the challenging market conditions by concentrating on encouraging customer activity, for example by leveraging data analytics at Pyaterochka to deliver personalised promotions as part of our new loyalty programme and through continued innovation to improve the effectiveness of targeted marketing efforts. With a constant focus on ensuring that our CVP best addresses the needs of our target consumers, we are confident that X5 Retail Group is prepared to continue to lead the increasingly competitive food retail landscape.

Developments in capital markets

X5 Retail Group has proven itself to be a reliable partner for public markets thanks to our ability to deliver on strategic targets and to build value for our investors. The Supervisory Board adopted the Company's first-ever dividend policy in 2017, which envisions paying out at least 25% of consolidated IFRS net profit if our financial position allows for it.

After the end of the reporting period, we also completed the listing of X5 GDRs on Moscow Exchange on 1 February 2018. This is the same instrument that trades on the London Stock Exchange, and we believe the additional listing in Moscow will help to expand the pool of investors and should have a positive impact on liquidity in the future.

Outlook

Looking ahead to 2018, we continue to have ambitious targets for rapid, sustainable and profitable growth that the entire team must work hard to achieve. While we remain cautious about the likelihood of any sustainable economic recovery in Russia in the near term, X5 will continue to innovate and to refine its CVP to best meet the needs of consumers in Russia in the most efficient and effective way possible.

We are committed to increasing the use of advanced technologies like machine learning and automation to both make our business more efficient and to make what we offer our custom-

ers more effective. X5 will also further develop its omni-channel offering, bringing Perekrestok Online to St Petersburg. We also hope to see benefits from innovative projects in areas like logistics that will further enhance our business.

Intensifying competition combined with contradictory macroeconomic forecasts mean that the consumer is likely to retain rational behaviour and demand accessible prices. This will be the key motivating factor for us to further increase the efficiency of our business through an even greater focus on reducing costs, as well as further development relationships with suppliers to offer consumers high-quality products at affordable prices.

We remain committed to our goal of growing our business faster than the market and competition, and we believe that the food retail market leader will see significant benefits due to scale and influence. Our primary focus for this expansion will be on organic growth, which has proven to be highly successful and efficient, but we also remain well-positioned to quickly analyse and finance potential M&A deals to expand our presence.

At X5, we aim to meet demand from every Russian consumer through our multi-format, omni-channel business model. Our customers are at the heart of everything that we do and every decision that we make, and they are the key to the success of every store that we open. This customer-centric approach to business will remain one of our guiding principles as we continue our rapid growth in the years ahead.

We delivered impressive growth in 2017, and this would not have been possible without the support of our investors, our Supervisory Board, X5's own management and employees, as well as our suppliers and business partners. I want to thank everyone who contributed to this success and wish everyone a productive and fruitful year ahead!

Igor Shekhterman

Chief Executive Officer

Our strategy in action

We are integrating advanced data analytics and innovations at every level of our business, from strategic decision-making to tactical selection of locations for new stores, to automatic generation of personalised offers for loyalty card holders based on their shopping preferences. X5 is transforming itself into a customer-centric, data-driven, innovative company that provides modern food retail to diverse groups of customers across the regions of Russia where we operate.

As we near 2020, X5 is well on track to maintaining its position as Russia's leading food retailer and growing faster than the market and competition.

Anton Mironenkov

Director of Strategy

We strengthened our position as Russia's leading food retailer in 2017, continuing to accelerate growth, while introducing innovations and advanced data analytics, and we remain focussed on sustainability, efficiency and adapting to the changing needs of Russian consumers.

In this year's report, we have expanded the discussion of our strategy to address the integrated approach we take to measuring our performance. In addition to financial and operating metrics, which are part of our strategy to 2020, we look at health, safety and the environment as well as governance goals that X5 Retail Group's management and Supervisory Board also consider key to our long-term strategy.

Strategic progress

	Multi-format operating model	Constant adaptation of value propositions
Strategic goals	• Provide diversified set of customer value propositions through portfolio of food retail formats • Efficiently manage retail operations through Corporate Centre that creates value for business • Grow presence across largest and most lucrative segments of the Russian food retail market • Grow omni-channel model to address current and future consumer preferences across local markets	• Adapt each format's distinct value proposition to changing consumer needs and expectations • Innovate and utilise advanced data analysis to unlock better and more targeted offerings • Continuously review all aspects of CVP, including format concepts, assortment and category offerings as well as store format
What we did in 2017	• Added 2,862 Pyaterochka proximity stores, 99 supermarkets and two Karusel hypermarkets • Launched Perekrestok Online in Moscow • Approved new branding and commercial model for Karusel hypermarkets • Expanded direct import operations, including opening of trading office in Hong Kong • Introduced innovative solutions to improve our business performance, which leverage advanced data analytics • Focused development on hypermarket, supermarket and proximity stores; announced plans to sell convenience store format	• Rolled out Pyaterochka loyalty programme that utilises big data to automatically generate personalised promotions for customers, with share of net retail sales reaching 44% • Expanded ability to adapt assortment to local demand and worked with local producers in regions where we operate. Local assortment reached ~17% on average • Introduced new private-label and exclusive brands • Worked to maintain and improve NPS scores • Continued to develop and improve Perekrestok's "regional supermarket" model

Goals for 2020

Intelligent growth

- Leverage technology to support high-quality growth
- Optimise business systems and processes to enable quick, efficient organic expansion
- Engage in M&A if and when attractive opportunities arise
- Refurbish stores in line with updated operating models, implement everyday improvements and other improvements on an ongoing basis

- Opened the landmark 12,000th store, ending year with 12,121 stores after adding 1.2 million square metres of selling space (87% of which was organic growth)
- Increased food retail market share from 8.0% in 2016 to 9.5% in 2017
- Increased presence in new cities and towns, growing by 25% year-on-year
- Updated and enhanced GIS system to streamline store openings, reduce cannibalisation and compete effectively against nearby competitors
- Expanded presence in the Siberian Federal District
- Pyaterochka refurbishment programme completed; 73% of Perekrestok stores operating under the new concept
- Bought O'KEY's supermarket business in December 2017, which should add 32 stores in 2018 in regions with developed modern retail infrastructure
- Launched new partnership with Acmero and Marathon Group to expand food retail services to transport passengers across Russia
- Partnership with Centrosoyuz may lead to the opening of up to 1,000 new stores under the COOP-Pyaterochka brand

- **Deliver strong top-line growth faster than the market and competition while maintaining margins**
- **Double the size of the business within 3–4 years after 2015**
- **Focus on organic expansion**
- **Continue to refine data-driven strategy in response to market developments**

Excellence in operational execution

- In-store execution
- Optimise distribution centre logistics and transportation
- Improve shelf availability

- Opened 10 new DCs in Moscow, Tyumen, Novosibirsk, Yekaterinburg, Ufa, Kuznetsk, Kirov, Orel and Perm
- Purchased 1,231 new trucks; increased own fleet from 2,318 as of 31 December 2016 to 3,144 as of 31 December 2017

- **Enhance customer-centric decision-making based on data analytics**
- **Support a self-regulation strategy for Russian retail**
- **Further optimise logistics and operating expenses**
- **Reduce shrinkage costs**

What we did in 2017

Our markets

Governance

- Approved and presented X5's first dividend policy
- Short-listed for best communication of investment case by UK IR Society, awarded best annual report in retail sector by Moscow Exchange

Risk management

- Established detailed risk map and risk appetite approved by the Supervisory Board
- Enhanced focus on Risk Management and Internal Control, separate from Internal Audit

Our people

Corporate culture aligned with strategic goals

- Continued training and development programmes that include support for X5 values
- Began transition to focus on culture-led development instead of strategy-led development
- Pyaterochka and Karusel updated corporate culture models

Learning and opportunities

- Continued programme of training to provide essential job and workplace skills
- Ran career advancement and staff reserve programmes to enable promising employees to develop within X5

Health and well-being

- Continued implementation and monitoring of unified Occupational Health and Safety (OHS) standards across our operations
- Conducted 3,903 store audits to ensure the quality and safety of products we sell

Our world

Environmental management

- Implemented recycling and programmes across all of our operations to reduce the waste we produce
- Purchased new, efficient trucks for our transport fleet, reducing average age of fleet to just two years
- Continued installation of energy-efficient LED lighting across all of our operations
- Installed systems to monitor refrigeration units and ensure they are operating at optimal use

Community commitment

- New programmes and expansion of existing programmes aimed at providing food support to needy people in Russia
- Leveraged Perekrestok supermarket format to encourage charitable programmes by employees

Long-term goals

- Maintain constructive dialogues with investors, analysts, regulators and other market stakeholders
- Continuously refine X5 Retail Group's governance and investor relations in line with developing regulations and best practice

- Maintain an appropriate balance between business growth that creates returns for shareholders and the long-term sustainability of our business
- Ensure that our business takes the appropriate steps to mitigate risks it faces as it seeks to build value for all stakeholders

- Ensure that employees at all levels of X5 Retail Group contribute to achieving the Company's long-term strategic goals in a productive and efficient way

- Retain promising and talented staff with training and advancement programmes that provide rewarding career opportunities

- Ensure that all of X5 Retail Group's workforce shares responsibility for maintaining the safety of our operations

- Minimise X5 Retail Group's impact on the environment while improving efficiency across our operations
- Seek to ensure that our suppliers engage in environmentally sustainable practices.

- Contribute to the well-being of people in Russia by investing in initiatives that support sustainable development and protect those most in need

Geography of operations

Expanding our presence across Russia's diverse regions

Russia is a diverse country with over 185 ethnic groups living within its borders. As we expand our presence into new regions, we aim to ensure that our retail formats' customer value propositions are adapted to the needs and expectations of local communities. This is reflected in the fact that we source a significant portion of the products our stores sell from local producers, and we regularly conduct training events for local suppliers across our network of distribution centres. The share of local goods across all X5 stores reached 17% in 2017, and we aim to reach 20% in 2018. In some regions, the share of locally produced goods in Pyaterochka stores in 2017 was above 25%.

X5 continued its rapid expansion in 2017, bringing its modern food retail formats to around 500 new population centres (approximately a 25% increase in cities and towns where X5 operates compared to 2016) and six new Russian regions during the year.

Our strategy to the end of 2020 calls for rapid and profitable expansion of X5's business in Russia, which we aim to do by:

- Strengthening and expanding X5's presence in our core geographies
- Building critical mass in attractive new regions through both organic growth and tactical M&A
- Tailoring CVP to new regions with our regional supermarket model, working with local suppliers and "clusterisation" of assortment in stores covering a small geographic area
- Accelerating expansion into rural areas while achieving investment return criteria
- Expanding logistics operations to support ongoing development of business in existing and new regions
- Leveraging innovations and big data to enable our business to adapt and meet the needs of local consumers across Russia's diverse regions

A platform for sustainable growth

Number of stores, eop	2013	2014	2015	2016	2017
Central	2,314	2,653	3,262	4,077	5,198
North-Western	644	720	845	1,095	1,416
Central and North-Western	**2,958**	**3,373**	**4,107**	**5,172**	**6,614**
Volga	1,002	1,368	1,848	2,468	3,169
Ural	325	405	551	764	999
Southern	201	276	418	606	874
North Caucasus	46	61	96	137	188
Siberian	-	-	-	40	277
Ukraine	12	-	-	-	-
TOTAL	**4,544**	**5,483**	**7,020**	**9,187**	**12,121**

Note: based on federal districts of the Russian Federation

Percentage of net retail sales by federal district in 2017

X5 today

Multi-format presence in seven federal districts

11,225
Pyaterochka stores

638
Perekrestok supermarkets

93
Karusel hypermarkets

165
Express stores

Total stores
12,121

Number of stores and DCs

Central FD

Pyaterochka 4,607
Perekrestok............ 389
Karusel 37

Distribution centres 16

Volga FD

Pyaterochka 3,038
Perekrestok............ 107
Karusel 24

Distribution centres 9

North-Western FD

Pyaterochka 1,333
Perekrestok...............65
Karusel 18

Distribution centres 4

Ural FD

Pyaterochka 951
Perekrestok.............. 40
Karusel 8

Distribution centres 6

Southern FD

Pyaterochka 841
Perekrestok................28
Karusel 5

Distribution centres 3

Siberian FD

Pyaterochka 277
Perekrestok................. 0
Karusel 0

Distribution centres 1

North Caucasus FD

Pyaterochka 178
Perekrestok.................9
Karusel 1

Advanced Geographic Information System

We are constantly updating our in-house GIS tools, which have helped us to make efficient and informed choices about where to open new stores, including in areas where there is cannibalisation. The GIS system is constantly gaining new data, which helps us to further refine selection criteria and better predict a new store's sustainable performance.


SCHOOL
ALLIED STORE
BANK OFFICE
HOSPITAL
POTENTIAL STORE LOCATION
TRANSPORT STOP

Leadership team

Our leadership team comes from a diverse set of backgrounds, which helps to ensure the right mix of retail experience combined with a wider set of competencies and views on Russian and international corporate practices.

Vitaly Valkov
Commercial Director

Timur Parshikov
Director of Transport

Stanislav Naumov
Government Relations Director

Svetlana Demyashkevich
Chief Financial Officer

Igor Shekht
Chief Exe
Chairma
of the M

Ekaterina Lobacheva
General Counsel

Anton Mironenkov
Director of Strategy

Olga Naumova
General Director of Pyaterochka

Vladim Sorokin
General D
of Perekr

nterman

xecutive Officer,
an and Member
Management Board

Olga Kruzhkova

Organisational Development Director

Dmitry Agureev

Head of Corporate Security

Svetlana Volikova

Director of Risk Management and Internal Control

Sergey Budylin

Director of Large Format Real Estate Management Department

mir
in

Director
krestok

Maksym Gatsuts

General Director of Karusel

Elena Konnova

Corporate Communications Director

Fabricio Granja

Chief Information Officer

Igor Shekhterman

Chief Executive Officer, Chairman and Member of the Management Board

Igor has served on X5's Supervisory Board since 2013. He has been Managing Partner and CEO of RosExpert, which he co-founded in 1996 and subsequently successfully developed into the Russian alliance partner of Korn/Ferry International. Igor started his career as finance manager at the Russian branch of Beoluna, the Japanese jewellery producer. Igor holds a degree in economics from the Kaliningrad Technical Institute (1992) and degrees in business administration from the Institute d'Administration des Enterprises (France, 1994) and the Danish Management School (1995).

Svetlana Demyashkevich

Chief Financial Officer

Svetlana joined X5 in June 2017. Beginning in 2005, she held several senior positions at Alfa-Bank, including Deputy CFO, head of audit and IFRS reporting. In her most recent post as Deputy CFO, Svetlana chaired the tender committee and the credit committee for small and medium-sized corporate clients, and she was involved in the activities of the Boards of Directors of several of the bank's subsidiaries. She also created and led the financial control service, investor and rating agency relations, the business intelligence centre, and the centralised purchasing service. From 2002 to 2004, she audited financial institutions at PricewaterhouseCoopers and was the Financial Controller at UNICEF Russia. Svetlana graduated with honours from the Financial University of the Government of the Russian Federation and is an ACCA qualified accountant.

Olga Naumova

General Director of Pyaterochka

Olga joined X5 in May 2013. She has over 20 years of managerial experience at the senior executive level with leading Russian and international companies, including Rimera, Severstal and IBS. During this time, Olga has effectively managed very large teams in both Russian and international environments and has a track record of success in business integration and restructuring. Olga graduated from the Social Sciences Faculty of Moscow State University in 1994.

Vladimir Sorokin

General Director of Perekrestok

Vladimir joined X5 in January 2013 as Deputy Purchasing Director, and in June 2013 he became the Director of Category Management for Pyaterochka. Vladimir has approximately 20 years of experience in the retail, FMCG and insurance industries and has held senior management positions at Alfa Insurance, SunInterbrew and Gillette, in which positions he successfully led both strategy development and business transformation projects. Vladimir attended the St Petersburg Institute of Economics and Trade, where he specialised in food production technology; and the National Research University Higher School of Economics, where he specialised in finance and credit.

Maksym Gatsuts

General Director of Karusel

With 20 years of managerial experience at various multinational industry leaders, Maksym has extensive expertise in food retail. From 2002, he worked for the METRO Group, holding positions as Store Manager, District Manager, Operations Director at METRO Cash & Carry Ukraine and Customer Management Director at METRO Cash & Carry Portugal. From 2012 to 2016, he served as Operations Director and a member of the Management Board at METRO Cash & Carry Russia. Maksym graduated from the Moscow Aviation Institute and holds an MBA from INSEAD.

Anton Mironenkov

Director of Strategy

Anton joined X5 as Deputy Director of the M&A Department in September 2006. In March 2011, he was appointed Director for M&A and Business Development, and in 2012 became the Director for Strategy and Business Development. In February 2014, he was appointed as General Director of the Express convenience store format. From 2005 to 2006, Anton managed various projects for the Alfa Group, including the merger of Pyaterochka and Perekrestok. He began his business career in 2000 as an auditor at PricewaterhouseCoopers and subsequently spent four years as an investment banker at Troika Dialog before transferring to the Vice President position at Troika Dialog Asset Management in 2005. Anton graduated with honours from Moscow State University in 2000 with a degree in economics.

Olga Kruzhkova

Organisational Development Director

Olga joined the X5 team in October 2015. She has a strong track record in implementing organisational change, improving governance, developing internal communications and managing HR projects. Before joining X5, Olga was a directorate head in the Organisational Development Department at ROSATOM. In 2006–2008, she ran a project management office at UC RUSAL. In 2005–2009, Olga was a senior partner and deputy CEO at AXES Management. In 1999–2005, she held various positions at ECOPSY Consulting, starting from associate and working her way up to head of the executive coaching practice. Olga graduated from Moscow State University with a degree in psychology.

Fabricio Granja

Chief Information Officer

Fabricio joined X5 Retail Group in October 2016. Fabricio has an impressive track record in the field of IT. Before joining X5, he worked as Vice President for IT & Projects at Eldorado LLC and was in charge of the Company's IT strategy. Fabricio has held management positions at a number of Russian and international IT consulting firms, including Ciber, ABPL Altamiro Borges Planejamento & Logistica, and FQS, focussing on projects for major companies. Fabricio graduated from the Federal University of São Carlos (São Paulo, Brazil) with a master's degree in IT.

Stanislav Naumov

Government Relations Director

Before joining X5 in March 2015, Stanislav held several high-level positions in the civil service. From 1992 to 2010, he worked as head of the public relations centre in the City of Magnitogorsk Administration, as an Assistant Chief of the State Tax Service of Russia, as the Assistant Deputy Prime Minister, as the Director of Economic Analysis and Prospective Planning of the Industry and Energy Ministry of Russia, and as Deputy Minister of Industry and Trade of the Russian Federation. From 2010 to 2012, Stanislav was Vice President for Government and Public Relations at the Skolkovo Foundation. Since December 2010, he has been acting as President of the Russian Association of Public Relations (RPRA); since 2013, he has been the Chairman of the Board of Directors of CROS Public Relations & Public Affairs Company; and he is also the Executive Director of the Eurasian Centre for Integration Studies and Communications. Stanislav graduated from the Faculty of Philosophy of the Ural State University in 1994, where he specialised in political science. He received his PhD and an executive MBA from the Moscow Skolkovo School of Management.

Elena Konnova

Corporate Communications Director

Elena joined X5 in January 2015. She has 15 years of experience handling public relations with some of Russia's largest companies. Before joining X5, Elena worked for Volga Group, Gazpromneft, NIS (Naftna Industrija Srbije), and Ilim Group (a Russian pulp and paper holding). Prior to that, Elena spent more than 10 years working as a journalist for the Russian business press, including at Kommersant and Expert. Elena graduated from St Petersburg State University with a degree in sociology and economics.

Dmitry Agureev

Head of Corporate Security

Dmitry has approximately 23 years of experience working in government and corporate security, including at leading Russian and international companies. Dmitry started his career in the Intelligence Service of the Russian Federation. Prior to joining X5, he was the security director at Volvo Group Russia, Ukraine and Belarus and also held security positions at Gazprom and Transneft. Dmitry holds degrees from the Moscow Suvorov Military School, the Serpukhov Military Command-Engineering College of Nuclear-Missile Forces and the Russian Academy of the Intelligence Service as well as a Volvo MBA.

Sergey Budylin

Director of Large Format Real Estate Management Department

Sergey joined X5 in 2016. He has around 30 years of managerial and hands-on experience in project development, construction and refurbishment in the real estate sector. He has held leading positions in large companies such as Rosatom, DC Development, Hypercenter, East Line, and others. Sergey graduated from the Moscow Power Engineering Institute (technical university).

Timur Parshikov

Director of Transport

Timur joined the X5 team in September 2013 as Director of the Transport Department. Timur has over 15 years of experience as a logistics manager with leading Russian companies, including Lebedyansky, ROLF and Unimilk. It was in the latter that Timur was appointed head of a transport logistics company to integrate the transport logistics of Danone and Unimilk. Timur graduated from the St Petersburg University of Architecture and Civil Engineering with a degree in civil engineering.

Svetlana Volikova

Director of Risk Management and Internal Control

Svetlana joined the X5 team in 2007 and has held managerial positions within several of the Company's business units since then. From August 2012, she worked as Karusel's CEO, before being appointed Chief Corporate Audit Officer in July 2014. In 2016, the Corporate Audit Department was transformed into the Audit, Risk and Compliance Department. In 2017, the Audit Risk and Compliance Department was divided into two separate divisions: the Risk Management and Internal Control Department, and the Internal Audit Department. Svetlana was appointed as the head of Risk Management and Internal Control Department, with responsibility for development of the Company's internal control systems, monitoring and evaluating risks at a company-wide level, as well as monitoring X5's financial, business and economic activities. Svetlana graduated from the ISG Business School (Institut Supérieur de Gestion, France) in 1996. Before joining X5, she worked as a manager at Auchan and Danone.

Ekaterina Lobacheva

General Counsel

Ekaterina joined X5 in October 2016 as the Head of the Corporate Law and X5 Corporate Structure Department. She has over 15 years of successful managerial and practical experience in the field of law. Before joining X5 Retail Group, Ekaterina worked for over five years at Evraz Holding, where she implemented a number of large-scale projects in legal support for business. During her term at Evraz Holding, she held numerous positions, including Director of Corporate and Property Relations, Vice President, Legal, Law and Corporate Law Director. Ekaterina worked at MDM Bank as the Corporate Secretary from 2007 to 2011. She began her professional career in the legal field in 1999, working in several private and government entities before joining MDM Bank. Ekaterina graduated from the Russian Academy of State Service with a degree in Law in 2005 and received an additional degree in Finance and Credit from the Plekhanov Russian University of Economics in 2011.

Vitaly Valkov

Commercial Director

Vitaly joined X5 in 2005 as assistant manager in the dry products department and has progressed to become Commercial Director. Currently, Vitaly is responsible for developing initiatives to ensure the most favorable purchasing conditions for X5, enhancing X5's competitive advantages through strategic partnerships with suppliers and manufacturers of goods, and increasing the efficiency of category management. Vitaly graduated from Moscow State Institute of Electronics and Mathematics.

Pyaterochka
proximity stores

We set new all-time records for Pyaterochka, passing RUB 1 trillion in net retail sales and adding more than 1 million square metres of new selling space for the first time in our history. With 29% year-on-year growth in net retail sales in 2017, we achieved the fastest pace of growth of any public food retail banner in Russia. Pyaterochka was operating 11,225 stores in around 2,500 cities and towns across Russia at the end of 2017.

While achieving this rapid expansion, we have maintained a focus on adapting to the needs of local customers. Russia is an economically and ethnically diverse country, and we want to meet the different needs of our customers in every store that we operate. We have successfully adjusted our operating model to enable greater localisation of assortments at the level of operational clusters, meaning we can adapt to demand more flexibly. Another constant focus has been on leveraging data analytics to offer personalised promotions for higher-quality relationships with our customers.

Olga Naumova

General Director of Pyaterochka

Pyaterochka is one of the top brands in Russia, and is the fastest-growing retail format in our portfolio. Our proximity stores aim to deliver a satisfactory shopping experience and offer a wide assortment of high-quality goods to consumers in Russia. Pyaterochka's highlights include convenient locations, a unique loyalty programme with personalised offers, attractive weekly promotions and reasonable prices. On average, a Pyaterochka store is 394 square metres in size, with more than 4,500 PLUs on offer.

Performance highlights

Record new openings

New stores added

2,862

and 1.1 million square metres of new selling space added

Selling space
as of 31 December 2017

4,427 ths sq m

+33.0% year-on-year

Stores
as of 31 December 2017

11,225

+34.2% year-on-year

Net retail sales

RUB 1,001 bln

+29.0% year-on-year

Customer visits

3.3 bln

25% year-on-year increase in cities and towns of operation

Helping Card (Vyruchai-Karta) loyalty programme

Cards launched

>45 mln

more than 20 million active users

Traffic penetration
as of 31 December 2017

44%

and 61% of retail sales attributable to loyalty card holders

Strategic highlights

New loyalty programme
launch and full rollout leveraging data analytics to automatically generate personalised offers for customers

Record new selling space
and store openings underpinned by updated GIS, which helps to ensure quality openings in good locations while minimalising cannibalisation

Adapting to Russia's diverse regions:
expanded cooperation with local suppliers, with local assortment accounting for an average of 17% of our assortment in 2017, and as high as 25% in some regions

Meeting demand at a regional level:
began "clusterisation" of assortment matrix, enabling Pyaterochka to adapt to the needs of customers on a more precise basis

Updated organisational structure
in line with rapid business growth: Pyaterochka is now managed in 13 divisions and more than 150 clusters

Geographic expansion:
expanded presence in Siberian Federal District, opened stores in around 500 new cities and towns

Operational excellence:
completed five-year refurbishment programme and continued to focus on day-to-day in-store improvements

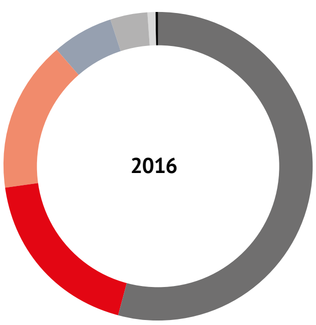
Innovation and efficiency:
launched automated/centralised cash control monitoring system and mobile work stations for supervisors; further developed our direct import operations

Advanced data analytics:
thanks to successful launch of loyalty programme that leverages data about customer shopping habits to automatically generate personalised offers; integrated big data analytics into decision-making and planning processes

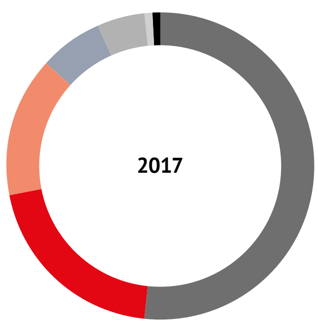
Key operating results

	2013	2014	2015	2016	2017
Number of stores, eop	3,882	4,789	6,265	8,363	11,225
Selling space ‘000 m², eop	1,414	1,754	2,423	3,329	4,427
Net retail sales, RUB bln	348	436	585	776	1,001
Customer visits, mln	1,450	1,645	1,990	2,543	3,267

Pyaterochka net retail sales by region, %



2016		2017
54.3	Central FD	51.9
18.7	Volga FD	20.1
15.8	North-Western FD	14.7
6.3	Ural FD	6.8
4.1	Southern FD	4.9
0.8	North Caucasus FD	0.9
0.1	Siberian FD	0.7



Strategic priorities for 2017

Our priorities	What we did
Rapid, high-quality growth	• 11,225 stores as of 31 December 2017, up 34.2% year-on-year • 4.4 million square metres of selling space, up 33.0% year-on-year • Continued to enhance GIS system to support efficient decision-making and high-quality openings • Began pilot introduction of "macrodivisions" in organisational structure to efficiently manage rapidly expanding business
Expand to new geographies and strengthen position in existing locations	• Expanded presence in Siberia, entering 53 new cities and towns in the Siberian Federal District • Opened stores in around 500 new cities and towns, increasing our regional coverage by 25% year-on-year • Over 40% of Pyaterochka stores are now located in locales with populations under 100,000 • Opened new DC in Novosibirsk, providing strong support for accelerated expansion in Siberia
Continue to adapt value proposition and improve customer experience	• Completed refurbishment programme while continuing to introduce improvements at existing stores • Regularly adapted assortment based on customer demand, including expansion of locally produced products: over 1,050 new producers from 63 Russian regions began supplying goods to X5 stores in 2017 • Started "clusterisation" of assortment, enabling Pyaterochka to adapt store contents to meet demand at the local level
Effective loyalty and promo programmes	• Rolled out Helping Card (Vyruchai-Karta) loyalty programme, which leverages advanced data analytics to automatically generate personalised offers • Launched debit card loyalty programme in partnership with Post Bank • Introduced advanced analytics system that enables partners to track effectiveness of promo activity on consumer behaviour
Optimise efficiency and costs	• Negotiated improved terms with suppliers • Made improvements to logistics: opened nine new DCs and closed five old DCs that were not meeting efficiency criteria • Automated high-volume recruitment process with custom AI solution • Made SG&A improvements: lease costs, utilities, other store costs and other expenses

What we plan to do

Maximise the share of customers, and maximise the share of these customers' wallet:

- Continue to enhance the current value proposition and increase ability to adapt to demand at the local level
- Focus on ensuring high-quality openings to support rapid and sustainable growth with ongoing improvements to GIS data and modelling
- Increase share of assortment from local producers in each region, as well as stores' ability to adapt offering in response to local demand
- Further development of private label
- Improve NPS
- Further develop data analytics-driven loyalty programme and personalised promo offerings

Improve efficiency and reduce costs:

- Adapt organisational structure to retain ability to effectively manage large and rapidly expanding business
- Continue to use innovative solutions to automate processes and cut operating costs
- Develop and integrate systems that enable us to maintain a lean and agile approach while continuing to grow rapidly
- Maintain focus on improvements in opex and purchasing terms, while supporting customer loyalty and maintaining margins

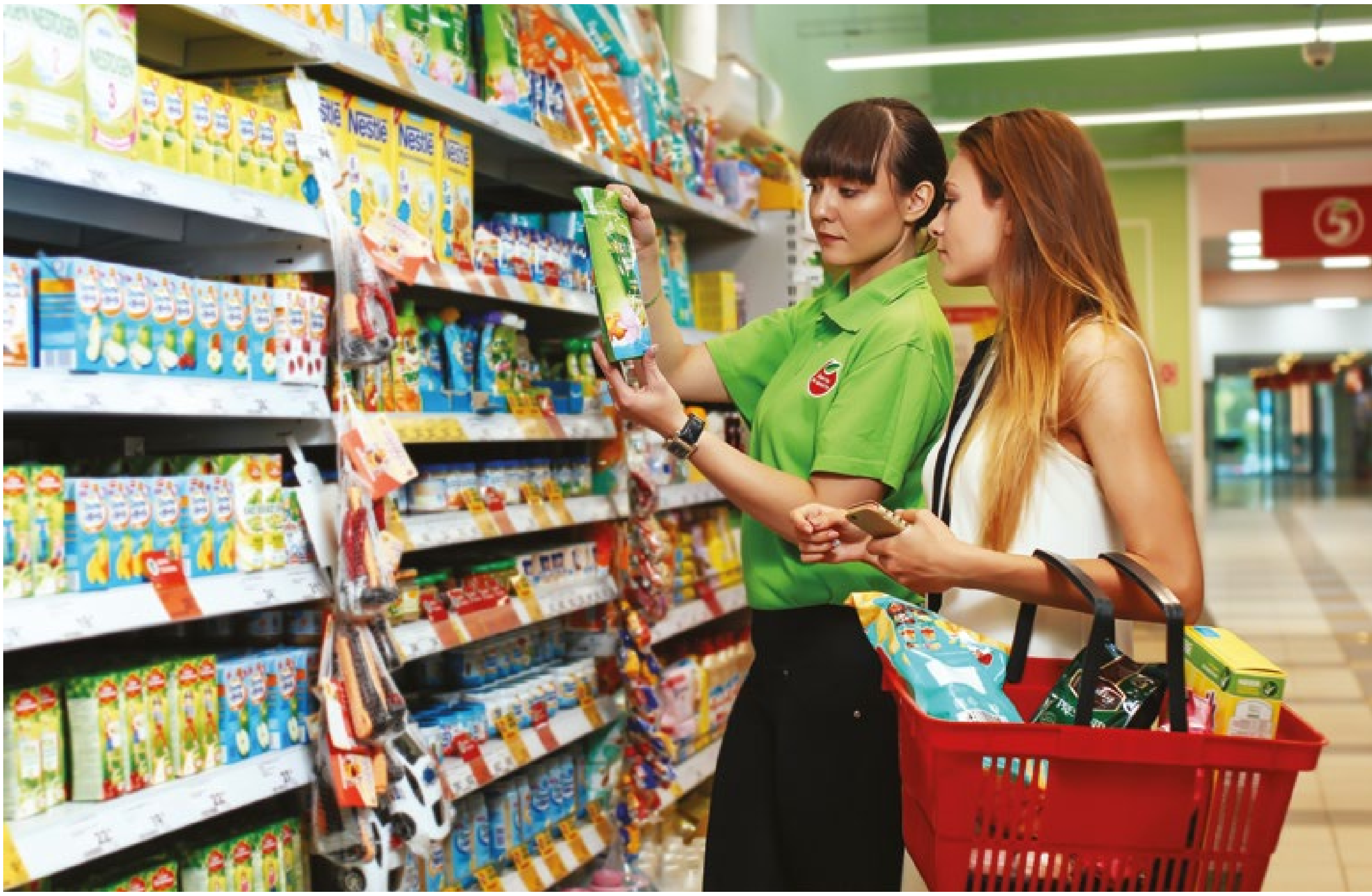
Rapid and high-quality growth

We continued to set new records for growth in 2017, passing the threshold of 1 million square metres of new selling space added and RUB 1 trillion in net retail sales. This continued expansion is only possible with robust and effective systems in place to enable us to efficiently select locations, open stores and offer customers the best value proposition.

GIS: GIS has been one of the core tools for selecting the right location for our new stores. In order to increase the quality of the system, we are constantly adding new data and algorithms to further improve its accuracy.

Adapting organisational structure: We are constantly seeking to enhance our ability to effectively manage our decentralised business, enabling Pyaterochka to adapt to local needs while maintaining a single strategic focus. As of the end of 2017, we were operating 13 divisions and 158 clusters, and we had begun piloting a new level of "macrodivisions".

Efficiently building an excellent team: Recruitment plays a major role in our successful and rapid expansion. While continuing to focus on training, development and motivation for employees, we have also started automating parts of the recruitment process with advanced IT solutions that conduct online searches, analysis of CVs and even call potential applicants before requiring one-on-one human interaction.



Refurbishment complete, increased focus on in-store improvements

We renovated just 267 stores in 2017, down from 1,185 in 2016, as we completed Pyaterochka's renovation programme. At the same time, our stores are constantly changing: a Pyaterochka renovated in 2013-2014 when we launched this programme will look significantly different today due to the day-to-day improvements we have introduced over the years.

We monitor trends and innovations, and we can rapidly introduce new practices at our stores, such as optimising the produce selling space to make it more convenient and easier for customers to get a broader range of products. These include testing of new equipment and shelves, placement of products and other innovations aimed at continuously improving the shopping experience for customers.

Expansion into smaller cities

While Pyaterochka continues to grow its share in existing markets and enter new regions, the format is expanding into smaller cities and towns, where it is the primary provider of modern retail services.

Effective promo and data-driven loyalty programme

One of the key achievements in 2017 was the launch and rollout of the Helping Card (Vyruchai-Karta) loyalty programme, which goes beyond offering points for purchases, using advanced data analytics based on customer behaviour to automatically generate personalised offers to encourage shoppers to choose Pyaterochka. Personalised promotions are now being rolled out across the entire Pyateochka network in 2018, after successful testing in 2017.

In addition to Helping Card (Vyruchai-Karta), we launched a new debit card offering with Post Bank, a mobile loyalty card based on a mobile phone app, the "children's club" add-on for parents that use Helping Card (Vyruchai-Karta), and a partnership with A-MEGA pharmacies enabling customers to collect points on their Pyaterochka card when they shop at A-MEGA.

Programme	Highlights	Customer benefits	Geography
Helping Card (Vyruchai-Karta) loyalty programme	• Over 45 million cards issued • Over 20 million registered users • 44% traffic penetration • 61% retail sales penetration	• Earn points for purchases • Personalised promotions based on individual preferences	• Nationwide
Co-branded Post Bank debit card loyalty programme partnership	• Over 370,000 cards issued in 2017	• Extra points for birthday purchases • Earn points for all purchases with debit card, and 3x points for purchases at Pyaterochka • Earn extra points for first purchase at Pyaterochka	• Nationwide
Children's club loyalty programme add-on	• Add-on programme for parents using Helping Card (Vyruchai-Karta)	• Special offers and promotions for children's goods sold at Pyaterochka stores • Earn 2x points for purchases of children's goods at Pyaterochka • Programme website provides useful information for parents	• Nationwide
Earning points for New Year's loyalty programme promo	• Special promo run 5-17 December for Pyaterochka customers	• Earn 2x points for purchases of RUB 555 and 5x points for purchases over RUB 1,500	• Nationwide
A-MEGA pharmacy partnership loyalty programme partnership	• Points partnership with pharmacy chain	• Customers of A-MEGA can earn points on their Helping Card (Vyruchai-Karta)	• North-Western division (with expansion planned in 2018)

Loyalty programme

We launched Pyaterochka's loyalty programme in 2017, our first for the proximity format.

Starting in 2018, we will be rolling out personalised promotions to holders of the Pyaterochka Helping Card (Vyruchai-Karta).

Localisation

One of the key elements of Pyaterochka's CVP is its focus on localising assortment based on customer demand and products sold by regional producers. We are working with food producers and farmers in the regions where we operate to increase the share of their goods in our stores.

In 2017, the share of local assortment offerings at Pyaterochka stores reached 17%. We plan to increase this number, and we have already achieved a 25% share of local products in some regions. Another aspect of our focus on meeting demand at the local level is "clusterisation". We have adapted our operations to enable aggregation of merchandising at the "cluster" level, meaning that the assortment matrix for Pyaterochka stores can be better tuned to local demand.

Human resources and recruitment

Pyaterochka is a major employer in Russia: we employ over 160,000 people across all of the format's operations, from the head office to stores to logistics. Finding the right people to staff the stores we open is significantly more important and challenging than selecting a location and opening a store.

We pay close attention to building Pyaterochka's HR brand, and we engage in a wide range of activities to make sure our staff feel like part of the team and have opportunities to develop professionally. These include "cashier of the year" and professional competitions for employees of DCs, as well as regional conferences. Conferences cover a range of topics and are one of our key forums for engaging in dialogue with our employees and sharing ways to create value for them in their professional careers with Pyaterochka.

Another area of focus is motivation, team building and developing an internal staff reserve within each format. One of the annual highlights for the Pyaterochka team is Turboliada, our annual company-wide sports competition aimed at strengthening corporate culture and team building.

Turboliada 2017 in numbers

ТУРБОЛИАДА
2017

13
cities

25,000
employees and members of their families

160
teams

3,200
athletes

17
unique competitions

>20,000
km of track

>45
tonnes of equipment

First
Turboliada in Novosibirsk

Perekrestok

supermarkets

Perekrestok strengthened its position as Russia’s #1 supermarket format in 2017, with 638 stores operating in around 130 cities and towns as of year end. While we continue to focus on organic growth, with over 100 new gross openings during the year, we also acquired O’KEY’s supermarket business, which should add 32 stores in attractive locations in 2018, 18 of which will be in St Petersburg.

While Russia’s supermarket sector saw a recovery in 2017, Perekrestok managed to outperform competitors in the supermarket sector, with year-on-year LFL traffic growth of 6.7% for 2017. We remain focused on adapting our CVP to attract a wider customer base to all of our stores, while tailoring our regional supermarkets to meet local demand. With the refurbishment programme well under way, and the launch of our online supermarket last year, we aim to bring our customers the best shopping experience across every single store we operate while continuing to expand through new channels.

Vladimir Sorokin

General Director of Perekrestok

Perekrestok is Russia's largest supermarket format, and is the oldest modern food retail format in the country. Today, we are opening modern stores in cities across Russia, while also refurbishing and updating our existing stores in traditional home markets like Moscow and St Petersburg. 2017 was a year of record growth for the supermarket banner, with 99 stores added and 88,769 square metres of net selling space added during the year. We continue to adapt the Perekrestok CVP to the needs of regional customers outside of our core regions as we expand outside of our traditional markets, while also trying to attract a broader base of customers across the chain.

Perekrestok stores offer an assortment of 8,000-15,000 PLUs, with an average selling space of 999 square metres.

Performance highlights

Net retail sales

RUB 187 bln

+20.3% year-on-year

Stores in operation

as of 31 December 2017

638

+18.4% year-on-year

Selling space

as of 31 December 2017

637 ths sq m

16.2% year-on-year

Customer visits

407 mln

+16.2% year-on-year

Stores refurbished

76

+22.6% year-on-year

LFL traffic growth in 2017

6.7%

the highest rate of growth among X5 Retail Group formats in 2017

Strategic highlights

Record number of new openings:

99 stores added in 2017 (excluding 32 O'KEY supermarkets acquired in December 2017, should be added in 2018 and be refurbished as Perekrestoks)

Continued development in regions

with the highest level of modern retail penetration and competition (Central and North-Western Federal Districts), with approximately 60% of stores opened in Moscow, the Moscow region and St Petersburg and the Leningrad region

Regional expansion:

ongoing adaptation and development of our CVP to meet the needs of customers outside of our core regions and Russia's major cities, with all new and refurbished stores in regions opened according to our new concept

Refurbishment programme:

76 stores were refurbished in 2017, with 73% of the store base operating under our new concept as of 31 December 2017 (vs. 52% as of 31 December 2016)

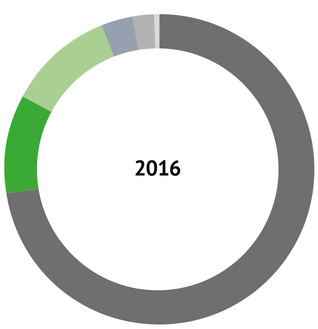
Service and efficiency:

made across-the-board efficiency improvements in operational expenses, shrinking costs and SG&A

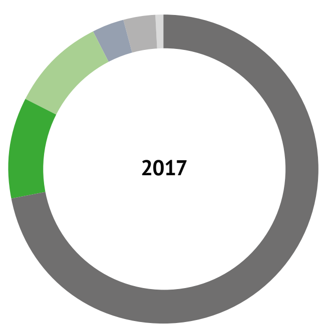
Key operating results

	2013	2014	2015	2016	2017
Number of stores, eop	390	403	478	539	638
Selling space ’000 m^2, eop	398	416	484	549	637
Net retail sales, RUB bln	111	116	130	155	187
Customer visits, mln	307	302	304	350	407

Perekrestok net retail sales by region, %



2016		2017
72.6	Central FD	72.2
10.4	North-Western FD	10.5
10.9	Volga FD	9.9
3.4	Southern FD	3.5
2.3	Ural FD	3.2
0.4	North Caucasus FD	0.7



Strategic priorities for 2017

Our priorities	What we did
Continue opening new stores to preserve foothold for future growth	• 71% of stores are located in the Central and North Western Federal Districts, the two retail markets in Russia with the highest level of modern retail • 62% of new openings were in Moscow, St Petersburg and other cities with a population of over 1 million people
Continue to refine CVP to meet demand from core customers, while expanding overall base	• Continued measures to adapt assortment and improve service have delivered positive results: LFL sales growth of 10.1% in 2017 was highest among X5's formats and set a new record among Russian public food retailers • Successful expansion of loyalty programme with more than 14 million customers registered • 63% of retail sales attributable to loyalty card holders as of December 2017 • Expanded private-label offering, began partnerships with suppliers to provide exclusive labels for Perekrestok customers
Move towards omni-channel approach, with online supermarket in core markets	• Successfully launched and rolled out Perekrestok Online in Moscow • Approved plan to expand online supermarket platform to St Petersburg in 2018
Expand and develop regional supermarket model	• Expanded and adapted regional supermarket model, improving quality of regional growth • All new and refurbished stores in regions were opened under the new regional supermarket concept • Developed regional logistics, including new DC in Yekaterinburg, helping to improve efficiency of regional supermarkets
Continue to implement refurbishment programme	• 76 stores were refurbished in 2017, with over 73% of Perekrestok stores operating under the new concept as of 31 December 2017 • Decreased average refurbishment period from 44 days in 2016 to 41 days in 2017
Focus on further refining service and efficiency of operations	• Focused on quality of service and shelf availability • Improved opex, logistics, shrinkage costs and SG&A: staff costs, lease costs, marketing and security

What we plan to do

Fine-tune value proposition and adapt to customer needs:

- Maintain pace of organic growth and refurbishments with local M&A deals
- Expand regional model to support ongoing growth
- Further adapt assortment to meet demand of wider customer base
- Develop loyalty programme and expand personalised promotions
- Expand and develop online supermarket in Moscow and St Petersburg
- Improve NPS

Improve efficiency and reduce costs:

- Increase the share of private labels
- Further develop direct imports
- Further improve logistics (forecasting, stock replenishment system)
- Undertake targeted and rational reinvestment of improvements in opex and purchasing terms into adapting CVP to better address customer demand

Accelerating expansion

With 99 new stores added in 2017, last year marked our fastest-ever rate of expansion. While we continue to concentrate on Russia's largest cities, our regional model has proven to be a successful way for Perekrestok to expand into cities with populations of less than 1 million.

We have also integrated X5's GIS software into our decision-making, and we sometimes work together with Pyaterochka when selecting locations for new stores to determine which format is best-suited for a specific location.

While our primary focus remains on organic expansion, we also took advantage of an attractive M&A opportunity with the purchase of OKEY's supermarket business, which reflects X5 Retail Group's commitment to growing the Perekrestok supermarket format. Through this transaction, Perekrestok should add 32 supermarkets in 2018, 18 of which will be located in St Petersburg and four in Moscow.

Refurbishment: improving brand perception

The Perekrestok refurbishment programme remains among our top strategic priorities, as we try to ensure that each of our stores offers shoppers a modern and high-quality supermarket shopping experience. In addition to refurbishments, which have been going on since 2014, we are constantly introducing improvements to our stores, and a Perekrestok that was refurbished four years ago looks very different today as a result of everyday improvements that we have introduced.

Refurbishments include installation of state-of-the-art equipment and updates to interior and exterior store design. The new concept improves the efficiency of store layouts and upgrades the lighting, giving customers more space and light in the store for a better shopping experience. Zoning and location of promotional offers are also taken into account under the refurbishment programme. These changes to refurbished stores make it possible to increase the share of fresh goods, improve service and make goods more readily available on shelves.

Some of the programme's 2017 highlights include:

Number of stores refurbished in 2017

76

vs. 62 stores in 2016

Share of stores operating under the new concept
as of 31 December 2017

73

vs. 52% a year ago

Average duration of store closure

41 days

vs. 44 days in 2016

Average sales recovery period

5 months

Average LFL sales growth
after recovery period

18–19%

Perekrestok Online — moving to omni-channel sales

NPS level

73%

Availability

99.4%

Perekrestok Online was launched in Moscow in 2017. Our core audience includes active internet users who are driving the rapid growth of e-commerce across many segments of Russia's retail market. By leveraging Perekrestok's well-known brand, we aim to build an online business that integrates know-how and best practices from international leaders in the field, adapted to Russia's operating environment and consumer expectations.

Even in the short period that it has been operating, since its launch in the second quarter of 2017, we have refined and improved Perekrestok Online, and we managed to achieve profitability by the end of the year. Perekrestok Online started operations in April with 20-30 orders per day and finished the year with 800 orders on New Year's Eve.

The online service increased drops per trip from four to 12 in 2017, for example, and optimised order selection in order to decrease missing items and substitutions to just 2% of items ordered. Perekrestok Online's customers are loyal, with more than 70% of orders coming from loyal customers. Our NPS for 2017 was at the very high level of 73%. Throughout the year, the average basket for Perekrestok Online was also several times higher than at brick-and-mortar Perekrestok stores.

Following our successful launch in Moscow in 2017, we aim to expand Perekrestok Online to St Petersburg in 2018.

Private label

Perekrestok further expanded its private-label offering in 2017, introducing the new exclusive dairy brand Sarafanovo during the year. We also plan to introduce the new dairy brand Verkhovye in 2018. Both of these new brands are good examples of how our focus on private-label goods includes a significant number of goods in the medium-price segment.

In 2017, the share of private-label goods in Perekrestok's net retail sales was 5.4%. As of December 2017, we were offering over 1,600 private-label SKUs.

We offer cross-category private labels in the low-price (Prosto) and the mid-price (Market Perekrestok) categories. We are continuing to develop our private labels in the high-price segment as well. Perekrestok is also continuing to develop several niche private labels: Bonte (confectionary), Novy Okean (seafood) and Perekrestok Chef (cookery), as well as a children's brand and “fresh from the farm”.

Sarafanovo

	CURRENT BRANDS	NEW BRANDS
MEDIUM AND MEDIUM+	• MARKET PEREKRESTOK • SARAFANOVO	• VERKHOVYE • UHTISHKI
FIRST PRICE	• PROSTO	
NICHE	• BONTE • NOVY OKEAN • PEREKRESTOK CHEF	

Loyalty programme

The updated Perekrestok Club loyalty programme has contributed to our successful growth, with 4.2 million active users in December 2017. The Perekrestok Club card offers customised promotional programmes that offer discounts to loyal customers on goods we know they buy regularly. We have also expanded the functionality of the loyalty programme's mobile app, which had been installed on 1.1 million devices as of the end of 2017.

Loyalty card holders accounted for 63% of Perekrestok's net retail sales in December 2017. The average check of a Perekrestok Club member was 38% higher than the overall average check across all Perekrestok stores.

In addition to Perekrestok loyalty cards, we entered into a strategic partnership with Alfa-Bank and began offering a co-branded MasterCard in November 2016. Three types of cards are available: reloadable prepaid cards, debit cards and credit cards. Cardholders earn points on all purchases that can be redeemed against goods at Perekrestok supermarkets (10 points for every rouble spent). Purchases made at Perekrestok stores earn additional points. As of the end of 2017, we had issued around 100,000 debit cards, as well as around 225,000 prepaid cards.

Kitchen Factory

In order to further enhance our CVP and introduce unique products available only at Perekrestok stores, we have invested in the Kitchen Factory. This facility, which will produce ready-to-eat food, will be an advanced in-house production facility that supplies ultra-fresh and ready-to-eat products to our stores.

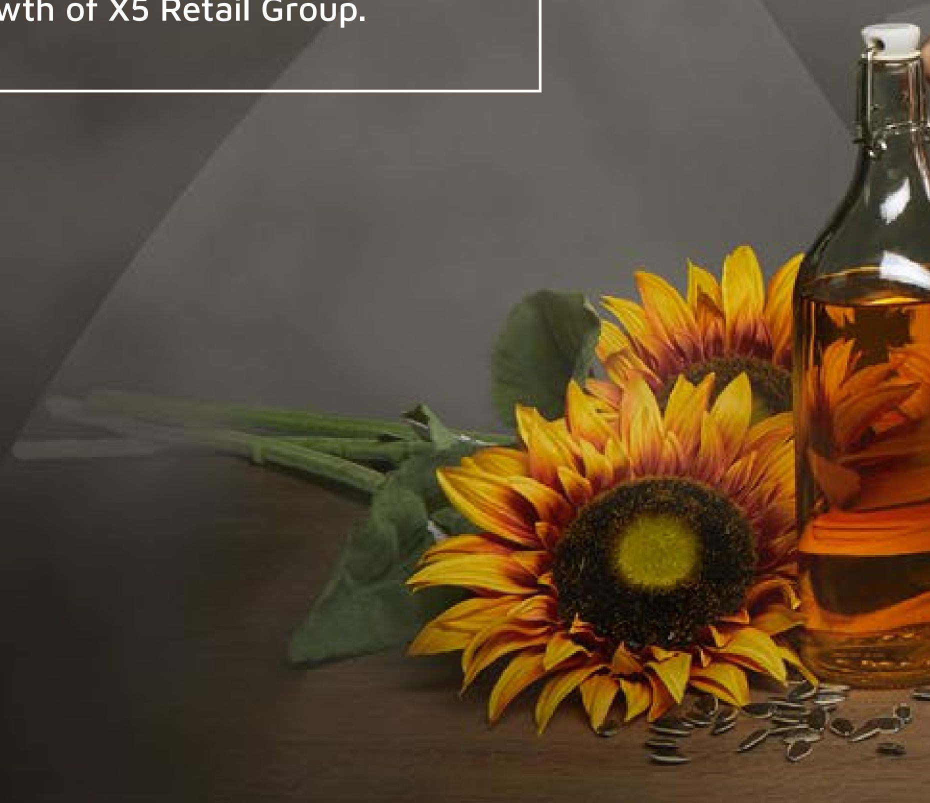
The Kitchen Factory will help Perekrestok significantly expand the share of in-house production in total turnover. With a target output of 120 tonnes per day, the Kitchen Factory will add up to 800 new SKUs to Perekrestok's product range, becoming the largest manufacturer of ready-to-eat products in Russia and one of the major production facilities in Europe.

In the future, the Kitchen Factory's products will be supplied to Pyaterochka and Karusel stores. With construction already underway and a total planned capital expenditure of RUB 3.5 billion, the facility is due to become fully operational in 2018.

Karusel

hypermarkets

> Last year marked a turning point for Karusel, as we developed and approved a new customer value proposition and branding for our hypermarkets, which are based on a deep understanding of our target audience and modern shopping trends. Our approach is to offer customers a modern and convenient shopping experience, including in-store entertainment, such as our own restaurants, coffee shops and pizzerias, as well as an assortment that covers the needs of an entire family and facilitates stocking up for a longer period of 1-2 weeks. Our price and promo proposition, supported by a modern loyalty programme, is aimed at generating value for our customers and building long-term relationships with them. Our services are upgraded in order to create hassle-free, time-efficient shopping, hence allowing our customers to spend more quality time with their families.
>
> This approach has been developed through extensive pilot testing, and we are confident that the new Karusel hypermarkets will create significant value for our customers and contribute to the future growth of X5 Retail Group.



Maksym Gatsuts

General Director of Karusel

Karusel is one of the largest hypermarket formats in Russia, offering customers a modern and convenient shopping experience with a wide choice of food products and a smart selection of non-food product "worlds". With families as our key target audience, we aim to provide solutions for family budgets. In 2017, we launched a pilot hypermarket based on Karusel's new branding and operating model, and we plan to expand this new model across the format in the coming years.

Karusel stores offer an assortment of 22,000 to 30,000 PLUs of food and non-food items, with an average selling space of 4,143 square metres.

Performance highlights

Net retail sales

RUB 89 bln

+6.9% growth year-on-year

Stores in operation

as of 31 December 2017

93

Selling space

as of 31 December 2017

385 ths sq m

Customer visits

135 mln

Stores refurbished

7

Strategic highlights

Recruitment and appointment
of new management team completed

New CVP and branding
for Karusel hypermarkets developed and approved

First Karusel hypermarket
operating under the new branding launched, with elements of the new CVP in St Petersburg in October 2017

Refurbishment programme
updated in line with new CVP and branding due to be rolled out starting from 2018

Assortment adjusted and optimised
with focus on fresh and ultra-fresh and other leader categories and enabling customers to complete large shopping trips in-store

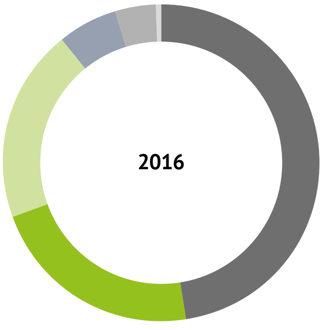
Own production and private label
offerings further developed in different price segments

Loyalty programme
further enhanced with mobile app for registered users

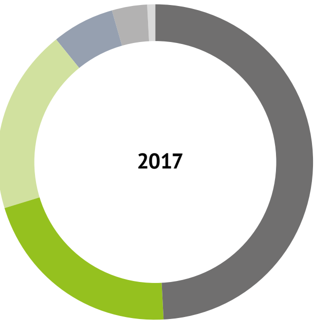
Key operating results

	2013	2014	2015	2016	2017
Number of stores, eop	83	82	90	91	93
Selling space, '000 m² eop	376	359	390	387	385
Net retail sales RUB bln	64	69	77	84	89
Customer visits, mln	122	123	129	134	135

Karusel net retail sales by region, %



2016		2017
47.6	Central FD	49.2
21.9	North-Western FD	21.1
19.7	Volga FD	19.0
6.2	Ural FD	6.4
4.0	Southern FD	3.6
0.5	North Caucasus FD	0.7



Strategic priorities for 2017

Our priorities	What we did	What we plan to do
Adapt CVP to target customer base	• Identified rational shoppers and families as key target audiences • Streamlined assortment, reducing PLUs and increasing share of first-price and mid-price goods • Focus on hypermarket model with 4,000-5,000 square metres of space in good locations within city limits • Updated store navigation to enhance customer experience, simplify and enhance communication • Expanded own production and private-label offerings	• Gradually rebrand the stores using new branding, giving priority to older stores or stores in one particular region • Expand omni-channel offering • Increase loyalty card penetration and implement personalised promotions • Increase the share of private labels • Increase sales density at least to peers' average • Improve logistics, reduce lease costs and shrinkage • Expand digital services offering to increase efficiency and create a single digital environment in every store
Launch new CVP and rebranding	• Approved new CVP • Developed new branding concept • Launched first hypermarket using elements of the new branding in St Petersburg • Updated refurbishment programme in line with new branding and operating model	
Develop programmes to enhance customer loyalty	• Continued to refine loyalty programme based on data analytics with special promotions for cardholders • Launched "My Karusel" mobile app	
Adopt omni-channel model	• Entered partnership with Instamart, which offers an online ordering and delivery platform based on the Karusel assortment in Moscow, with potential to expand to St Petersburg	

New CVP launched

In 2017, we approved our new CVP and introduced elements of this in-store in St Petersburg. The updated proposition is aimed at families with a rational approach to shopping who are looking to buy goods for 1-3 weeks in advance. Our new store layouts are intended to provide customers with easy navigation, access to a full range of products for the whole family, and offer a convenient in-store experience with cafes and restaurants on premises that are equipped with shopping cart “parking spaces” next to tables.

Under the new CVP, we aim to open 4,000-5,000-square-metre hypermarkets in prime locations. The assortment in new hypermarkets will be slightly smaller than before, with 20,000 to 22,000 PLUs, with an increased focus on first-price and mid-price goods. We aim for Karusel to be perceived as a price leader in key traffic categories and to encourage customers to stock up with larger volumes of basic goods.

Customers have responded well to the new elements that have already been introduced, and the pilot hypermarket in St Petersburg has achieved better NPS scores, as well as higher sales in several key categories.

- Arranging store zones according to customer logic
- Easily readable navigation
- Redistribution of shelf space according to category roles
- Emotional design in non-food product categories and leaders
- Creating product worlds (in leader categories)
- Communication focus on prices and creating customer value. Minimum noise
- Using the design to emphasise the scale of the store

Rebranding

The new Karusel brand launched in 2017 is aimed at communicating the updated CVP, with a focus on stability, order and structure. The new branding, aimed at rational buyers, is meant to be associated with favourable pricing, honesty and transparency in our offer to customers.

In order to communicate the changes in Karusel's CVP and improve the perception by the target audience, we decided to change the brand identity.

Our key goals were to retain Karusel's current loyal audience and brand awareness, while also showing that the brand is changing for the better in order to attract new customers.

гипермаркет КАРУСЕЛЬ

ГИПЕРМАРКЕТ КАРУСЕЛЬ

Updating our assortment

Under the updated CVP, the Karusel assortment will focus on leader categories and on encouraging customers to buy larger volumes of goods in a single shopping trip. By optimising the assortment and increasing the share of basic and leader categories, we believe that we will be able to better meet our customers' shopping needs.

We will also increase our assortment in fresh categories, while the selection of non-food goods will also contract, with a focus on creating “category worlds” such as “home”, “childhood” and “seasonal offers”.

	CURRENT BRANDS	NEW BRANDS
HIGH		• VERKHOVYE
MEDIUM	• AMPERSAND	• UMNOE RESHENIE
FIRST PRICE	• KRUGLI GOD (YEAR-ROUND)	
NICHE	• SARAFANOVO	• UHTISHKI • HONEY KID

Private labels

Private labels are an efficient way to diversify our assortment and price offerings. The share of private-label goods in net retail sales increased to 3.5% in Q4 2017 from 3.2% in Q4 2016. As of the end of 2017, our hypermarkets had over 800 “Year-Round” (“Krugli God”) private-label PLUs and more than 120 other private-label SKUs. By the end of 2020, we are aiming for private label goods to account for 6-8% of net retail sales.

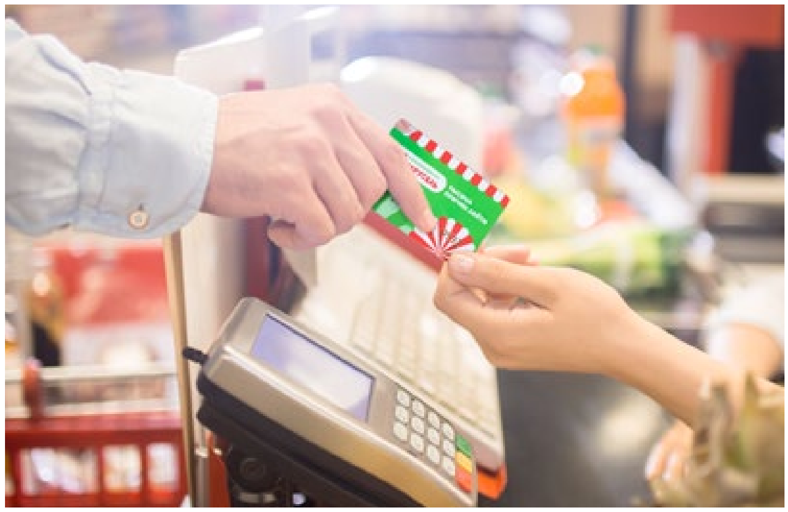
Our new private label, “Smart solution” (“Umnoe Reshenie”), is being developed in line with the updated CVP, which targets rational shoppers buying goods for the whole family.

Umnoe Reshenie

Own production

Karusel's in-store production is a key part of our updated CVP, and we continued to develop this part of the business in 2017. The share of Karusel's own production in net retail sales increased from 13.7% in 2016 to 14.1% in 2017. We aim to increase the share of our own production in the future across a range of products from delicatessen and ready-to-eat to fresh meat and poultry, fish and seafood, bakery and cheeses.

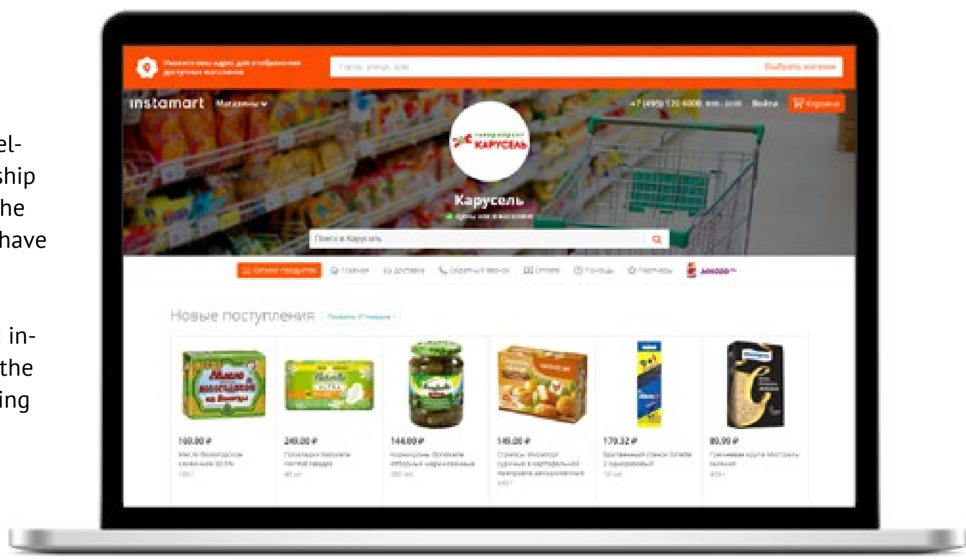
Loyalty programme



Karusel's loyalty programme, which was relaunched in 2015, continues to develop in line with our Group-wide push to leverage data analytics to improve performance. Karusel's loyalty card holders have started receiving personalised offerings and promotions based on their preferences and shopping behaviour. We have also launched the "My Karusel" mobile app for loyalty programme members.

The Karusel loyalty programme accounted for 68% of net retail sales on average in 2017, with almost 80% at the end of the year, increasing from 46% in 2016. The long-term goal is to reach 90-95% by the end of 2020.

Online sales



Omni-channel sales are a key to the future development of Karusel, and we launched a partnership with Instamart in late 2017 to give customers the option to order goods from Karusel online and have them delivered by Instamart.

At present, this partnership covers Moscow and includes 8,500 SKUs that are available online. In the future, we are considering expanding this offering to St Petersburg.

Financial Review

In 2017, X5 Retail Group delivered impressive results despite continued macro-headwinds and continued weakness in consumer behaviour: revenue for the year grew by 25.3% year-on-year to RUB 1,295 billion (despite a slowdown in food inflation from 6.0% in 2016 to 3.0% in 2017), while adjusted EBITDA[1] grew by 24.7% to RUB 99.1 billion, meaning we were able to maintain our adjusted EBITDA margin of 7.7%.

One of the core drivers of our ability to maintain margins, in line with our strategic goal, was our strict control of SG&A costs through ongoing efficiency efforts. Adjusted SG&A[2] grew by just 22.9% year-on-year to RUB 218.0 billion, declining as a share of revenue by 33 basis points year-on-year to 16.8%, which is the lowest level since 2010.

Adjusted net profit[3] for 2017 grew by 51.5% year-on-year to RUB 33.8 billion, meaning that adjusted net profit margin increased by 45 b.p. to 2.6%. This performance is especially positive in light of the Supervisory Board's inaugural dividend recommendation of RUB 21.6 billion (RUB 79.5 per GDR) under the Company's new dividend policy. X5 Retail Group's management and Supervisory Board both believe that the Company can continue to deliver on its established strategic growth targets while also paying out dividends.

X5 Retail Group successfully decreased the average interest rate on its debt portfolio from 11.3% in 2016 to 9.5% in 2017. With a net debt/EBITDA ratio of 1.73x, which is the lowest level in the Company's history, we believe that the Company's debt load is at a comfortable level.

Looking ahead, we will continue to focus on the Company's further profitable growth, while continuing to prioritise efficiency by implementing new systems and projects and controlling operating costs across the business. Our healthy balance sheet and efficient operations put X5 in a good position to continue its rapid growth, even as we distribute profit in line with the new dividend policy.

[1] Adjusted EBITDA is EBITDA before costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 104-107.

[2] Adjusted SG&A is SG&A before depreciation, amortisation and impairment costs as well as costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 104-107.

[3] Adjusted net profit is a measure of the Company's earnings for the reporting period, adjusted for the Company's dividend policy and impairment related to Perekrestok Express. For more information on alternative performance measures, see pages 104-107.

Svetlana Demyashkevich

Chief Financial Officer

Financial review

The financial and operational information contained in this financial review comprises information about X5 Retail Group N.V. and its consolidated subsidiaries (hereinafter jointly referred to as “we”, “X5” or the “Company”).

The following is a review of our financial condition and results of operations as of 31 December 2017 and for the years ended 31 December 2017 and 31 December 2016. The Consolidated Financial Statements and related notes thereto are available on pages 196-254 of this document and were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Key highlights

Revenue:
RUB 1,295 bln
(25.3% year-on-year increase)

Adjusted SG&A expenses:
16.8% of revenue
(33 b.p. year-on-year decrease)

Adjusted EBITDA margin:
7.7%
(4 b.p. year-on-year decline)

Capital expenditure:
RUB 98.6 bln
(22.3% year-on-year increase)

Net debt/EBITDA:
1.73x
(the lowest level in the Company's history)

Dividends:
RUB 21,590 mln
RUB 79.5 per GDR, 69% of consolidated IFRS net profit (first-ever dividend payment by X5 Retail Group)

Selected macroeconomic data

Russian macroeconomic indicators, year-on-year comparison, %					2017					2016
	Q1	Q2	Q3	Q4	**FY**	Q1	Q2	Q3	Q4	**FY**
Real GDP	0.5	2.5	1.8	1.3*	**1.5***	(0.4)	(0.5)	(0.4)	0.3	**(0.2)**
RUB/USD exchange rate, weighted average for the period	58.8	57.1	59.0	58.4	**58.4**	74.6	65.9	64.6	63.1	**67.0**
CPI	4.6	4.2	3.4	2.6	**3.7**	8.4	7.3	6.8	5.7	**7.1**
Food inflation	3.8	4.1	2.8	1.3	**3.0**	7.0	5.7	6.4	5.3	**6.1**
Real wage growth	1.8	3.4	3.1	5.9	**3.5**	(0.6)	0.3	1.2	1.8	**0.8**
Real income growth	(0.6)	(2.9)	(1.8)	(1.1)	**(1.7)**	(3.3)	(5.4)	(6.9)	(6.6)	**(5.8)**
Unemployment rate	5.5	5.2	5.0	5.1	**5.2**	5.9	5.7	5.3	5.4	**5.5**
Retail turnover	3.9	5.7	5.8	5.5	**5.3**	3.6	2.5	3.7	1.7	**2.9**
Food retail turnover	2.4	4.6	5.5	5.0	**4.4**	3.6	1.8	3.4	1.3	**2.5**

*First Rosstat estimate

Results of operations for the year ended 31 December 2017 compared to the year ended 31 December 2016

The following table and discussion provide a summary of our consolidated results of operations for the years ended 31 December 2017 and 31 December 2016.

Profit and loss statement: highlights

Russian roubles (RUB), millions[3]	2017	2016	% change, y-o-y
Revenue	1,295,008	1,033,667	25.3
incl. net retail sales[4]	1,286,949	1,025,589	25.5
Pyaterochka	1,000,942	775,580	29.1
Perekrestok	186,936	155,404	20.3
Karusel	89,302	83,558	6.9
Express	9,769	11,048	(11.6)
Gross profit	308,938	249,985	23.6
Gross profit margin, %	23.9	24.2	(33) b.p.
Adj. SG&A	(218,003)	(177,426)	22.9
Adj. SG&A, % of revenue	16.8	17.2	(33) b.p.
Adj. EBITDA	99,131	79,519	24.7
Adj. EBITDA margin, %	7.7	7.7	(4) b.p.
Operating profit	57,758	45,631	26.6
Operating profit margin, %	4.5	4.4	5 b.p.
Adj. net profit	33,768	22,291	51.5
Adj. net profit margin, %	2.6	2.2	45 b.p.
Net profit	31,394	22,291	40.8
Net profit margin, %	2.4	2.2	27 b.p.

[3] Please note that in this and other tables and text, immaterial deviations in the calculation of percentage changes, subtotals and totals are explained by rounding.
[4] Net of VAT and revenue from wholesale operations and revenue from franchise services and other services.

Revenue and net retail sales

In 2017, X5's revenue increased by 25.3% year-on-year and amounted to RUB 1,295 billion. Net retail sales for 2017 grew by 25.5% year-on-year, driven by a 5.4% increase in like-for-like (LFL) sales and a 20.1% sales growth contribution from a 27.4% rise in selling space. Net retail sales growth of RUB 261.4 billion was the highest in X5's history.

The Company's proximity store format, Pyaterochka, was the main driver of growth in 2017: Pyaterochka's net retail sales rose by 29.1% year-on-year, driven by a 4.6% increase in LFL sales and a 24.5% contribution to sales growth from a 33.0% expansion in selling space.

Net additional selling space of 1.2 million square metres, driven primarily by organic expansion (87% of net selling space added), represents the largest annual opening programme delivered by X5.

X5's LFL traffic growth improved to 3.0% in 2017, up from 2.5% in 2016, the highest level since 2009. The Company demonstrated positive LFL traffic for all three major formats.

Gross profit

The Company's gross profit margin in 2017 decreased by 33 basis points year-on-year to 23.9%, primarily due to investments in our customers to support loyalty, including updating our customer value proposition, expanding our fresh assortment with growing direct import operations, widening the share of our local assortment, development of loyalty programmes across all formats. Another important factor for gross profit margin reduction was the format mix effect of proportionally more sales coming from Pyaterochka.

Summary of operational results

2017 net retail sales results, y-o-y % change	Average ticket	Number of customers	Net retail sales
Pyaterochka	0.4	28.5	29.0
Perekrestok	3.5	16.2	20.3
Karusel	6.7	0.2	6.9
Express	(2.5)	(9.6)	(11.6)
X5 Retail Group	0.1	25.3	25.5

Selling space end-of-period, square metres	31 Dec. 2017	31 Dec. 2016	% change, y-o-y
Pyaterochka	4,426,808	3,329,273	33.0
Perekrestok	637,242	548,473	16.2
Karusel	385,271	386,897	(0.4)
Express	30,420	37,110	(18.0)
X5 Retail Group	5,479,741	4,301,752	27.4

2017 LFL[5] results, % growth y-o-y	Sales	Traffic	Basket
Pyaterochka	4.6	2.8	1.7
Perekrestok	10.1	6.7	3.2
Karusel	5.4	0.1	5.3
Express	(8.6)	(6.3)	(2.4)
X5 Retail Group	5.4	3.0	2.3

[5] LFL comparisons of retail sales between two periods are comparisons of retail sales in the local currency (including VAT) generated by relevant stores. The stores that are included in LFL comparisons are those that have operated for at least 12 full months. Their sales are included in the LFL calculations starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period.

Adjusted selling, general and administrative (SG&A) expenses

RUB mln	2017	2016	% change y-o-y
Staff costs	(99,124)	(80,786)	22.7
% of revenue	7.7	7.8	(16) b.p.
incl. LTI and share-based payments	(2,938)	(3,252)	(9.7)
staff costs excl. LTI % of revenue	7.4	7.5	(7) b.p.
Lease expenses	(60,080)	(47,020)	27.8
% of revenue	4.6	4.5	9 b.p.
Utilities	(23,795)	(19,590)	21.5
% of revenue	1.8	1.9	(6) b.p.
Other store costs	(15,450)	(14,112)	9.5
% of revenue	1.2	1.4	(17) b.p.
Third-party services	(10,854)	(8,181)	32.7
% of revenue	0.8	0.8	5 b.p.
Other expenses	(11,638)	(10,989)	5.9
% of revenue	0.9	1.1	(16) b.p.
SG&A (excl. D&A&I)	220,941	(180,678)	22.3
% of revenue	17.1	17.5	(42) b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	**(218,003)**	**(177,426)**	**22.9**
% of revenue	**16.8**	**17.2**	**(33) b.p.**

Selling, general and administrative (SG&A) expenses analysis

In 2017, adjusted SG&A expenses as a percentage of revenue declined year-on-year by 33 basis points to 16.8%, primarily due to the positive impact of ongoing projects to improve operational efficiency and as a result of operating leverage. Other store costs, other expenses and utilities were the main sources of this improvement.

Staff costs (excluding LTI and share-based payments) in 2017, as a percentage of revenue, declined year-on-year by 7 basis points to 7.4%, mainly due to the positive operating leverage effect. At the same time, this was slightly offset in Q3 2017 when we decided to fine-tune the motivation scheme for in-store personnel in line with market benchmarks to improve service levels and reduce staff turnover.

Lease expenses as a percentage of revenue in 2017 increased year-on-year by 9 basis points to 4.6%, mainly due to the growing share of leased space in X5's total real estate portfolio, which accounted for 73% as of 31 December 2017, compared to 68% as of 31 December 2016.

Utilities expenses as a percentage of revenue declined year-on-year by 6 basis points to 1.8% due to the continued effect from installation of energy-efficient equipment in stores and distribution centres.

In 2017, other store costs as a percentage of revenue declined year-on-year by 17 basis points to 1.2%, driven by a reduction in security costs and lower maintenance and repair expenses.

Third-party service expenses as a percentage of revenue increased year-on-year by 5 basis points in 2017 to 0.8% due to increased expenses for marketing services related to promo activities, including the development of the recently launched Pyaterochka loyalty programme.

Other expenses as a percentage of revenue declined by 16 basis points year-on-year in 2017 to 0.9%, primarily due to higher income from sales of recyclable materials and the release of provisions.

Long-term incentive (LTI) programme

As described in the Remuneration Report on pages 188-191, a two-stage LTI programme is being run in the Company until 31 December 2019. The LTI programme targets have been structured to substantially align the long-term interests of shareholders and management.

Each stage of the programme includes a deferred component of conditional payouts, maintaining focus on long-term goals throughout the programme and also providing for an effective retention mechanism.

After meeting the targets for the first stage of the LTI programme in 2015, additional performance indicators in line with the strategic objectives set by X5's Supervisory Board were met in 2016, and therefore all targets set for the deferred payout under the first stage of the LTI programme were achieved as of 31 December 2016. Part of the deferred payout expense from the first stage of the LTI programme was accrued at the beginning of 2017. Accordingly, expenses for this stage of the LTI programme amounted to RUB 373 million in 2017.

LTI programme expense

RUB mln	2017	2016	2015
LTI	2,494	2,648	3,184
SSC attributable to accrued LTI	382	405	423

Based on Q1 2017 results, the Company successfully achieved the targets of the second stage of the LTI programme. Therefore, an accrual of RUB 955 million has been made in the Consolidated Financial Statements for the year ended 31 December 2017 related to the second stage of the LTI programme.

In addition, based on management's assessment that the targets under the deferred component of the second stage of the programme are likely to be achieved in 2018, an accrual of RUB 1,166 million has been made in the Consolidated Financial Statements for the year ended 31 December 2017.

Social taxes related to the LTI programme amounted to RUB 382 million in 2017.

All LTI accruals and attributable social taxes since the beginning of the programme are summarised in the table below.

EBITDA and adjusted EBITDA

RUB mln	2017	2016	% change y-o-y
Gross profit	308,938	249,985	23.6
Gross profit margin, %	23.9	24.2	(33) b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	(218,003)	(177,426)	22.9
% of revenue	16.8	17.2	(33) b.p.
Lease/sublease and other income	8,196	6,960	17.8
% of revenue	0.6	0.7	(4) b.p.
Adj. EBITDA	**99,131**	**79,519**	**24.7**
Adj. EBITDA margin, %	**7.7**	**7.7**	**(4) b.p.**
LTI, share-based payments and other one-off remuneration payment expenses	2,556	2,826	(9.7)
% of revenue	0.2	0.3	(8) b.p.
SSC attributable to accrued LTI, share-based payments and other one-off remuneration payment expenses	382	426	(10.3)
% of revenue	0.03	0.04	(1) b.p.
EBITDA	**96,193**	**76,267**	**26.1**
EBITDA margin, %	**7.4**	**7.4**	**5 b.p.**

Lease/sublease and other income

As a percentage of revenue, the Company's income from lease, sublease and other operations changed immaterially in 2017 compared to 2016, totalling 0.6%.

EBITDA and adjusted EBITDA analysis

As a result of the factors discussed above, X5's adjusted EBITDA in 2017 grew year-on-year by 24.7% and totalled RUB 99,131 million, while the adjusted EBITDA margin remained stable at 7.7%.

Analysis by segments

Pyaterochka

RUB mln	2017	2016	% change y-o-y
Revenue	1,004,406	779,448	28.9
EBITDA	82,891	64,441	28.6
EBITDA margin, %	8.3	8.3	(1) b.p.

In 2017, Pyaterochka's EBITDA margin decreased year-on-year by 1 basis points to 8.3% due to investments in customers to support loyalty, including updating our customer value proposition, widening the share of our local assortment and developing Pyaterochka's loyalty programme.

Perekrestok

RUB mln	2017	2016	% change y-o-y
Revenue	188,501	157,004	20.1
EBITDA	13,012	11,935	9.0
EBITDA margin, %	6.9	7.6	(70) b.p.

Perekrestok's EBITDA margin decreased by 70 b.p. year-on-year in 2017 due to the evolving value proposition, including the introduction of new entry-price SKUs with lower mark-ups to better support the format's core audience, as well as increasing staff costs driven by an investment to raise staff quality to further improve service levels.

Karusel

RUB mln	2017	2016	% change y-o-y
Revenue	90,608	84,649	7.0
EBITDA	4,618	4,322	6.8
EBITDA margin, %	5.1	5.1	(1) b.p.

In 2017, Karusel's EBITDA margin remained almost unchanged in 2017.

Other segments

RUB mln	2017	2016	% change y-o-y
Revenue	11,493	12,566	(8.5)
EBITDA	(68)	(195)	(65.1)
EBITDA margin, %	(0.6)	(1.6)	96 b.p.

Other segments include Perekrestok Express. EBITDA margin improved by 96 b.p. mainly due to the closure of underperforming stores. In 2017, the Company took the strategic decision to sell this format and strengthen its focus on its three major formats.

Corporate Centre

RUB mln	2017	2016	% change y-o-y
EBITDA	(4,260)	(4,236)	0.6

X5's Corporate Centre EBITDA remained almost stable in absolute terms in 2017.

Depreciation, amortisation and impairment costs

Depreciation, amortisation and impairment costs in 2017 totalled RUB 38,435 million (RUB 30,636 million for 2016), remaining flat as a percentage of revenue at 3.0%.

Total impairment costs was RUB 4,586 million in 2017, compared to RUB 3,709 million in 2016, remaining flat as a percentage of revenue at 0.4% despite substantial business expansion. Additional impairment costs related to Perekrestok Express totalled RUB 1,086 million in 2017. In October 2017, the Company announced its plans to sell convenience stores operating under the Perekrestok Express brand.

Non-operating gains and losses

RUB mln	2017	2016	% change y-o-y
Operating profit	57,758	45,631	26.6
Operating profit margin, %	4.5	4.4	5 b.p.
Net finance costs	(16,017)	(17,318)	(7.5)
Net FX result	75	340	(77.9)
Profit before tax	41,816	28,653	45.9
Income tax expense	(9,264)	(6,362)	45.6
Change in deferred tax liability associated with investments in subsidiaries[6]	(1,158)	-	-
Net profit	31,394	22,291	40.8
Net profit margin, %	2.4	2.2	27 b.p.
Adj. net profit	**33,768**	**22,291**	**51.5**
Adj. net profit margin, %	**2.6**	**2.2**	**45 b.p.**

[6] In September 2017, the Group approved a dividend policy and recommended to the General Meeting that dividends be distributed to shareholders in 2018 based on 2017 results. As a result the Group estimates that part of temporary difference related to investments in subsidiaries will be reversed in the foreseeable future and therefore accrued related deferred tax liability.

Non-operating gains and losses analysis

Net finance costs in 2017 amounted to RUB 16,017 million, a 7.5% decrease from 2016. The weighted average effective interest rate on X5's debt portfolio decreased from 11.3% for 2016 to 9.5% for 2017 due to declining interest rates in Russian capital markets and actions undertaken by X5 to minimise interest expenses.

Income tax expenses excluding change in deferred tax liability associated with investments in subsidiaries increased by 45.6% in 2017, and profit before tax increased by 45.9%. In 2017, X5's effective tax rate (excluding the change in deferred tax liability associated with investments in subsidiaries) remained stable at 22.2%. The Russian statutory income tax rate for both periods was 20.0%.

The deviation of X5's effective tax rate from the statutory tax rate is due to different treatment of income and expenses in IFRS and local GAAP and tax deductibility rules with respect to certain items.

Consolidated cash flow

RUB mln	2017	2016	% change y-o-y
Net cash from operating activities before changes in working capital	**96,830**	**75,745**	**27.8**
Change in working capital	(11,386)	20,056	n/m
Net interest and income taxes paid	(26,786)	(20,886)	28.2
Net cash flows generated from operating activities	**58,658**	**74,915**	**(21.7)**
Net cash used in investment activities	**(87,274)**	**(77,279)**	**12.9**
Net cash generated from financing activities	**38,017**	**11,641**	**226.6**
Effect of exchange rate changes on cash and cash equivalents	14	(45)	n/m
Net decrease/(increase) in cash and cash equivalents	**9,415**	**9,232**	**2.0**

Cash flow analysis

In 2017, the Company's net cash from operating activities before changes in working capital increased by RUB 21,085 million, or 27.8%, year-on-year, totalling RUB 96,830 million. The negative change in working capital was primarily due to changes in accounts payable as a result of amendments to the Trade Law that came into effect from 1 January 2017 and initiatives to increase shelf availability, including enhancing the share of our local assortment, and an increase in inventories due to intensified promo activity in H2 2017.

Net interest and income tax paid in 2017 increased year-on-year by RUB 5,900 million, or 28.2%, totalling RUB 26,786 million. The effect from increased gross debt as of 31 December 2017 compared to 31 December 2016 was offset by the lower weighted average effective interest rate on X5's debt for 2017. Income tax paid increased due to the low base effect of 2016 driven by a tax offset in 2016 following tax overpayment in 2015.

As a result, in 2017 net cash flows generated from operating activities totalled RUB 58,658 million, compared to RUB 74,915 million for the same period in 2016.

Net cash used in investment activities, which generally consists of payments for property, plants and equipment, totalled RUB 87,274 million in 2017, compared to RUB 77,279 million in 2016, and reflects higher expenditures for store expansion. X5 added 1.2 million square metres of selling space in 2017, a 21.6% year-on-year increase of net selling space added.

Net cash generated from financing activities totalled RUB 38,017 million in 2017, compared to RUB 11,641 million in 2016. The increase was related to the drawdown of available credit lines and bonds issued to finance the Company's investment programme.

Liquidity update

RUB mln	31 Dec 17	% in total	31 Dec 16	% in total	31 Dec 15	% in total
Total debt	194,296		156,033		144,215	
Short-term borrowings	58,674	30.2	45,168	28.9	42,670	29.6
Long-term borrowings	135,622	69.8	110,865	71.1	101,545	70.4
Net debt	**166,691**		**137,843**		**135,257**	
Net debt/EBITDA	**1.73x**		**1.81x**		**2.45x**	

Liquidity analysis

As of 31 December 2017, the Company's total debt amounted to RUB 194,296 million, 30.2% of which was short-term debt and 69.8% was long-term debt. The Company's debt is 100% denominated in Russian roubles. As of 31 December 2017, 100% of X5's debt had fixed interest rates.

In 2017, the Company's ratings had the following changes:

- S&P upgraded X5's long-term corporate credit rating to BB from BB- with a Stable outlook
- Moody's upgraded X5's corporate family rating (CFR) to Ba2 from Ba3 with a Positive outlook
- RAEX rating agency assigned X5 a long-term credit rating of ruAA with a Stable outlook

As of 31 December 2017, the Company had access to RUB 314.8 billion in available credit limits with major Russian and international banks.

Dividends

While the Company has not paid dividends in the past, the Supervisory Board decided in 2017 that X5 Retail Group had achieved a point in its development where the introduction of a dividend policy would broaden the investment appeal to the Company's shareholders. On an ongoing basis, the Supervisory Board carefully monitors the Company's progress against its strategic goals, as well as its operating and financial performance. In proposing the introduction of a dividend policy, the Board expressed its belief that X5 now has the capacity to pay dividends while continuing to meet the strategic targets that have been set.

The dividend policy approved by the X5 Supervisory Board in September 2017 sets a target payout ratio of at least 25% of X5 Retail Group's consolidated IFRS net profit, provided that the Company's financial position allows for it. When considering a dividend recommendation to the General Meeting of Shareholders, the Supervisory Board will be guided by a target consolidated net debt/EBITDA ratio of below 2.0x, in line with the Company's financing strategy.

Based on the Company's 2017 financial results, the Company's Supervisory Board has put forward a recommendation to pay dividends in the amount of RUB 21,590 million/RUB 79.5 per GDR, which represents 69% of X5 Retail Group's 2017 net profit. This proposal will be considered by the AGM, which will be held on 10 May 2018.

Information on alternative performance measures

In this report and other public disclosures, X5 Retail Group presents certain alternative performance measures (APMs) that it believes provide readers with a more detailed and accurate understanding of the Company's financial and operating performance. In accordance with European Securities Markets Authority guidelines, a list of definitions, explanations of the relevance of APMs, comparatives and reconciliations are provided below.

EBITDA

(including EBITDA margin)

Earnings before interest, tax, depreciation and amortisation (EBITDA) is a measure of the Company's operating performance. It is a way to evaluate X5 Retail Group's performance exclusive of financing, accounting and taxation factors. X5 believes that showing EBITDA and EBITDA margin performance provides readers with greater detail about the Company's performance.

RUB mln	2017	2016
Operating profit	57,758	45,631
Depreciation, amortisation and impairment	38,435	30,636
EBITDA	**96,193**	**76,267**

RUB mln	2017	2016
Revenue	1,295,008	1,033,667
EBITDA	96,193	76,267
EBITDA margin, %	**7.4**	**7.4**

Adjusted EBITDA

(including adjusted EBITDA margin)

Adjusted earnings before interest, tax, depreciation and amortisation (adjusted EBITDA) is a measure of the Company's operating performance. It is a way to evaluate a company's performance exclusive of financing, accounting and taxation factors, and also excluding the effects of the LTI programme, which does not represent an ongoing cost of doing business. X5 believes that showing adjusted EBITDA and adjusted EBITDA margin performance provides readers with a more accurate understanding of the Company's ongoing performance.

RUB mln	2017	2016
EBITDA	**96,193**	**76,267**
Adjustments:		
LTI, exit payment and share-based payment expenses	2,556	2,826
SSC attributable to accrued LTI, exit payment and share-based payment expenses	382	426
Adj. EBITDA	**99,131**	**79,519**

RUB mln	2017	2016
Revenue	1,295,008	1,033,667
Adj. EBITDA	**99,131**	**79,519**
Adj. EBITDA margin, %	**7.7**	**7.7**

Adjusted SG&A

(including adjusted SG&A as % of revenue)

Selling, general and administrative expenses (SG&A) are reported on the income statement as the sum of all direct and indirect selling expenses and all general and administrative expenses of the Company. X5 Retail Group reports adjusted SG&A, which excludes the effects of the LTI programme, as well as depreciation, amortisation and impairment. The Company believes that adjusted SG&A provides additional detail to readers looking to understand the long-term SG&A costs of the business.

RUB mln	2017	2016
SG&A	259,376	211,314
Adjustments:		
LTI, exit payment and share-based payment expenses	(2,556)	(2,826)
SSC attributable to accrued LTI, exit payment and share-based payment expenses	(382)	(426)
Depreciation, amortisation and impairment	(38,435)	(30,636)
Adjusted SG&A	**218,003**	**177,426**

RUB mln	2017	2016
Revenue	1,295,008	1,033,667
Adjusted SG&A	218,003	177,426
Adjusted SG&A expenses as % of revenue	**16.8**	**17.2**

Adjusted net profit

(including adjusted net profit margin)

Adjusted net profit is a measure of the Company's earnings for the reporting period, adjusted for:
a) income tax expense affected by the Company's dividend policy (change in deferred tax liability associated with investments in subsidiaries); and
b) a non-recurring increase in impairment related to the Perekrestok Express segment as a result of the decision to focus on the three major formats. X5 believes that showing adjusted net profit and adjusted net profit margin performance provides readers with a more accurate understanding of the Company's ongoing performance.

RUB mln	2017	2016
Net profit	**31,394**	**22,291**
Adjustments:		
Change in deferred tax liability associated with investments in subsidiaries	1,158	–
Increase in impairment and DTA write-off related to Perekrestok Express	1,216	n.a.
Adjusted net profit	**33,768**	**22,291**

RUB mln	2017	2016
Revenue	1,295,008	1,033,667
Adjusted net profit	33,768	22,291
Adjusted net profit margin, %	**2.6**	**2.2**

Net debt/EBITDA

The net borrowings to earnings before interest depreciation and amortisation (EBITDA) ratio is a measurement of leverage. It is calculated as the Company's long-term and short-term borrowings, minus cash and cash equivalents, divided by EBITDA. The net debt to EBITDA ratio is a commonly used indicator that helps readers to understand the Company's debt burden.

RUB mln	31 Dec 17	31 Dec 16
Total debt, incl.:	194,296	156,033
Short-term borrowings	58,674	45,168
Long-term borrowings	135,622	110,865
Cash and cash equivalents	(27,605)	(18,190)
Net debt	**166,691**	**137,843**
EBITDA	96,193	76,267
Net debt/EBITDA	**1.73x**	**1.81x**

Net retail sales

Net retail sales shows the amount of sales generated by the Company after the deduction of revenue from franchise services, wholesale operations and other services. Because food retail is X5 Retail Group's core business, net retail sales is provided for readers to more clearly understand the performance of the Company's core business activity.

RUB mln	2017	2016
Revenue	**1,295,008**	**1,033,667**
Adjustments:		
Revenue from wholesale operations and other services	(8,030)	(8,044)
Revenue from franchise services	(29)	(34)
Net retail sales	**1,286,949**	**1,025,589**

Like-for-like (LFL)

LFL comparisons of retail sales between two periods are comparisons of retail sales in the local currency (including VAT) generated by relevant stores. The stores that are included in LFL comparisons are those that have operated for at least 12 full months. Their sales are included in the LFL calculation starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period. This is a commonly used indicator in the retail industry that helps readers understand the sustainability of a company's growth by focussing on the performance of stores that have already been operating for more than 12 months, by removing the effect of new stores opened during the period.

%	2017	2016
Net retail sales growth	25.5	27.5
Less contribution from an increase in selling space	(20.1)	(19.8)
LFL	**5.4**	**7.7**

Product safety and production quality

At X5, we aim to offer our customers fresh, high-quality products at every store we operate. This requires maintaining and adhering to consistent policies and systems that cover the entire product chain, from before it is delivered to a warehouse or store all the way to the end consumer. The policies and systems that we implement comply with all Russian legislation and regulatory requirements and also draw on global best practices in the food retail sector.

2017 in numbers

Pyaterochka

Around **17,000** **items** tested and accepted into the product matrix (approximately 12% more than in 2016)

2,268 **stores** audited in 2017, 16% more than in 2016

Perekrestok

174 **suppliers** audited

14,294 **random samples** of stores' in-house products sent for testing

Karusel

728 **internal quality audits** carried out at hypermarkets

5,303 **random samples** taken from employees' hands for lab-based hygiene testing

Policy highlights

Across all of our formats, we implement a clear set of rules and guidelines regarding the quality and safety of what we sell. Our quality control systems span our operations, from supplier audits to monitoring and checking the goods on shelves in stores.

Our ongoing goal is to improve safety and quality practices in our supply chain and retail operations. In order to do this, we are constantly seeking out and implementing recommendations on best practices from leading inspection, verification, testing and certification companies.

Our retail formats each maintain their own quality and safety monitoring policies, which are based on the following principles:

- Understanding the current and future needs of consumers, meeting their stated and unstated goals, aspiring to exceed their expectations
- Ensuring food safety and social responsibility
- Specifying the quality level based on the end user
- Establishing and maintaining mutually beneficial partnerships with producers and suppliers
- Creating and maintaining a corporate culture in which all of a format's employees are fully engaged and interested in achieving their goals, using their knowledge and experience
- Running formats using a process- and systems-based approach to the various stages of a product's life cycle: starting with the development and entry of goods into the assortment, to production, to sale to the consumer
- Introducing modern quality management methods to improve the efficiency and effectiveness of the organisation in ensuring food safety
- Continuous improvement as a permanent goal

As the largest food retailer in Russia, X5 works closely with federal regulators and decision-makers to draft documents, including food standards, legislative proposals, regulations and consumer rights protection proposals.

In order to maintain a dialogue with all stakeholders, X5 also works with industry associations, including the Consumer Market Participants Union, the Russian Union of Industrialists and Entrepreneurs, the All-Russian Association of SMEs (Opora), the Civic Chamber of the Russian Federation, the National Dairy Producers Union, the RusBrand Association of Branded Goods Manufacturers, the Seafood Processors Union and the RusProd-Soyuz Association of Food Manufacturers and Suppliers.

System highlights

The Quality Department is responsible for establishing safety and quality standards and product specifications at the Corporate Centre level, and all of these requirements are agreed with the Commercial Department. The Quality Department receives and analyses information about internal audits and supplier audits and monitors whether standards are being adhered to. It is the shared responsibility of the Quality and Commercial Departments to respond to incidents of non-compliance by taking measures to eliminate shortcomings and help suppliers develop their systems or products properly. The two departments produce periodic reports for management review.

In addition, our retail formats regularly engage accredited international auditors to conduct audits of their suppliers, and update quality specifications and standards for food products, private labels and packaging on an ongoing basis.

X5 deploys the principles of Hazard Analysis and Critical Control Points (HACCP) to ensure that its products are safe for consumers and the environment, and that they meet retail standards and customer needs.

Other quality assurance practices that we use include:

- lab testing and analysis at research and development centres and accredited research laboratories;
- staff training;
- safe storage and handling of products;
- modern monitoring methods, innovative technologies; and
- supplier audits.

Introducing goods to our product range

All potential suppliers supply us with samples and documentation certifying the quality, safety and origin of their products before signing a supply contract with X5. The Company's quality experts then ensure that suppliers meet both X5's and regulatory requirements.

In 2017, Pyaterochka initiated a project to automate the process of introducing goods into the assortment matrix, which will enable the format to streamline this process, automate it and create a database to analyse supplier errors that impede stable cooperation with them. This data will also be used to help suppliers improve in order to avoid risks associated with errors that may entail fines from the regulatory or oversight authorities.

Acceptance at distribution centres

Our distribution centres carry out testing to ensure that all incoming food products comply with X5's standards of appearance, texture, taste and smell, as well as with Customs Union and Russian national regulatory requirements. X5's quality control for fruits, vegetables and exotic fruits meets national standards and those of the United Nations Economic Commission for Europe (UNECE), as well as X5's own quality catalogue and acceptance criteria, including calibre, size and ripeness.

In 2017, Pyaterochka continued implementing the "Remote Acceptance" project at DCs and hubs. This project enabled the format to reduce losses by using video monitoring, random sampling and reducing corruption risks.

The Company also initiated a project in 2017 to improve the monitoring of the supply of chilled goods from the supplier to the store shelf. As part of this project, all of Pyaterochka's DCs and hubs were equipped with equipment that enables personnel to take a proactive approach to product quality and safety, thereby increasing the level of responsibility of personnel.

Quality control in stores

Under our Quality Hour programme, all products on our shelves are sorted and checked for quality and freshness every morning between 9 a.m. and 10 a.m. Pyaterochka store directors are personally responsible for product freshness in their additional role as “freshness directors”.

Store audits in 2017 were carried out as follows:

	2017	2016	2015
Pyaterochka	2,268	1,956	702
Perekrestok	907	427	305
Karusel	728	265	212
X5 total	**3,903**	**2,648**	**1,219**

All of our formats regularly audit stores to monitor compliance with safety and quality standards, which means we are able to address issues quickly as they arise and improve the quality of the service we offer to customers.

Interaction with consumers

In addition to a customer hotline, X5 regularly monitors social networks, blogs and online forums for potential complaints. We thoroughly investigate all customer complaints about product safety and quality. This verification process may involve making control purchases and sending samples for analysis.

We regularly publish the results of our quality monitoring procedures on the Quality section of our website to ensure full transparency for our customers and to ensure that all of our products are genuine and high-quality. Products found to be in breach of quality and safety standards are immediately taken off the shelves and returned to the supplier.

Audit of branded and private-label products

A supplier audit is one of the criteria for selection and rating of suppliers. The Supplier Audit Programme is available on the supplier portal along with a requirements checklist. All new suppliers undergo a mandatory audit to ensure that their production facilities are compliant with quality and food safety requirements.

During the year, all of X5's formats conducted audits of suppliers, while samples of product items were sent to independent, accredited testing facilities for analysis. The analysis was aimed at verifying the products' organoleptic, physical, chemical and microbiological properties and, in some cases, the declared ingredients, specifically to identify any replacements with cheaper alternatives and any use of food additives, artificial colourants, sweeteners or preserving agents not indicated on the label.

X5's supplier evaluation criteria are applied across the group, so that all of our brands are able to use the audit results from one format. In addition, our call centres have established procedures for handling customer complaints about private-label products.

Audits conducted in 2016-2017:

Producer	Pyaterochka	Perekrestok	Karusel
Number of audits 2017	977	174	33*
Number of audits 2016	939	167	14*
Change, y-o-y (%)	4	4	136

*Karusel uses Pyaterochka's database

In 2017, items were sent to independent, accredited testing facilities for analysis as follows:

Pyaterochka

2,667 items
504 of which, or 18.9%, were found to be below quality standards

Perekrestok

1,909 finished products from suppliers

14,294 items produced in-store

Karusel

1,281 products from suppliers

379 private-label products

6,331 items produced in-house

Interaction with public authorities and self-regulating organisations

In 2017, the Quality Department drafted over 100 proposals on refining existing legislation and amending specific legal acts regarding technical regulation, accreditation and standardisation, food product quality and safety, veterinary control and supervision, sanitary and phytosanitary measures and consumer rights protection.

In 2017, the Company also signed an agreement with the Russian Federation Federal Service for Veterinary and Phytosanitary Surveillance to begin using an electronic system for tracking veterinary documentation of meat and poultry products. Starting from January 2018, paper forms of veterinary certificates were replaced with electronic forms, which are issued by the Mercury FGIS. This will not only help ensure the traceability of goods, but will also reduce paperwork and, as a result, achieve tangible savings and optimise costs associated with this process.

Retail operations infrastructure

Our logistics, transport and IT systems are key to supporting the ongoing, uninterrupted operations of our stores as we continue to expand X5 across Russia.

The effectiveness and efficiency of our retail operations infrastructure are key to ensuring that we are able to provide a consistent value proposition and operational excellence in every store, every day.

Logistics

We are developing our logistics operations to support the rapid expansion of our business. Pyaterochka runs its own logistics, while Perekrestok and Karusel share infrastructure. In 2017, X5 opened 10 new DCs with a total area of 249,079 square metres; we also closed six DCs with a total area of 72,632 square metres that did not meet our efficiency criteria. As of 31 December 2017, we were operating 39 DCs with a total floor space of 1.1 million square metres, providing sufficient coverage for the Company's rapidly expanding operations.

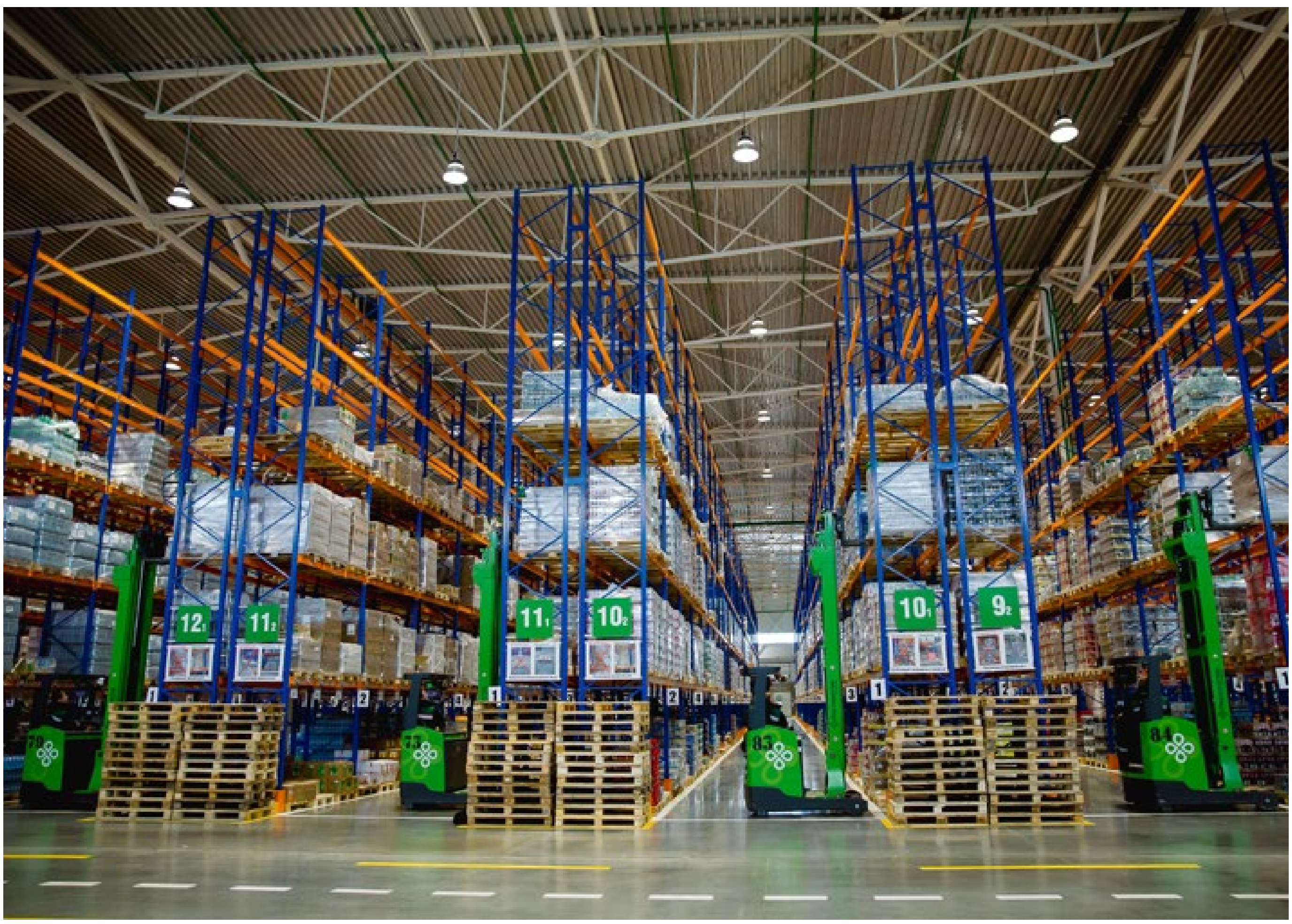
X5 Retail Group's company-wide SLT level (order processing based on timely deliveries) remained stable at 91.5%, while centralisation increased from 88% in 2016 to 93% in 2017.

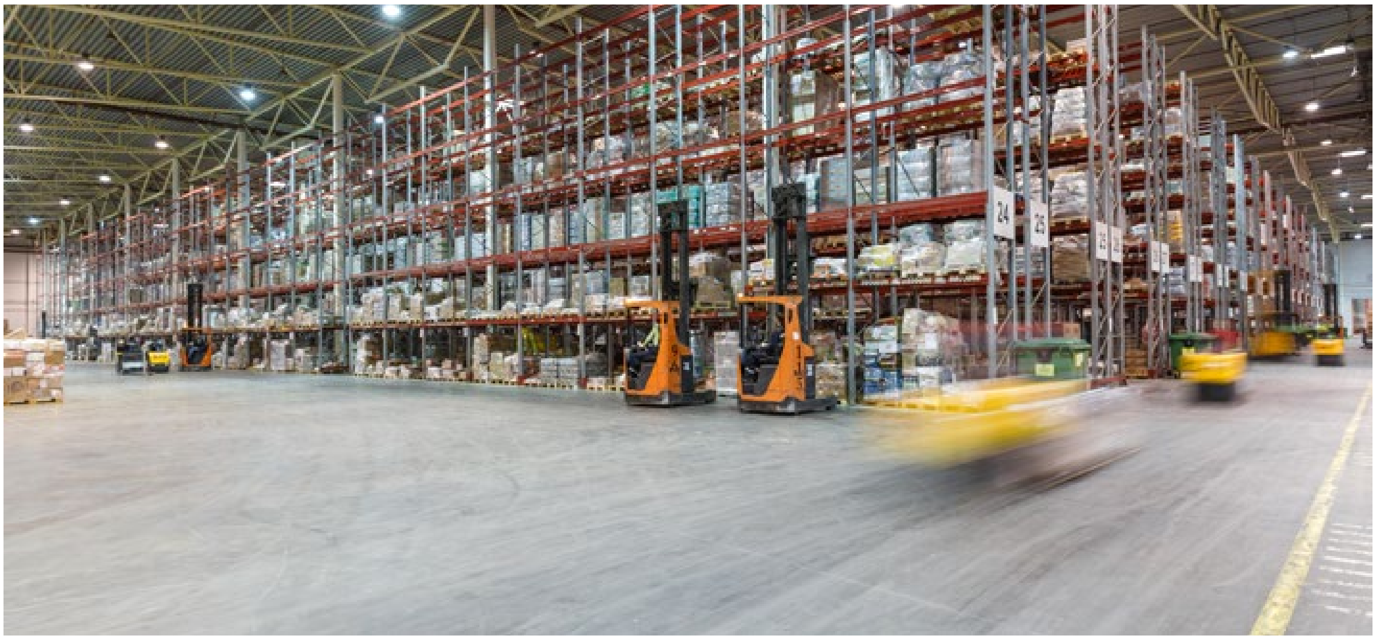
Logistics and Transportation Strategy

One of the key milestones achieved in 2017 was the adoption of a new Logistics and Transportation Strategy to 2025, which covers plans for the development of our logistics operations. While our logistics operations are divided to address the specific needs of different formats, the Corporate Centre together with the formats are constantly working together to share best practices, improve efficiency and leverage synergies.

The focus of the new strategy will be on reducing costs, cutting delivery times and ensuring the availability of a wide assortment of goods on our stores' shelves. The strategy was developed to enable X5's logistics to:

- Support the unique CVP of each retail format
- Respond to forecast demand through 2025 for each specific location
- Enable each format to achieve target market share, expanding operations based on the planned number of stores while reducing share of costs
- Allow formats to manage their own supply chain operations while in parallel seeking and implementing opportunities to achieve synergies





General approach to Logistics and Transportation Strategy development

CVP
(elements related to the supply chain)

Demand forecast
2017-2025

Logistics and Transportation Strategy

Network optimisation

Transport Strategy

KPIs
(standardisation)

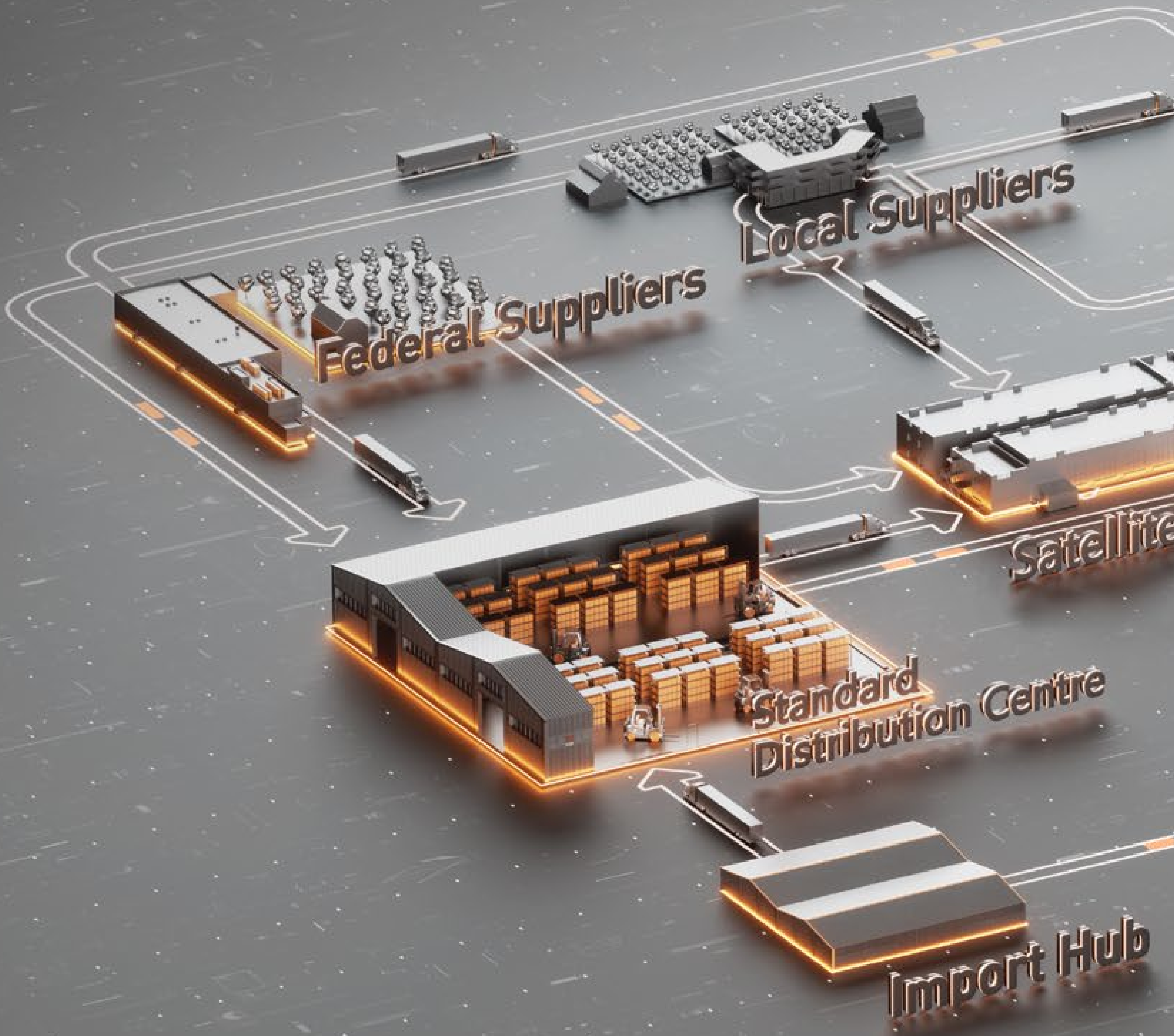
End-to-End Logistics and Transportation Strategy
(analysis of current situation, future requirements, gaps in competencies, roadmaps)

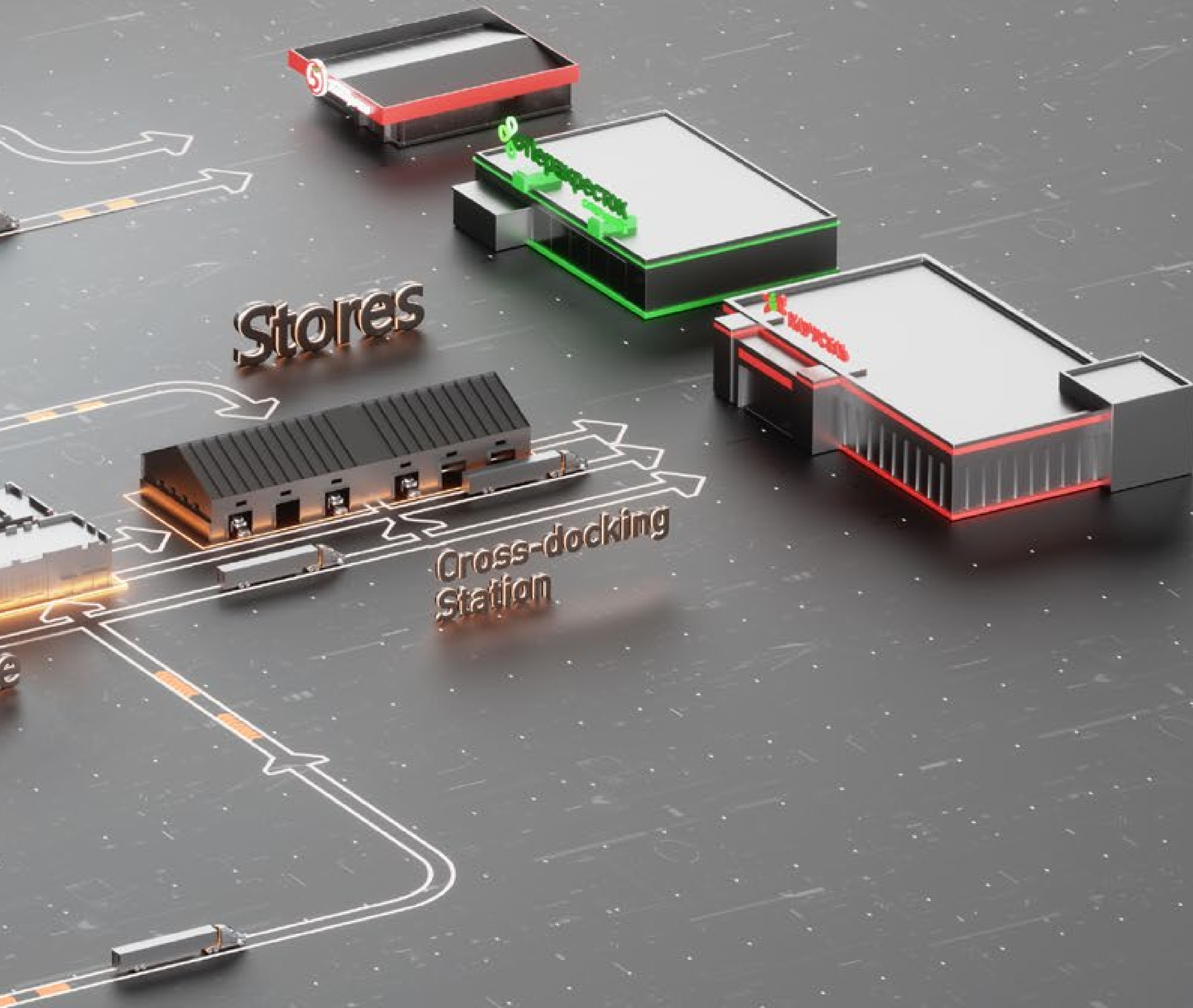
How we manage logistics

The X5 Corporate Centre is responsible for setting standards and monitoring performance of DC operations. It also aims to facilitate the sharing of best practices and technologies between formats, and it acts as a central resource for analysis and planning of the expansion of our logistics infrastructure.

All of our DCs utilise an automated warehouse management system (WMS) that includes features like voice picking and weighing technology. We are now testing new, innovative technologies such as radio frequency identification (RFID) tags and drone copters to monitor inventory status.

Logistics infrastructure





We have invested significant time and resources into developing an advanced supply chain that leverages the latest technologies and efficient systems to provide high-quality, consistent and reliable service at all of our stores.

Pyaterochka

Pyaterochka opened nine DCs with a total area of 235,447 square metres and closed five RCs with an area of 69,632 square metres that did not meet X5's strict efficiency criteria. While remaining the fastest-growing format in X5 Retail Group, Pyaterochka managed to significantly optimise logistics costs thanks to the increased operational efficiency of DCs.

2017 performance highlights:

- Maximum DC throughput increased by 37% year-on-year, from 30.2 million boxes/week in 2016 to 41.3 million boxes/week in 2017
- Warehouse costs (RUB/box) continued to decline, decreasing by 21% year-on-year in 2017 from 12.9 RUB/box to 10.2 RUB/box
- Approximately RUB 3 billion in savings achieved through various warehouse cost optimisation measures, including streamlining staffing, cutting rental payments and reducing losses

Key highlights of 2017 included:

- Began introduction of new WMS from market leader Manhattan Association in order to improve operational efficiency and management
- Continued to develop multilayered logistics infrastructure, including improving the efficiency of import hubs in St Petersburg and Novorossiysk, as well as the development of cross-docking stations in remote regions
- Focussed on improving efficiency of transportation between own DCs
- Engaged staff in improvement initiatives, with special programme to seek employees' ideas on how to increase the quality and efficiency of their daily routine duties. Ideas are grouped into five areas (security enhancement, workplace organisation, quality assurance, process improvement, resource consumption), and are then used to update warehouse and transport standards. All Pyaterochka DCs participated in this initiative in 2017

Inventory management

- Under the "Chain of Freshness" programme, we are developing a strategy for fruit and vegetable complexes that will combine import and domestic fresh produce supplies, accelerating the flow of goods from suppliers to stores through X5's supply chain and helping to achieve higher quality while reducing costs
- Regular quality audits, introduced in 2016, were expanded to include elements of the BRC Food Safety Standard regarding the storage and transportation of goods. This included staff training, internal cross-audits of DCs, and the full-scale implementation of the BRC Food Safety Standard at the Lobnya DC
- The development of multi-use containers for fruit and vegetables continues, helping to minimise losses and simplify operations in warehouses.

Distribution centres and supply chain optimisation

- Our Logistics and Transportation Strategy utilises the Llamasoft platform to support its goals of maintaining the Company's growth in its current locations and to provide for expansion into new regions, while optimising storage and transportation costs. This software enables us to develop our supply chain based on an analysis of a wide range of factors, including planned store openings through 2025, the location of key suppliers, DC inventory levels, the operational efficiency of warehouses, transport tariffs, the level of supply centralisation and the assortment matrix
- Using data analytics, we are now able to identify locations and plan the size of new DCs based on the potential volume of stores to be serviced

Plans for 2018

- Further integration of the WMS system, with completion planned for 2018
- Ongoing monitoring of innovations that may advance warehouse and transportation technologies
- Roll out intelligent inventory monitoring system that utilises RFID tags and drone copters to track inventory levels and quickly identify improperly stored items

Perekrestok and Karusel

Our larger-format stores share logistics infrastructure that is fine-tuned to their needs. As of the end of 2017, Perekrestok and Karusel were operating 12 DCs.

Key highlights of 2017 included:

As part of X5's Logistics and Transportation Strategy, Perekrestok and Karusel are implementing four key projects:

- Using big data to improve the choice of locations for new DCs based on demand and store locations
- Integrating plans with suppliers to enable end-to-end supply chain management
- Implementing a WMS together with Pyaterochka
- Optimising layouts and designs of regional DCs

In line with Perekrestok's CVP, which focuses on quality of goods and services, as well as freshness, development of the supply chain will concentrate on further improving shelf availability of goods in stores.

Inventory management

Our inventory management efforts in 2017 included:

- Reducing inventories, order fulfilment timing and increasing the availability of goods in stores
- Improving DC productivity: we managed to bring DC running costs down by 5%-7% thanks to efficiency measures
- Implementing JDA for 90% of volumes, which had a significant effect on reducing inventory levels. The JDA delivery system has enabled us to start making same-day deliveries to our stores in and around Moscow
- Enhancing synergies with Pyaterochka for shipments to remote regions (shared use of transport)
- Implementing same-day shipment of goods (except for the DCs in Kosulino and Samara)

Distribution centres and supply chain optimisation

- We launched a new DC in Yekaterinburg in the Urals (Kosulino DC, with an area of 13,700 square meters), which helped to optimise logistics for our regional expansion
- We helped to increase the efficiency of Perekrestok's regional supermarket model, helping suppliers in the regions work directly with the new Kosulino DC. This enabled us to reduce logistics costs from RUB 38 per box in Q1 2017 to RUB 26 per box in December 2017
- We further developed direct imports through our import hubs in Novorossiysk and St Petersburg
- We introduced BT-9 temperature monitoring technology, which provides real-time temperature and humidity data all the way from the supplier to the DC and then to the store

Plans for 2018

- Further development and optimisation of regional logistics efficiency
- Complete implementation of JDA for all turnover in H1 2018
- Further develop supply synergies with Pyaterochka for remote regions
- Increase DC productivity, including staff productivity, by implementing new technologies, and focussing on improving the availability of goods
- Further develop direct imports, mainly for fruit and vegetables
- Launch a banana ripening complex at the Sofino DC in February 2018, ensuring the supply of bananas to the Perekrestok and the Karusel formats (starting with Moscow and the Moscow region)

Transport

Our transport fleet consisted of 3,144 trucks as of 31 December 2017, and we were capable of handling 74% of our transportation needs during the year. Our own fleet constitutes a key element of our retail operations infrastructure, which has to support our retail formats as they rapidly expand across Russia. At the same time, we are developing new modes of transportation to help us access new areas and transport goods faster and efficiently across Russia's long distances.

Transport strategy

In June 2017, we approved our Logistics and Transportation Strategy to 2025, which will govern how we develop our transport operations in the years ahead. The new strategy aims to provide a reliable, timely and efficient supply of goods to our stores, including to locations with poor accessibility by road and/or requiring travel across significant expanses of Russia's territory.

The key elements of our transport strategy are:

- **The best offering in a competitive market:** we aim to ensure we can achieve the best transport service rates across our operations by developing our own fleet and diversifying our third-party transport service providers across a variety of channels.
- **Establish 4PL operations in remote regions:** in order to support ongoing regional expansion, including in remote regions of Russia, we aim to establish our own 4PL integration platform for efficient, multimodal transport of goods to our stores.
- **Technology-driven:** we are constantly testing and introducing new technologies to improve the efficiency of our operations. This includes everything from cutting-edge technologies like driverless trucks to using platforms that source trucks, drivers and trailers separately in order to optimise lead time and costs.
- **Focus on service quality:** our goal is to achieve a 98% success rate in meeting delivery windows and temperature requirements for deliveries, and we have established business processes that enable us to respond quickly to the changing requirements of X5's retail formats.

The overarching goal of our transport strategy is to effectively and efficiently support X5 Retail Group's development plans as it expands and refines its operations in existing and new regions of the Russian Federation.

How we manage transport

The Director for Transport, located in the Corporate Centre, is responsible for implementing and monitoring performance targets and establishing strategic goals with regard to X5's transport operations.

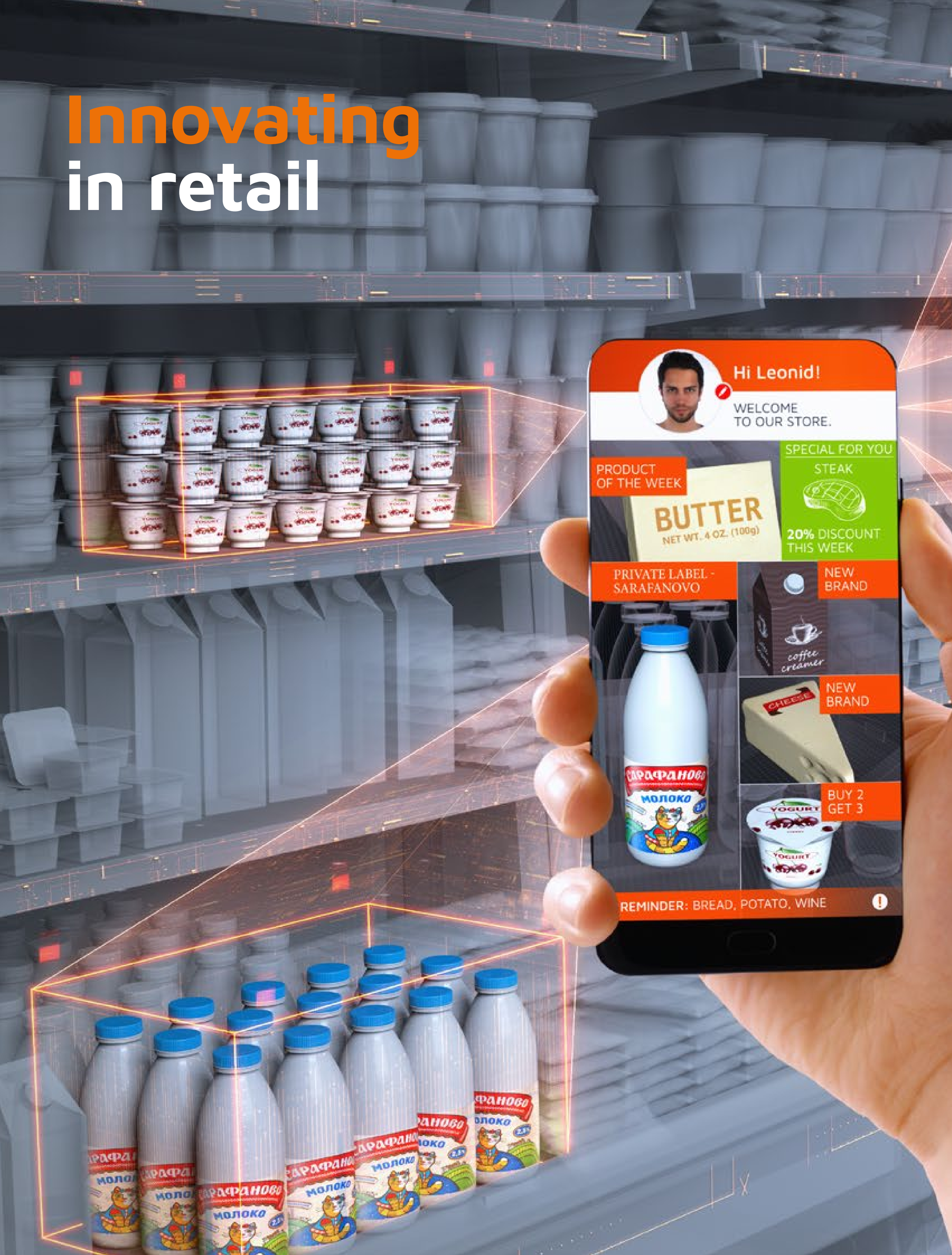
Starting in 2016, the Corporate Centre's Transport Department took over management of all of Pyaterochka's third-party transportation operations in the Central division. Starting from 2018, as Pyaterochka creates "macroregions" for management of its stores, the Transport Department will establish identical macroregions for management of transport operations.

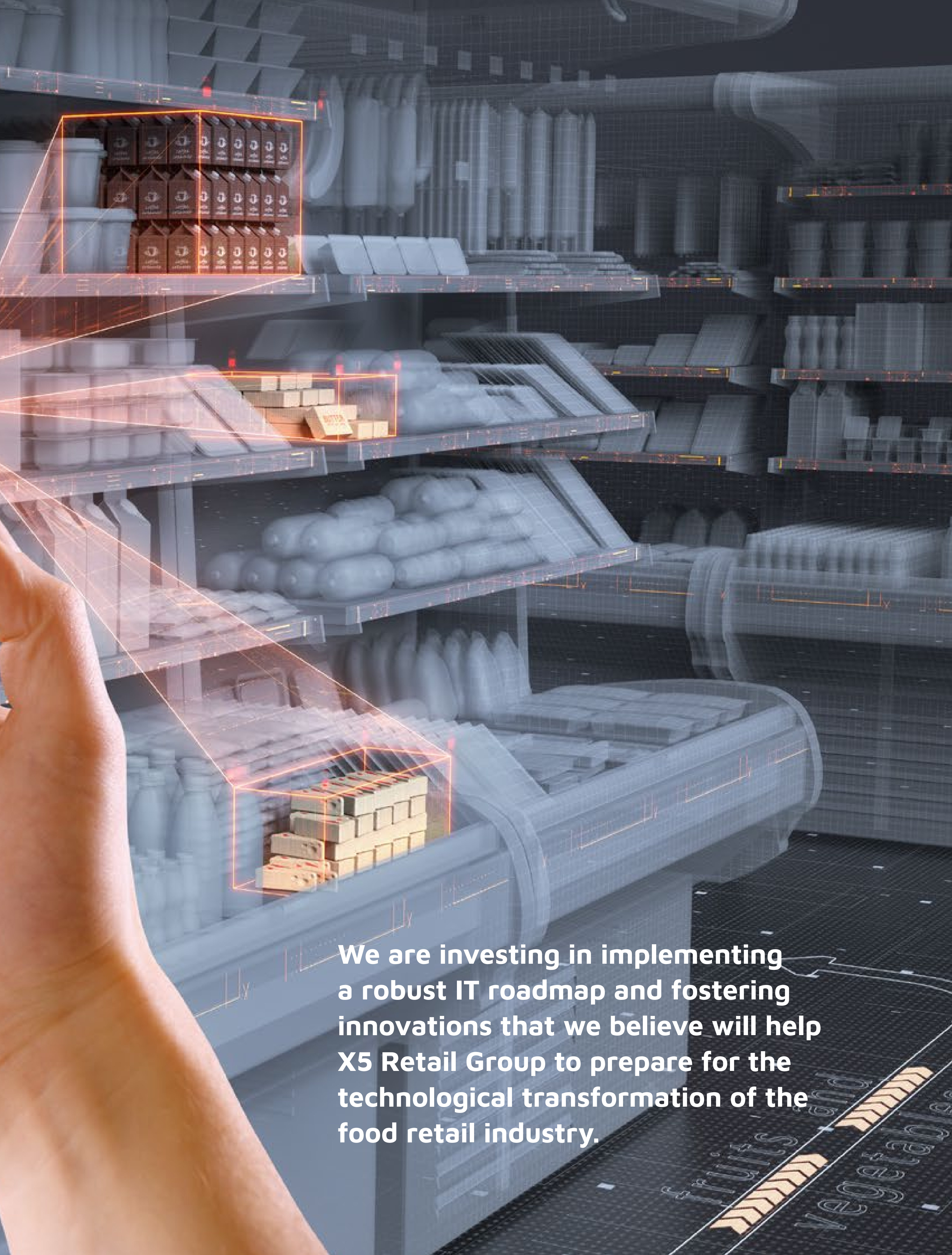
In order to effectively monitor our growing fleet, we use centralised transport management systems to maintain a real-time view of the location, condition and storage temperatures of the entire fleet. Thanks to GPS/GLONASS systems, X5 is able to monitor the movement of shipments from DCs, helping stores to plan for arrivals and be alerted to delays.

What we did in 2017

- **Substantially increased own truck fleet:** purchased 1,231 trucks (including 100 trucks with dual-fuel engines), increasing the size of X5's fleet by 36% year-on-year to 3,144 trucks as of 31 December 2017. As a result, the average age of our transport fleet decreased from three years in 2016 to two years in 2017.
- **Developed multimodal delivery:** began using rail transport to supply stores in areas like Komi, where there are no normal roads for motor transport. We also launched delivery of fruit and vegetables from the St Petersburg port to our DC in Novosibirsk. This has enhanced our ability to ensure a stable supply of quality goods to remote and distant regions as we expand throughout Russia.
- **Continued development of GoCargo:** In addition to the Central division we launched our own decentralised cargo service in other regions across Russia, with the share of GoCargo deliveries reaching up to 16.0%.
- **Cross-docking:** in 2017, we opened three new cross-docking sites, primarily to optimise logistics and increase the efficiency of deliveries to remote regions, including as a substitute for DCs.
- **Less-than-truckload shipping:** in Moscow and St Petersburg, we opened two sites for the consolidation of small lots of goods for delivery to our DCs in these regions. This is especially important as a platform for fresh and frozen goods, and it is a unique service in Russia. This technology helps our suppliers reduce the cost of delivering products to DCs.
- **Pilot joint deliveries:** in order to increase the efficiency of using our own transport for some suppliers to other customers.

Innovating in retail



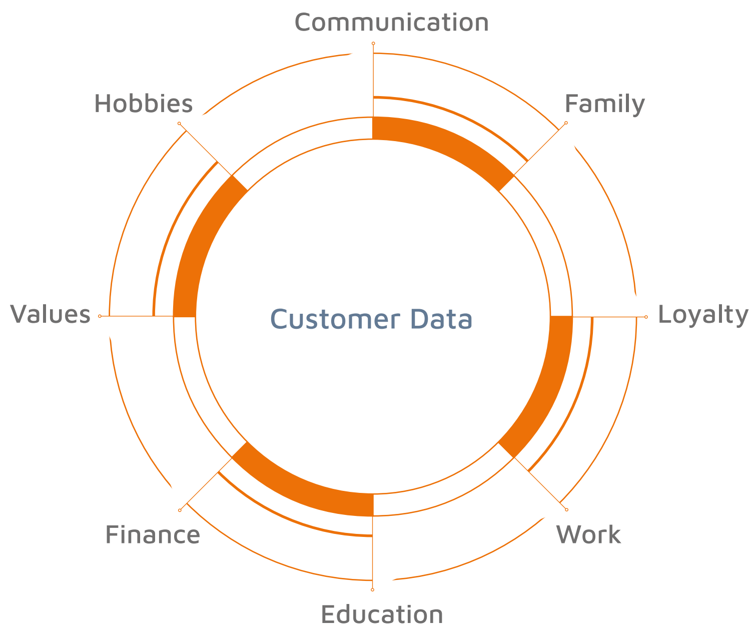


We are investing in implementing a robust IT roadmap and fostering innovations that we believe will help X5 Retail Group to prepare for the technological transformation of the food retail industry.

Innovation and information technologies

Innovation

In the next three to five years, the retail landscape will likely change dramatically with artificial intelligence (AI), automation and other technologies, as well as the rapidly evolving omni-channel shopping behaviour of consumers driving this change. X5 intends to be at the forefront of the AI- and technology-driven transformation of our sector, both by developing its own big data and analytics capabilities and by implementing new and promising technologies as they emerge.



Innovation strategy

Innovation and technology will play key roles in the successful and sustainable development of X5 Retail Group. Our strategy includes focussing on innovation as a key source of growth. We aim to become a leading innovator in the Russian retail sector in the next several years.

We are gearing up for a future where customers will demand more convenience and personalised services, which will be made possible by emerging technologies and AI. Our ability to offer these services effectively and efficiently will play an increasingly important role in consumers' choice of where to shop and what to buy. X5 bases its innovation strategy on three key pillars that we believe will help us do more than just keep pace with global leaders in retail innovation

Customer-centricity
one of the core areas of focus for our technology and innovation efforts is to improve the omni-channel customer experience and our overall CVP with the help of AI, big data and IT systems ranging from real-time personalisation of offers, to shopping experience customisation, to assortment and pricing optimisation based on localised customer needs and preferences.

Increased mobility

we are helping customers who want greater freedom and mobility by launching online shopping offerings in core markets (Moscow in 2017 and St Petersburg in 2018), while also creating mobile apps that help enhance their experience when they are in stores.

Data-driven

we are developing and enhancing our big data and analytics capabilities, which help X5 operate more effectively and efficiently. This ranges from optimising our store locations by leveraging our unique GIS system, to offering customers a more individualised experience based on their personal shopping habits and preferences, to optimising our supply chain network and transportation routes, leveraging the best-of-breed analytical and optimisation tools.

What we did in 2017

One of the key initiatives in 2017 aimed at supporting this drive for innovative leadership was X5-Lab, which unites employees from the three retail formats and the Corporate Centre into an innovation hub.

To ensure a continued flow of innovative solutions and technologies as part of its innovation strategy, X5 launched strategic partnership programmes with the Internet Initiatives Development Fund and the Skolkovo Foundation. These partnerships helped X5 identify and review several hundred startups offering innovative retail solutions and technologies. Thanks to these partnerships, we managed to select and launch several dozen joint pilot projects with high-tech companies to test their most advanced solutions and technologies at X5. Projects were launched in areas like pricing, assortment, and OSA optimisation using computer vision technologies, customer shopping experience enhancement leveraging in-store video-analytics technologies, as well as a number of in-store operations, finance and HR process improvements leveraging automation and robotisation.

Other highlights we achieved in 2017 include:

Big data: We launched a data analytics platform that enables X5 and key suppliers to analyse the effectiveness of promo activities by measuring the impact of targeted online advertising on offline sales through anonymised data about X5's customers.

Omni-channel retailing: Perekrestok Online, our own online supermarket platform, was launched in Moscow in April 2017 and is expected to roll out in St Petersburg in 2018; Karusel Online was launched in 2017 in partnership with a number of delivery service operators that provide in-store pickup and home delivery services for our customers.

Image recognition: This newly developed software will enable us to monitor the consistency of shelf placement with planograms, assure shelf availability and optimise store layouts.

Robot Vera: This automated recruitment system independently searches for CVs and potential job applicants online based on a predetermined set of parameters, then initiates contact with automatically selected candidates to invite them to apply for positions available at the Company. Interested candidates are then transferred to a recruitment specialist to discuss specific terms and conditions.

X5 aims to create a personalised real-time monitoring system of customers' needs, and to transform itself into a next-generation food retail company. Today, we are already implementing a smart data strategy, and we aim to adapt rapidly in the years ahead to enhance our ability to put customers at the centre of everything we do.

LEVEL
#1

Smart Data Strategy

2018

LEVEL
#2

Customer-centric decision-making on data analytics

Data-driven strat

2020

How we manage our innovations initiatives

Management of our investments in innovations is handled by the Corporate Centre, while each of the formats is responsible for detailed requirements and customisation, customer loyalty programme management and other software they use to improve their business efficiency.

The five key areas we plan to focus on in our drive for AI- and technology-driven innovation are goods, business processes, services, business models and technologies. With technologies at the core, each of these areas will help make us a stronger and more sustainable leader in our sector.

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LEVEL
#3

"Next-Gen Retail" – real-time monitoring system of individual customer data

Business processes | **Goods** | **Services** | **Business model**

Technology

Image recognition

- Competitive price monitoring
- Planogram assurance and optimisation
- On-shelf availability assurance

Video analytics

- Know the customer: WHO (e.g. gender, age, etc.) and HOW (e.g. shopping habits)
- Understand customer path (heat mapping, dead zones, for layout/assortment/price optimisation)

Robotisation/ automation

- At DCs (drones, automatic MHTs, etc.)
- Process automation (e.g. Finance)
- For HR (Robot-Vera – for automatic cold calling/recruitment

Omni-channel

- Perekrestok.ru
- Karusel is testing in-store pickup and courier delivery services, etc.

After 2020

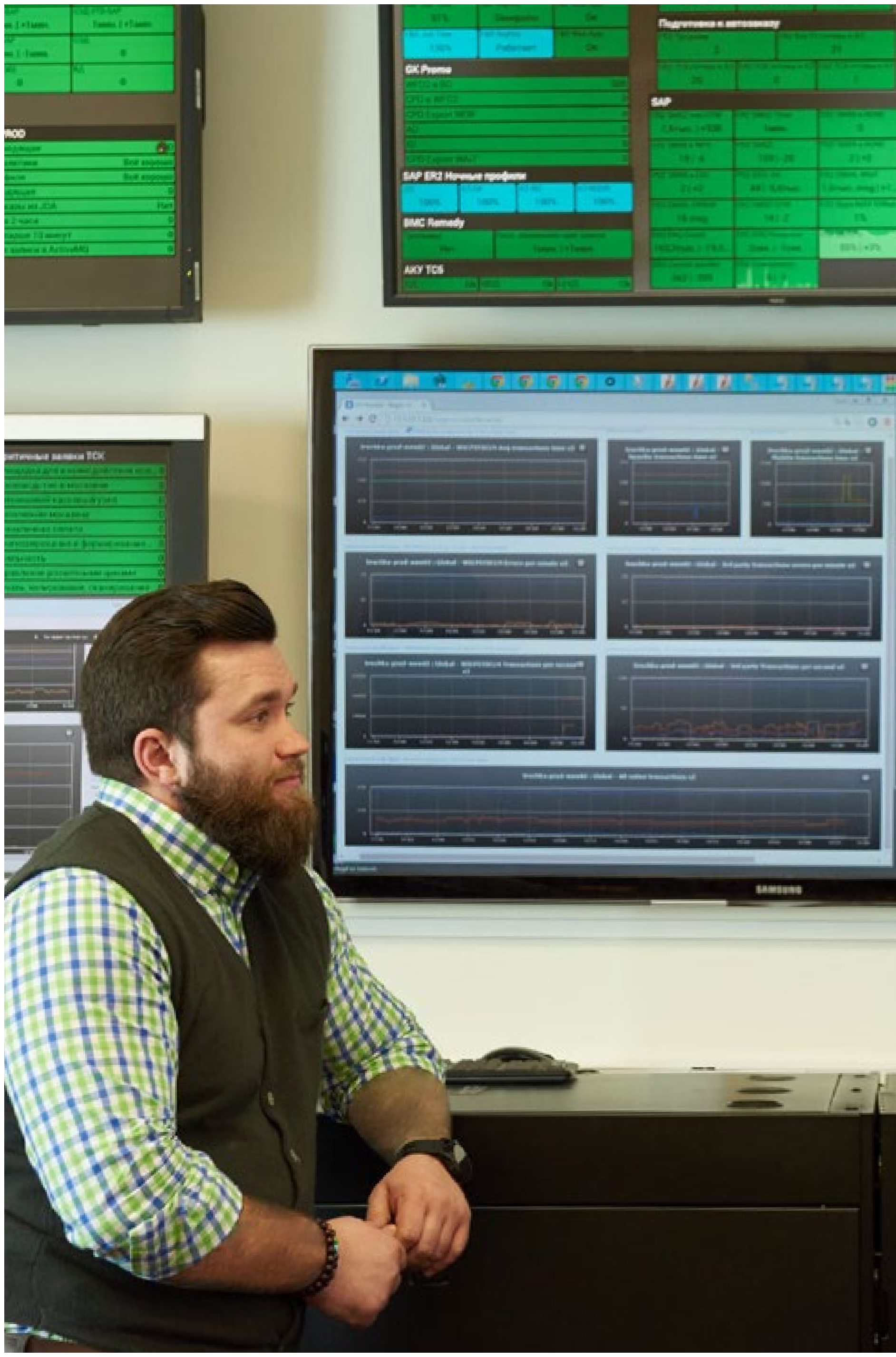
Information technologies

Successful development and transformation as an innovative business is not possible without reliable and efficient IT platforms. Our IT systems both support existing operations and act as the core for our innovation efforts.

X5 Retail Group's Information Technology Department manages X5's IT systems and subdivisions, as well as ensuring the integrity of the architecture and infrastructure for innovations that require IT resources. An innovation team has been created within X5's IT department to monitor and analyse new technologies and test innovative solutions. All innovative solutions are reviewed to ensure compatibility with the Corporate Centre's IT architecture and infrastructure.

2017 highlights

- **New IT roadmap:** we developed and approved a new roadmap for the development of X5's IT systems through 2020, with the aim of improving the stability of the Company's IT infrastructure in order to support the continued fast pace of organic growth, and with a particular focus on projects to optimise the current information systems and improve the efficiency of IT processes.
- **Reliability and resilience:** we approved a new strategy for IT continuity and took steps to further improve the resilience and stability of the Company's information systems, including reserve data storage sites, core architecture and new equipment purchases.
- **Capacity for growth:** We secured the ongoing organic growth of the SAP ERP system through 2020 and introduced a capacity assessment process to ensure the organic growth of other information systems. We also established the capability to quickly add new resources with IaaS systems.
- **Enhancing commercial activities:** we continued to develop loyalty programmes that offer personalised promos based on real-time processing of customer preferences. Pyaterochka's Helping Card (Vyruchai-Karta) loyalty programme, which was rolled out in 2017, already had over 20 million active users by the end of December 2017.



Integrating regulatory systems

In 2017, we continued implementation of Company-wide projects to automate the monitoring of alcohol inventory as part of the Unified State Alcohol Information System (EGAIS). Changes affected each of X5's retail outlets: as of the end of the year, the accounting and reporting of alcohol inventory across the Company's operations were fully in compliance with updated requirements, and there were no cases of alcohol licences being revoked due to a failure to properly monitor and report on inventories.

Another important project launched in 2017 was Mercury, which is required for compliance with new Russian legislation on the registration and monitoring of meat and poultry products. X5 implemented a platform that is integrated with the state's FGIS Mercury system for the recording and storage of electronic veterinary documents. We automated the main processes for processing documents at X5's stores, helping to reduce costs through the use of the FGIS Mercury web interface.

In line with Federal Law No. 54, which requires that retailers transmit information directly from each cash register to the Federal Tax Service in real time, X5 updated over 40,000 pieces of equipment after becoming one of the first companies to cooperate with the Tax Service on piloting a comprehensive solution. After nine months of testing, the Company successfully implemented its automated cash control solution across its retail operations, and checkout productivity has not been affected by the updates.

Plans for 2018

In the year ahead, we will continue to implement our activities according to the IT roadmap to 2020. This includes:

- Launch of IT infrastructure for Big Data development
- Implementing projects related to adherence with new legislative requirements (Mercury, EGAIS, etc.)
- Modernisation of the GK software trading system and the transfer of large formats from Numero Quatrum (NQ) to GK software
- Transition to the SAP PI enterprise service bus for all stores Company-wide

We plan to develop and implement a big data platform and projects, and we continue to automate routine tasks carried out by Finance Department staff.

Sustainable development

We measure our performance by more than just financial and operating metrics, because our long-term success and sustainability depend on our ability to create value for a wide array of stakeholders.

Sustainability

Stakeholder engagement

Interaction with our stakeholders is key to creating value and achieving sustainable growth in the long term. Accordingly, X5 actively engages with the stakeholders for whom we aim to create value in order to ensure a positive outlook for our business operations in the future.

Stakeholders	Suppliers	Society and local communities
Why we interact	• Ensure high-quality products • Maximise share of goods from local producers • Build partner relationships with suppliers, coordinating promo and other sales activities • Ensure that we are able to provide ready and relevant solutions to the end consumers of our products • Create business relationships built on trust and respect • Help guarantee the health and safety of end consumers • Reduce waste and losses, increase yield and productivity • Develop more efficient ways to bring our products to consumers	• Address community needs and social or environmental concerns • Support the health and well-being of the communities where we operate • Enhance our image and reputation • Build strong relationships with the world around us • Increase brand recognition • Attract positive media attention • Develop relationships with local authorities to make doing business easier • Identify new business opportunities within the communities in which we operate • Maintain awareness of government policies or regulatory changes that could impact our business
How we interact	• Engaging in fair business practices and aiming to be a reliable partner • Adapting our business processes to enable more efficient work with small local producers • Aiming to increase the share of locally produced goods across our formats • Training events at DCs help suppliers work efficiently with X5 • Nationwide distribution and logistics operations designed to integrate large federal and smaller local suppliers • Maintaining transparent, collaborative relationships	• Investment in charity and social initiatives that leverage X5's position as Russia's leading food retailer • Supporting charitable initiatives like Basket of Kindness • Giving to local community priorities • Taking a responsible approach to the environment • Focussing on reducing consumption and waste generated by our activities • Keeping the community up to date on decisions that impact them • Developing relationships with local community leaders
Performance in 2017	• Established relationships with 1,050 new suppliers in 63 regions • Development of new private labels • 17% of assortment from local suppliers in 2017 with 25% in some regions	• Created over 40,000 new jobs in 63 regions through the opening of new stores and DCs • Paid over RUB 67 billion in local, regional and federal taxes • Provided convenient, modern and reliable food retail services to people in around 2,500 cities and towns in Russia (over 3,800 million checks)

Through our engagement with key stakeholders, including customers, employees, investors, suppliers and local communities, we take into account the expectations of all these groups and aim to realise these expectations as far as possible.

	Personnel	Shareholders	Consumers
	• Create conditions for the professional growth and social well-being of employees • Establish an effective corporate culture • Maintain productive relationships with trade unions and employees • Educate employees about health and safety procedures in the workplace • Maintain a dialogue with employees to identify opportunities to further improve our operations • Retain and develop a workforce of skilled and committed employees • Attract new talent • Improve employee motivation, help them build their interpersonal and teamwork skills	• Educate new investors about X5, our strategy and performance • Improve the culture and quality of corporate governance • Build X5's long-term value • Apply knowledge gained from dialogue to improve the running of the business • Commitment to openness • Inform investors about X5's operating and financial performance and other significant events • Maintain a dialogue with investors in X5's capital market activities • Ensure long-term capital growth for the Company.	• Inform customers about X5's value proposition • Explain what sets us apart from other food retailers • Meet our customers' shopping needs and improve their shopping experience • Improve customer loyalty and increase share of spending at X5 stores • Enable customers to give us feedback • Provide customers with answers to their questions through direct engagement • Adapt to changing demand • Reduce food waste • Give customers the chance to get to know the company and its brands
	• Providing stable and fair wages to X5 Retail Group's employees • Providing meaningful career opportunities and competitive compensation packages • Ensuring strict adherence with workplace health and safety requirements across our operations • Training and development programmes • Social support for employees with regard to long-term illness or accidents, bereavement or loss of property • Recognition of significant contributions to the Company's development	• Implementing our strategy aimed at smart, sustainable, rapid and profitable business growth • Maintaining high standards of transparency and disclosure • Implementing best-practice corporate governance practices • Investor website with annual reports, financial statements, press releases, presentations • Roadshows • Investor conferences • Conference calls • Group meetings with analysts and investors • Five independent non-executive directors on the Supervisory Board ensure that the interests of public shareholders are represented	• Customer hotline • Presence on social media and messenger platforms • Data analytics of customer behaviour used to adapt assortment and CVP and better meet customers' expectations
	• Invested around RUB 140 million in professional training and development • Held over 1,300 employee engagement events attended by more than 155,000 people to maintain dialogue with employees • Implemented and refined workplace health and safety policies and practices • Approved and implemented a diversity policy across all of X5's operations	• Adopted a dividend policy • Implemented award-winning investor relations practice • Hundreds of conference calls and meetings with investors and analysts • Five roadshows • No fewer than 10 investor conferences • Around 30 RNS press releases	• Brought X5's modern retail services to around 500 new Russian cities and towns • Constant adaptation of formats' CVPs to consumers' needs • Introduced new loyalty programmes that utilise big data analytics to automate personalised offers

Business conduct review

Key objectives

Ensuring the Company's compliance with laws on combating bribery and commercial subornation is a key objective of its Policy on Countering Misconduct, Including Fraud and Corruption.

Policy highlights

- Combating corruption is one of our Company's key objectives. Measures taken in this area include:
  - establishing effective procedures and initiatives to prevent corruption
  - forging a corporate culture of honesty and zero tolerance for corrupt behaviour
  - minimising the risk of the Company's involvement in corrupt activities
- We have adopted a Declaration on Human Rights.
- The Company tolerates no discrimination on any grounds or forced labour with respect to its employees, customers, or partners. Every employee has equal opportunities for merit-based recognition and career growth regardless of sex, race, colour, nationality, language, social or occupational position, age, attitude towards religion, as well other factors not related to the employee's professional qualities.
- X5 protects its employees from any physical, verbal, sexual or psychological abuse in the workplace. The Company fosters respect and ethical working conditions.
- We respect, and pay due regard to, cultural values and customs of local communities across our footprint, including those of indigenous minorities.
- The Company respects the rights of its employees to establish, join or not join trade unions or other associations supporting their interests.
- The Company provides a healthy and safe workplace for its employees in compliance with regulatory occupational health and safety requirements.
- The Policy on Countering Misconduct, Including Fraud and Corruption, applies to all Company employees, including senior management and members of governance bodies.

System highlights

- Our key measure of performance in the area of business conduct is the successful introduction and implementation of business processes aimed at reducing compliance risks in the areas of preventing fraud, corruption, management of conflicts of interest and protection of personal data.
- Our key measure of performance in the area of human rights is the successful introduction and implementation of policies and procedures that ensure our company is able to monitor and respond to human rights issues that may be encountered by our employees or other stakeholders.

- Responsibility for investigating and addressing human rights issues is held by the Risk and Monitoring Division, the Security Division and the Organisational Development Division.
- The Organisational Development Division is also responsible for training activities aimed at ensuring that X5 employees are familiar with our human rights policies and procedures.
- X5 Retail Group has established channels for employee and counterparty messages on violations of laws and internal regulations, including:
  - an ethics hotline (for reporting human rights violations or unlawful or corrupt behaviour) and
  - a hotline for the Head of Security (for reporting unscrupulous practices by staff).
- Any corruption-related or human rights violation is subject to an internal investigation. The Company investigates any instances of suspected corrupt activity or human rights violations.
- We regularly monitor bribery and corruption risk levels as part of day-to-day operations at all levels of the business.
- Our anti-bribery and corruption policies extend to our supplier contracts, which are in the process of being updated to reflect these policies.
- We have an experienced and knowledgeable investor relations team that ensures that we conduct regular dialogue and communications with our current and potential shareholders.

2017 performance highlights

- In September 2017, X5 Retail Group adopted a Policy on Countering Misconduct, Including Fraud and Corruption. This is X5's main internal regulation that sets out the approach and principles used by the Company in combating corruption (bribery and commercial subornation) by its employees and counterparties. This document establishes the Company's zero-tolerance policy towards corruption and fraud.
- We have sought to ensure that all employees have familiarised themselves with this new policy, and as of 18 March 2018, we achieved the following progress:

Status of review of Policy on Countering Misconduct, Including Fraud and Corruption

	Number of employees	% of total employees
Corporate Centre	646	100
Pyaterochka (office)	8,808	100
Pyaterochka (retail operations)	145,384	88.6
Perekrestok	28,115	87
Karusel	13,114	100
Transport	2,201	100
Perekrestok Express	975	100

- Conducted training for senior management at the Corporate Centre and the retail formats to explain key areas of the Policy on Countering Misconduct, Including Fraud and Corruption.
- Worked with external consultants to establish a checklist for X5's adherence to international best practice in anti-corruption measures.
- In order to comply with European and Russian human rights legislation, X5 Retail Group adopted a Declaration on Human Rights. This Declaration specifies its principles and rules in respect of compliance with, and promotion of, high international standards for the protection of human rights at every stage of the Company's operations. These principles and rules are based on recognition of a human being's dignity, as well as the freedom and equality of all people.
- Reviewed and updated electronic service by which employees may declare conflicts of interest, and analysed compliance related to currently declared conflicts of interest.
- We complied with Russian legislation governing personal data protection, and analysed potential compliance risks in relation to the EU's General Data Protection Regulation that takes force from May 2018.
- The Company maintains an anonymous whistleblower hotline: in 2017, the hotline received 1,826 complaints that were investigated, which resulted in 218 violations being identified and addressed. A total of 3,194 complaints were received about Labour Code violations.
- In 2017, the ethics hotline received 5,020 complaints related to violations of the Labour Code of the Russian Federation and X5's Code of Business Conduct and Ethics. The Company conducts internal investigations on all reports received via the hotline. In the event that a violation is found, all necessary measures are taken: elimination of the violation (when possible), launching legal cases or investigations against the violators, changing business processes (if necessary).
- In order to reduce compliance risks, support staff morale and improve the Company's reputation as a responsible employer, X5 has begun automating certain parts of the whistleblower hotline in order to improve response time and efficiency and quickly identify major issues.
- Every employee that joins an X5 Retail Group company must confirm that they are familiar with the Code of Corporate Conduct as part of the on-boarding procedures.
- In 2017, we launched a distance learning course for new employees to help acquaint them with key areas of the Code of Conduct.

People review

Key highlights

Headcount

250,874
2017

196,128
2016

Male/female

26%/74%
2017

26%/74%
2016

Investments in training

RUB 139.3 million
2017

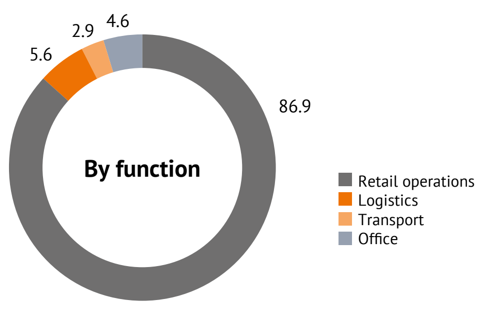
RUB 84.6 million
2016

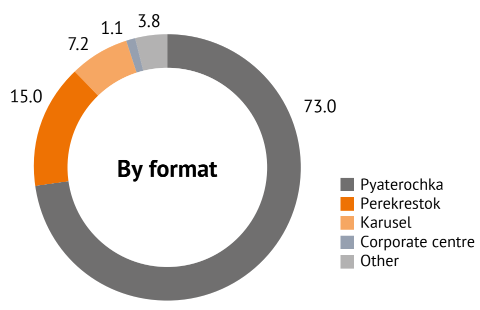
Number of training participants

234,899
2017

44,626
2016

Personnel breakdown in 2017, %





Our key objective

X5 Retail Group's key priorities in HR management are attracting people in the quantity and of the quality required to support the Company's goals, identifying and developing talented people with high potential, as well as retaining and motivating our best-performing employees. We added nearly 3,000 new stores in 2017 alone, and having an efficient and effective HR function for our growing business is critical to our success.

HOW WE MAINTAIN OUR HR BRAND

In 2017, the X5 Corporate Centre ran its first summer internship programme, with 37 interns selected from over 380 students and six hired after the programme completion.

In order to attract young talent, Pyaterochka developed the Give Me Five! internship programme for final-year students (one-year training for future store managers) that it will be rolling out in eight cities with populations over 1 million during 2018. Perekrestok brought its Fresh Start internship programme to remote regions where it operates.

To strengthen its HR brand, Pyaterochka is also developing corporate groups in social media, with over 12,000 subscribers in VKontakte (a two-fold increase over 2016) and over 3,000 in Odnoklassniki.

Our commitment and approach

- **Human rights.** We support the four fundamental principles outlined in the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work. We do not discriminate on the basis of gender, colour, ethnicity, religion, sexual orientation or disability. We ensure that employment with us is freely chosen. We prohibit the use of forced and child labour throughout our operations and supply chain.
- **Government requirements.** We align all of our people policies with Russian Labour Law, providing the appropriate rights, benefits and reimbursements to all employees across Company.
- **Labour safety and working conditions.** We aim to create a comfortable working environment for our people through an integrated safety programme, continuous monitoring and improvement of labour conditions, as well as by accelerating efforts to upgrade work processes.
- **Effective motivation and fair remuneration.** X5's performance management system and remuneration policy aim to attract, motivate and retain the best talents on a sustainable basis in order to support the Company's strategic and operational objectives. Our processes are designed to uphold a fair, consistent and transparent remuneration and motivation system related to individual performance and team results, and they comply with market practice.
- **People development.** Our employees are central to the Company's success, and therefore our development programmes are aimed at strengthening our performance and accelerating growth in our strategic capabilities. Various training programmes are offered to different groups of employees, from key managers to retail staff, based on job requirements, employee assessments and specific business needs. At the same time, we focus on identifying talented individuals with high potential, and providing them relevant career and development opportunities to strengthen our future.
- **Corporate culture.** X5's top corporate priorities are teamwork, constant improvement, customer orientation and leadership.
- **HR Brand.** We reinforce our internal and external employer brand in order to send a clear message about our value proposition as an employer and to attract people with the skills our business needs. In order to increase our HR brand recognition among young specialists, X5 partners with universities and colleges, organising various internships, career fairs and student competitions. Special attention is given to cooperation with youth groups like World Skills and general consumer organisations.
- **Common purpose.** Our people have a shared vision of how to achieve the Company's strategic goals. Effective regular communications and special events support overall awareness, with top-down target setting and setting the tone at the top level of management. We run comprehensive functional and strategic planning conferences for our managers to discuss plans, results and priorities for business and people development.


X5RETAILGROUP

System highlights

- X5 Retail Group's HR team engages in the full cycle of work with staff: from understanding business needs and building an organisational structure that meets those needs, to attracting the necessary talent, and providing for staff motivation, long-term career development and forming an external and internal staff reserve.
- X5's Head of Human Resources is responsible for the Company's management of people matters at the Corporate Centre level. The internal HR function's responsibilities include ensuring that effective management systems are in place, as well as establishing corporate HR standards and HR management tools that support achieving X5's strategic goals.
- Each of the retail formats runs their own human resources department, which are responsible for developing people and implementing HR processes in line with that format's strategy and unique CVP, as well as X5's overall HR priorities.
- The responsibilities of each format's HR team include promoting and monitoring the Company's approach to diversity and equal opportunities across the business.
- In order to ensure that employees are informed about all aspects of X5's business, including strategic goals, key events and projects, we use internal communications including email lists, news digests, a corporate intranet, X5 TV and a variety of corporate events.
- The fast-growing and dynamic character of our business requires employees to be efficient and constantly refine their management and communication skills. We therefore devote significant time and resource to staff development: a selection of training and development programmes are available to all staff. These are tailored according to the needs of each individual and their roles. Programmes are provided in various forms and concepts: internal and external courses, lectures, business simulations, online training and video classes.
- We revised our remuneration policy and have established unified compensation and benefits guidelines, with a compliance toolkit that can be applied Company-wide.
- We expanded X5's benefits and special activities programmes to promote well-being, which include improved health insurance coverage, special events, medical diagnostics, as well as sports and fitness activities.

X5 professional competitions

Pyaterochka

Cashier of the Year

Pyaterochka

Captains

competition for store managers

Perekrestok

Checkout Win

Perekrestok

The Face of Perekrestok

- During the year, we established an HR data quality control system, and implemented a group-wide KPI dashboard to monitor key HR processes and to create a framework for data-driven decision-making.
- We extended the talent pool programme to cover all formats and business units. The talent pool is built for the Corporate Centre and each format based on the Company's strategy and the format's priorities.
- An integrated programme for retention and development of key managers continued in 2017: the average tenure of top managers at X5 increased by 41% year-on-year.
- Launched large-scale research aimed at predicting X5's demand for personnel and the labour market's ability to supply that personnel, which was used to develop our key strategic priorities for hiring and retaining people at X5 Retail Group.
- Total investments into personnel development increased by 65% year-on-year, with over 235,000 training participants in 2017, which represents 120% of total average headcount during the year.
- Pyaterochka launched a shared HR service centre to centralise recruitment of retail personnel and HR document flow. The centre performs around 300,000 operations per month.
- The year's key trend were the competitions for different groups of employees, including shop assistants, drivers, bakers, cashiers and DC employees. These events support the strategic objectives of each, help recognise the best-performing employees and teams and create a positive perception regarding retain jobs and careers offered by X5.
- As part of its efforts to promote its new concept, Karusel launched a number of I'm a Customer of Karusel! incentive initiatives to establish a strong focus on being client-oriented.
- 2017 was the fifth year when we ran the X-Friday project, with office employees working on the sales floor in December to support store staff during the peak holiday season, while also receiving hands-on experience and a practical understanding of our operations and business processes.

Pyaterochka

Best DC Employee

competition for electric forklift drivers and warehouse operators

Perekrestok

Food Feud

competition for bakers and cooks

Pyaterochka

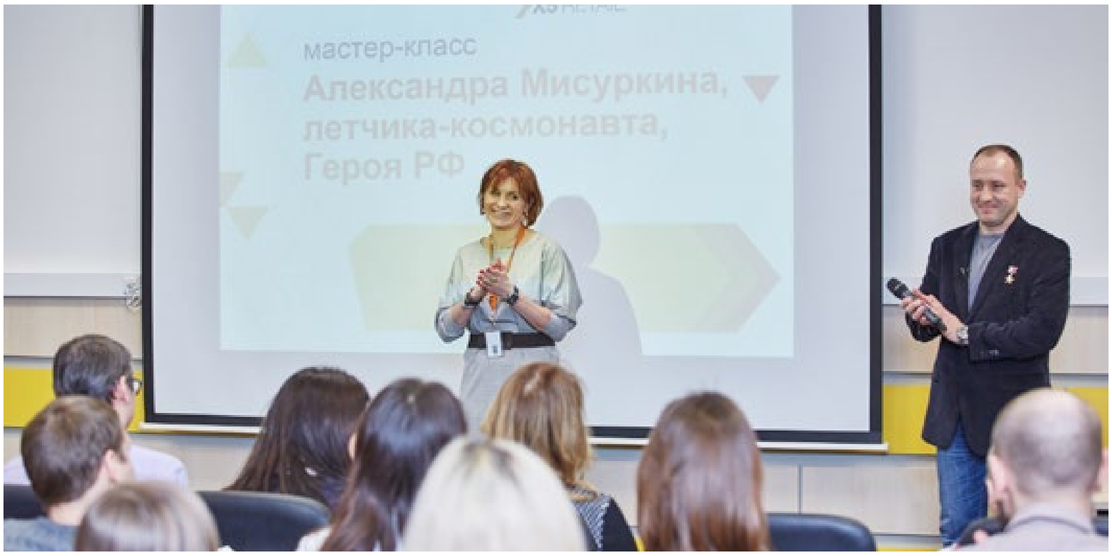
Best Area Security Manager

X5 Logistics

Professional Driver League

Development of the Special Wednesday project to increase X5's brand value for employees and job seekers.

Special Wednesday is an open corporate forum where X5 employees can share their experience and ideas and keep developing. It underpins our commitment to providing professional growth opportunities, while also creating additional value for our people. The project features face-to-face interactive workshops held by outstanding individuals in various fields, e.g. music, sports, marketing, psychology, space travel, etc. The forum also serves to support X5's corporate projects, such as Like for Like.



Special Wednesday

Highlights for 2017

>1,700
participants of face-to-face meetings

>3,150
participants of distant learning programmes

14
events

9.1
average score in feedback forms

70%
ENPS

Occupational health and safety

OHS Strategy

X5's Health and Safety Strategy is aimed at:

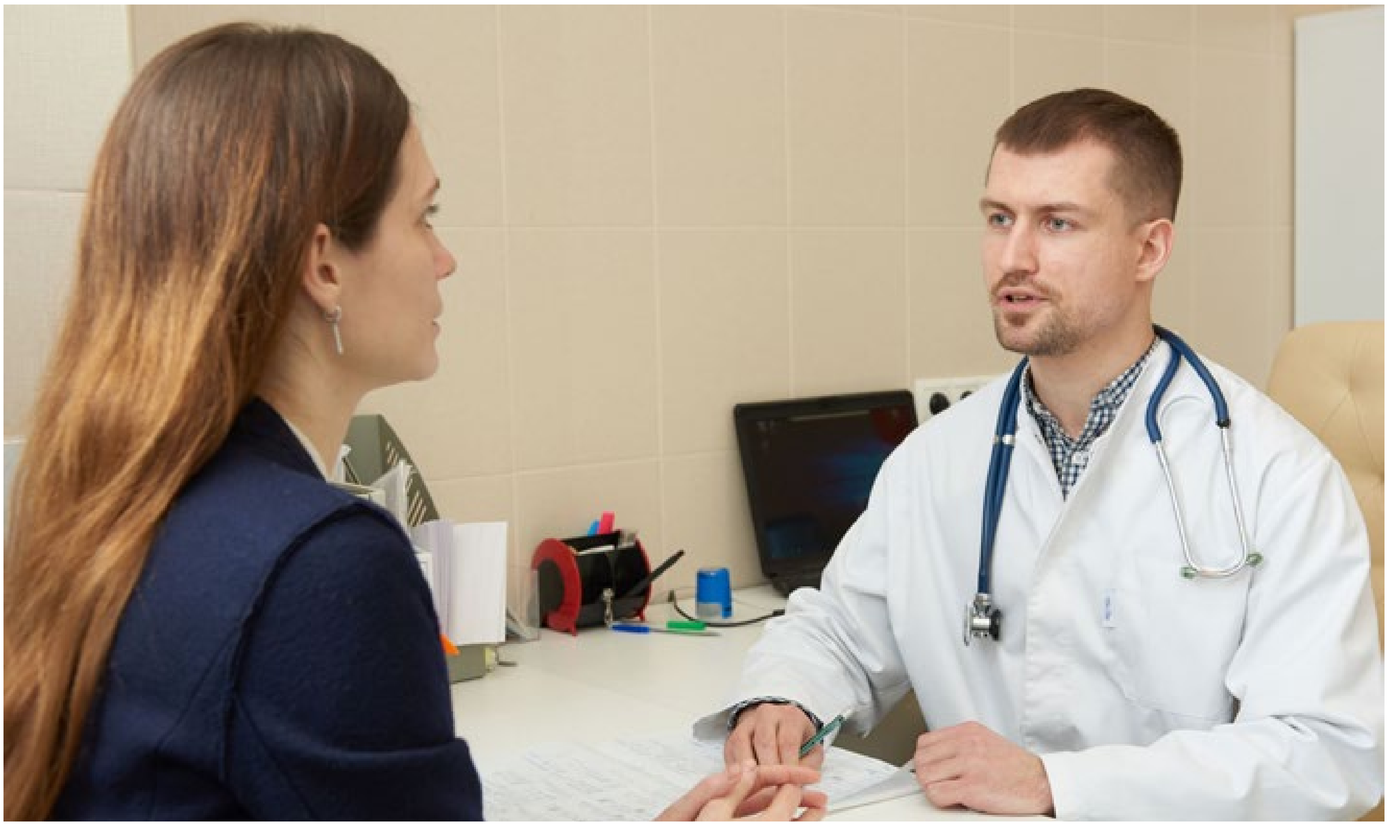
- Ensuring the health and safety of our employees
- Reducing the injury rate and eliminating the risk of accidents and emergencies
- Preventing occupational diseases

OHS policy highlights

- We comply with the health and safety laws of the Russian Federation and other relevant regulations.
- We make sure every employee is aware of the known health and safety risks and hazards in the workplace, providing them with reliable information and ensuring involvement at all levels.
- We continuously improve our health and safety management system so that it meets the evolving needs of society.
- We ensure compliance with applicable laws and other OHS regulations, aiming to create a healthy and safe working environment and prevent workplace accidents and occupational diseases.

OHS system highlights

- The Company's management is responsible for implementing the policy: it sets goals and objectives, engages in planning and funding relevant initiatives. The retail format management and the Health and Safety Department work together to deliver on these goals and objectives.
- The Company's Occupational Health and Safety Department monitors compliance with health and safety regulations in cooperation with heads of functions.
- Every month, the Company communicates the following to retail format management:
    - the results of internal audits and assessments of OHS compliance;
    - results of external audits by supervisory authorities, including claims;
    - results of investigations, as well as remedial and preventive initiatives;
    - measures the format has implemented based on previous audits;
    - information on new developments, including changes in laws and other OHS regulations;
    - quarterly and annual injury rate reports;
    - annual reports on working conditions and their compliance with laws and other OHS regulations.
- A member of each retail format's senior management (usually the HR director) is directly responsible for health and safety regardless of their other responsibilities.
- In 2017, the Company launched the Health and Safety Management System (HSMS), its most effective tool for upholding the Occupational Health and Safety Policy. The HSMS was developed in line with the international OHSAS 18002 Occupational health and safety management systems standard. The Company implemented the HSMS using the Plan-Do-Check-Act methodology.
- To provide health and safety training for its management and employees, the Company has developed Training Regulations and e-learning courses.
- The Company organises pre-employment and regular medical examinations to monitor and maintain the health of its employees. The Company provides uniforms and protective clothing to ensure safe working conditions.
- Internal audit data and results of accident investigations are used to develop initiatives set to improve workplace conditions. Analysis of occupational injury data also provides inputs for such initiatives.



OHS organisational chart

Corporate Centre
Head of Health and Safety

Pyaterochka,
Health and Safety Manager

Cluster
Health and Safety Engineer

Perekrestok,
Health and Safety Officer

Division
Health and Safety Engineer

Karusel,
Senior Health and Safety Engineer

Branch
Health and Safety Engineer

Agro-Avto
(transportation), Senior Health and Safety Engineer

Vehicle
fleet operator's Health and Safety Engineer

Express Retail,
Health and Safety Engineer

2017 performance highlights

- Health and safety training courses developed: in 2017, the Health and Safety E-Training for Blue-Collar Workers project provided training for 44,871 workers through the Company's online training portal.
- The Company successfully completed its Internal Health and Safety Audit project using the WRS-3 Electronic Checklist system. The project reduced the labour intensity of inspections and therefore enabled the Company to inspect more facilities, thus improving the overall health and safety environment.
- The Automated Medical Examination project intensified management involvement in medical examinations, accelerated processing and extraction of reliable data.
- In 2017, there was only a slight increase in the severity and frequency rates compared to previous years, attributable to new openings and hence increased headcount.
- At the same time, as the Company is in strict compliance with OHS standards, not a single case of occupational disease was registered in 2017.

The inspections carried out in 2017 revealed 550 organisational violations that did not result in employees suffering from injuries or occupational diseases.

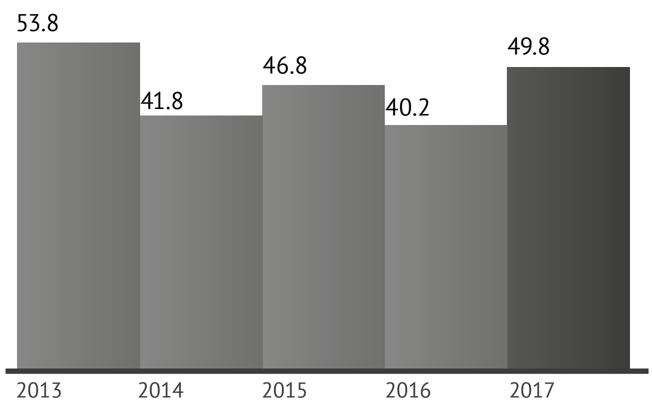
Government regulatory bodies identified 43 violations in the field of occupational health and safety and issued prescriptions to ensure the timely elimination of violations of the legislative and regulatory requirements of labour law.

Scheduled inspections in 2017:

RC	Number of inspections	Number of identified violations	Rectified within five days	Rectified within more than five days
Perekrestok	600	67	60	7
Karusel	94	45	40	5
TC5	2,122	385	346	39
Agro-Avto	78	53	51	2
Total	**2,894**	**550**	**497**	**53**

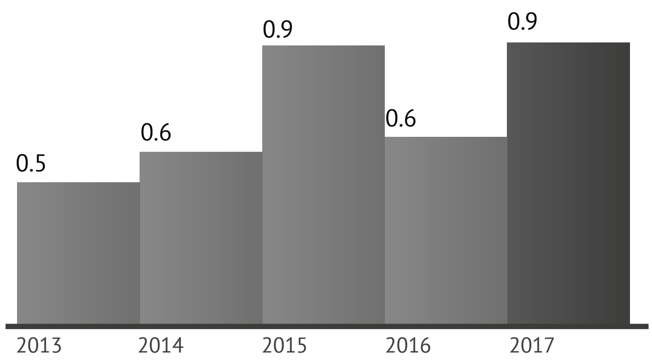
Severe accident ratio

Total number of employee work days lost per accident



Accident frequency rate

Number of accidents per 1,000 employees



Environmental review

Key objective

As our business grows and develops, so does our environmental impact. Taking a responsible approach to our impact on the environment is key for X5's successful and sustainable long-term development.

Policy highlights

- We strive to fully comply with Russian legislative requirements and the highest international environmental protection standards wherever possible. We believe that environmental care is not just a part of a large company's social responsibility, it also provides ample opportunities to improve business efficiency and reduce costs, and in some cases, even to generate additional income
- We regularly monitor our environmental performance at the senior management and Board level
- We endeavour to minimise any negative impact on the environment arising from our waste generation and emissions:
  - Each of our formats is responsible for implementation of its environmental policy and compliance with Russian Federation regulatory norms regarding waste disposal and emissions
  - At the Corporate Centre level, we set Group-wide strategic priorities that impact our environmental footprint
  - We implement programmes aimed at minimising emissions and waste from the Corporate Centre
  - We aim to reuse and recycle all materials
  - We endeavour to minimise the risks of violation of sanitary norms and rules during the collection, storage and disposal of waste
- We aim to minimise our energy consumption by installing efficient technologies at our stores, DCs and offices
- We preserve the environment and conserve resources
- We encourage dialogue and stakeholder participation in our approach to managing our impact on the environment

System highlights

- The Company's management team is responsible for implementing the policy: it sets goals and objectives, engages in planning and funding relevant initiatives.
- Each of our retail formats, as well as our logistics and transport operations, is independently responsible for adhering to Russian legislation and X5 Retail Group environmental policies.
- To ensure the participation of every manager and employee in our environmental actions, the Company has developed special training and courses.
- Our DCs and logistics facilities follow pest control and de-infestation procedures.
- Waste generated by our stores is transferred to third parties either for burial at landfill sites or for further recycling. We have established a list of recyclable waste to be disposed of by third parties, significantly reducing the quantities to be discarded and, as a result, the negative environmental impact from landfills.
- In 2017, Pyaterochka launched a project to reduce the cost of garbage collection for every site.
  The project's main goals are:
  - Development and implementation of waste generation standards, monitoring of waste removal in accordance with standards
  - Making changes to normative legal acts (Federal Law No. 89 and Federal Law No. 29) to simplify the process of dealing with food waste
  - Repurposing food waste for farming purposes
  - Repurposing waste through recycling or for generation of energy or other materials
  - The Company is expecting to save RUB 43 million in 2018 as a result of these initiatives.
- In 2017, we launched our Energy Consumption Accounting System project. The goal of the project is to buy electricity at favourable rates for Pyaterochka stores. For this, Pyaterochka is taking the following steps:
  - Equipping the entire network with an automatic data collection system to measure electricity consumption
  - Building a global processing system that will analyse the data flow and calculate optimal tariffs and then transfer the data to marketing companies
- Internal audits allow us to evaluate the efficiency of our actions and to set new environmental goals for the Company.

X5 is conscious of the environmental impact of its operations, and goals and targets are in place within the retail formats with respect to food and biological waste, cleaning and disinfection, and waste-water management. Distinct KPIs relating to CO_2 emissions, waste disposal, recycling or energy efficiency are currently being considered at the Group level and will be reflected in next year's Annual Report.

Format	Goals and targets
Pyaterochka	Management of accounts receivable for municipal services, management of retail format property
	Management of budget for removal of food and biological waste
Perekrestok	Management of budget for pest control, cleaning and disinfection agents
Karusel	Reducing fines for discharges of waste water from Karusel hypermarkets

Our key activities in 2017

	Recycling	Reuse	Energy efficiency
Pyaterochka	• In 2017, the Company started a new project called "Portal for recycling containers for suppliers". The portal allows our suppliers to pick up recycled waste depending on the capacity of our DCs. • In 2017, we completed the process of collecting and consolidating secondary raw materials from our stores. The purpose of this process change is to get a better price by selling bigger lots. In 2017, we sold 200,000 tonnes of wastepaper and exceeded the plan of sales of secondary raw materials by 7%.	• In 2017, a project was launched to calculate trolley needs at every store. The goal of the project was to reduce the purchase cost of trolleys.	• In 2017, the system for monitoring refrigeration equipment at every site was improved. Remote monitoring enabled control and maintenance of refrigeration equipment and reduced the consumption of energy by 0.3%. In 2018, the main development will be remote control of refrigeration temperatures. • We provided our stores with refrigerators that make it possible to maintain the correct temperature in the store and to save on energy consumption. This project will enable savings of RUB 600 million every year.
Perekrestok	• Perekrestok recycles different types of packaging: packing carton and polyethylene, plastic boxes, polystyrene, trolleys, wooden containers. • With the help of the new NQ accounting and recycling control system, the sales of raw materials increased by 61%. • We provided every store with refrigerators for the temporary collection of food and biological waste. This made it possible to follow the proper procedures for collection in accordance with veterinary rules.	• Perekrestok sends back to DCs all reusable containers, pallets and plastic boxes.	• Every Perekrestok store uses LED lighting.
Karusel	• New entities are equipped with bio-compactors for processing and pressing organic waste. • Karusel recycles different types of packaging: carton, plastic boxes, used vegetable oil, metal, pallet scraps.		• 7 Karusel sites are fully on LED lighting. • LED lights replaced neon signs at 16 sites.

Income from the sale of recyclable waste, RUB mln

Format	2017	2016	Change, %
Pyaterochka	1,386	913	52
Perekrestok	172	107	61
Karusel	139	126	10
Total	**1,697**	**1,146**	**48**

Each of our formats is responsible for its environmental performance, and implements a variety of programmes aimed at reducing waste and increasing efficiency.

Our environmental initiatives

Logistics

We manage environmental risks separately for our distribution centres and transport divisions. Our distribution centres transfer plastic shrink-wrap, cardboard and packing materials, as well as domestic solid waste, for recycling. The transportation division disposes of car tyres and tubes, batteries, ferrous and non-ferrous metals, car oil and other materials as required by Russian legislation.

Distribution centres

Pyaterochka is implementing eco-development principles for its logistics network. The main goals of these principles are to reduce the consumption of energy and materials, while also increasing the quality of buildings and reducing operating costs. As a result of this initiative, we expect to reduce the impact of DC construction on the environment.

Transport

Our most significant environmental impact comes from our transport unit, where we use various approaches to minimise the damage caused by transport from our distribution centres to stores. Our fleet covered 74% of our transport needs in 2017, and it is newer than the fleets of most of our external contractors. Contractors are responsible for compliance with environmental requirements, and our transport service agreements stipulate that trucks must meet all legislative requirements, including environmental requirements.

We use certified service stations to provide regular maintenance for our trucks in line with legislation and the norms established by truck manufacturers based on either the number of kilometres on the odometer or the vehicle's working life. Daily monitoring of the condition of our vehicles, including their exhaust systems, is part of our mechanics' and drivers' responsibilities. If serious failures are detected in a vehicle, it is withdrawn from use and sent for repair.

In addition, we do not purchase used or outdated vehicles, nor do we use vehicles that have reached the end of their service life in accordance with the manufacturer's recommendations. By the end of 2017, the average age of our fleet was two years, compared to an average age of three years at the end of 2016.

A full 100% of our transportation fleet meets Euro 3, Euro 4 or Euro 5 standards. Since 2014, we have been purchasing only Euro 4 or higher-class vehicles, and we have been using only high-quality fuel from leading producers.

Community investment review

Community strategy

- As one of Russia's leading food retailers, X5 recognises that its activities have a social impact, and the Company is proud to make a meaningful contribution to society. We believe that genuine engagement with local communities in the areas where we operate, as well as effective dialogue with public authorities of all levels and other stakeholders, represents the best way to maintain our social licence to operate on a sustainable basis.

Policy highlights

- X5 complies with relevant local and national regulations, frameworks, guidelines, globally applicable standards and best practices at all times.
- The Company's senior management team and Board of Directors monitor and regularly review X5's community investment activity and its performance against set targets.
- X5 implements its community investment activities in such a way as to facilitate the implementation of national development programmes, contribute to raising living standards and to provide support to vulnerable groups in society.
- X5's community investment activities are designed to be focussed and targeted in three key areas: food aid, support for children's causes and helping those with disabilities.
- We do not provide financial or other forms of support to non-charitable organisations or activities, nor do we provide financial assistance on an individual basis.
- X5 does not seek commercial or other benefits from its community investment activities, nor does it undertake such activities as a way of exerting influence over public authorities, political figures, or private companies.

System highlights

- Oversight of X5's community investment activities lies with the Company's Corporate Communications Department.
- Responsibility for day-to-day implementation of our community investment activities lies with different business units of X5, depending on the specific tasks and responsibilities required.
- The community investment activities of X5's individual retail formats are determined jointly between the formats themselves and the Corporate Centre, which provides support and advice on best practices and ensures that all activities are coordinated to create value for all stakeholders.
- KPIs are determined during the year in conjunction with experienced external consultants as part of the development of the Company's overall sustainable development programme.
- We regularly monitor our community relationships and conduct periodic audits and assessments to ensure that our aims are being achieved while meeting the needs of local communities.
- X5 is committed to regular dialogue with local communities and other stakeholders in our regions of presence, as well as with authorities at all levels to ensure our community investment activities dovetail with local, regional and national priorities.

Activity highlights

Food aid

X5 runs a number of programmes to provide food aid to those in need.

Since 2015, the Company has worked alongside the Rus Food foundation to promote the Basket of Kindness initiative, which encourages customers to buy food to be donated to those in need. In 2017, this initiative was rolled out across more than 800 stores and collected more than 77 tonnes of produce that was provided to more than 6,000 families in need.

In November 2017, the Company launched the Basket of Kindness website, корзинадоброты.рф, to allow customers to donate online and to get more people involved in volunteering activities, as well as providing news about food-banking. In the site's first two months, more than 30,000 users bought and donated produce online worth a total value of more than RUB 300,000.

In December 2017, X5 took part in a "food marathon" organised in conjunction with the Rus Food Foundation, the Billa and Dixy chains and supported by the Moscow city government. Some 194 Perekrestok stores took part, and the marathon collected more than 30 tonnes of food, which was distributed to over 20,000 elderly people across Russia for New Year's Eve.

Support for children's causes

X5 works closely with the Life Line Foundation on a number of initiatives to provide support for children in need across Russia. These initiatives include:

- In-store donation boxes to collect funds to help children with severe health issues. In 2017, more than RUB 14 million was donated through these boxes.
- Customers of Perekrestok, Pyaterochka and Karusel can buy a "Kindness Candy" at the check-out to donate RUB 5 to Life Line. This initiative collected RUB 7.8 million for children with severe health issues in 2017.
- Members of the Perekrestok Club loyalty programme can help seriously ill children by donating accumulated bonus points to charitable causes. In 2017, RUB 1.1 million was transferred to the Life Line Foundation in this way, helping to pay for operations for five children.
- Since 2016, Perekrestok supermarkets have donated RUB 1 from every sale of Bonte-brand wafer biscuits to the Life Line Foundation. In 2017, this raised more than RUB 800,000.
- Company employees regularly take part in charity fairs that X5 runs with its partners. In 2017, these fairs raised around RUB 300,000 for the Life Line Foundation.

X5 also works with the Connection foundation, which supports people with hearing and visual impairments. In April 2017, the Company launched a new initiative called "Buy a bag, help a child", which donates a portion of all sales of plastic bags sold at Pyaterochka, Perekrestok and Karusel towards medical treatment and support for children with hearing and visual impairments. In 2017, the initiative raised more than RUB 28 million.

Since January 2017, X5 has been supplying food products for the "Quiet House", Russia's first sheltered accommodation for people with hearing and visual impairments, from a Pyaterochka in the town of Troitsk.

Support for vulnerable social groups

X5 supports vulnerable social groups by offering basic food products at affordable prices. For a number of years, we have been offering discounts for elderly customers, and we plan to continue this practice in the future. Pensioners get a 10% discount at Pyaterochka stores on Mondays, and 5% on all other days – the scheme was extended to weekends in 2017. Perekrestok supermarkets offer a 10% discount from 9 a.m. to 1 p.m. on weekdays, while Karusel hypermarkets offer a 5% discount from opening until 1 p.m.

In 2017, more than 208,000 people made use of the electronic social cards programme launched by the Moscow city government to make purchases at Pyaterochka, Perekrestok and Karusel stores, up from 130,000 in 2016.

Volunteering

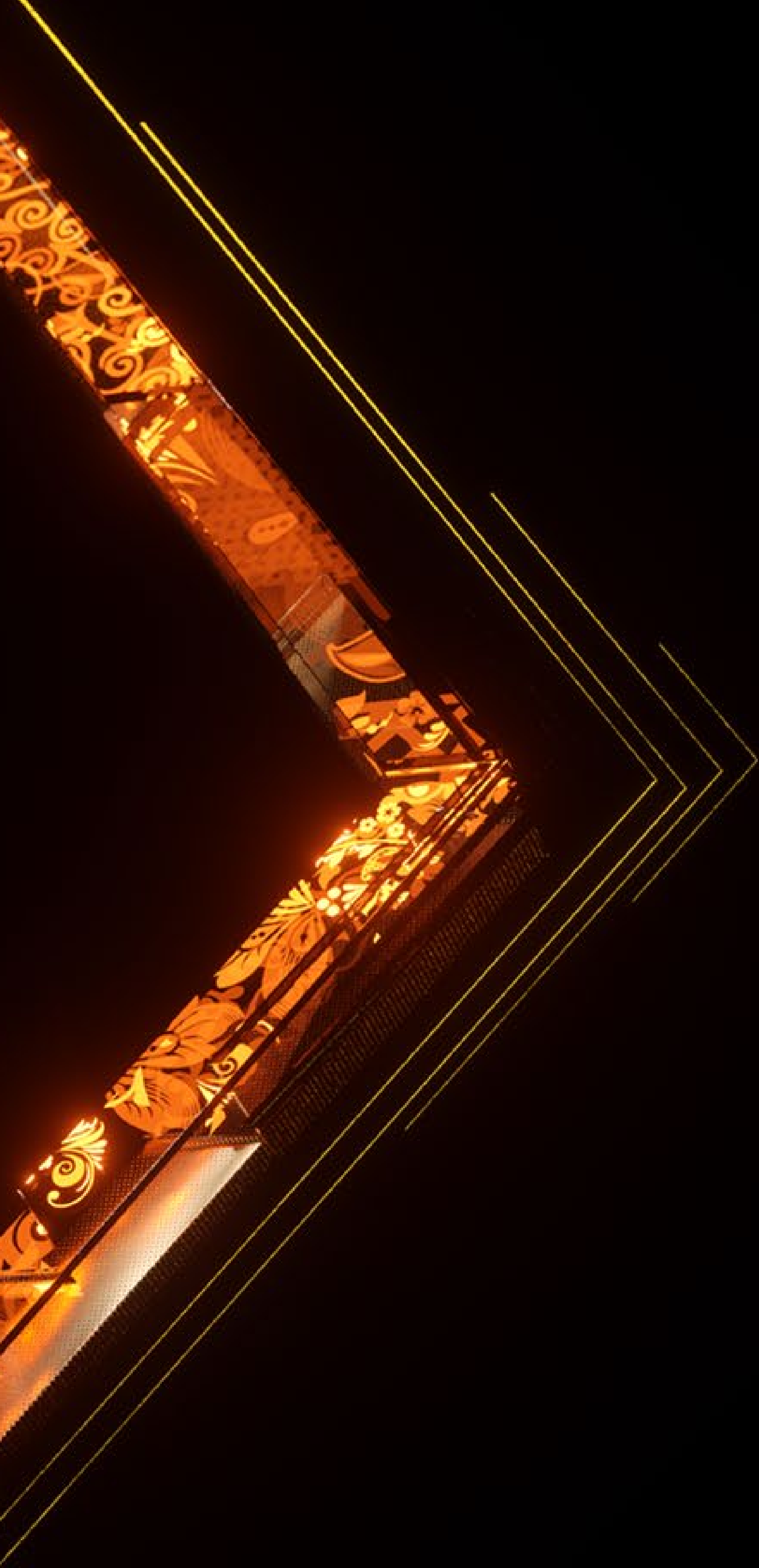
X5 encourages its employees to get involved in its community-focussed initiatives.

In 2017, almost 250 of the Company's employees took part in the Run for Life charity marathon organised by the Life Line Foundation, raising RUB 2.5 million for charitable causes. Last year also saw X5 employees participate in a new Life Line Foundation initiative, a charitable Nordic walk. Almost 100 employees took part, raising more than RUB 600,000.

In November 2017, the Company launched an online platform to encourage volunteering. The platform allows employees to share ideas and their experiences of volunteering, find out about their colleagues' voluntary activities, organise volunteering activities and provide updates on social hot topics. Almost a thousand unique users have used the platform since it launched.

›02

Corporate governance report



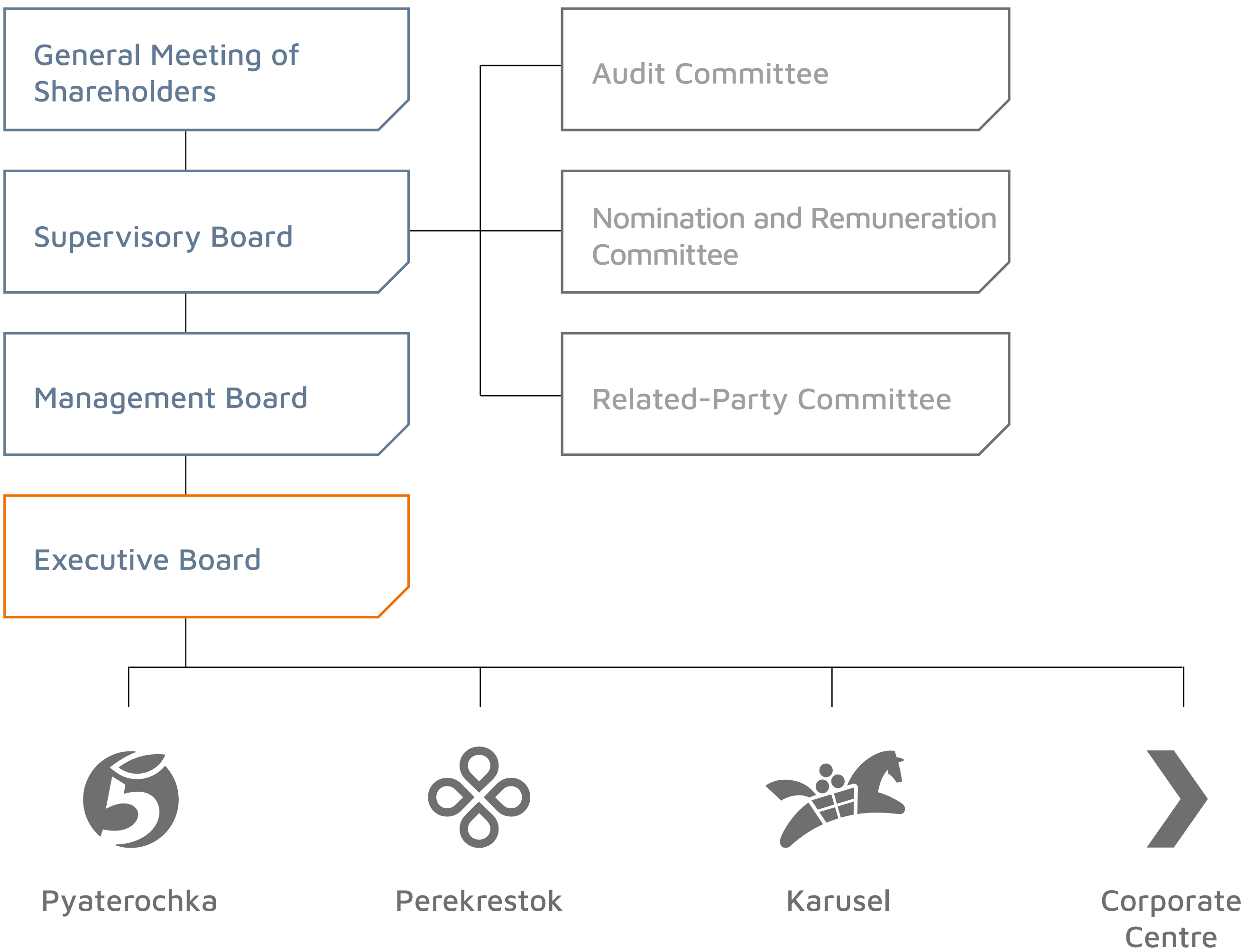
X5 Retail Group N.V. is public limited-liability company incorporated under the laws of the Netherlands, with global depositary receipts listed on the London Stock Exchange. The Company is required to comply with, among other regulations, the Dutch Corporate Governance Code as recently amended on 8 December 2016 (the “Code”).

The full text of the Code can be viewed on X5’s website at www.x5.ru.

In accordance with the Code, a broad outline of the Company’s corporate governance structure is presented in this section, including any deviations from the Code’s principles and best practices. X5 aspires to high standards of corporate governance and is committed to a corporate governance structure that best supports its business, meets the needs of its stakeholders, and that is in compliance with applicable rules and regulations.

Governance structure

The Company has a two-tier board structure, comprising a Management Board and a Supervisory Board. The Supervisory Board advises and supervises the Management Board and the general course of affairs at X5 and its affiliated businesses and ensures that external experience and knowledge are embedded in the Company's operations. The Management Board and the Supervisory Board are independent of one another and accountable to the General Meeting of Shareholders.



Management Board

The Management Board has ultimate responsibility for the overall management of the Company and oversees all corporate governance activity. It is accountable for the Company's pursuit and achievement of corporate goals and objectives, its strategies and policies. The Management Board is responsible for complying with all relevant legislation and regulations, for managing the risks associated with the Company's activities and for financing and external communication.

In managing X5's general affairs and its day-to-day operations, the Management Board is supported by the Executive Board, which was established to provide for a leadership team at the level of the Company's operating subsidiaries in Russia in order to best support X5's strategy and businesses at the local operating level. The Management Board is ultimately responsible for the actions and decisions of the Executive Board.

The current members of the Management Board and the Executive Board, including their biographies, are presented on pages 50-55 and 180-181

Composition and reappointment schedule of the Management Board

Name	Year of birth	Year of first appointment	End of current term of appointment
Igor Shekhterman	1970	2015	2019
Frank Lhoëst	1962	2007	2019

Supervisory Board

The Supervisory Board is responsible for supervising and advising the Management Board and overseeing the general course of affairs, strategy and operational performance of X5 and its businesses. In performing its duties, the Supervisory Board takes into account the relevant interests of the Company and all its stakeholders, and, to that end, considers all appropriate interests associated with the Company and its affiliated businesses, including corporate responsibility issues that are relevant to the Company. Major business decisions require the approval of the Supervisory Board. The Supervisory Board is responsible for monitoring and assessing its own performance.

The General Meeting of Shareholders determines the number of members of the Supervisory Board, which currently consists of eight members.

The current members, including their biographies, are presented on pages 180-181

The Supervisory Board has prepared a profile of its size and composition, taking account of the nature of the Company's business and its activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board evaluates its profile and composition annually.

Supervisory Board members are appointed for a period of up to four years and may be re-elected, whereby the total term of office may not exceed 12 years. The Supervisory Board has prepared a retirement and reappointment schedule to, as far as possible, prevent simultaneous reappointments. The Supervisory Board's profile and rotation plan can be viewed on the Company's website.

Composition and reappointment schedule of the Supervisory Board

Name	Year of birth	Year of first appointment	Year of possible reappointment
Stephan DuCharme (Chairman)[1]	1964	2015	2019
Mikhail Fridman	1964	2006	2021
Christian Couvreux[2]	1950	2010	2018
Pawel Musial	1968	2013	2021
Geoff King	1965	2015	2019
Peter Demchenkov	1973	2015	2019
Michael Kuchment	1973	2015	2019
Andrei Elinson	1979	2016	2020

[1]Stephan DuCharme previously served on the Supervisory Board from 2008 until 2012.
[2]Christian Couvreux reached the end of his second term in office and will not be eligible for reappointment at the 2018 Annual General Meeting of Shareholders.

Committees of the Supervisory Board

As of 1 January 2018, the Supervisory Board dissolved the Strategy Committee, as its meetings were effectively meetings of the full Supervisory Board, with all members attending. In the future, such meetings will be convened as dedicated strategy meetings of the Supervisory Board. As a result, the Supervisory Board currently has three permanent committees: the Audit Committee, the Nomination and Remuneration Committee and the Related-Party Committee. The members of each committee are appointed by the Supervisory Board and from among its members. Each committee has a charter describing its role and responsibilities and the manner in which it discharges its duties and reports to the full Supervisory Board. These charters are included in the Rules of Procedure of the Supervisory Board, which can be viewed on X5's website.

Audit Committee

The Audit Committee assists the Supervisory Board in overseeing the integrity of X5's financial statements, system of internal business controls and risk management, financing and finance-related strategies, tax planning, the Company's compliance with legal and regulatory requirements, as well as the qualifications, performance and independence of the external auditor and the performance of the internal audit function.

Nomination and Remuneration Committee

The Nomination and Remuneration Committee recommends the remuneration policy for the Management Board to be adopted by the General Meeting of Shareholders, prepares proposals to the Supervisory Board for remuneration of the individual members of the Management Board in line with the remuneration policy and advises the Management Board on the level and structure of compensation for other senior personnel. The Nomination and Remuneration Committee also advises in respect of the selection and appointment of members of the Supervisory Board, the Management Board and the Executive Board.

Related-Party Committee

The Related-Party Committee advises the Supervisory Board on handling and deciding on reported (potential) conflicts of interest and any other related-party transactions that are contemplated between X5, on the one hand, and conflicted persons or entities, including but not limited to its shareholders, members of the Supervisory Board and members of the Management Board, on the other hand.

Diversity

The Supervisory Board operates a policy that aims for a diverse composition of both the Management Board and the Supervisory Board in particular areas of relevance for X5. This includes diversity of experience, nationality and background. Appointments to the Management Board and Supervisory Board are evaluated against the relevant profile, the existing balance of skills, knowledge and experience on the respective board and the need for the relevant board to be prepared for disruption and change. Management Board and Supervisory Board members are prompted to be mindful of diversity, inclusiveness and meritocracy considerations when examining and proposing nominations to the Management Board and Supervisory Board. In the selection and appointment of new Management Board or Supervisory Board members, the Supervisory Board will consider a diverse range of candidates. This will also include diversity of gender and age so that when the final appointment is made the Supervisory Board can be confident that the most effective candidate has been selected.

Composition of the Supervisory Board Committees

Name	Audit Committee	Nomination and Remuneration Committee	Related-Party Committee
Stephan DuCharme		Member	
Mikhail Fridman			
Christian Couvreux	Member	Member	
Pawel Musial	Member		
Geoff King	Chairman		Chairman
Peter Demchenkov		Chairman	
Michael Kuchment			Member
Andrei Elinson	Member	Member	

Each year, the Supervisory Board conducts an evaluation of its functioning and the functioning of the Management Board. In this context, the Supervisory Board gives careful consideration to the diversity of its own composition, as well as that of the Management Board, so as to be effective in performing its role.

While the Management and Supervisory Boards are currently not balanced with regard to gender, X5 recognises the benefits of gender diversity, and importance is attached to achieving this. Our aim is to create a balance, to the extent possible, in which the diversity referred to above is expressed and where the objective is to comply with the statutory requirements. X5 recognises the importance of diversity, including gender, at all levels of the group and has a very strong track record of developing a critical executive layer of female business leaders. Across all of the Group's operations, specific diversity targets are taken into account in recruitment, talent development, appointments, retention of employees, mentoring and coaching programmes, succession planning, training and development.

Appointment, suspension and dismissal

The General Meeting of Shareholders appoints the members of the Management and Supervisory Board from a binding nomination, to be drawn up by the Supervisory Board. The recommended candidate is appointed by the General Meeting of Shareholders unless the nomination is deprived of its binding character by a qualified majority vote of at least two-thirds of the votes cast, representing more than one-half of the issued share capital of the Company.

Members of the Supervisory Board serve for a maximum term of four years from the date of their appointment or a shorter period if determined upon their appointment by the General Meeting of Shareholders or as per the Supervisory Board's rotation schedule. A Supervisory Board member can be reappointed after their first term of four years, for one additional term of four years, followed by two additional terms of two years. A Supervisory Board member may not serve more than 12 years. A Supervisory Board member who directly or indirectly holds at least 10% of the shares in the issued share capital of the Company may hold office for more than 12 years and is eligible for reappointment after that term (see "Compliance with Dutch Corporate Governance Code" in this report).

Members of the Management Board are also elected for a period of four years. The Articles of Association do not limit the total term of office for Management Board members.

Each member of the Supervisory Board and Management Board may, at any time, be dismissed or suspended by the General Meeting of Shareholders. A member of the Management Board may, at any time, be suspended by the Supervisory Board. Such suspension may be discontinued by the General Meeting of Shareholders at any time.

Remuneration

In line with the remuneration policy adopted by the General Meeting of Shareholders, the remuneration of the individual members of the Management Board will be decided by the Supervisory Board upon the recommendation of its Nomination and Remuneration Committee. The remuneration of the members of the Supervisory Board is determined by the General Meeting of Shareholders. The remuneration policy for members of the Management Board and Executive Board can be found in the remuneration report on pages 188-191. The remuneration principles for the Supervisory Board are described in the Supervisory Board Report on pages 182-187.

Reporting on conflicts of interest

A member of the Management Board or Supervisory Board is required to immediately report and provide all relevant information to the Chairman of the Supervisory Board (and to the other members of the Management Board if it concerns a member of that board) on any conflict of interest, or potential conflict of interest, that they may have with the Company and that may be of material significance to them or the Company.

If a member of the Supervisory Board or a member of the Management Board has a conflict of interest with the Company, that member may not participate in the discussions or decision-making process on subjects or transactions relating to the conflict of interest. A decision taken by X5 to enter into a transaction involving a conflict of interest with a member of the Management Board or a member of the Supervisory Board that is of material significance to them or the Company requires the approval of the Supervisory Board. The Related-Party Committee advises the Supervisory Board on handling and deciding on (potential) conflicts of interest and prepares resolutions of the Supervisory Board in relation thereto. An account of related-party transactions in 2017 is included in the Supervisory Board Report on pages 182-187.

Shareholders and their rights

General Meeting of Shareholders

X5 Retail Group N.V. is required to hold a General Meeting of Shareholders within six months after the end of the financial year, among other things, to adopt the financial statements, to decide on any proposal concerning profit allocation and to discharge the members of the Management Board and Supervisory Board from their responsibility for the performance of their respective duties for the previous financial year.

Extraordinary meetings are held as often as the Management Board or the Supervisory Board deems necessary. In addition, shareholders and holders of global depositary receipts (GDRs) jointly representing 10% of the outstanding share capital may ask the Management Board and the Supervisory Board to hold a General Meeting of Shareholders, stating their proposed agenda in detail.

The powers of the General Meeting of Shareholders are specified in the Articles of Association. Apart from the decisions taken at the Annual General Meeting of Shareholders, the main powers of the General Meeting of Shareholders are to appoint (subject to the Supervisory Board's right to make binding nominations), suspend and dismiss members of the Management Board and Supervisory Board, to appoint the external auditor, to adopt amendments to the Articles of Association, to issue shares and grant subscriptions for shares, to authorise the Management Board or the Supervisory Board to issue shares and grant subscriptions for shares, to authorise the Management Board or the Supervisory Board to restrict or exclude pre-emptive rights of shareholders upon the issuance of shares, to authorise the Management Board to repurchase outstanding shares in the Company, to adopt the remuneration policy of the Management Board, to determine the remuneration of members of the Supervisory Board, and to merge, demerge or dissolve the Company.

The notice for a General Meeting of Shareholders needs to be published no later than 42 days prior to the day of the meeting. The mandatory record date, establishing which shareholders are entitled to attend and vote at the General Meeting of Shareholders, is set at least 28 days prior to the date of the meeting.

One or more shareholders or holders of GDRs representing at least 3% of X5's issued share capital are entitled to request that a matter be included on the agenda of the General Meeting of Shareholders. Such requests, if sufficiently substantiated and received by the Company at least 60 days before the date of the meeting, can only be refused on the grounds of exceptional circumstances, to be checked against the principles of reasonableness and fairness.

All shareholders and other persons who, pursuant to Dutch law or the Articles of Association, are entitled to attend and/or vote at a General Meeting of Shareholders are entitled to address the General Meeting of Shareholders. X5 uses the Bank of New York Mellon, the depositary for X5's GDR facility (the "Depositary"), to enable GDR holders to exercise their voting rights represented by the shares underlying the GDRs. As described in the "Terms and Conditions of the Global Depositary Receipts", holders of GDRs may instruct the Depositary with regard to the exercise of the voting rights connected to the shares underlying their GDRs. Alternatively, upon request of the holders of such depositary receipts, the Depositary will grant a proxy to such holders who wish to vote in person at a General Meeting of Shareholders. Persons who hold a written proxy may represent shareholders at a General Meeting of Shareholders. The written proxy must be duly executed and legalised in accordance with the applicable laws and may be submitted electronically.

Voting rights

Each share confers the right to cast one vote at the General Meeting of Shareholders. There are no restrictions, either under Dutch law or in the Articles of Association, on the right of non-residents of the Netherlands or foreign owners to hold shares or to vote, other than those also imposed on residents of the Netherlands. Resolutions of the General Meeting of Shareholders are passed by a simple majority of the votes cast in a meeting where more than 25% of the issued share capital is present or represented. If 25% or less of the issued share capital is present or represented, a second meeting should be convened no later than four weeks following the first meeting. At the second meeting, no quorum requirement will apply. However, the General Meeting of Shareholders can only resolve on (i) a merger or demerger, (ii) the authorisation to limit or exclude pre-emptive rights and (iii) cancellation of shares with a majority of at least two-thirds of the votes cast if less than 50% of the issued capital is represented in that meeting.

Dividend rights

Any distribution of profits to shareholders will be made after the adoption by the General Meeting of Shareholders of the annual accounts of the Company from which it appears that such distribution is permitted. The Company may only declare profit distributions insofar as its net assets exceed the sum of its issued share capital plus any legal reserves required to be maintained pursuant to Dutch law. A loss may only be applied against such reserves to the extent permitted by Dutch law. On a proposal of the Supervisory Board, the General Meeting of Shareholders will determine which part of the profits will be added to the reserves and the allocation of the remaining profits.

On a proposal of the Supervisory Board, the General Meeting of Shareholders may resolve to pay an interim dividend insofar as X5's net assets exceed the sum of its issued share capital and the reserves that are required to be maintained pursuant to Dutch law, as evidenced by an interim financial statement prepared and signed by all the members of the Management Board. In addition, on a proposal of the Supervisory Board, the General Meeting of Shareholders may resolve to make distributions to the shareholders out of any reserves that need not be maintained pursuant to Dutch law.

Dividends and other distributions that have not been claimed within five years after the date on which they became due and payable revert to the Company.

Significant ownership of voting shares

According to the Dutch Financial Markets Supervision Act *(Wet op het financieel toezicht)*, any person or legal entity who, directly or indirectly, acquires or disposes of an interest in X5's capital and/or voting rights must immediately give written notice to the Netherlands Authority for Financial Markets (AFM) if the acquisition or disposal causes the percentage of outstanding capital interest and/or voting rights held by that person or legal entity to reach, exceed or fall below any of the following thresholds: 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%.

The following table lists the shareholders on record on 28 February 2018 in the AFM's public register that hold an interest of 3% or more in the share capital of the Company:

Shareholder	Date of disclosure	Capital interest[1]	Voting rights[1]
CTF Holdings Ltd.	2 August 2007	48.41%	48.41%
Axon Trust	22 December 2009	11.43%	11.43%

[1]In accordance with the filing requirements, the percentages shown include both direct and indirect capital interests and voting rights. The percentages may differ from the actual shareholders' interests due to the fact that changes within the thresholds mentioned above do not require a notification to the AFM. Further details can be obtained at www.afm.nl.

Securities owned by board members

The members of the Management Board and Supervisory Board and X5's other senior management are subject to the Company's Inside Information and Dealing Code. This Code contains rules of conduct to prevent trading in X5's GDRs of shares or other financial instruments when holding inside information or during blackout periods when trading is not permitted (for instance, prior to the publication of quarterly financial results). The Inside Information and Dealing Code can be viewed on the Company's website.

Under the Inside Information and Dealing Code, members of the Management Board and Supervisory Board must notify the AFM of X5 securities and voting rights at their disposal. These positions can be viewed in the AFM's public register.

Repurchase by the Company of its own shares

The Company may acquire fully paid shares, or GDRs thereof, in its capital for a consideration only following authorisation by the General Meeting of Shareholders and subject to certain provisions of Dutch law and the Company's Articles of Association, if:

- Shareholders' equity minus the purchase price is not less than the sum of X5's issued and fully paid-in capital plus any reserves required to be maintained by Dutch law; and
- X5 and its subsidiaries would not, as a result, hold shares or GDRs thereof with an aggregate nominal value exceeding half of the issued share capital.

In 2017, the Management Board was authorised to acquire up to 10% of the shares or GDRs thereof. This authorisation is valid through 12 November 2018. In addition, the Supervisory Board resolved that in case a purchase of shares or depositary receipts thereof by X5 would lead to X5 holding more than 5% of the shares or GDRs thereof, the Management Board would require the Supervisory Board's prior approval for such purchase.

Authorisation by the General Meeting of Shareholders is not required if X5's own shares are acquired for the purpose of transferring those shares to X5 employees pursuant to any arrangements applicable to such employees.

Shares or GDRs thereof held by X5 or a subsidiary may not be voted on and are not taken into account for determining whether quorum requirements, if any, are satisfied.

Issue of new shares and pre-emptive rights

Shares in X5 may be issued, and rights to subscribe for shares may be granted, pursuant to a resolution of the General Meeting of Shareholders or another X5 corporate body to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. In 2017, the General Meeting of Shareholders approved a delegation of this authority to the Supervisory Board, relating to the issuance and/or granting of rights to acquire up to 6,789,322 shares (10% of the issued share capital) through 12 November 2018.

Upon the issue of new shares, holders of X5's shares have a pre-emptive right to subscribe for shares in proportion to the aggregate amount of their existing holdings of X5's shares. According to the Company's Articles of Association, this pre-emptive right does not apply to any issue of shares to employees of X5 or a Group company. Pre-emptive rights may be restricted or excluded pursuant to a resolution of the General Meeting of Shareholders or another corporate body of X5 to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. The General Meeting of Shareholders has delegated the authority to restrict or exclude the pre-emptive rights of shareholders upon the issue of shares and/or the granting of rights to subscribe for shares to the Supervisory Board through 12 November 2018.

Articles of Association

X5's Articles of Association contain rules on the Company's organisation and corporate governance.

Amending the Company's Articles of Association requires a resolution of the General Meeting of Shareholders. A proposal to amend the Articles of Association, including the text of the proposed amendment, must be made available to the holders of shares and GDRs for inspection at the offices of X5 as of the date of the notice convening the meeting of the General Meeting of Shareholders until the end of the meeting of the General Meeting of Shareholders at which the proposed amendment is voted on.

The current text of the Articles of Association is available on the Company's website.

Anti-takeover measures and change-of-control provisions

According to provision 4.2.6 of the Code, the Company is required to provide a survey of its actual or potential anti-takeover measures and to indicate in what circumstances it is expected that they may be issued.

No special rights of control, as referred to in Article 10 of the EU Directive on takeover bids, are attached to any share or GDR in X5.

There are no important agreements to which the Company is a party and that will automatically come into force, be amended or be terminated under the condition of a change of control over the Company as a result of a public offer. However, the contractual conditions of most of X5's important financing agreements and notes issued (potentially) entitle the banks and noteholders, respectively, to claim early repayment of the amounts borrowed by the Company in the situation of a change of control over the Company (as specified in the respective agreement).

Auditor

The General Meeting of Shareholders appoints the external auditor. The Audit Committee makes a recommendation to the Supervisory Board with respect to the external auditor to be proposed for appointment or reappointment by the General Meeting of Shareholders. In addition, the Audit Committee evaluates and, where appropriate, recommends the replacement of the external auditor. The Audit Committee also pre-approves the fees for audit and permitted non-audit services to be performed by the external auditor. The Audit Committee will not approve the engagement of an external auditor to render non-audit services prohibited by applicable laws and regulations or that would compromise the independence of the auditor. Specific rules relating to non-audit work performed by the external auditor are included in X5's "Rules on External Auditor Independence and Selection". This document is available on the Company's website.

On 12 May 2017, the General Meeting of Shareholders appointed Ernst & Young Accountants LLP as external auditor for the financial year 2017.

Compliance with the Dutch Corporate Governance Code

In February 2016, the Dutch Corporate Governance Code Monitoring Committee started a consultation process that led to a revision of the Code. The amended Code was published on 8 December 2016 and entered into force on 1 January 2017. The full text of the Code can be viewed on the Company's website.

We have performed a full review of the implications for our corporate governance structure and, where relevant, have amended our internal rules, procedures and policies. In view of the revised Code, the key aspects of X5's corporate governance structure and compliance with the Code will be discussed at the 2018 Annual General Meeting.

X5 applies the relevant principles and best practices contained in the Code in the manner as described in this Corporate Governance Report. X5 generally adheres to the Code, but does not comply with the following recommendations:

2.1.7/2.1.8:
Independence of the Supervisory Board and its members

Both Mikhail Fridman and Andrei Elinson are related to companies that are owned or controlled by companies that ultimately hold 10% or more of the shares in the Company. Stephan DuCharme was a member of the Management Board immediately prior to his appointment to the Supervisory Board in November 2015. These members of the Supervisory Board are, therefore, not considered to be independent within the meaning of the Code.

In accordance with best practice provision 2.1.7, at most one Supervisory Board member may represent a shareholder who directly or indirectly holds more than 10% of the shares in the Company. Furthermore, X5 believes that the non-independent members of the Supervisory Board have in-depth knowledge of the geographic market, of business in general and of retail specifically, as well as a relevant track record in the markets in which X5 operates. This is of particular advantage to X5 and its shareholders. Meanwhile, with five independent members, the Supervisory Board has a majority of independent board members and remains committed to improving the ratio between independent and non-independent board members.

2.1.9:
Independence of the Chairman of the Supervisory Board

In 2015, Stephan DuCharme stepped down as CEO and was appointed as Chairman of the Supervisory Board. Having carefully considered the interests of the Company and its shareholders, the Supervisory Board took the view that these interests are best served by retaining Stephan's experience and leadership for X5 in a renewed capacity as Chairman of the Supervisory Board. This offers shareholders the greatest continuity and ensures that the Chairman entrusted with X5's progress has a proven track record, as well as the confidence of critical stakeholder groups and investors.

2.2.2:
Appointment and reappointment periods of Supervisory Board members

Mikhail Fridman was appointed as a member of the Supervisory Board in 2006. In 2017, he was reappointed for a fourth term, thus exceeding the maximum of 12 years prescribed by the Code.

Mikhail is the founder and chairman of the Alfa Group Consortium, currently the majority shareholder in X5 with a holding interest of 47.86%. X5 believes that long-term value creation stands to benefit from committed shareholders, and that the interests of Supervisory Board members holding more than 10% of the shares largely coincide with those of the Company. These Supervisory Board members are generally involved in the Company for a prolonged period of time, which fits in well with long-term value creation for the Company.

2.3.2:
Supervisory Board Committees

"If the Supervisory Board consists of more than four members, it should designate […] a Remuneration Committee and a Selection and Appointment Committee." As it is felt that issues related to selection, appointment and remuneration are interlinked, the Supervisory Board decided that all these activities should be dealt with by one Committee: the Nomination and Remuneration Committee.

3.3.2:
Award of shares and/or rights to shares to members of the Supervisory Board

As determined by the General Meeting of Shareholders, members of the Supervisory Board may participate in the Company's restricted stock unit plan. X5 acknowledges that the awarding of shares to members of the Supervisory Board constitutes a deviation from the Code. However, in order to attract and reward experienced individuals with a track record that is of specific relevance to the Company, X5 believes it is necessary to allow members of the Supervisory Board to participate in the Company's equity-based remuneration plan. This structure aligns the interests of Supervisory Board members with those of shareholders and strengthens their commitment and confidence in the future of the Company. Equity-based awards given to members of the Supervisory Board are not subject to performance criteria, and are determined by the General Meeting of Shareholders.

How we manage risk

The Management Board of X5, supported by the Executive Board and the Risk Management Team, is responsible for designing, implementing and operating an adequately functioning risk management system for the Company. The aim of this system is to ensure that the extent to which the Company's strategic and operational objectives are being achieved is understood, that the Company's reporting is reliable and that the Company complies with relevant laws and regulation.

Risk management and internal control

Risk management

During 2017, the Management Board of X5, supported by the Executive Board, continued to pay special attention to strengthening the design and effectiveness of the risk management and internal control system, ensuring that:

- a comprehensive review of both internal and external risks is carried out at least annually;
- risk appetite is defined;
- risk impact is quantified;
- risks of both strategic and short-term objectives of X5 are assessed;
- desired risk responses and risk mitigating activities are put in place;
- the Company's reporting is accurate and reliable; and
- the Company complies with relevant laws and regulations.

X5's new risk management policy was developed and approved in 2016, providing an integrated approach to risk classification and assessment, risk mitigation and allocation of risk management responsibilities. The policy will be updated in 2018, providing more specific details on principles of managing risks, arranging responsibilities in accordance with changes in the organisational structure, and defining relations with and between other internal regulatory documents or management systems. The procedure for interaction on key risk management areas will be revised and formalised in a separate internal regulatory policy. The updated risk management and internal control systems will contribute to interacting in more open, usable and efficient ways.

Under the authority delegated by the Management Board, management teams at all levels of the organisation are responsible for identifying, managing and monitoring relevant risks. The central Risk Management Team facilitates a company-wide view of risk-relevant issues, helps to develop risk management activities in both business and functional divisions and ensures that the Management Board is continuously and promptly informed of important risk management developments.

During the annual strategy review and budgeting process, Company management reassessed strategic Company risks and developed action plans to mitigate risks and allocate appropriate resources for risk mitigation. Results of performing risk mitigation actions are regularly monitored and reported to the Audit Committee quarterly. X5 is committed to mitigating its risks and extends risk management initiatives into the following year if required.

Risk-appetite boundaries are set through X5's strategy, Code of Business Conduct and Ethics, authority matrixes, budgets and other policies. X5's risk appetite differs by risk areas:

Limited potential losses (prefer to avoid risk)

The maximum **potential** impact from these risks should be lower or equal to the minimal return. The necessary mitigation actions and controls should prevent losses.

Highest priority (willingness to take risk)

The risk impact is inferior to the targets to be reached.

X5's risk appetite

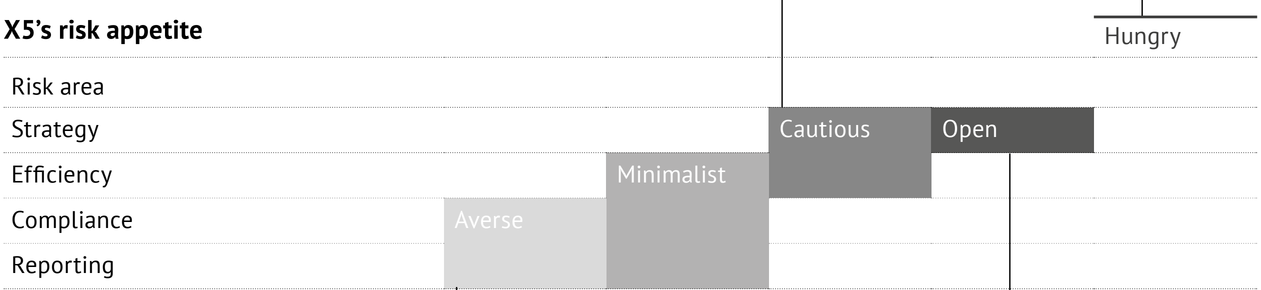


Table 2 shows the X5 risk-appetite scale used for risk-appetite calibration.

Avoidance (unacceptable risks)

Risks are unacceptable in any case despite mitigating factors and considerable potential reward.

Extremely conservative (taking risk with extreme reluctance)

Potential losses from these risks should be calculated and planned in advance, provisions should be created or insurance contracts should be in place, and necessary controls should be in effect.

Willingness to consider potential losses (taking risk only under right conditions)

The risk impact may exceed the potential level of return; compensating factors may partly mitigate this impact.

Internal control

To ensure the effectiveness and completeness of the Company's internal control system, X5 employs a three-tier model to establish and maintain control:

- The first tier of control requires each business unit to establish and operate the necessary controls for each of their specific business processes.
- The second tier of control is owned by various central functions that design and develop X5's internal control systems, while also ensuring compliance with controls through monitoring and testing; the risk management, internal control and compliance teams are the central part of the second tier of control.
- The third tier of control is the Internal Audit function, which reports directly to X5's Management Board, with direct access to the Audit Committee. The Internal Audit function's role is to regularly assess, and recommend improvements to the first and second control tiers of the Company.

In 2017, the Internal Control Policy, which outlines the framework and key requirements for internal control over X5's business processes, was approved. On an ongoing basis, the Internal Audit and Risk Management teams arrange and hold training for key employees across all businesses and functions on issues related to risk management and internal controls. The Company plans to enhance and further develop such activities.

Ethics and compliance culture

Values and business principles are crucial elements of the internal environment for risk management. X5 is committed to values and business principles that contribute to a culture of integrity and long-term value creation, and has established and internally communicated rules and policies that outline these values and principles, including X5's Code of Business Conduct and Ethics; X5's Policy on Countering Misconduct, Including Fraud and Corruption, and X5's Declaration on Human Rights Protection (the 'Policies'). These Policies are available on X5's public website at www.x5.ru.

The principles of the Policies apply to all X5 employees. New employees are trained in the Code of Business Conduct and Ethics and acknowledge compliance with the Policies. In 2017, the Company continued to develop e-learning courses on the Policies, compulsory for all employees, specifically addressing integrity and transparency in dealings and relations with external parties.

The Policies also aim to help employees understand when and where to ask for advice or report a breach of the Policies, if necessary through the ethics hotline. All cases reported through the ethics hotline are thoroughly reviewed and investigated. X5 periodically reviews and updates the internal policies in line with new or amended legislation. Accordingly, in 2017, X5's Policy on countering misconduct (including fraud and corruption) was thoroughly reviewed and brought in line with international rules, regulations and best practices.

The Company adheres to a principle of zero tolerance for corrupt and fraudulent activities, which is documented in X5's Policy on Countering Misconduct, Including Fraud and Corruption, which was approved in 2017.

Employees are regularly made aware of new policies through newsletters published on the corporate intranet, and through additional communications highlighting key provisions of these documents in corporate videos and the standard Business Ethics section of the corporate news digest.

The central Compliance team is strongly embedded in the Company's businesses, monitors ongoing business processes and takes part in key projects to align business activities with applicable laws.

The Compliance team plays an important role in enhancing awareness of and compliance with the Policies.

The Compliance team also monitors X5 employees' conflicts of interest. Significant potential conflicts of interest are reviewed by the Ethics Committee and reported to the Audit Committee.

Monitoring and assurance

Internal Audit provides independent and objective assurance of the impact of the above-mentioned control processes. Systematic and disciplined evaluations of risk management, internal control and governance activities are performed with the help of X5's Control Heat Map, which lists all the key business processes with an overall evaluation of the effectiveness of internal control in each business process. Following a risk-based audit planning approach, Internal Audit performs evaluations of operational, financial and information systems and tests of controls on key business processes that reveal internal control issues. Internal Audit provides recommendations to improve controls to the responsible executives. Action plans that address control issues raised by Internal Audit are prepared by business process owners and approved by the General Directors of retail formats or the Directors of corporate functions. The timely implementation of management action plans is monitored and followed up on a monthly basis, and the status of addressing these control issues is regularly reported and discussed with the CEO and the Audit Committee.

The Company's principal risks

Risk profile

Strategy

Group risk	Risk appetite	Influenced indicator	Mitigation
Market and customer value proposition (CVP) If the client value proposition of X5's retail formats fails to meet customer needs and preferences, this can lead to a slowdown in expansion, slower revenue growth and lower profit. The risk can be caused by: • Failure to promptly respond to changes in customer preferences, behaviour patterns and lifestyle • Failure to promptly respond to new business models, services and technologies used in the retail and related markets • Failure to take local consumption and regional economic potential into account in the CVP • Investment in inefficient or unproven retail formats and lines of business	Minimalist to Cautious	Net Sales, Gross Profit	• Constantly monitor retail and related markets in Russia and internationally • Revise the CVP on an annual basis and have it reviewed and approved by the Supervisory Board • Strictly adhere to the approved CVP and oversee compliance with it, analyse operating performance indicators and NPS on the parent company level • Explore, test and implement new retail technologies and emerging retail market segments Also see "Our brands" on pages 24-25 and "Our strategy in action" on pages 40-45. as well as the section on each retail format
Economic and market conditions Major changes in the economic environment may challenge the existing business strategy, have a material impact on financial performance and lead to a competitive disadvantage. Such changes include: • A sharp drop in consumer demand (structural changes and shrinking consumer demand in money and absolute terms), depending on real income, consumer confidence and the unemployment level • Social and demographic developments • Excessively low or high consumer inflation • Unexpected decline in fiscal revenues, muted business activity, slowdown in manufacturing, and, consequently, lower personal income, shrinking markets for commercial and non-commercial goods and services • Political events with a potentially negative impact on markets, resulting in lower supply, shortage of goods and higher purchase prices	Cautious to Open	Gross Profit	• Rely on a multi-format model that enables the Company to respond to changes in customer demand and meet the needs of customers with various lifestyles and income levels (all groups of customers in Russia) • Monitor the economic environment, manage the product mix and pricing policy and identify geographies for further expansion based on local customer demand • Develop direct imports, partner with direct suppliers and develop private labels to drive expansion of the product mix and bring purchase prices down • Work to ensure the robust growth of retail formats in regions that demonstrate the strongest potential Also see "Economic and consumer trends" on pages 30-31
Growth and expansion The Company is committed to opening new stores and providing logistics capacities while also ensuring the efficiency of new openings and refurbishment of existing stores. These business goals are the pillars of the Company's strategy. The Company's growth and development are associated with the following risks: • Lack of cost-efficient locations for new openings may result in slower growth • Higher costs of opening and refurbishment projects can erode margins and net profit • Lack of logistics capacities to accommodate expansion of the retail format could bring about higher logistics costs and, consequently, lower margins • Suboptimal geographical plan for expansion and overly optimistic expectations for project economics in certain locations • Inefficient synergies from M&A deals to acquire local players	Cautious to Open	Selling Space, Number of Stores, Net Sales	• Analyse the economy in Russia's regions, optimise the expansion strategy at the Company and retail format level • Have a valuation methodology in place for stores of each format, ensure that investment and post-investment valuation is carried out • Maintain and leverage M&A competencies • Project the Company's future need for logistics capacities and open new distribution centres to accommodate the target growth rate for each format • Drive expansion based on a decentralised model, improve store opening and refurbishment processes • Optimise the performance of stores with negative margins Also see "Geography of operations" on pages 46-47, as well as the section on each retail format

The principal risks that may impede the achievement of X5's objectives with respect to strategy, operations, compliance and reporting matters are described below. It should be noted that there are additional risks that management believes are immaterial or otherwise common to most companies, or that we are currently not aware of. This Annual Report presents the updated Risk Profile; risks mentioned in the 2016 Annual Report are re-grouped, descriptions and activities are updated, and risk-appetite is indicated per identified risk.

Efficiency

Group risk	Risk appetite	Influenced indicator	Mitigation
Retail operations The operational efficiency of the logistics network, stores and back office units determines the operating performance of existing and new stores and the Company's margins in general. Operating activities are subject to the following risks: • Operational disruptions and drawbacks in implementing the CVP • Lower efficiency of the logistics network and higher logistics costs • Lower efficiency of inventory management at the DCs and stores (reduced availability of goods, increase in inventories and write-offs)	Minimalist to Cautious	Gross Profit, Operation Cost	• Ensure an optimal level of decentralisation for operational business processes • Manage the product mix across the retail formats in line with the CVP on an ongoing basis, and develop strategic partnerships • Develop the logistics strategy, manage supply chains within the existing logistics network • Improve and automate processes involving the back office, DCs and stores • Monitor the operating performance of stores and DCs based on management accounts • Monitor the operations of national and regional competitors on an ongoing basis and ensure a prompt response Also see "Retail operations infrastructure" on pages 114-131, as well as the section on each retail format
Human resources The Company's strategic goals are heavily dependent on the competencies and performance of its officers and employees. Risks related to HR management include: • High turnover rates • Shortage of qualified professionals and employees at the operational level level • Strong competition • Underqualified staff • Inadequate or lack of succession planning	Cautious to Open	Operation Cost	• Monitor the labour market and provide employee benefits in line with the market • Have a system for employee onboarding, training, and development in place, along with a talent pool • Plan the recruitment process, use various employee search and recruitment instruments, rely on outstaffing and outsourcing practices • Develop the Company's corporate culture • Monitor the level of reliance on selected employees, develop their job descriptions and redistribute their duties • Automate operations Also see "People review" on pages 138-145
IT performance, continuity The Company's operating model and scale of business depends on the capabilities and reliability of its IT systems. Changes in the operating processes of retail companies require agile adjustments of the IT infrastructure. The inability to meet business-driven IT requirements can limit expansion and decrease profitability. IT management is subject to the following risks: • Failure to match IT capabilities, scalability and reliability in relation to business requirements • Disruptions of business continuity due to IT issues	Minimalist to Cautious	Revenue Operation Cost	• Engage the best external experts and develop partnerships and in-house expertise in key IT solutions used at X5 • Use effective outsourcing practices, introduce an SLA and monitor compliance • Ensure corporate governance of IT architecture and the integration of IT systems • Ensure sufficient reliability of centralised IT infrastructure • Implement policies and procedures to ensure cybersecurity Also see "Information technologies" on pages 130-131

Efficiency

Group risk	Risk appetite	Influenced indicator	Mitigation
Cybersecurity The Company understands the rising trend of external threats to information security, including cyberattacks, viruses and other malicious actions to, for instance, infiltrate our IT systems or damage data.	Minimalist to Cautious	Revenue Operation Cost	• Implement policies and procedures to ensure cybersecurity • The Information Security Unit was established to monitor issues related to cyber-risks • Use of special hardware and software for protection against malicious software, spam, external and internal cyberattacks, data leaks • Use of information systems to detect atypical behaviour in the corporate network. Also see "Information technologies" on pages 130-131
Real estate, rent and maintenance Maintaining the existing chain of stores is a major objective of our operations. Keeping the stores and facilities in a proper state of repair is part of the CVP and contributes directly to a better customer experience and revenue generation. Optimal service costs also affect the Company's margins. In pursuing these objectives, the following risks can arise: • Unplanned increases in lease rates • Termination of lease agreements by the lessor • Poor technical maintenance of stores and equipment • Higher utility rates • Higher vacancy rates and a resulting decrease in revenues from subleased areas	Minimalist to Cautious	Operation Cost	• Have store refurbishment projects collectively approved on the Company level • Sign long-term lease agreements, specify rules for their termination, and manage rental rates • Manage relations with lessors and sub-lessees • Standardise and monitor the utility and technical maintenance of stores and automate store monitoring processes • Optimise selling space and subleased areas, ensure timely refurbishments
Financial risks Financial risks are driven by external factors. They can have an adverse impact on X5's liabilities and margins. The most common financial risks include: • Significant volatility of foreign exchange rates • Increases in interest rates and/or banking fees • Liquidity risk • Credit risk	Averse to Minimalist	See Financial Statements	• Plan and monitor the budget and its performance, introduce changes needed to achieve financial targets • Monitor repayment schedules for long-term and short-term accounts receivable, oversee the use of short-term lending via available credit lines to manage liquidity • Manage the effective financing rate • Raise financing in Russian roubles, avoid FX-denominated agreements in operating activities, include a currency clause in agreements • Implement the KYB ("know your bank") criteria for partner banks, providing banking or cash-related products, in order to minimise risks related to partner banks • Ensure continuity of funding on the best available market terms, with a diverse credit portfolio in Russian roubles • Arrange funding ahead of requirements and maintain sufficient undrawn credit limits in banks • Maintain a strong credit rating so that maturing debt may be refinanced as it falls due Also see "Financial risk management" on pages 94-103

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
Reputation and social responsibility As X5's success depends to a significant extent upon brand recognition, the brand names Pyaterochka, Perekrestok, Karusel and X5 and their associated reputations are key long-term assets of X5's business. As a market leader, X5 is fully aware of its social responsibility and is committed to managing social aspects involved in its operations, thus building a foundation for sustainable development. In terms of reputation and social responsibility, the following risks can arise: • Unethical conduct, unscrupulous practices by X5 management and employees in their relations with customers, counterparties, government authorities, non-profit associations, investors and other stakeholders • A mismatch between the Company's social responsibility standards and the expectations of communities, market players and stakeholders based on X5's role, scale of business and growth potential • Abuse by third parties using X5's trademarks and brands • Misleading information about X5 in social and mass media that may damage the reputation of the Company and its retail formats • Leakage of critical (sensitive) information onto the Internet or to competitors	Averse to Minimalist	N/A	• Use X5's Code of Business Conduct and Ethics; X5's Policy on Countering Misconduct, Including Fraud and Corruption; X5's Charity Policy • Raise awareness, train employees and develop the corporate culture to make sure unethical behaviour is seen as unacceptable and that there is zero tolerance for any fraudulent activities • Use the X5 Retail Group Code of Interaction with Business Partners, review complaints filed by counterparties and engage the Conciliation Commission to look into any incidents that take place • Take disciplinary action in cases of unethical behaviour • Record, arrange and process reports received from the Company's employees via the hotline • Use the Customer Service Standards and the hotline for customers, and work with reports and complaints • Engage in external and in-house social and charity projects • In emergencies, use dedicated channels of communication and rely on the Crisis Response Team to mitigate financial and non-financial damage to X5 • Ensure accessibility for special-needs customers and employees Also see "Community investment review" on pages 152-155
Environment X5 is committed to preserving and protecting the environment and making sustainable use of natural resources. • Unsustainable use of natural resources • Environmental pollution	Averse to Minimalist	N/A	• Monitor the vehicle fleet, purchase vehicles that meet improved emission standards and optimise transportation by car • Sell the Company's used equipment and reuse it in refurbishment and other projects • Collect waste and send it for recycling, and expand the list of waste suitable for recycling • Implement energy-efficient technologies and equipment • Make wider use of paperless document flows • Monitor contractors in their work for X5 Also see "Environmental review" on pages 149-151

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
Human rights While most human rights laws concern relationships between the state and individuals, it is widely acknowledged that non-state organisations can affect individuals' human rights, and they thus have a responsibility to respect them. In its operations, X5 addresses the following human rights violations: • Discrimination against employees, customers and representatives of the Company's partners on the grounds of age, gender, sexual orientation, social status, nationality or ethnicity, cultural or political beliefs, etc. • X5's involvement in human rights violations by third parties • Unethical behaviour on the part of employees in violation of human rights (forced or unpaid labour, harassment or workplace bullying, offensive language, humiliation of human dignity) • Restriction of freedom of assembly and association • Inequality in terms of employees' rights and opportunities	Averse to Minimalist	N/A	• X5's Declaration on Human Rights (available on the Company's website) • Use the Code of Business Conduct and Ethics, provide training to employees and develop the corporate culture • Use the Internal Labour Rules and the Compensation and Benefits Policy and communicate them to employees • Receiving and processing complaints from the Company's employees via the hotline and taking disciplinary actions in case of violations of labour or other legislation, internal Company policies and procedures, revising the Company's business processes to reduce the number of complaints • Improvement of the Company's business processes to eliminate the root causes of complaints received through the hotline are monitored by the Audit Committee • Use the Customer Service Standards and the hotline for customers, and work with reports and complaints • Ensure accessibility for special-needs customers and employees Also see "People review" section on pages 138-145
Health and safety The health and safety of our employees and customers is a top priority for the Company. Injuries or fatalities may have a negative impact on the trust and loyalty of our customers and X5's business reputation. The Company addresses the following risks: • Accidents causing injuries, including fatal injuries, to employees or individuals at X5 facilities and in adjacent areas • Injuries to employees due to an unsafe and uncomfortable working environment • Failure to provide first aid on a timely basis as required	Averse to Minimalist	N/A	• Provide a safe and comfortable working environment (premises, equipment, uniform) at the Company's offices, DCs and stores, and carry out workplace assessments • Ensure compliance with employees' working hours and holiday schedule (work and rest schedule) • Provide employees with life and health insurance programmes and seasonal vaccinations • Arrange regular medical examinations for employees and health screening assessments to confirm that they are fit to work Also see "Occupational health and safety" on pages 146-148
Product safety and quality Product safety and quality are important criteria for our customers and part of the Company's CVP. Products of poor quality and with little shelf life remaining after delivery by suppliers can lead to lower revenue and a decrease in operational efficiency. This risk may be triggered by: • Selling products that fail to meet safety standards and representations about quality • Violations of operational process rules that may lead to spoilage and contamination • Accepting from suppliers products that fail to meet safety standards and representations about quality	Averse to Minimalist	N/A	• Audit suppliers, carry out laboratory tests of product samples before adding the products to the product mix or expanding the product mix. Remove unscrupulous suppliers from the product mix • Ensure inspection of incoming products at DCs and stores (for products coming from both suppliers and DCs) • Comply with approved rules for product transportation, storage and sale • Comply with sanitation and personal-hygiene rules • Provide training for employees to ensure quality, including quality assurance • Have products with flaws in production withdrawn or discontinued • Handle complaints and requests from customers Also see "Product safety and production quality" on pages 108-113

Group risk	Risk appetite	Influenced indicator	Mitigation
Legislation and litigation X5's activities are governed by a wide range of laws and regulations. By complying with these, the Company maintains its reputation and manages operating expenses. Unfavourable legislative developments may affect X5's strategy and margins. Contractual terms that are unfavourable for X5, failure of counterparties to fulfil their obligations and court action against X5 due to contract violations may have a negative impact on the Company's performance and reputation. Risks related to legislation and protection of X5's interests can include: • Non-compliance with applicable laws, including failure to change or adjust the Company's activities on a timely basis in line with new developments • Unfavourable changes in retail laws (e.g. market share limitation, sales restrictions introduced for certain types of products) and obsolete requirements • Unfavourable changes in legislation that result in higher operating expenses for the Company • Risk of legal action against X5 initiated by regulators and counterparties • Counterparties taking advantage of laws and contractual provisions that fail to properly protect X5's interests • Issues related to violations of data protection compliance (see Cybersecurity risk).	Averse to Minimalist	N/A	• Interaction with government agencies as prescribed by applicable laws, participation in public organisations, representation of interests • Monitoring of draft laws, timely initiation of internal projects to alter and adjust X5's activities to legislative developments • Implementation of X5's Compliance Policy: assessment of compliance risks, rollout and improvement of compliance procedures to integrate them into the Company's processes, consistent efforts to identify violations and non-compliance with laws, and disciplinary action • Personnel training to ensure compliance with laws • Legal support, audit of contracts, development and use of contract templates
Fraud and corruption Like any other industry, the retail sector is exposed to risks of fraud and corruption. The scale of X5's activities and the diversity of its business lines and operations can result in fraud risks and corruption. These risks include: • Theft, fraud, acts of corruption and abuse on the part of X5 employees • Hidden conflicts of interest • Fraud, commercial bribery and theft by third parties (customers, counterparties)	Averse to Minimalist	Operation Cost	• Use the Code of Business Conduct and Ethics and X5's Policy on Countering Misconduct, Including Fraud and Corruption • Promote among employers zero tolerance of abuse, and provide personnel training • Implement automated and manual controls in business processes, and separate the rights to access information systems (SoD) • Ensure security of the Company's assets and inventories • Conduct background checks on counterparties and employees • Identify abuses, fraud and theft by independent units (Inspection and Audit Division, Risk and Monitoring Department, Security Department), carry out internal checks, take disciplinary action, initiate administrative or criminal proceedings against employees, counterparties or customers • Record, arrange and process reports received from the Company's employees via the hotline, from counterparties in the Conciliation Commission and from the Security Department • Required declaration of a conflict of interest for all employees
Taxation Compliance with taxation regulations is often complex, open to differing interpretations and depends on the Company's risk appetite. Tax risks may be related to: • Unfavourable changes in tax calculation rules, introduction of new taxes and fees • Federal and regional authorities interpreting tax laws in a way that is adverse for X5 • Developments in case law involving tax disputes • Attempts to challenge previous transactions and amounts of associated tax payments	Averse to Minimalist	See Financial Statements	• Monitoring of taxation-related legislative initiatives and case law, changes to business processes • Tax planning with preliminary reviews and advisory sessions • Tax risk assessment before executing transactions and signing contracts • Tax budgeting, provisioning for tax risks • Tax control during transactions

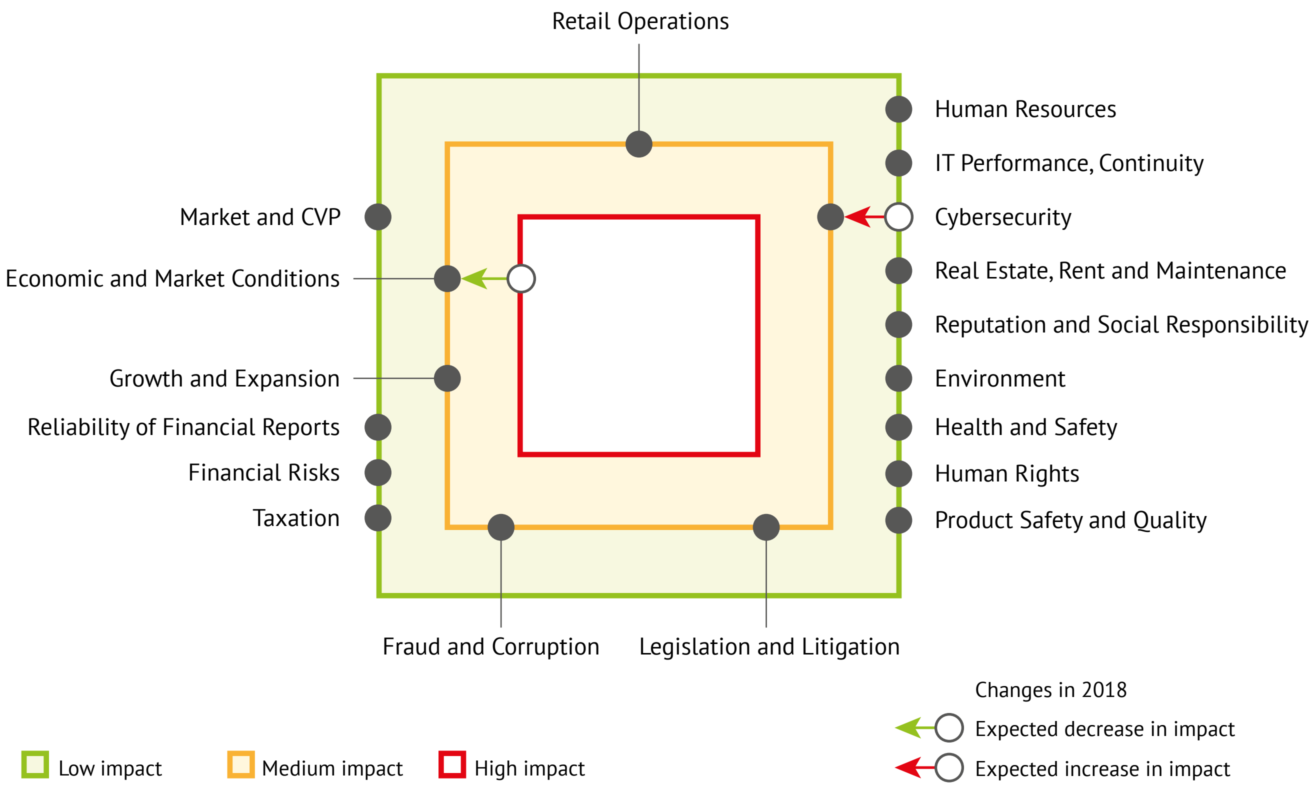
Reporting

Group risk	Risk appetite	Influenced indicator	Mitigation
Reliability of financial reports The reliability and completeness of financial reports is an integral element when it comes to ensuring the trust of shareholders and other stakeholders. Management accounts and financial statements are directly linked to the timeliness and quality of the decisions taken by X5's management. The preparation, distribution and use of accounts and statements are exposed to the following risks: • Non-compliance with statutory requirements on financial reporting • Misrepresentation of management accounts and financial statements • Ambiguity of management accounts and financial statements • Disclosure level not in line with shareholder, lender and market expectations	Averse to Minimalist	N/A	• Monitoring of legislative initiatives and case law regarding financial statements, changes in reporting methodologies • Audit by external auditors • Management of the methodology used in preparing management accounts • Internal controls for the preparation of financial statements • Internal audit to assess the effectiveness of the internal controls used for the preparation of financial statements

Expected risk tendency

For the designated risk groups, X5 analysed the actual risk impact in 2017 and made predictions about the expected future impact, taking external conditions and trends into account.

Expected risk tendency



Statement of the Management Board

The Management Board reviewed and analysed the strategic, operational, compliance and reporting risks to which the Company was exposed, as well as the effectiveness of the Company's internal risk management and control systems over the course of 2017. The outcome of this review and analysis has been shared with the Audit Committee and the Supervisory Board and has been discussed with X5's external auditors.

The Management Board reviewed the effectiveness of X5's internal risk management and control systems, based on:

- internal audit reports on reviews performed throughout the year; observations and measures to address issues were discussed with management and the Audit Committee;
- a systematic review of scoping, control execution and control assessments in the context of the internal control strategy for 2017-2020;
- periodic risk reports reported by the management of corporate functions and the three main business segments (retail formats):
- ongoing monitoring of key risk-management initiatives aimed at mitigating risks and keeping risks at an acceptable level;
- the external auditor's ongoing reflections on the control framework on the control framework, and the management letter from the external auditor with observations and remarks regarding internal controls. This letter has been discussed with the Audit Committee and Supervisory Board.

For more information on X5's risk management activities, internal control, risk management systems and key risks, see the above section "How we manage risk". The purpose of X5's internal risk management and control systems is to adequately and effectively manage the significant risks to which the Company is exposed. Such systems can never provide absolute assurance as to the realisation of operational and strategic business objectives, nor can they prevent all misstatements, inaccuracies, errors, fraud and non-compliance with legislation, rules and regulations. These systems do not provide certainty that the Company will achieve its objectives.

Based on the annual evaluation and discussion of X5's internal control and risk management systems and identified risk factors, the Management Board confirms that, according to the current state of affairs and to the best of its knowledge:

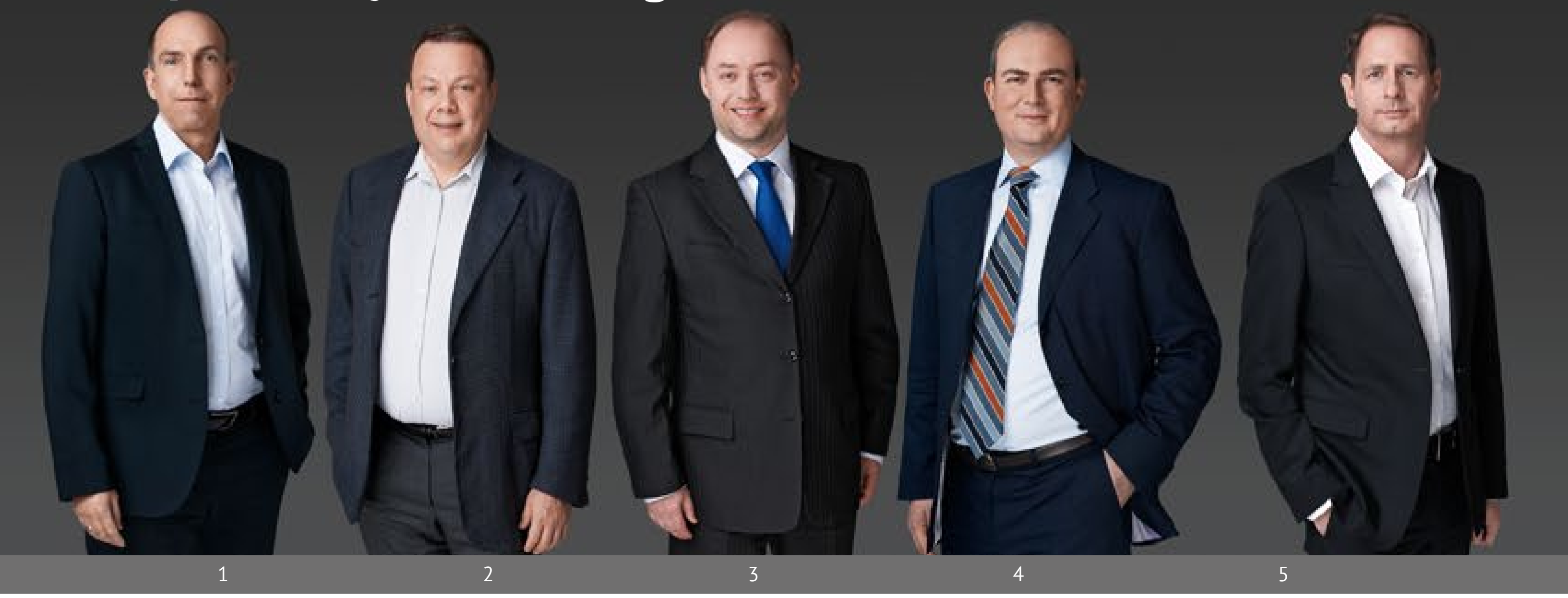
- X5's internal risk management and control systems provide reasonable assurance that the Company's financial reporting does not contain any material inaccuracies;
- there have been no material failings in the effectiveness of X5's internal risk management and control systems;
- there are no material risks or uncertainties that could reasonably be expected to have a material adverse effect on the continuity of X5's operations in the coming 12 months;
- it is appropriate that the financial reporting b prepared on a going concern basis.

In view of all of the above, the Management Board confirms that, to the best of its knowledge, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and its consolidated subsidiaries, and the management report includes a fair review of the position on the balance sheet date and of the development and performance of the business during the financial year together with a description of the principal risks and uncertainties that the Company faces.

The Management Board

28 March 2018

Supervisory and Management Boards



1. Stephan DuCharme

Chairman of the Supervisory Board

Stephan DuCharme, a dual US/German citizen, is managing partner at L1 Retail, the retail investment branch of LetterOne, and currently serves on the Board of the holding company of Holland & Barrett International. Stephan served as CEO and Chairman of the X5 Management Board from July 2012 until November 2015, after having previously served on X5's Supervisory Board beginning in 2008. Prior to X5, he held senior management positions with Alfa Group, the European Bank for Reconstruction and Development (EBRD) and Salomon Brothers Inc. He graduated with distinction from the University of California at Berkeley and received an MBA from INSEAD.

2. Mikhail Fridman

Member of the Supervisory Board

Mikhail Fridman, one of the original founders of Alfa Group Consortium, is Chairman of the Supervisory Board of Alfa Group Consortium, one of Russia's largest privately owned financial-industrial conglomerates. Mr. Fridman is also a member of the Supervisory Board of VEON, a member of the Board of Directors of Alfa-Bank, and a member of the Board of Directors at ABH Holdings. Mr Fridman is co-founder of LetterOne, the international investment business, headquartered in Luxembourg. Mr. Fridman is a member of the Board of the Russian Union of Industrialists and Entrepreneurs and of the International Advisory Board of the Council on Foreign Relations (USA). He graduated from the Moscow Institute of Steel and Alloys in 1986. Mr. Fridman was born in Lvov, Ukraine, in 1964.

3. Peter Demchenkov

Member of the Supervisory Board, Chairman of the Nomination and Remuneration Committee

Peter Demchenkov, a Russian citizen, is CEO of ALIDI, a leading provider of distribution and logistics services in Russia. From 2004 to 2005, he was Development Director at the investment bank CIT Finance, and from 1997 to 2004, Peter worked in Procter & Gamble's Business Development Department for Eastern Europe. Peter graduated from the St Petersburg Polytechnic University with a degree in Technical Cybernetics.

4. Andrei Elinson

Member of the Supervisory Board

Andrei Elinson is the Director of Asset Management at CTF Holdings, where he has worked since December 2015. Currently, Mr. Elinson is a member of the Board of Directors of ABH Holdings S.A., a member of the Board of Directors of Alfa-Bank, and a member of the Board of Directors of AlfaStrakhovanie Group. Prior to joining CTF, Mr. Elinson was Deputy CEO of Basic Element, where he worked from August 2007, with responsibility for managing companies in the aviation, construction, automotive, financial and other industries. From 1997 to 2007, Mr. Elinson worked at Deloitte CIS, and later became a Partner in 2005. Mr. Elinson graduated with honours from the Accounting & Auditing Faculty at the Russian State Finance Academy. Mr. Elinson is a US Certified Public Accountant and a US Certified Fraud Examiner. He holds a Certificate in Company Direction (UK). Mr. Elinson was born in Moscow, Russia, in 1979.

5. Geoff King

Chairman of the Audit Committee, Chairman of the Related-Party Committee

Geoff King is a British national, and is a director of GNC Group Consulting, a retail-focussed advisory practice in South-east Asia. Between 1988 and 2009, Geoff held many leadership roles in his career with Tesco PLC, including CFO for Ireland, Poland and Regional CFO for Asia and Central Europe. Between 2010 and 2013, he was the Group CFO of Maxis, a major telecoms operator in Malaysia and India. Geoff graduated from Exeter University with a degree in Pure Mathematics and is a qualified CIMA Accountant.

6. Christian Couvreux

Member of the Supervisory Board

Christian Couvreux, a French citizen, formerly held several leadership positions at Group Casino, including the position of CEO from 1997 until 2003, as well as at CFAO (now part of PPR) with CFAO-Congo and La Ruche Meridionale. More recently, he acted as a retail consultant in several Asian countries, including Thailand, Vietnam, Indonesia and the Philippines. Mr. Couvreux holds a Master's degree in Economic Sciences from the University of Paris and an MBA from the French business school H.E.C.

7. Michael Kuchment

Member of the Supervisory Board

Michael Kuchment, a Russian citizen, is the co-founder and Vice President of Hoff, one of the leading home furnishing retailers in Russia. Currently, Michael is also Chairman of the Supervisory Board of Sovcombank, one of the leading Russian consumer banks. From 2008 until 2015, Michael was a board member of M.Video, the largest consumer electronics chain in Russia and the country's first public non-food retailer. Previously, from 2002 until 2008, Michael worked as the Commercial Director at M.Video. Michael graduated from the Moscow Institute of Physics and Technology as a physics researcher, and holds an Executive MBA from the Skolkovo Moscow School of Management.

8. Pawel Musial

Member of the Supervisory Board

Pawel Musial, a Polish citizen, served until 2017 as Chairman of Profi Rom Food, one of the largest supermarket chains in Romania, following his position as CEO of the chain from 2010 until 2015. In 2008 and 2009, he was Chairman of the Ukrainian supermarket chain EKO Market. From 2006 to 2007, Pawel was Chief Commercial Officer and member of the Management Board of X5, having previously been General Director and Chief Operating Officer of the Perekrestok format from 2004. Prior to joining Perekrestok, Pawel held senior management positions in the food retail industry in Poland, including five years with Tesco Polska, with his last position as Regional Director. Pawel graduated from the Warsaw University of Life Sciences (SGGW) with an engineering degree in Nutrition Technology.

Management Board

9. Igor Shekhterman

Chief Executive Officer, Chairman and Member of the Management Board

Igor Shekhterman has served on X5's Supervisory Board since 2013. He was previously the Managing Partner and CEO at RosExpert, which he co-founded in 1996, and subsequently successfully developed into the Russian partner of Korn/Ferry International. Igor started his career as Finance Manager at the Russian branch of Beoluna, the Japanese jewellery producer. Igor holds a degree in Economics from the Kaliningrad Technical Institute (1992) and degrees in Business Administration from the Institute d'Administration des Enterprises (France, 1994) and the Danish Management School (1995).

10. Frank Lhoëst

Company Secretary, Member of the Management Board

Frank Lhoëst joined X5 in November 2007, having previously held several positions at Intertrust Group. Frank graduated from Leiden University with a degree in Law.

Report of the Supervisory Board

The Supervisory Board is responsible for supervising and advising the Management Board and overseeing the general course of affairs, strategy and operational performance of the Company. In performing its duties, the Supervisory Board acts in accordance with the interests of the Company and its affiliated businesses, taking into consideration the overall good of the Company and the relevant interests of all its stakeholders. In X5's two-tier corporate structure under Dutch law, the Supervisory Board is a separate body operating fully independently of the Management Board.

Composition and profile of the Supervisory Board

X5's General Meeting of Shareholders determines the number of members of the Supervisory Board. Currently, X5's Supervisory Board consists of eight members, with a majority of five independent members. On an ongoing basis, the Supervisory Board reviews the profile of its size and (future) composition, as well as its rotation schedule, taking into account the evolving nature of X5's business and activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board's profile is published on X5's corporate website.

At the Annual General Meeting of Shareholders on 12 May 2017, both Mikhail Fridman and Pawel Musial were reappointed for an additional four-year term, following their nomination in accordance with the rotation schedule of the Supervisory Board.

At the 2018 Annual General Meeting of Shareholders, Christian Couvreux will retire, having served two terms in office since 2010. Christian advised the Company that he will not be available for reappointment.

An overview of the current composition of the Supervisory Board and a short biography of each member is presented in the Corporate Governance Report on pages 180-181.

Composition of the committees

While retaining overall responsibility, the Supervisory Board assigns certain tasks to its three permanent committees: the Audit Committee, the Nomination and Remuneration Committee and the Related-Party Committee. An overview of the current composition of the committees is presented in the Corporate Governance Report. In 2017, the Supervisory Board decided to dissolve the Strategy Committee as of 2018, as meetings of this committee were effectively meetings of the full Supervisory Board, with all members attending. Going forward, such meetings will be convened as dedicated strategy meetings of the Supervisory Board.

In line with corporate governance best practice, which says that the Nomination and Remuneration Committee should not be chaired by the Chairman of the Supervisory Board, Peter Demchenkov took over Stephan DuCharme's position as Chairman of the Nomination and Remuneration Committee as of 1 April 2017, with Mr. DuCharme remaining a member of the Committee.

Induction

Induction and permanent education are key elements of good governance. Following their appointment, new Supervisory Board members go through X5's strategic, financial, legal and reporting affairs with senior executives of the Company. In addition, prior to their appointment, they attend meetings of the Supervisory Board and its committees. On an ongoing basis, and together with members of senior management, members of the Supervisory Board visit stores and distribution centres to develop deeper knowledge of local operations, opportunities and challenges.

Meetings of the Supervisory Board

In 2017, the Supervisory Board held four regular meetings and one meeting by conference call. In addition, resolutions in writing were adopted when necessary during the year. For each of the four meetings in 2017, the Supervisory Board meeting was preceded by meetings of the Audit Committee and the Nomination and Remuneration Committee, and on three occasions the Supervisory Board meeting was preceded by a meeting of the Strategy Committee. The Related-Party Committee convened throughout the year, if and when necessary. In 2017, the Supervisory Board continued its practice of having all meetings of the Strategy Committee attended by all members of the Supervisory Board. As a result, the Supervisory Board effectively convened three times for two consecutive days, thus ensuring sufficient time for the meetings and discussions on specific themes, such as operational performance, strategy and management development. All these meetings included feedback sessions with members of the Executive Board.

All meetings were attended by the full Supervisory Board. The CEO and CFO attended the meetings, and other members of senior management were regularly invited to present. In 2017, the Supervisory Board held regular private sessions without members of the Management Board present to independently discuss matters related to the performance, functioning and development of members of the Executive Board. The external auditor attended the meeting in March at which the 2016 Annual Report and financial statements were recommended for adoption by the Annual General Meeting of Shareholders. In between the Supervisory Board meetings, several informal meetings and telephone calls took place among Supervisory Board members and members of the Management Board and other Company management to consult with each other on various topics and to ensure that the Supervisory Board remained well informed about the running of the Company's operations.

The Supervisory Board confirms that all Supervisory Board members have adequate time available to give sufficient attention to the concerns of the Company. In 2017, the attendance rate was 100% for both the Supervisory Board and the committee meetings.

Activities in 2017

In 2017, the Supervisory Board reviewed various matters related to all significant aspects of the Company, its activities and operational results, its strategy going forward and the management team and its development. Throughout the year, the Board continued to monitor the implementation of X5's corporate strategy, with a focus on operational discipline, sustainability and long-term value creation.

During its strategy meetings, convened by the Strategy Committee, the Supervisory Board devoted considerable time to key areas that are critical to supporting the Company's long-term growth strategy, recognising that strong growth in a competitive environment and challenging macroeconomic conditions are demanding for both people and the Company. Key areas discussed were the supply chain strategy, the human resources strategy to support the rapidly expanding store base, and the IT strategy, with a focus on IT infrastructure and security.

In addition, as part of its strategic cycle, the Supervisory Board reviewed a progress update of X5's "Strategic Vision 2020", which served as a framework for the medium-term plan approved in September. In this context, the Supervisory Board extensively discussed X5's current and future capability and requirements in terms of organisation, leadership and corporate culture to ensure sustainable growth in a rapidly transforming retail landscape driven by innovative business concepts and omni-channel retailing.

As part of the ongoing performance review of the Company's various functions and business divisions, the main topics reviewed and discussed by the Supervisory Board included:

- the sustainable leadership strategy for the Pyaterochka and Perekrestok retail formats, with a focus on disciplined growth and operational efficiencies;
- the organisational structure and leadership requirements in light of the Company's rapid growth, including the role and size of the Corporate Centre in support of a decentralised business model;
- the performance and value proposition of the hypermarket format (Karusel);
- category management;
- the divestment of Perekrestok Express, in line with the Company's strategy to concentrate on its three main retail formats;
- the Company's new dividend policy.

In addition, throughout the year, the Supervisory Board discussed the following (regular) topics:

- the financial reporting process and in particular the approval of the 2016 Annual Report and review of the 2017 half-yearly and quarterly financial reports;
- reports by the internal and external auditors;
- the regular assessment of the members of the Executive Board, including talent management and succession planning;
- a review of the profile and composition of the Supervisory Board, particularly in the context of the in-depth board evaluation performed by an external evaluator during the second half of the year;
- the corporate responsibility strategy, including consideration of the Dutch decree on disclosure of non-financial information, implementing EU Directive 2014/95;
- corporate governance developments, including an impact assessment of the new Dutch Corporate Governance Code that entered into force on 1 January 2017;
- X5's risk landscape and risk appetite, as well as risk mitigation measures and internal controls;
- M&A strategy, including the acquisition of O'KEY supermarkets in December;
- The annual budget for 2018.

Board evaluation

X5 undertakes an annual review of the Supervisory Board, its committees and its individual members. The evaluation operates on a three-year cycle, with one externally led evaluation followed by two subsequent years of internal evaluations. Following this cycle, the 2017 evaluation was performed by an external party by means of a questionnaire, individual interviews and observation of the Board and committee meetings held in September. Fidelio Partners was engaged as the external evaluator.

Items assessed and subsequently discussed included: the profile and composition of the Supervisory Board, members' skills and expertise, oversight of business performance, risk and governance processes, responsibility for the culture within X5, effectiveness in overseeing strategy, effectiveness of the committees in alleviating the Board's overall oversight and the relationship with the Executive Board. In addition to the self-assessment by the Supervisory Board members, input was also solicited and received from selected members of the Executive Board and members of the Management Board.

The main conclusions of the evaluation were collectively discussed by the Supervisory Board at its meeting in December. The evaluation concluded that the Board felt its work and performance during the year had been positive. There had been an effective process to develop and refresh the group's "Strategic Vision 2020", and Board discussions remained open and constructive. Key points of attention resulting from the evaluation in 2017 included enhanced focus on the profile and composition of the Board, making sure that the Board remains "fit for tomorrow", further emphasis on the induction and development of new and current Board members, and improving the effectiveness of discussions in the boardroom.

The Supervisory Board attaches great value to these evaluations. They ensure continuous focus on the quality of the activities, composition and functioning of the Supervisory Board and its Committees and relationship with the Executive Board.

Meetings of the committees

Audit Committee

The role of the Audit Committee is described in its charter, which is available on the Company's website. On 31 December 2017, the Audit Committee consisted of Geoff King (Chairman), Christian Couvreux, Pawel Musial and Andrei Elinson. In 2017, the Audit Committee held four meetings in person. Additional meetings were held by conference call when necessary, for instance to review the publication of the half-yearly results. As a rule, all meetings were attended by the CFO, the external auditor and the internal audit director. Other members of the Supervisory Board and senior management were invited when necessary or appropriate. The Audit Committee met once with the external auditor without the presence of management.

The Audit Committee's focus in 2017 was, among other things, on overseeing the integrity and quality of X5's financial reporting and the effectiveness of the internal risk and control systems. The Audit Committee reviewed the Company's annual and interim financial statements, including non-financial information, the quarterly results and related press releases, as well as the outcomes of the year-end audit. The Audit Committee discussed relevant accounting principles and reviewed new accounting standards for financial instruments under IFRS 9, revenue recognition under IFRS 15 and lease accounting under IFRS 16. Throughout the year, the Audit Committee reviewed the level of financial provisions, key movements in the balance sheet, working capital changes and any contingent liability movements.

Furthermore, the Audit Committee reviewed and approved the audit plans of the internal and external auditors, with a focus on scoping, materiality and key risks. The Audit Committee monitored the progress of the internal and external audit activities, including a review of observations identified as a result of the internal audit activities during the quarter, quarterly procedures performed by the external auditor and the audit performed at year end by the external auditor. The Audit Committee oversaw follow-up by management on the recommendations made in the internal and external management letters. The Audit Committee assured itself of the independence of the external auditor and reviewed requests for non-audit services provided by the external auditor, in line with the Company's Rules on External Auditor Independence and Selection.

The Audit Committee closely monitored risk management and the risk management process, including the timely follow-up to high-priority actions and risk mitigation measures based on quarterly progress updates. A substantial amount of attention was paid to a review of the Company's risk profile and the approach and methodology for establishing the Company's risk appetite. Furthermore, specific attention was paid to risk management and controls in the area of data protection and cybersecurity.

The Audit Committee extensively discussed the effectiveness of the internal control framework. This included scoping, framework updates in the context of the internal control strategy for 2017-2020, control execution and control assessments. Each quarter, the agenda includes a discussion on current control topics, including internal audit findings and the external auditor's reflections on the control framework. These discussions guided management and Internal Audit to focus on the right priorities throughout the year and to build a relevant internal audit plan for 2018.

In the context of the quarterly ethics and compliance updates and whistle-blower reports, the Audit Committee dedicated specific attention to detection and prevention of fraud, corruption and illegal practices, and risk mitigating measures to protect the Company in these areas. In the second half of the year, the Audit Committee reviewed the Company's renewed anti-fraud and corruption policy and monitored its implementation throughout all levels of the organisation.

Throughout the year, the Audit Committee continued to review the operational control framework, paying particular attention to stock and fixed assets. Management processes concerning stock-holding and loss levels were examined across all formats. The Audit Committee also closely monitored the effectiveness of the capital investment process, the appraisal methodology and the safeguarding of core assets. Twice during the year, the Audit Committee reviewed an assessment of the level of returns from recent investments, as well as management actions addressing underperforming stores and assets whose carrying value were impaired.

The General Meeting of Shareholders determines the remuneration of the members of the Supervisory Board. The detailed amounts are stated in notes 26 and 27 to the consolidated financial statements

The Audit Committee also discussed other issues, including:

- the external auditor's report with respect to accounting and audit issues and internal control recommendations in respect of their audit of the 2016 consolidated financial statements;
- quarterly interim financial reports and trading updates;
- X5's financing strategy;
- the Company's new dividend policy;
- tax policy and planning management and residual tax risks, with specific attention to the group's corporate tax structure;
- material legal cases;
- regulatory compliance and changes in legislation, with ongoing attention in 2017 to amendments to the Russian Trade Law that entered into force in 2016, and the impact on the Group's working capital and product margin structures as a result of tighter payment-related provisions in contracts with suppliers;

With respect to the external auditor's management letter about the 2017 financial year, the Audit Committee confirms that the management letter contained no significant items that need to be mentioned in this report.

Nomination and Remuneration Committee

The role of the Nomination and Remuneration Committee is described in its charter, which is available on the Company's website. On 31 December 2017, the Nomination and Remuneration Committee consisted of Peter Demchenkov (Chairman), Stephan DuCharme, Christian Couvreux and Andrei Elinson. The Nomination and Remuneration Committee held five meetings in 2017, including one held by conference call. The CEO was invited to attend every meeting, and other members of the Supervisory Board and senior management were invited when necessary or appropriate.

In 2017, the Nomination and Remuneration Committee continued to focus on succession planning, management development and human resource needs in relation to the Company's multi-format operating model and growth objectives. The Nomination and Remuneration Committee further reviewed and prepared the following items for recommendation or report to the full Supervisory Board, as part of its ongoing responsibilities:

- the annual assessment of the Management Board and Executive Board and its individual members;
- governance and organisational structure, including the role of the corporate centre in support of the decentralised operating model;
- management changes, including the appointment of Svetlana Demyashkevich as CFO and member of the Executive Board, succeeding Dmitry Gimmelberg as of 1 July 2017;
- the nomination of Mikhail Fridman and Pawel Musial for reappointment to the Supervisory Board at the 2017 Annual General Meeting of Shareholders;
- evaluation of the Supervisory Board and its individual members and committees;
- proposals on the remuneration of individual members of the Management Board and Executive Board;
- principles of a new long-term incentive programme to support the Company's strategy for sustainable growth and value creation.

For information on the remuneration policy, see "Remuneration" on pages 188-191. Details of actual remuneration in 2016 can be found in notes 26 and 27 to the consolidated financial statements.

The Supervisory Board

28 March 2018

Related-Party Committee

The role of the Related-Party Committee is described in its charter, which is available on the Company's website. On 31 December 2017, the Related-Party Committee consisted of Geoff King (Chairman) and Michael Kuchment. In 2017, the Related-Party Committee convened once in person; resolutions in writing were adopted when necessary during the year. Under the Company's Related-Party Transactions Policy, the Related-Party Committee reviews transactions of a recurring nature that are pre-approved by the Supervisory Board, transactions with a materiality threshold for either the Company or members of the Supervisory Board, Management Board and Executive Board, and transactions that qualify as significant related-party transactions as defined in the policy. Pursuant to this policy, the Related-Party Committee specifically discussed the following transactions in 2017:

- service agreements with Alfa Services Limited;
- a loyalty card agreement with Alfa-Bank;
- a licensing agreement with Alfa-Bank related to the use of Company trademarks belonging to the Company or one if its Group companies;
- a bank card agreement with Sovcombank;
- an agreement with Beeline for fiscal data processing services.

These transactions were discussed and approved by the Related-Party Committee and/or the Supervisory Board with due observance of best practice provisions 2.7.3 and/or 2.7.5 of the Corporate Governance Code, as well as the rules set forth in Article 10 (Conflicts of Interest) of the rules of procedure of the Supervisory Board, which are available on the Company's website. The Supervisory Board determined that, to the extent that any of the listed transactions constituted a conflict of interest for certain members of the Supervisory Board, such conflict did not undermine the independent judgment of these Board members while performing their duties for X5.

Financial statements

This Annual Report and the 2017 consolidated financial statements, audited by Ernst & Young Accountants LLP, were presented to the Supervisory Board in the presence of the Management Board and the external auditor. Ernst & Young's report can be found on pages 265-275.

The Supervisory Board recommends that shareholders adopt these financial statements and, as proposed by the Management Board, appropriate RUB 21,590 million for dividend payments for the 2017 financial year, representing 69% of net profit. The proposed dividend amounts to RUB 79.5 per GDR. An amount of RUB 9,804 million, representing the remaining amount of the profit for the 2017 financial year, will be added to the retained earnings.

The Supervisory Board furthermore requests that the Annual General Meeting of Shareholders grant discharge to the members of the Management Board for their management and to the members of the Supervisory Board for their supervision in 2017.

The Supervisory Board wishes to express its sincere appreciation for the results achieved and would like to thank the Executive Board and all X5 employees for their continued dedication and efforts in 2017.

Remuneration

This report outlines the remuneration policy of the Company's Management Board of as well as the actual remuneration of the Management Board for the 2017 financial year. This report also addresses the way in which the remuneration policy will be applied in the 2018 financial year and beyond. Further details of actual remuneration for the Management Board and Supervisory Board in 2017 can be found in notes 26 and 27 to the Consolidated Financial Statements.

Remuneration policy

The Supervisory Board resolved that the remuneration policy for the Management Board will also apply to members of the Executive Board. In view of the relative size and composition of both boards, this policy refers to the Executive Board unless specific provisions apply to members of the Management Board only, which will be clearly indicated.

The objective of X5's remuneration policy is twofold:

- to create a remuneration structure that will support a healthy corporate culture and allow the Company to attract, reward and retain qualified executives who will lead the Company on a sustainable basis in achieving its strategic objectives
- to balance short-term operational performance with the Company's long-term objectives and sustainable value creation for its shareholders and stakeholders.

The Supervisory Board's Nomination and Remuneration Committee closely monitors developments in regional and local labour markets and takes these developments into account when making recommendations on Executive Board compensation to the Supervisory Board for consideration and approval. While developing the remuneration policy, the Nomination and Remuneration Committee carries out scenario analyses to determine the risks to which variable remuneration may expose the Company. On a going-forward basis, the Committee takes into account pay ratios within the Company and in comparison with the peer group, whereby it is important to note that pay ratios across industries are impacted by the different mix of functions from one industry to another. Even within the same industry, comparing pay ratios is challenging due to different market conditions within the Company's geographical footprint.

Upon the recommendation of the Nomination and Remuneration Committee, and if in the interest of the Company, the Supervisory Board may at its discretion deviate from the remuneration policy when offering a remuneration package to a newly appointed member of the Executive Board or when amending the remuneration package of a current member of the Executive Board. This discretion may be applied in the event of exceptional circumstances if clearly in the interest of the Company and its shareholders.

Benchmarking with industry peers

Benchmarking is applied to X5 base salaries and variable salary components. Executive Board remuneration is targeted at the labour market peer group. As a company with operations mainly in Russia, the peer group created for the benchmarking is composed of Russian companies equivalent in terms of size of business, complexity of operations and corporate governance.

Total direct compensation

The basic elements of the total direct compensation provided to Executive Board members are: a base salary, a performance-related annual cash incentive (STI) and a performance-related long-term cash incentive (LTI).

In addition to this total direct compensation, members of the Executive Board are entitled to other benefits, such as described below under "Other remuneration components".

Base salary

Base salaries are specified in individual contracts with members of the Executive Board and reflect their respective qualifications, experience, expertise and responsibilities. The levels of base salaries are determined by (i) benchmarking with industry peers, as described above, and (ii) the specific responsibilities of the individual member of the Executive Board. The annual review date for base salaries is April 1.

Short-term incentive (STI)

The annual incentive for members of the Executive Board is predicated upon both quantitative financial indicators and individual targets. The on-target payout as a percentage of base salary is 100%, contingent on the objectives being fully achieved, with a cap at 140% of the base salary in the event of above-target performance.

At the beginning of each financial year, the Supervisory Board sets the annual incentive targets and their relative weight, as well as performance ranges, i.e. the value below which no payout will be made (the threshold), the on-target value and the maximum payout level. The financial targets comprise components related to the Company's operational performance, including net revenue and return on invested capital (ROIC), as well as a profitability threshold as a condition for STI payout. The individual targets include leadership, divisional performance or key project-related targets.

Both financial and individual performance measures contribute to the Company's success in the short term, while also securing the Company's long-term objectives. X5 does not disclose the actual targets set, as they are considered to be commercially sensitive.

Long-term incentive (LTI)

The LTI is a cash incentive programme in two stages over a five-year period from 1 January 2015 until 31 December 2019. The programme awards the Company's senior executives and other key employees for the achievement of ambitious goals during each applicable performance cycle. LTI targets have been structured to align the long-term interests of shareholders and management on a sustainable basis. The targets reflect the Company's strategic direction approved in 2014, a specific focus on net revenue and market share relative to the competition within each performance cycle, without sacrificing EBITDA margin or incurring undue risk. The second stage of the programme starts once the targets under the first stage are achieved.

Each stage of the programme includes a deferred component of conditional payouts in order to maintain the focus on long-term goals throughout the programme and to provide for an effective retention mechanism. Specifically, the deferred components are conditional upon maintaining achieved targets, including leadership in net revenue terms, during an extended 12-month period, with final deferred payouts under the second stage in 2019. The size of each individual cash award is based on a predetermined score reflecting the participant's role and contribution to meeting the LTI targets at both the individual and team level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

The total available fund for all payouts under the LTI programme is capped at 12% of EBITDA in the year that the final-stage performance targets are achieved.

Other remuneration components

Members of the Executive Board may be offered a number of other arrangements, such as an expense allowance, medical insurance, accident insurance and life insurance, in accordance with Company policy. The Company's policy does not allow personal loans and guarantees to members of the Executive Board, nor does the Company provide pension arrangements for members of the Executive Board.

Contractual arrangements

Management Board members are appointed for a four-year term, to be extended upon reappointment by the Annual General Meeting of Shareholders. Members of the Management Board are engaged on the basis of a Management Services Agreement with a four-year term and, for the CEO based in Russia, a contract of employment with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract reflect the responsibilities of the relevant Management Board member in the Netherlands and/or in Russia.

Clawback

The Supervisory Board may recover from the Management Board members all or part of a paid bonus if such bonus is based on incorrect information regarding the targets or the conditions of the bonus. Furthermore, the Supervisory Board has the discretionary authority to adjust an unpaid bonus to an appropriate amount if payment of the bonus is considered unreasonable or unfair.

Severance arrangement

Severance payment is limited to a maximum of one year's base salary for members of the Management Board and to a maximum of six months' base salary for Executive Board members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances.

Insurance and indemnity arrangements

Members of the Management Board and Supervisory Board, as well as certain senior management members, are insured under X5's Directors and Officers Insurance Policy.

Although the insurance policy provides broad coverage, X5's directors and officers may incur uninsured liabilities. Members of the Management Board may be indemnified by the Company against any claims arising out of or in connection with the general performance of their duties, provided that such claim is not attributable to gross negligence, wilful misconduct or intentional misrepresentation by the director or officer in question. Similar indemnities granted by the Company to members of the Supervisory Board were approved by the 2016 Annual General Meeting of Shareholders.

2017 Management Board remuneration

The following table provides an overview of the Management Board's actual remuneration that became unconditional in 2017 or at year end (in millions of Russian roubles). For disclosures in line with IFRS reporting requirements, which are accrual-based over earning/performance periods and partly depend on estimations/assumptions, see note 8 "Related party transactions" on pages 222-223.

Expenses recognised for remuneration of the members of the Management Board:

Name	Year	Base salary[1]	Short-term incentive[2]	Long-term incentive[3]	Share based compensation	Social security cost	Total
I. Shekhterman	2017	46	36	211	8	43	344
	2016	47	52	296	1	59	455
F. Lhoëst	2017	18	10	–	–	–	28
	2016	20	6	10	–	–	36
TOTAL	**2017**	**64**	**46**	**211**	**8**	**43**	**372**
	2016	**67**	**58**	**306**	**1**	**59**	**491**

Ad (1) - Base salary

In 2017, Mr. Shekhterman's annual base salary remained unchanged at the level of RUB 42 million. The table reflects actual base salary amounts, including adjustments based on number of days spent on vacation (as well as business trips in 2016), in accordance with Russian labour law. For Mr. Shekhterman, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr. DuCharme when in office as CEO, thereby securing continuity. As such, Mr. Shekhterman's reward package does not include a severance entitlement and, instead, he will be entitled to a minimum annual compensation package of USD 4,000,000. Should, in a given year, the minimum compensation to which the CEO is entitled exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman will receive the difference upon completion of his full term as CEO.

Ad (2) – Short-term incentive

Short-term incentives are based on results achieved in 2017 and payable in 2018. For 2017, the Supervisory Board determined in advance that the achievement of Company performance targets represented an 80% weighting of the total on-target bonus opportunity for the CEO, while his individual performance targets had a weighting of 20%. Group targets consist of elements related to the Company's operational performance, including net revenue and return on invested capital (ROIC), with a profitability threshold as a condition for STI payout. For the Company Secretary, the STI is based on achievement of individual targets, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO and 60% for the Company Secretary. With regard to financial targets, the Group achieved EBITDA above the target threshold. Other group targets, including the net revenue target, were partially met, albeit within the target range set by the Supervisory Board. The achievement of performance targets was assessed and determined by the Supervisory Board, resulting in payouts of 85% of base salary for Mr. Shekhterman and 55% of base salary for Mr. Lhoëst.

The Supervisory Board

28 March 2018

Ad (3) – Long-term incentive

The targets set for the first payout under the second stage of the LTI were achieved as per 31 March 2017, as specific comparative performance indicators were met, and EBITDA also exceeded the target threshold. Pursuant to the rules of the LTI programme, 50% of the achievement award is payable in 2018, and 50% is deferred to 2019, subject to maintaining the comparative performance against the competition in 2018. For Mr. Shekhterman, the expense recognised for the long-term incentive reward is composed of two elements: (i) accrual for 2017 with respect to the first payout under the second stage of the LTI programme, and (ii) accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 December 2018.

Internal pay ratio

The pay ratio of CEO compensation compared to the average employee compensation during 2017 is 161:1. This pay ratio is obtained by dividing the 2017 remuneration for the CEO by the 2017 average remuneration per employee of X5. The pay ratio was calculated based on following methodology: annual remuneration of the CEO (base salary and short-term incentive) compared with total annual remuneration of X5 employees, divided by the number of employees on a FTE basis. Awards under the long-term incentive programme are not included in the pay ratio.

As is commonly understood, pay ratios are specific to the company's industry, geographical footprint and organisational model. As a major food retail company, the relatively small number of executive staff vs. operational staff in stores and warehouses across seven federal districts in Russia adds to the variety of pay within the Company and substantially differentiates the average employee compensation from compensation levels of Management Board members. For companies in other industries, this will be different. Furthermore, pay ratios can be volatile over time, as they can depend heavily on the Company's annual performance since that performance impacts the remuneration of the Management Board (and Executive Board) much more than all other employees.

Pay ratio between	Year	Ratio
X5 CEO and X5 employees	2017	161:1
	2016	198:1
Company Secretary and X5 employees	2017	61:1
	2016	53:1

Remuneration policy in 2018 and beyond

As described in this remuneration report, the targets under the second stage of the LTI programme were achieved in 2017. Since the launch of the programme, X5 has made significant progress in achieving the long-term strategic targets set by the Supervisory Board in 2014, including becoming the largest food retailer in Russia by revenue. Building on this achievement, the targets under the second stage of the LTI programme were achieved in 2017, as described in this remuneration report. Subject to meeting the sustainability criteria set out in the LTI programme, management expects that the targets for the deferred component under the second stage of the LTI programme are likely to be met at the end of 2018, with payouts to take place in 2019.

Whereas the LTI was specifically designed to support the Company's ambitious transition to accelerated growth and expansion in line with long-term strategic targets, the Supervisory Board recognises that the Company is entering a new stage with enhanced focus on sustainability and strategic objectives that contribute to long-term value creation for the Company.

In view of this transition, the Supervisory Board developed in 2017 a new LTI programme that will be submitted for approval to the 2018 Annual General Meeting of Shareholders. The new programme is specifically designed for a wider group of participants within the Company and is aimed at creating greater balance between the short- and long-term compensation of the programme participants.

The new LTI targets are structured to align the long-term interests of shareholders and management, with a continued focus on revenue and, as an additional long-term objective, leadership in terms of enterprise value multiple, relative to competition. Additionally, the new LTI includes triggers relating to (i) the EBITDA margin to ensure that profitability is not sacrificed and (ii) the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management. Consistent with the current LTI programme, the new programme is designed with a conditional payout as a deferred component subject to continued achievement of targets beyond the end date of the programme. This creates a focus on long-term goals throughout the programme and provides an effective mechanism for motivating and retaining members of management who are critical to the Company's ongoing success.

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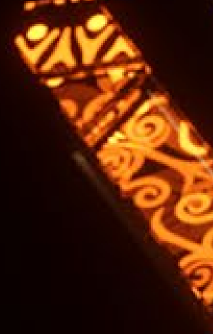
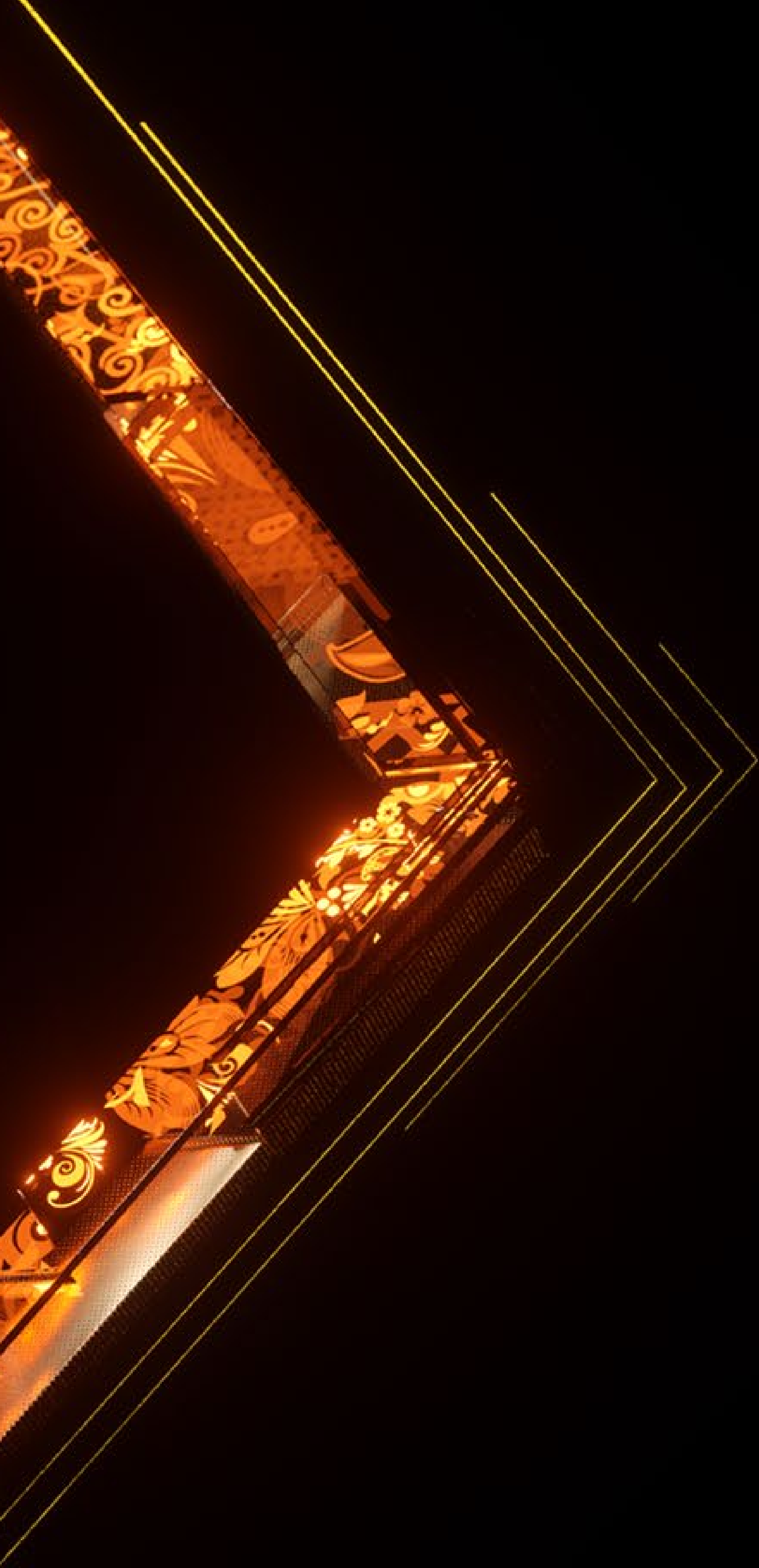
Financial statements





X5 RETAIL GROUP N.V.

International financial reporting standards

Consolidated financial statements

31 December 2017

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X5 RETAIL GROUP N.V.

Consolidated statement of financial position

at 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2017	31 December 2016
Assets			
Non-current assets			
Property, plant and equipment	10	278,928	232,316
Investment property	11	5,488	4,590
Goodwill	12	90,276	80,369
Other intangible assets	13	18,442	16,380
Other non-current assets	16	7,708	4,448
Deferred tax assets	28	5,143	5,306
		405,985	**343,409**
Current assets			
Inventories	14	99,300	73,801
Indemnification asset	33	106	182
Trade, other accounts receivable and prepayments	16	15,531	28,027
Current income tax receivable		2,384	954
VAT and other taxes receivable	17	14,347	8,922
Cash and cash equivalents	9	27,605	18,190
		159,273	**130,076**
TOTAL ASSETS		**565,258**	**473,485**
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	20	2,458	2,458
Share premium		46,212	46,251
Retained earnings		109,655	78,261
Share-based payment reserve	27	117	70
		158,442	**127,040**
Total equity		**158,442**	**127,040**
Non-current liabilities			
Long-term borrowings	19	135,622	110,865
Deferred tax liabilities	28	5,670	6,505
Long-term deferred revenue		5	8
Other non-current liabilities		1,344	1,697
		142,641	**119,075**
Current liabilities			
Trade accounts payable		130,766	131,180
Short-term borrowings	19	58,674	45,168
Interest accrued		1,642	1,177
Short-term deferred revenue		1,701	282
Current income tax payable		635	821
Provisions and other liabilities	18	70,757	48,742
		264,175	**227,370**
Total liabilities		**406,816**	**346,445**
TOTAL EQUITY AND LIABILITIES		**565,258**	**473,485**

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated statement of profit or loss

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2017	2016
Revenue	22	1,295,008	1,033,667
Cost of sales	23	(986,070)	(783,682)
Gross profit		**308,938**	**249,985**
Selling, general and administrative expenses	23	(259,376)	(211,314)
Lease/sublease and other income	24	8,196	6,960
Operating profit		**57,758**	**45,631**
Finance costs	25	(16,138)	(17,372)
Finance income	25	121	54
Net foreign exchange gain		75	340
Profit before tax		**41,816**	**28,653**
Income tax expense	28	(10,422)	(6,362)
Profit for the year		**31,394**	**22,291**
Profit for the year attributable to:			
Equity holders of the parent		31,394	22,291
Basic earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	**462.45**	**328.37**
Diluted earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	**462.36**	**328.36**

X5 RETAIL GROUP N.V.

Consolidated statement of comprehensive income

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	2017	2016
Profit for the year	**31,394**	**22,291**
Total comprehensive income for the year, net of tax	**31,394**	**22,291**
Total comprehensive income for the year attributable to:		
Equity holders of the parent	**31,394**	**22,291**

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated statement of cash flows

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2017	2016
Profit before tax		**41,816**	**28,653**
Adjustments for:			
Depreciation, amortisation and impairment of property, plant and equipment, investment property and intangible assets	23	38,435	30,636
(Gain)/loss on disposal of property, plant and equipment, investment property and intangible assets		(61)	47
Finance costs, net	25	16,017	17,318
Impairment of trade, other accounts receivable and prepayments	23	522	247
Share-based compensation expense	27	71	48
Net foreign exchange gain		(75)	(340)
Other non-cash items		105	(864)
Net cash from operating activities before changes in working capital		**96,830**	**75,745**
Decrease in trade, other accounts receivable and prepayments		4,290	350
Increase in inventories		(25,498)	(15,914)
Increase in trade payable		448	27,471
Increase in other accounts payable		9,374	8,149
Net cash flows generated from operations		**85,444**	**95,801**
Interest paid		(15,069)	(17,236)
Interest received		59	40
Income tax paid		(11,776)	(3,690)
Net cash flows from operating activities		**58,658**	**74,915**
Cash flows from investing activities			
Purchase of property, plant and equipment		(78,355)	(68,694)
Acquisition of businesses, net of cash acquired	7	(6,467)	(6,658)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		776	589
Purchase of other intangible assets		(3,438)	(2,516)
Proceeds from disposal of available-for-sale investments		210	–
Net cash flows used in investing activities		**(87,274)**	**(77,279)**
Cash flows from financing activities			
Proceeds from loans	19	100,780	131,563
Repayment of loans	19	(62,700)	(119,922)
Purchase of treasury shares		(63)	–
Net cash flows generated from financing activities		**38,017**	**11,641**
Effect of exchange rate changes on cash and cash equivalents		14	(45)
Net increase in cash and cash equivalents		**9,415**	**9,232**
Movements in cash and cash equivalents			
Cash and cash equivalents at the beginning of the year	9	18,190	8,958
Net increase in cash and cash equivalents		9,415	9,232
Cash and cash equivalents at the end of the year	9	**27,605**	**18,190**

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated statement of changes in equity

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	Attributable to equity holders of the parent						
	Number of shares	Share capital	Share premium	Share-based payment reserve	Retained earnings	Total shareholders' equity	Total
BALANCE AS AT 1 JANUARY 2016	**67,882,421**	**2,458**	**46,253**	**37**	**55,970**	**104,718**	**104,718**
Profit for the period	–	–	–	–	22,291	22,291	22,291
Total comprehensive income for the period	–	–	–	–	**22,291**	**22,291**	**22,291**
Share-based payment compensation (Note 27)	–	–	–	31	–	31	31
Transfer and waiving of vested equity rights	1,919	–	(2)	2	–	–	–
BALANCE AS AT 31 DECEMBER 2016	**67,884,340**	**2,458**	**46,251**	**70**	**78,261**	**127,040**	**127,040**
BALANCE AS AT 1 JANUARY 2017	**67,884,340**	**2,458**	**46,251**	**70**	**78,261**	**127,040**	**127,040**
Profit for the period	–	–	–	–	31,394	31,394	31,394
Total comprehensive income for the period	**–**	**–**	**–**	**–**	**31,394**	**31,394**	**31,394**
Share-based payment compensation (Note 27)	–	–	–	71	–	71	71
Transfer and waiving of vested equity rights	2,408	–	(39)	(24)	–	(63)	(63)
BALANCE AS AT 31 DECEMBER 2017	**67,886,748**	**2,458**	**46,212**	**117**	**109,655**	**158,442**	**158,442**

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Notes to the consolidated financial statements

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

01 Principal activities and the Group structure

These consolidated financial statements are for the economic entity comprising X5 Retail Group N.V. (the "Company") and its subsidiaries, as set out in Note 6 (the "Group").

X5 Retail Group N.V. is a joint stock limited liability company established in August 1975 under the laws of the Netherlands. The principal activity of the Company is to act as a holding company for a group of companies that operate retail grocery stores. The Company's address and tax domicile is Parkstraat 20, 2514 JK The Hague, the Netherlands.

The main activity of the Group is the development and operation of grocery retail stores. As at 31 December 2017 the Group operated a retail chain of 12,121 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express" (each representing separate format) in major population centres in Russia, including but not limited to Moscow, St Petersburg, Nizhniy Novgorod, Rostov-on-Don, Kazan, Samara, Lipetsk, Chelyabinsk, Perm, Ekaterinburg (31 December 2016: 9,187 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express"), with the following number of stores.

	31 December 2017	31 December 2016
"Pyaterochka" – Proximity stores		
Central FD	4,607	3,512
Volga FD	3,038	2,348
North-western FD	1,333	1,028
Ural FD	951	730
Southern FD	841	577
Siberian FD	277	40
Northern Caucasus	178	128
TOTAL	**11,225**	**8,363**
"Perekrestok" – Supermarkets		
Central FD	389	336
Volga FD	107	95
North-western FD	65	50
Ural FD	40	26
Southern FD	28	24
Northern Caucasus	9	8
TOTAL	**638**	**539**
"Karusel" – Hypermarkets		
Central FD	37	35
Volga FD	24	25
North-western FD	18	17
Ural FD	8	8
Southern FD	5	5
Northern Caucasus	1	1
TOTAL	**93**	**91**
"Perekrestok Express" – Express	**165**	**194**
TOTAL STORES	**12,121**	**9,187**

As at 31 December 2017 the principal shareholder exerting significant influence over the Company is CTF Holdings S.A. ("CTF"). CTF owns 47.86% of total issued shares in the Company, indirectly through Luxaro Retail Holding S.a.r.l. As at 31 December 2017 the Company's shares were listed on the London Stock Exchange in the form of Global Depositary Receipts (GDRs), with each GDR representing an interest of 0.25 in an ordinary share (Note 20).

02 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

2.1 Basis of preparation

These consolidated financial statements for the year ended 31 December 2017 have been prepared in accordance with and comply with International Financial Reporting Standards as adopted by the European Union and with Part 9 Book 2 of the Dutch Civil Code.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss. The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

On 28 March 2018, the Management Board authorised the consolidated financial statements for issue. Publication is on 29 March 2018.

2.2 Consolidated financial statements

Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. The existence and effect of substantive rights, including substantive potential voting rights, are considered when assessing whether the Group has power over another entity. For a right to be substantive, the holder must have practical ability to exercise that right when decisions about the direction of the relevant activities of the investee need to be made. The Group may have power over an investee even when it holds less than majority of voting power in an investee. In such a case, the Group assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of investee's activities or apply only in exceptional circumstances, do not prevent the Group from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of businesses other than those acquired from parties under common control. The consideration transferred is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, including fair value of assets or liabilities from contingent consideration arrangements but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs related to the acquisition and incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt as part of the business combination are deducted from the carrying amount of the debt and all other transaction costs associated with the acquisition are expensed. The date of exchange is the acquisition date where a business combination is achieved in a single transaction. However, when a business combination is achieved in stages by successive share purchases, the date of exchange is the date of each exchange transaction; whereas the acquisition date is the date on which acquirer obtains control of the subsidiary.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date.

Goodwill is measured by deducting the fair value of net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount (bargain purchase gain) is recognised in consolidated statement of profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed and reviews appropriateness of their measurement.

02 Summary of significant accounting policies

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interest method (also referred as "the predecessor values method"). Under this method the consolidated financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented or, if later, the date when the combining entities were first brought under common control. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts.

The predecessor entity is considered to be the highest reporting entity in which the subsidiary's IFRS financial information was consolidated. Related goodwill inherent in the predecessor entity's original acquisitions is also recorded in these consolidated financial statements. Any difference between the carrying amount of net assets, including the predecessor entity's goodwill, and the consideration for the acquisition is accounted for in these consolidated financial statements as an adjustment to other reserve within equity.

2.3 Foreign currency translation and transactions

(a) Functional and presentation currency

The functional currency of the Group's entities is the national currency of the Russian Federation, the Russian Rouble ("RUB"). The presentation currency of the Group is the Russian Rouble ("RUB"), which management believes is the most useful currency to adopt for users of these consolidated financial statements.

(b) Transactions and balances

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the official exchange rate of the Central Bank of Russian Federation ("CBRF") at the respective reporting dates. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into the functional currency at period-end official exchange rates of the CBRF are recognised in profit or loss. Translation at period-end rates does not apply to non-monetary items.

2.4 Segment reporting

Operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker has been identified as the Management Board. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments. The Group identifies retail chains of each format (see Note 1) as separate operating segments in accordance with the criteria set forth in IFRS 8. Reportable segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

2.5 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, where required. Cost includes expenditure that is directly attributable to the acquisition or construction of the item.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of property, plant and equipment are capitalised and the replaced parts are retired. Capitalised costs are depreciated over the remaining useful life of the property, plant and equipment or part's estimated useful life whichever is sooner.

Leasehold improvements are capitalised when it is probable that future economic benefits associated with the improvements will flow to the Company and the cost can be measured reliably.

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment including construction in progress. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs of disposal and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the consolidated statement of profit or loss. An impairment loss recognised for an asset in prior years is reversed if there has been a favourable change in circumstances affecting estimates used to determine the asset's value in use or fair value less costs of disposal.

Gains and losses on disposals determined by comparing the proceeds with the carrying amount are recognised in profit or loss.

Land is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Buildings are divided into foundation and frame with a depreciation period of 40-50 years and other parts of 7-8 years. Other parts mainly include fixtures and fitting.

The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are as follows:

	Useful lives
Buildings (foundation and frame)	40-50 years
Buildings (other parts)	7-8 years
Machinery and equipment	5-10 years
Refrigerating equipment	7-10 years
Vehicles	5-7 years
Other	3-5 years

The residual value of an asset is the estimated amount that the Group would currently obtain from the disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

2.6 Investment property

Investment property consists of buildings held by the Group to earn rental income or for capital appreciation, or both, and which are not occupied by the Group. The Group recognises the part of owned shopping centres that are leased to third party retailers as investment property, unless they represent insignificant portions of the property and are used primarily to provide auxiliary services to retail customers not provided by the Group rather than to earn rental income. After purchase or construction of the building the Group assesses the main purpose of its use and, if the main purpose is to earn rental income or for capital appreciation, or both, the building is classified as investment property.

Investment properties are stated at cost less accumulated depreciation and provision for impairment, where required. If any indication exists that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs of disposal. Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment without changes in the carrying amount and cost of that property for measurement or disclosure purposes. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are 40-50 years.

Fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The Group engaged an independent valuation specialist to assess the fair value of investment properties. The measurement is classified in level 3 of the fair value hierarchy.

2.7 Intangible assets

(a) Goodwill

Goodwill is carried at cost less accumulated impairment losses. Goodwill represents the excess of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date over the fair value of the net assets of the acquired subsidiary at the date of exchange. Goodwill is not deductible for tax purposes.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is tested on the operating segment level.

(b) Lease rights

Lease rights represent:

- Rights for favourable operating leases acquired in business combinations. Lease rights acquired in a business combination are recognised initially at fair value;
- Key money payments due to incumbent tenants and other directly attributable costs for entering into lease contracts.

Lease rights are amortised using the straight-line method over the lease term of the respective lease contracts – ranging from 5 to 50 years.

(c) Brand and private labels

Brand and private labels acquired in a business combination are recognised initially at fair value. Private labels are amortised using the straight-line method over their useful lives. In 2017 the Group revised the useful life of its "Pyaterochka" and "Karusel" brands and estimated them to be indefinite-lived as there is no foreseeable limit to the period over which the brands are expected to generate net cash inflows for the Company. Change in estimate was based on the demonstration of the brands' ability to survive changes in the economic environment.

	Useful lives
Private labels	1-8 years

(d) Franchise agreements

Franchise agreements represent rights to receive royalties. Franchise agreements acquired in a business combination are recognised initially at fair value. Franchise agreements are amortised using the straight-line method over their useful lives.

(e) Software and other intangible assets

Expenditure on acquired patents, software and licenses is capitalised and amortised using the straight-line method over their useful lives ranging from 1 to 10 years (5 on average).

(f) Impairment of intangible assets

Where an indication of impairment exists, the recoverable amount of any intangible asset, including goodwill, is assessed and, when impaired, the asset is written down immediately to its recoverable amount. Goodwill and intangible assets not yet available for use are tested for impairment at least annually and whenever impairment indicators exist.

2.8 Operating leases

Leases of assets under which substantially all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease except preopening rentals, which are directly attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management, capitalised as a part of retail store or distribution centre construction costs.

The Group leases retail outlets and distribution centres under terms of fixed and variable lease payments. The variable lease payments depend on revenue earned by the respective retail outlets. The Group classifies variable lease payments as contingent rents.

Initial direct costs incurred by the Group in negotiating and arranging an operating lease including key money paid to previous tenants for entering into lease contracts are recognised as lease rights.

2.9 Inventories

Inventories at distribution centres and retail outlets are stated at the lower of cost and net realisable value. Cost comprises direct costs of goods, transportation and handling costs. Cost is determined by the weighted average method. Net realisable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

The Group provides for estimated inventory losses (shrinkage) between physical inventory counts on the basis of a percentage of cost of sales. The provision is adjusted to actual shrinkage based on regular inventory counts. The provision is recorded as a component of cost of sales. The Group also provides for aged stock provision where the expected selling price is below cost.

2.10 Financial assets and liabilities

The Group classifies its financial assets into the following measurement categories: loans and receivables and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date, if required under IFRS. The Group designates investments as available-for-sale only when they fall outside the other category of financial assets.

Initial recognition of financial instruments

Financial assets are initially recorded at fair value plus transaction costs. Financial liabilities are initially recorded at fair value minus transaction costs. Fair value at initial recognition is best evidenced by the transaction price.

Impairment

The Group reviews the carrying value of its financial assets on a regular basis. If the carrying value of an asset is greater than the recoverable amount, the Group records an impairment loss and reduces the carrying amount of assets by using an allowance account.

Derecognition of financial assets

The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into the following measurement categories: (a) financial derivatives and (b) other financial liabilities. Financial derivatives are carried at fair value with changes in value recognised in the consolidated statement of profit or loss in the period in which they arise. Other financial liabilities are carried at amortised cost.

2.11 Loans, trade and other receivables

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term. Loans receivable and other receivables are carried at amortised cost using the effective interest rate method. Trade receivables are initially recognised at their fair values and are subsequently carried at amortised cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The Group determines that there is objective evidence of impairment by assessing groups of receivables against credit risk factors established based on historical loss experience for each group. Indications that the trade receivable may be impaired include financial difficulties of the debtor, likelihood of the debtor's insolvency, and default or significant failure of payment. The amount of the provision is recognised in the consolidated statement of profit or loss. Uncollectible receivables are written off against the related impairment provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recovery of amounts previously written off is credited to impairment account within the profit or loss for the year.

02 Summary of significant accounting policies

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments used for meeting short term cash commitments.

2.13 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are measured as the best estimate of the expenditure required to settle the present obligation at the reporting date.

2.14 Value added tax

Output VAT related to sales is payable to tax authorities on the earliest of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice and fulfilment of other conditions in compliance with Russian tax legislation.

The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability, except for VAT, presented within other non-current assets. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

2.15 Employee benefits

Wages, salaries, bonuses, paid annual leave and sick leave are accrued in the period in which the associated services are rendered by the employees of the Group. The Group's entities contribute to the Russian Federation's state pension and social insurance funds in respect of their employees. These contributions are accrued when incurred. The Group's commitment ends with the payment of these contributions.

2.16 Share-based payments

Employee stock plan

The Group receives services from employees as consideration for conditional rights to receive GDRs after vesting period of 3 years and fulfilment of certain predetermined performance conditions.

Share-based payment transactions under the employee stock plan are accounted for as equity-settled transactions.

The fair value of the employee services received in exchange for the grant of the conditional rights is recognised as an expense over the vesting period with the corresponding increase in equity (Share-based payment reserve) and measured by reference to the market price of the GDRs which is determined at grant date.

The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The expense or credit in the statement of profit or loss for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

2.17 Borrowings

Borrowings are initially recognised at their fair value, net of transaction costs, and are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the consolidated statement of profit or loss over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial period of time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised.

2.18 Trade and other payables

Trade and other payables are accrued when the counterparty performs its obligation under the contract and are carried at amortised cost using the effective interest method. Trade payables are recognised initially at fair value.

2.19 Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as share premium.

2.20 Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared on or before the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the consolidated financial statements are authorised for issue.

2.21 Treasury shares

Where any group company purchases the Company's equity share capital, the paid consideration, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any received consideration, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.22 Earnings per share

Earnings per share are determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting period. Diluted earnings per share are calculated by adjusting the earnings and the number of shares for the effects of dilutive options.

2.23 Taxes

Current tax is the amount expected to be paid to, or recovered from, the state budget in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if consolidated financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Current income tax liabilities (assets) are measured in accordance with IAS 12 *Income Taxes*, based on legislation that is enacted or substantively enacted at the reporting date, taking into consideration applicable tax rates and tax exemptions.

Deferred income tax is provided using the reporting liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. In accordance with the initial recognition exception, deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period in which the asset is realised or the liability is settled, based on tax rates which are enacted or substantially enacted at the reporting date.

02 Summary of significant accounting policies

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted within the consolidated group of taxpayers (CGT) and within individual companies of the Group for the entities that are not members of the CGT.

The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period. Adjustments for uncertain income tax positions are recorded within the income tax charge. Interest incurred in relation to taxation is included in finance costs in the consolidated statement of profit or loss. Provisions are maintained, and updated if necessary, for the period over which the respective tax positions remain subject to review by the tax and customs authorities, being 3 years from the year of filing.

2.24 Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 32.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:
- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:
- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

2.25 Income and expense recognition

Income and expenses are recognised on an accrual basis as earned or incurred. Recognition of the principal types of income and expenses is as follows:

(a) Revenue

Revenue from the sale of goods through retail outlets is recognised at the point of sale. Revenue from franchisee fees is recognised based on contractual agreements over the term of the contracts. The up-front non-refunda ble franchisee fees received by the Group are deferred and recognised over the contractual term. Revenue from advertising services is recognised based on contractual agreements. Revenues are measured at the fair value of the consideration received or receivable. Revenues are recognised net of value added tax.

The Group has a loyalty card scheme. Discounts earned by customers through loyalty cards are recorded by the Group by allocating some of the consideration received from the initial sales transaction to the award credits and deferring the recognition of revenue.

(b) Cost of sales

Cost of sales includes the purchase price of the products sold and other costs incurred in bringing the inventories to the location and condition ready for sale, i.e. retail outlets. These costs include costs of purchasing, storing, rent, salaries and transporting the products to the extent it relates to bringing the inventories to the location and condition ready for sale.

The Group receives various types of allowances from suppliers in the form of volume discounts and other forms of payment. In accounting for supplier bonuses received by the Group, the Group determined that these bonuses are a reduction in prices paid for the product and are reported as part of the cost of sales as the related inventory is sold. Bonuses receivable from suppliers in cash are presented as trade receivables.

(c) Interest income and expense

Interest income and expense are recognised on an effective yield basis.

(d) Selling, general and administrative expenses

Selling expenses consist of salaries and wages of stores employees, store expenses, rent or depreciation of stores, utilities, advertising costs and other selling expenses. General and administrative expenses include costs of salaries and wages of support office employees, rent and depreciation of support offices, impairment and amortisation charges of non-current assets and other general and administrative expenses. Selling, general and administrative expenses are recognised on an accrual basis as incurred.

2.26 Impairment of non-current assets other than goodwill

The Group periodically assesses whether there is any indication that non-current assets may be impaired. If any such indicators exist, the Group estimates the recoverable amount of the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash generating unit to which it belongs. Individual stores are considered separate cash-generating units for impairment testing purposes. Impairment loss is recognised whenever the carrying amount of an asset or the related cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the consolidated statement of profit or loss. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.27 Fair value of assets and liabilities at the acquisition date

A primary valuation of assets and liabilities of acquired companies was performed on a provisional basis. Once the valuation is finalised, any adjustments arising are recognised retrospectively.

2.28 Indemnification asset

The indemnification asset equivalent to the fair value of the indemnified liabilities is included in net assets acquired in the business combination if the selling shareholders of the acquiree agreed to compensate possible claims or contingencies. Subsequent measurement of the indemnification asset and contingent liability does not have any impact on future earnings, unless the indemnification asset becomes impaired.

2.29 Offsetting of financial assets and financial liabilities

Accounts receivable and accounts payable are offset and the net amount is presented in the consolidated statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and intends to settle on a net basis.

03 Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities include:

Impairment of goodwill

The Group tests goodwill for impairment at least annually. The recoverable amount of a cash-generating unit has been determined based on the higher of fair value less costs to sell or value-in-use calculations. These calculations require the use of estimates as further detailed in Note 12. During 2017 the Group recognised impairment of goodwill for Perekrestok Express segment (included in other segments) in the amount of RUB 286 due to underperformance of the relevant CGUs.

Identifying a business combination

The Group enters into transactions to acquire integrated set of assets and operations of retail stores. The Group determines whether such transactions represent a business combination or assets acquisitions. The Group treats such transactions as business combinations when the integrated set of activities and assets acquired is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to the Group. In making this judgment the Group considers whether it acquired inputs and processes applied to the inputs that have ability to create output. All acquisitions of assets and operations of retail stores occurred in 2017 and 2016 were treated by the Group as business combinations.

Litigations

The Group exercises considerable judgment in measuring and recognising provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations (Note 33).

Deferred tax assets and liabilities

Group's management judgment is required for the calculation of current and deferred income taxes. Deferred tax assets are recognised to the extent that their utilization is probable. The utilization of deferred tax assets will depend on whether it is possible to generate sufficient taxable income in respective tax type and jurisdiction. Various factors are used to assess the probability of the future utilization of deferred tax assets, including past operating results, the operational plan, expiration of tax losses carried forward, and tax planning strategies. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in profit or loss.

IAS 12 requires a deferred tax liability to be recognised for all taxable temporary differences associated with investments in subsidiaries unless: (a) the parent, investor joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and (b) it is probable that the temporary difference will not reverse in the foreseeable future. The Group excercises significant judgment in assessing the amount of taxable temporary differences associated with investments in subsidiaries (unremitted earnings) that will not reverse in the foreseeable future.

If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected.

Property, plant and equipment

The Group's management determines the estimated useful lives and related depreciation charges for its plant and equipment (Note 10). The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets. Management increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that property, plant and equipment may be impaired. The Group performs assets impairment testing (Note 10). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2017 the Group recognised an impairment loss in the amount of RUB 5,311 (year ended 31 December 2016: a net impairment loss in the amount of RUB 3,132).

Investment property

The Group's management determines the estimated useful lives and related depreciation charges for its investment properties (Note 11). Management increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that investment property may be impaired. The Group performs assets impairment testing (Note 11). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2017 the Group recognised a net impairment gain in the amount of RUB 1,007 (year ended 31 December 2016: a net impairment loss in the amount of RUB 257).

Lease rights

The Group's management determines the fair value of lease rights acquired in business combinations. The assessment of the fair value of such lease rights is based on the estimate of the market rates of the lease (Note 13). The Group periodically assesses whether there is any indication that lease rights may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2017 the Group recognised a net impairment gain in the amount of RUB 178 (year ended 31 December 2016: a net impairment loss in the amount of RUB 66).

Inventories of goods for resale provisions

The Group provides for estimated inventory shrinkage on the basis of historical shrinkage as a percentage of cost of sales. This provision is adjusted at the end of each reporting period to reflect the historical trend of the actual physical inventory count results. The Group also provides for aged stock where the expected selling price is below cost (Note 14).

Revenue recognition - Loyalty programmes

The Group estimates the amount of obligations related to customer loyalty programmes by allocating transaction price to loyalty points based on the standalone selling price of the points. The standalone selling price of the points is reduced for the expected amount of the points that will expire unredeemed. As at 31 December 2017 the estimated liability for unredeemed points was RUB 1,665 (31 December 2016: RUB 236).

Provision for impairment of trade and other receivables

The Group determines an allowance for doubtful accounts receivable at the end of the reporting period (Note 16). In estimating an allowance for uncollectible accounts receivable the Group takes into account the historical collectability of the outstanding accounts receivable balances supplemented by the judgement of management.

03

Critical accounting estimates and judgements in applying accounting policies

Brand and private labels

The Group periodically assesses whether there is any indication that brand and private labels may be impaired. The Group performs assets impairment testing of brands with indefinite useful lives at least annually (Note 13). The Group estimates the recoverable amount of the asset and if it is less than the carrying amount an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2017 the Group recognised impairment in the amount of RUB Nil (year ended 31 December 2016: an impairment loss in the amount of RUB 68).

04

Adoption of new and revised standards and interpretations and new accounting pronouncements

In the preparation of these consolidated financial statements, the Group followed the same accounting policies and methods of computation as compared with those applied in the previous year, except for the adoption of new standards and interpretations and revision of the existing standards as of 1 January 2017.

- *Amendments to IAS 7 – Disclosure Initiative*

The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The Group disclosed additional information in Note 19 in these consolidated financial statements for the year ended 31 December 2017.

- *Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses*

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

The application of these amendments has no effect on the Group's financial position and performance as the Group followed the same principles in prior periods.

- *Annual Improvements Cycle – 2014-2016*

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of disclosure requirements in IFRS 12

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10-B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale.

These amendments do not have any impact on the Group as there has been no entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale during the period.

The amendments described above had no significant impact on the financial position and performance of the Group or the disclosures in the consolidated financial statements.

The Group has not early adopted any standard, interpretation or amendment that has been issued but is not yet effective.

Standards issued but not yet effective in the European Union	Effective for annual periods beginning on or after
IFRS 9 Financial Instruments	1 January 2018
Amendments to IFRS 4 – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	1 January 2018
IFRS 15 Revenue from Contracts with Customers	1 January 2018
IFRS 16 Leases	1 January 2019
Annual Improvements to IFRSs 2014-2016 Cycle	1 January 2018
Amendments to IAS 40 – Transfers of Investment Property	1 January 2018*
Amendments to IFRS 2 – Classification and Measurement of Share-based Payment Transactions	1 January 2018*
IFRIC 22 Foreign Currency Transactions and Advance Consideration	1 January 2018*
Amendments to IAS 28 – Long-term Interests in Associates and Joint Ventures	1 January 2019*
Amendments to IFRS 9 – Prepayment Features with Negative Compensation	1 January 2019*
IFRIC 23 Uncertainty over Income Tax Treatments	1 January 2019*
Annual Improvements to IFRSs 2015-2017 Cycle	1 January 2019*
Amendments to IAS 19: Plan Amendment, Curtailment or Settlement	1 January 2019*
IFRS 17 Insurance Contracts	1 January 2021*

*Subject to EU endorsement

The Group expects that the adoption of the pronouncements listed above will not have a significant impact on the Group's results of operations and financial position in the period of initial application except for IFRS 16.

The Group plans to apply IFRS 9 and IFRS 15 starting from the dates effective in the European Union. At present the Group is in the process of analysis of the possible impact of the application of these standards on its consolidated financial statements, but the preliminary results show that the impact will not be significant.

IFRS 9 Financial Instruments

Starting from 2018, the Group will apply IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Group will adopt the new standard on the required effective date and due to the exemption in IFRS 9 will not restate comparative periods in the year of initial application. As a consequence, any adjustments to the carrying amounts of financial assets or liabilities are to be recognised at 1 January 2018, with the difference recognised in the opening balance of accumulated profits.

During 2017, the Group has performed a detailed impact assessment of all three aspects of IFRS 9. This assessment is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Group in 2018. Overall, the Group expects no significant impact on its statement of financial position and equity. The Group has assessed the impact of IFRS 9 to the Group's consolidated financial statements as follows:

(a) Classification and measurement

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. IFRS 9 includes three principal classification categories for financial assets: measured at amortised cost, at fair value through other comprehensive income and at fair value through profit or loss. It eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available-for-sale financial assets.

Based on the assessment, the Group does not expect a significant impact on its statement of financial position or equity on applying the classification and measurement requirements of IFRS 9.

04

Adoption of new and revised standards and interpretations and new accounting pronouncements

Loans, trade and other receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. The Group analysed the contractual cash flow characteristics of those instruments and concluded that they meet the criteria for amortised cost measurement under IFRS 9. Therefore, reclassification for these instruments is not required.

(b) Impairment

Under IFRS 9, the new impairment model requires the recognition of impairment provisions based on the expected credit losses rather than only incurred credit losses under IAS 39. The expected credit losses represent measures of an asset's credit risk. This will require considerable judgement about how changes in economic factors affect expected credit losses, which will be determined on a probability-weighted basis.

The new impairment model applies to the Group's financial assets, including, but not limited to, trade and other receivables, cash and cash equivalents.

Loss allowances are measured on either of the following bases:

- 12-month basis - these are expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date; or
- lifetime basis - these are expected credit losses that result from all possible default events over the expected life of a financial instrument.

The Group has chosen to apply applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which permits the use of the lifetime expected loss provision for all trade and other receivables.

The Group's cash and cash equivalents have low credit risk based on the external credit ratings of banks and financial institutions.

Based on the assessments undertaken to the date, the Group expects an insignificant change in the loss allowance for trade debtors and other financial assets held at amortised cost.

(c) Hedge accounting

The Group does not have hedge relationships that are currently designated as effective hedging relationships and therefore applying the hedging requirements of IFRS 9 will not have a significant impact on Group's financial statements.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014, and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group plans to adopt the new standard on the required effective date using the full retrospective method. During 2016, the Group performed a preliminary assessment of IFRS 15, which was continued with a more detailed analysis completed in 2017.

The Group is in the retail business and sells their goods both as acting as principal or through franchisees acting as agents. The Group expects the revenue recognition to occur when control of the asset is transferred to the customer, generally for the retail customers it is occurred in the stores at the point of sale. Other revenue streams are not significant. The Group performed analysis of its revenue streams through a five-step model established by IFRS 15. The Group does not expect a significant impact on its balance sheet or equity on applying the requirements of IFRS 15.

In preparing to adopt IFRS 15, the Group considered the effect of IFRS 15 requirements on accounting for its loyalty programmes. Under IFRIC 13 Customer Loyalty Programmes, the Group allocated a portion of the transaction price to the loyalty programme using the fair value of points issued and recognised the deferred revenue in relation to points issued but not yet redeemed or expired. The Group concluded that under IFRS 15 the loyalty programme gives rise to a separate performance obligation because it generally provides a material right to the customer. Under IFRS 15, the Group will need to allocate a portion of the transaction price to the loyalty programme based on relative standalone selling price instead of the allocation using the fair value of points issued, i.e. residual approach, as it did under IFRIC 13. The Group determined that more revenue must be allocated to the goods sold in comparison to the existing accounting policy. The Group assessed that the effect of this change in accounting policy is insignificant.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases. IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

In 2018, the Group will continue to assess the potential effect of IFRS 16 on its consolidated financial statements.

05 Segment reporting

The Group identifies retail chains of each format (see Note 1) as separate operating segments in accordance with the criteria set forth in IFRS 8.

The following significant operating functions are decentralised by formats:
- Category management, including purchasing, pricing, assortment management, promotion management;
- Distribution centres logistics;
- Development function.

The formats' general managers are determined as segment managers in accordance with IFRS 8. The chief operating decision-maker has been determined as the Management Board. The Management Board reviews each format's internal reporting in order to assess performance and allocate resources.

The Management Board assesses the performance of the operating segments based on a measure of sales and adjusted earnings before interest, tax, depreciation, amortisation and impairment (EBITDA). Other information provided to the Management Board is measured in a manner consistent with that in the consolidated financial statements. Capital expenditures include additions of property, plant and equipment, investment properties and intangible assets, acquisitions of property, plant and equipment, investment properties and intangible assets through business combinations as well as goodwill acquired through such business combinations.

The accounting policies used for segments are the same as accounting policies applied for these consolidated financial statements.

05

Segment reporting

The segment information for the year ended 31 December 2017, comparative figures for earlier periods and reconciliation of EBITDA to profit for the year is provided as follows:

Year ended 31 December 2017	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	**1,004,406**	**188,501**	**90,608**	**11,493**	**–**	**1,295,008**
EBITDA	**82,891**	**13,012**	**4,618**	**(68)**	**(4,260)**	**96,193**
Depreciation, amortisation and impairment						(38,435)
Operating profit						**57,758**
Finance cost, net						(16,017)
Net foreign exchange result						75
Profit before income tax						**41,816**
Income tax expense						(10,422)
Profit for the year						**31,394**
Capital expenditure	70,401	23,734	4,047	103	356	98,641
31 December 2017						
Inventories	75,304	14,627	8,472	897	–	99,300

Year ended 31 December 2016	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	**779,448**	**157,004**	**84,649**	**12,566**	**–**	**1,033,667**
EBITDA	**64,441**	**11,935**	**4,322**	**(195)**	**(4,236)**	**76,267**
Depreciation, amortisation and impairment						(30,636)
Operating profit						**45,631**
Finance cost, net						(17,318)
Net foreign exchange result						340
Profit before income tax						**28,653**
Income tax expense						(6,362)
Profit for the year						**22,291**
Capital expenditure	62,971	11,881	5,213	501	112	80,678
31 December 2016						
Inventories	52,022	12,050	8,951	778	–	73,801

06

Subsidiaries

Details of the Company's significant subsidiaries at 31 December 2017 and 31 December 2016 are as follows:

Company	Country	Nature of operations	Ownership (%) 31 December 2017	31 December 2016
Agrotorg LLC	Russia	Retailing	100	100
Trade House PEREKRIOSTOK JSC	Russia	Retailing	100	100
Agroaspect LLC	Russia	Retailing	100	100
X5 Nedvizhimost CJSC	Russia	Assets holding company	100	100
KOPEYKA-MOSCOW Ltd.	Russia	Retailing	100	100
Krasnoborskoe LLC	Russia	Assets holding company	100	100
PEREKRESTOK HOLDINGS Ltd.	Gibraltar	Holding company	100	100
PEREKRIOSTOK-2000 LLC	Russia	Assets holding company	100	100
ALPEGRU RETAIL PROPERTIES Ltd.	Cyprus	Assets holding company	100	100
Beta Estate LLC	Russia	Assets holding company	100	100
SPEAK GLOBAL Ltd.	Cyprus	Assets holding company	100	100
X5 FINANSE LLC	Russia	Bond issuer	100	100
X5 Finance B.V.	the Netherlands	Bond issuer	100	100
Agro-Avto LLC	Russia	Assets holding company	100	100

07 Acquisition of businesses

Acquisitions in 2017

Acquisition of business from Monetka retail chain

During 2017 the Group acquired a number of stores from Monetka retain chain in Moscow and Moscow region. This acquisition was considered as an acquisition of business. The Group acquired 100% interest in these stores.

In the year ended 31 December 2017 the acquired business contributed revenue of RUB 3,007 from the date of acquisition. As the business was not acquired as a separate legal entity, it is impracticable to disclose net profit from the date of acquisition. The business did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2017 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities of acquired business and the related goodwill are as follows:

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	319
Other intangible assets (Note 13)	24
Deferred tax assets (Note 28)	142
Net assets acquired	**485**
Goodwill (Note 12)	2,869
Purchase consideration	**3,354**
Net cash outflow arising from the acquisition	**2,017**

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within a 12 month period from the acquisition date which is not yet finished at the date of approval of these consolidated financial statements.

The purchase consideration comprised the transfer of cash and cash equivalents of RUB 2,017 and RUB 1,337 as deferred consideration measured at fair value and payable in 2018.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to this acquisition was allocated to Pyaterochka and Perekrestok segments.

Acquisition of business from Sedmoy Kontinent retail chain

In August and September 2017 the Group acquired a number of stores from Sedmoy Kontinent retail chain in Moscow, the Moscow and Ivanovo regions. This acquisition was considered as an acquisition of business. The Group acquired 100% interest in these stores.

In the year ended 31 December 2017 the acquired business contributed revenue of RUB 1,845 from the date of acquisition. As the business was not acquired as a separate legal entity, it is impracticable to disclose net profit from the date of acquisition. The business did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2017 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities of acquired business and the related goodwill are as follows:

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	15
Other intangible assets (Note 13)	49
Other non-current assets	895
Deferred tax assets (Note 28)	313
Net assets acquired	**1,272**
Goodwill (Note 12)	1,254
Purchase consideration	**2,526**
Net cash outflow arising from the acquisition	**2,449**

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within 12 months from the acquisition date.

The purchase consideration comprised the transfer of cash and cash equivalents of RUB 2,449 and RUB 77 as deferred consideration measured at fair value and payable in 2018.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to this acquisition was allocated to Pyaterochka and Perekrestok segments.

07 Acquisition of businesses

Acquisition of business from O'KEY retail chain

In December 2017 the Group acquired a number of stores from O'KEY retail chain in St Petersburg, Moscow, the Moscow and Leningrad regions, Volgograd, Astrakhan, Lipetsk, Togliatti and Novocherkassk.

In the year ended 31 December 2017 the acquired business didn't contribute any revenue from the date of acquisition. Net loss from the date of acquisition comprised RUB 5. The business did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2017 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities of acquired business and the related goodwill are as follows:

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	2,091
Other intangible assets (Note 13)	47
Deferred tax assets (Note 28)	142
Trade, other accounts receivable and prepayments	51
VAT and other taxes receivable	165
Cash and cash equivalents	5
Provisions and other liabilities	(23)
Net assets acquired	**2,478**
Goodwill (Note 12)	4,175
Purchase consideration	**6,653**
Net cash inflow arising from the acquisition	**(5)**

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within 12 months from the acquisition date.

The purchase consideration for the reporting period comprised RUB 6,653 as deferred consideration.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to these acquisitions was allocated to Perekrestok segment.

Other acquisitions

In 2017 the Group acquired 100% of several businesses of other retail chains in Russian regions. The acquisitions were individually immaterial.

In the year ended 31 December 2017 the acquired businesses contributed revenue of RUB 3,890 from the date of acquisition. As the businesses were not acquired as separate legal entities, it is impracticable to disclose net profit from the date of acquisition. The businesses did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2017 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities of acquired businesses and the related goodwill are as follows:

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	821
Other intangible assets (Note 13)	41
Deferred tax assets (Note 28)	282
Net assets acquired	**1,144**
Goodwill (Note 12)	1,895
Purchase consideration	**3,039**
Net cash outflow arising from the acquisitions	**2,006**

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within 12 months from the acquisition date.

The purchase consideration comprises the transfer of cash and cash equivalents of RUB 2,006 and 1,033 as deferred consideration measured at fair value and payable in 2018.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to these acquisitions was allocated to Pyaterochka and Perekrestok segments.

Acquisitions in 2016

In 2016 the Group acquired 100% of several businesses of other retail chains in Russian regions. The acquisitions were individually immaterial.

In the year ended 31 December 2016 the acquired businesses contributed revenue of RUB 11,509 from the date of acquisition. The businesses did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2016 as though the acquisition date had been the beginning of that period. During 2017 the Group finalised purchase price allocation for acquisitions occurred in 2016, which resulted in no change from provisional values.

07 Acquisition of businesses

Details of assets and liabilities of acquired businesses and the related goodwill are as follows:

	Finalised fair values at the acquisition date
Property, plant and equipment (Note 10)	965
Other intangible assets (Note 13)	322
Deferred tax assets (Note 28)	627
Trade and other accounts receivable	1
Deferred tax liabilities (Note 28)	(18)
Net assets acquired	**1,897**
Goodwill (Note 12)	4,802
Purchase consideration	**6,699**
Net cash outflow arising from the acquisitions	**6,654**

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to these acquisitions was allocated to Pyaterochka and Perekrestok segments. During the year ended 31 December 2017 the Group has finalised fair value assessment of business combinations occurred during the year ended 31 December 2016 resulting in no change in the amount of goodwill initially recognised at provisional values.

The purchase consideration comprised the transfer of cash and cash equivalents of RUB 6,654, accounts receivable with fair value of RUB 44 and RUB 1 as deferred consideration. During 12 months ended 31 December 2016 the Group transferred RUB 4 as deferred payments for prior period's acquisitions.

08 Related party transactions

In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the relationships for those related parties with which the Group entered into significant transactions or had significant balances outstanding at 31 December 2017 are provided below. The ownership structure is disclosed in Note 1.

The following transactions were carried out with related parties:

	Relationship	2017	2016
CTF Holdings S.A.	Entity with significant influence over the Company		
Management services received		93	90
Other	Under control by the entity with significant influence over the Company		
Purchases from related parties		1,831	1,517
Insurance expenses		339	223
Other operating expenses		2	2
Bonuses from related parties		66	226
Other	Other		
Other operating expenses		1	42

The consolidated financial statements include the following balances with the related parties:

	Relationship	31 December 2017	31 December 2016
Other	Under control by the entity with significant influence over the Company		
Trade accounts payable		298	278
Other accounts payable		1	3
Trade accounts receivable		19	29
Other receivables and prepayments from related parties		2	11
Other	Other		
Other accounts payable		–	12
Other accounts receivable		–	–

Key management personnel compensation

Key management personnel compensation is disclosed in Note 26.

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the year-end are unsecured and interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. For the years ended 31 December 2017 and 2016, the Group did not record any impairment of receivables relating to amounts owed by related parties.

09 Cash and cash equivalents

	31 December 2017	31 December 2016
Bank current account – Roubles	12,120	5,799
Cash in transit – Roubles	11,750	9,105
Cash in hand – Roubles	3,063	2,599
Deposits – Euros	653	–
Deposits – US dollars	19	–
Deposits – Roubles	–	681
Bank current accounts and deposits – other currencies	–	6
TOTAL	**27,605**	**18,190**

The bank accounts represent current accounts. Interest income on overnights/term deposits was immaterial. Cash in transit is cash transferred from retail outlets to bank accounts and bank card payments being processed.

The Group assessed credit quality of outstanding cash and cash equivalents balances as high and considered that there was no significant individual exposure. The maximum exposure to credit risk at the reporting date was the carrying value of cash and bank balances.

Credit quality of cash and cash equivalents balances are summarised as follows (current ratings):

Bank	Moody's	Fitch	S&P	31 December 2017	31 December 2016
Alfa-Bank	Ba2	BB+	BB	1,123	1,088
Sberbank	Ba2[1]	BBB-	–	10,978	3,510
Russian Regional Development Bank	Ba2	–	–	374	–
Russian Agricultural Bank	Ba2	BB+	–	279	–
Gazprombank	Ba2	BB+	BB+	24	–
Credit Bank of Moscow	Ba3/NP	BB-	BB-	–	1,866
Other banks				14	22
Cash in transit and in hand				14,813	11,704
TOTAL				**27,605**	**18,190**

[1] LT Bank Deposits (Foreign) rating

10 Property, plant and equipment

	Land and buildings	Machinery and equipment	Refrigerating equipment	Vehicles	Other	Construction in progress[1]	Total
Cost							
At 1 January 2016	**171,981**	**24,409**	**28,053**	**7,367**	**21,959**	**12,613**	**266,382**
Additions	–	–	–	–	–	70,492	70,492
Transfers	36,816	10,874	12,964	5,273	6,873	(72,800)	–
Transfers to investment property (Note 11)	(473)	–	–	–	–	(312)	(785)
Assets from acquisitions (Note 7)	–	–	–	–	–	965	965
Disposals	(363)	(4,041)	(2,780)	(710)	(2,843)	(3)	(10,740)
At 31 December 2016	**207,961**	**31,242**	**38,237**	**11,930**	**25,989**	**10,955**	**326,314**
Additions	–	–	–	–	–	80,783	80,783
Transfers	41,288	11,854	11,745	5,774	10,520	(81,181)	–
Transfers to investment property (Note 11)	(267)	–	–	–	–	–	(267)
Assets from acquisitions (Note 7)	–	27	37	–	91	3,091	3,246
Disposals	(10,016)	(2,790)	(2,446)	(1,046)	(1,942)	(48)	(18,288)
At 31 December 2017	**238,966**	**40,333**	**47,573**	**16,658**	**34,658**	**13,600**	**391,788**
Accumulated depreciation and impairment							
At 1 January 2016	**(39,587)**	**(10,984)**	**(9,750)**	**(3,948)**	**(12,216)**	**(897)**	**(77,382)**
Depreciation charge	(10,677)	(3,907)	(3,929)	(1,133)	(4,470)	–	(24,116)
Impairment charge	(4,883)	(835)	(685)	(2)	(157)	(643)	(7,205)
Reversal of impairment	3,671	–	–	–	–	402	4,073
Transfers	(1,454)	(30)	(24)	–	1,416	92	–
Transfers to investment property (Note 11)	141	–	–	–	–	238	379
Disposals	166	3,909	2,717	642	2,819	–	10,253
At 31 December 2016	**(52,623)**	**(11,847)**	**(11,671)**	**(4,441)**	**(12,608)**	**(808)**	**(93,998)**
Depreciation charge	(12,655)	(5,091)	(5,215)	(1,983)	(6,292)	–	(31,236)
Impairment charge	(6,908)	(787)	(747)	(34)	(266)	(130)	(8,872)
Reversal of impairment	3,611	–	–	–	–	(50)	3,561
Transfers	(580)	(12)	3	–	33	556	–
Transfers to investment property (Note 11)	122	–	–	–	–	–	122
Disposals	9,871	2,736	2,413	615	1,922	6	17,563
At 31 December 2017	**(59,162)**	**(15,001)**	**(15,217)**	**(5,843)**	**(17,211)**	**(426)**	**(112,860)**
Net book value at 31 December 2017	**179,804**	**25,332**	**32,356**	**10,815**	**17,447**	**13,174**	**278,928**
Net book value at 31 December 2016	**155,338**	**19,395**	**26,566**	**7,489**	**13,381**	**10,147**	**232,316**
Net book value at 1 January 2016	**132,394**	**13,425**	**18,303**	**3,419**	**9,743**	**11,716**	**189,000**

[1] this category also includes machinery and equipment, refrigerating equipment, vehicles and other items of property, plant and equipment not yet put into use

10 Property, plant and equipment

Depreciation charge, impairment charge and reversal of impairment were included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2017 and 31 December 2016.

Construction in progress predominantly related to the development of stores through the use of sub-contractors.

The buildings are mostly located on leased land. Land leases with periodic lease payments are disclosed as part of commitments under operating leases (Note 33). No loans were collateralised by land and buildings including investment property as of 31 December 2017.

Impairment test

At the end of 2017 management performed an impairment test of property, plant and equipment, lease rights, franchise agreements and investment property. The approach for determination of the recoverable amount of an asset was different for each class of property, plant and equipment, lease rights, franchise agreements and investment property.

The evaluation for long-lived assets is performed at the lowest level of identifiable cash flows, which is generally at the individual store/unit level (cash generating unit – CGU). The variability of these factors depends on a number of conditions, including uncertainty about future events and changes in demand.

The impairment review has been carried out by comparing recoverable amount of the individual store/unit with their carrying values. The recoverable amount of store/unit is determined as the higher of fair value less cost of disposal or value in use.

The resulting impairment charge arose primarily from underperforming stores. At the same time the Group recognised the reversal of previously recorded impairment charges due to improved performance of certain stores. Due to the great number of CGUs being tested for impairment it is considered impracticable to disclose detailed information for each individual CGU.

Fair value less costs of disposal

Fair value of land and buildings and construction in progress is determined by an independent appraiser by reference to current observable prices on an active market subsequently adjusted for specific characteristics of respective assets. The fair value measurement of these assets is classified at level 3 of the fair value hierarchy.

Value in use

For property, plant and equipment, lease rights, franchise agreements and investment property the discounted future cash flow approach is applied and covers a 10 year period from 2018 onwards. The Group believes that use of 10 year forecast better reflects expected future cash flows of its cash generating units due to cyclical nature of their renovation expenditures. The future cash flows are based on the current budgets and forecasts approved by the management. For the forecast period, the data of the strategic business plan is extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. One of the main assumptions used for the forecast period is revenue growth being in the range from 4% to 7.9% in accordance with the strategic plan and consumer price index projections (31 December 2016: 3.5% to 6%). For the years beyond the forecast period the long term consumer price index forecast of 4% at 31 December 2017 is used (31 December 2016: 3.5%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 13.9% (31 December 2016: 15.9%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions. If the revised estimated discount rate consistently applied to the discounted cash flows had been 200 b.p. higher than management's estimates, the Group would need to reduce the carrying value of property, plant and equipment, investment property and intangible assets by RUB 1,449 (31 December 2016: RUB 1,005), if 200 b.p. lower – increase by RUB 1,589 (31 December 2016: RUB 1,643). If the annual revenue growth rate used in calculations of value in use had been 200 b.p. higher, the Group would need to increase the carrying value of property, plant and equipment, investment property and intangible assets by RUB 2,765 (31 December 2016: RUB 2,592), lower – decrease by RUB 3,261 (31 December 2016: RUB 2,473).

11 Investment property

The Group held the following investment properties at 31 December 2017 and 31 December 2016:

	2017	2016
Cost		
Cost at 1 January	**8,684**	**8,040**
Transfer from fixed assets	267	785
Disposals	(35)	(141)
Cost at 31 December	**8,916**	**8,684**
Accumulated depreciation and impairment		
Accumulated depreciation and impairment at 1 January	**(4,094)**	**(3,212)**
Depreciation charge	(254)	(246)
Impairment charge	(292)	(446)
Reversal of impairment	1,299	189
Transfer from fixed assets	(122)	(379)
Disposals	35	–
Accumulated depreciation and impairment at 31 December	**(3,428)**	**(4,094)**
Net book value at 31 December	**5,488**	**4,590**
Net book value at 1 January	**4,590**	**4,828**

Depreciation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2017 and 31 December 2016.

Rental income from investment property amounted to RUB 1,365 (2016: RUB 1,243). Direct operating expenses incurred by the Group in relation to investment property amounted to RUB 604 (2016: RUB 546). There were no significant direct operating expenses incurred by the Group in relation to investment property that did not generate rental income.

Management estimates that the fair value of investment property at 31 December 2017 amounted to RUB 9,701 (31 December 2016: RUB 7,839). The fair value was estimated using market approach with key inputs being rent income rates and market value of comparable assets.

Impairment test

At the end of 2017 management performed an impairment test of investment property. The evaluation performed and reasons for it are consistent with the approach for impairment testing of Property, Plant and Equipment (Note 10).

12 Goodwill

Movements in goodwill arising on the acquisition of businesses at 31 December 2017 and 31 December 2016 are:

	2017	2016
Cost		
Gross book value at 1 January	**146,681**	**141,625**
Acquisition of businesses (Note 7)	10,193	4,802
Effect of change in purchase price allocation	–	254
Gross book value at 31 December	**156,874**	**146,681**
Accumulated impairment losses		
Accumulated impairment losses at 1 January	**(66,312)**	**(66,312)**
Impairment charge	(286)	–
Accumulated impairment losses at 31 December	**(66,598)**	**(66,312)**
Carrying amount at 1 January	**80,369**	**75,313**
Carrying amount at 31 December	**90,276**	**80,369**

Goodwill impairment test

For the purposes of impairment testing, goodwill is allocated to groups of cash-generating units (groups of CGUs) being store chains of each format. This represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

The group of CGUs to which goodwill has been allocated is tested for impairment annually or more frequently if there are indications that the particular group of CGUs might be impaired. Goodwill is tested for impairment at the group of CGUs level by comparing carrying values of particular group of CGU assets including allocated goodwill to their value in use.

The allocation of carrying amounts of goodwill to each group of CGUs is as follows:

Year ended 31 December 2017	**Pyaterochka**	**Perekrestok**	**Karusel**	**Other**	**Total**
Goodwill	70,426	15,300	4,550	–	90,276
Year ended 31 December 2016	**Pyaterochka**	**Perekrestok**	**Karusel**	**Other**	**Total**
Goodwill	65,189	10,344	4,550	286	80,369

Value in use

For items of land, buildings and construction in progress the discounted future cash flow approach is applied and covers a 10 year period from 2018 onwards. The Group believes that use of 10 year forecast better reflects expected future cash flows of its cash generating units due to cyclical nature of their renovation expenditures. The future cash flows are based on the current budgets and forecasts approved by the management. For the forecast period, the data of the strategic business plan are extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. One of the main assumptions used for the forecast period is revenue growth being in the range from 4% to 7.9% in accordance with the strategic plan and consumer price index projections (31 December 2016: 3.5% to 6%). For the years beyond the forecast period the long term consumer price index forecast of 4% at 31 December 2017 is used (31 December 2016: 3.5%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 13.9% (31 December 2016: 15.9%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

Except for Perekrestok Express segment (included in other segments) the changes in assumptions applied in the model used for impairment testing do not indicate any trigger for impairment because the fair value less cost of disposal and the value in use are significantly higher than the carrying values of the cash generating unit assets.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions.

Impairment test

The recoverable amount of the groups of CGUs calculated exceeds their carrying amounts except for Perekrestok Express segment and therefore no impairment is recognised for them. Goodwill related to Perekrestok Express segment was impaired by RUB 286 due to underperformance of the relevant CGUs.

13 Other intangible assets

Other intangible assets comprise the following:

	Brand and private labels	Franchise agreements	Software and other	Lease rights	Total
Cost					
At 1 January 2016	**17,136**	**12**	**7,501**	**11,985**	**36,634**
Additions	–	–	3,294	549	3,843
Acquisition of businesses (Note 7)	–	–	–	322	322
Disposals	–	(12)	(20)	(91)	(123)
At 31 December 2016	**17,136**	**–**	**10,775**	**12,765**	**40,676**
Additions	–	–	3,821	437	4,258
Acquisition of businesses (Note 7)	–	–	–	161	161
Disposals	–	–	(15)	(82)	(97)
At 31 December 2017	**17,136**	**–**	**14,581**	**13,281**	**44,998**
Accumulated amortisation and impairment					
At 1 January 2016	**(10,996)**	**–**	**(3,029)**	**(7,508)**	**(21,533)**
Amortisation charge	(726)	(7)	(1,096)	(736)	(2,565)
Impairment charge	(68)	(5)	(181)	(442)	(696)
Reversal of impairment	–	–	–	376	376
Disposals	–	12	20	90	122
At 31 December 2016	**(11,790)**	**–**	**(4,286)**	**(8,220)**	**(24,296)**
Amortisation charge	(26)	–	(1,596)	(737)	(2,359)
Impairment charge	–	–	(174)	(358)	(532)
Reversal of impairment	–	–	–	536	536
Disposals	–	–	15	80	95
At 31 December 2017	**(11,816)**	**–**	**(6,041)**	**(8,699)**	**(26,556)**
Net book value at 31 December 2017	**5,320**	**–**	**8,540**	**4,582**	**18,442**
Net book value at 31 December 2016	**5,346**	**–**	**6,489**	**4,545**	**16,380**
Net book value at 1 January 2016	**6,140**	**12**	**4,472**	**4,477**	**15,101**

Brand and private labels includes brand “Pyaterochka” with the carrying amount of RUB 4,029 (31 December 2016: RUB 4,029) and brand “Karusel” with the carrying amount of RUB 1,258 (31 December 2016: RUB 1,258).

Amortisation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2017 and 31 December 2016.

Impairment test

At the end of 2017 management performed an impairment test of lease rights, brands and franchise agreements.

For private labels, lease rights and franchise agreements the evaluation performed and reasons for it are consistent with the approach for impairment testing of property, plant and equipment (Note 10). For brands, which are tested annually for impairment, evaluation performed is consistent with the approach for goodwill (Note 12).

Also the Group recognised an impairment of software and private labels which were no longer used.

14 Inventories

At 31 December 2017 inventories in the amount of RUB 99,300 were accounted at the lower of cost and net realisable value (31 December 2016: RUB 73,801). Write-off of inventory to net realisable value at 31 December 2017 amounted to RUB 1,986 (31 December 2016: RUB 1,311).

15 Financial instruments by category

	Loans and receivables
31 December 2017	
Assets as per consolidated statement of financial position	
Trade and other receivables excluding prepayments	12,214
Cash and cash equivalents	27,605
TOTAL	**39,819**

	Financial liabilities at amortised cost
31 December 2017	
Liabilities as per consolidated statement of financial position	
Borrowings	194,296
Interest accrued	1,642
Trade, other current and non-current payables excluding statutory liabilities and advances	188,639
TOTAL	**384,577**

	Loans and receivables
31 December 2016	
Assets as per consolidated statement of financial position	
Trade and other receivables excluding prepayments	25,021
Cash and cash equivalents	18,190
TOTAL	**43,211**

	Financial liabilities at amortised cost
31 December 2016	
Liabilities as per consolidated statement of financial position	
Borrowings	156,033
Interest accrued	1,177
Trade and other payables excluding statutory liabilities and advances	172,396
TOTAL	**329,606**

16 Trade, other accounts receivable and prepayments

	31 December 2017	31 December 2016
Trade accounts receivable	11,770	24,606
Other receivables	1,903	2,206
Accounts receivable for franchise services	9	15
Provision for impairment of trade and other receivables	(1,468)	(1,806)
Total trade and other accounts receivable	**12,214**	**25,021**
Prepayments	3,567	2,956
Advances made to trade suppliers	445	733
Provision for impairment of prepayments and advances	(695)	(683)
Total prepayments	**3,317**	**3,006**
TOTAL	**15,531**	**28,027**

Trade and other accounts receivable are categorised as loans and receivables under IAS 39 classification. The carrying amounts of the Group's trade and other receivables were primarily denominated in Russian Roubles.

Other non-current assets were mainly represented by long-term prepayments for rent in the amount of RUB 7,375 (31 December 2016: RUB 4,221).

Trade receivables

There were balances of RUB 765 that in accordance with accounting policies were past due but not impaired as at 31 December 2017 (31 December 2016: RUB 715).

The ageing of these receivables based on days outstanding was as follows:

	31 December 2017	31 December 2016
2-12 months	765	715
TOTAL	**765**	**715**

Movements on the provision for impairment of trade receivables were as follows:

	2017	2016
At 1 January	**(912)**	**(1,190)**
Addition of provision for receivables impairment	(235)	(666)
Release of provision for receivables impairment	92	645
Receivables written off as uncollectable	367	299
At 31 December	**(688)**	**(912)**

The creation and release of the provision for impaired receivables have been included in general and administrative costs in the consolidated statement of profit or loss.

The individually impaired trade receivables mainly related to debtors that expect financial difficulties or where there was likelihood of the debtor's insolvency. It was assessed that a portion of the receivables was expected to be recovered.

The ageing of accounts receivable (gross) that were individually impaired based on days outstanding was as follows:

	31 December 2017	31 December 2016
3-6 months	170	107
Over 6 months	818	1,161
TOTAL	**988**	**1,268**

For those receivables that were neither past due nor impaired the Group considered the credit quality as high. Trade receivables are mainly bonuses from suppliers of goods for resale receivable on quarterly basis with a low historic default rate. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

Other receivables and receivables for franchise services

There were balances of RUB 291 that in accordance with accounting policies were past due but not impaired as at 31 December 2017 (31 December 2016: RUB 189).

The ageing of these receivables based on days outstanding was as follows:

	31 December 2017	31 December 2016
2-12 months	291	189
TOTAL	**291**	**189**

Movements on the provision for impairment of other receivables and receivables for franchise services were as follows:

	2017	2016
At 1 January	**(894)**	**(947)**
Addition of provision for receivables impairment	(329)	(399)
Release of provision for receivables impairment	199	289
Receivables written off as uncollectable	244	163
At 31 December	**(780)**	**(894)**

The creation and release of the provision for impaired receivables have been included in general and administrative costs in the consolidated statement of profit or loss.

The individually impaired other receivables mainly related to debtors that expected financial difficulties or there was likelihood of the debtor's insolvency. It was assessed that a portion of the receivables was expected to be recovered.

The ageing of amounts receivable (gross) that were individually impaired based on days outstanding was as follows:

	31 December 2017	31 December 2016
3-6 months	136	119
Over 6 months	709	1,038
TOTAL	**845**	**1,157**

For those receivables that were neither past due nor impaired the Group considered the credit quality as high. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

16 Trade, other accounts receivable and prepayments

Prepayments and advances made to trade suppliers

There were balances of RUB 1,059 that in accordance with accounting policies were past due but not impaired as at 31 December 2017 (31 December 2016: RUB 876).

The ageing of prepayments based on days outstanding was as follows:

	31 December 2017	31 December 2016
2-12 months	1,059	876
TOTAL	**1,059**	**876**

Movements on the provision for impairment of prepayments and advances made to trade suppliers were as follows:

	2017	2016
At 1 January	**(683)**	**(868)**
Addition of provision for receivables impairment	(453)	(417)
Release of provision for receivables impairment	161	297
Receivables written off as uncollectable	280	305
At 31 December	**(695)**	**(683)**

The creation and release of the provision for impaired prepayments have been included in general and administrative costs in the consolidated statement of profit or loss.

The individually impaired prepayments mainly related to debtors that expected financial difficulties or there was likelihood of the debtor's insolvency. It was assessed that a portion of the prepayments was expected to be recovered.

The ageing of prepayments (gross) that were individually impaired based on days outstanding was as follows:

	31 December 2017	31 December 2016
Over 1 year	798	754
TOTAL	**798**	**754**

For those prepayments that were neither past due nor impaired the Group considered the credit quality as high. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

17 VAT and other taxes receivable

	31 December 2017	31 December 2016
VAT receivable	13,924	8,698
Other taxes receivable	423	224
TOTAL	**14,347**	**8,922**

18 Provisions and other liabilities

	31 December 2017	31 December 2016
Other accounts payable and accruals	24,725	14,232
Accrued salaries and bonuses	15,386	12,412
Accounts payable for property, plant and equipment	15,228	11,890
Taxes other than income tax	11,804	7,037
Advances received	1,752	1,462
Payables to landlords	1,368	1,210
Provisions and liabilities for tax uncertainties (Note 33)	494	499
TOTAL	**70,757**	**48,742**

There were no significant amounts of other payables to foreign counterparties as at 31 December 2017 and 31 December 2016.

19 Borrowings

The Group had the following borrowings at 31 December 2017 and 31 December 2016:

	Final maturity year[1]	Fair value		Carrying value	
Current		2017	2016	2017	2016
RUB Bonds X5 Finance series BO-05	2018	5,100	–	4,998	–
RUB Bonds X5 Finance series BO-06	–	–	5,045	–	4,993
RUB Bilateral Loans	2018	53,676	40,175	53,676	40,175
Total current borrowings		**58,776**	**45,220**	**58,674**	**45,168**
	Final maturity year[1]	**Fair value**		**Carrying value**	
Non-current		**2017**	**2016**	**2017**	**2016**
RUB Bonds X5 Finance series BO-04	2019	5,243	5,219	4,996	4,993
RUB Bonds X5 Finance series BO-05		–	5,089	–	4,995
RUB Bonds X5 Finance series BO-06	2019	5,002	–	4,996	–
RUB Bonds X5 Finance series BO-07	2019	5,095	5,008	4,995	4,991
RUB Bonds X5 Finance series 001P-01	2019	15,480	14,970	14,987	14,997
RUB Bonds X5 Finance series 001P-02	2020	10,135	–	9,985	–
RUB Eurobond X5 Finance B.V.	2020	20,490	–	19,872	–
RUB Bilateral Loans	2020	76,571	81,919	75,791	80,889
Total non-current borrowings		**138,016**	**112,205**	**135,622**	**110,865**
TOTAL BORROWINGS		**196,792**	**157,425**	**194,296**	**156,033**

1 In case of the Group's Bonds – the next oferta (put option) date.

19 Borrowings

Related to publically trade debt activities in 2017:

- In April 2017 the Group issued debut RUB 20 bln Eurobond with a 9.25% coupon rate per annum and 3-years maturity. Bonds are traded on the Irish Stock Exchange.
- In May 2017 the Group issued RUB 10 bln exchange corporate bonds series 001P-02 with 8.45% coupon rate and 3.5-years oferta (put-option).
- In November 2017 the Group successfully passed the oferta on the RUB 5 bln exchange corporate bonds series BO-06. The new annual rate for the next 3 semi-annual coupons was fixed at 7.95%.

In 2017 the Group executed and made drawdowns under new long-term bank loans with fixed interest rate in the total amount of RUB 42 bln.

The weighted average effective interest rate on X5's total borrowings for the year ended 31 December 2017 comprised 9.51% per annum (year ended 31 December 2016: 11.30%).

All borrowings at 31 December 2017 are shown net of related transaction costs of RUB 303 which are amortised over the term of the loans using the effective interest method (year ended 31 December 2016: RUB 267). Borrowing costs capitalised for the year ended 31 December 2017 amounted to RUB 338 (year ended 31 December 2016: RUB 285). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation was 9.37% (year ended 31 December 2016: 11.20%).

Change in total borrowings in amount of RUB 38,263 in 2017 equals to the proceeds from borrowings in amount of RUB 100,780, repayment of borrowings in amount of RUB 62,700 (the Consolidated Statement of Cash Flows) plus amortisation of transaction costs in amount of RUB 183.

In accordance with loan agreements the Group maintains an optimal capital structure by tracking certain covenants, such as the maximum level of Net Debt/EBITDA (4.00/4.25 during 2 quarters after acquisition). The Group's Eurobond documentation implies 3.75 leverage ratio threshold but with additional permitted indebtedness baskets and exclusions. At 31 December 2017 the Group complied with this covenant and Net Debt/EBITDA was equal to 1.73 (31 December 2016: 1.81).

20 Share capital

As at 31 December 2017 the Group had 190,000,000 authorised ordinary shares (31 December 2016: 190,000,000) of which 67,886,748 ordinary shares were outstanding (31 December 2016: 67,884,340) and 6,470 ordinary shares were held as treasury stock (31 December 2016: 8,878). The nominal par value of each ordinary share is EUR 1.

The Supervisory Board proposed to the General Meeting to distribute in 2018 current year profit in the amount of RUB 21,590 (318.03 RUB per ordinary share) to shareholders.

21 Earnings per share

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding treasury shares.

Earnings per share were calculated as follows:

	2017	2016
Profit attributable to equity holders of the parent	31,394	22,291
Weighted average number of ordinary shares in issue	67,885,831	67,883,606
Effect of share options granted to employees, number of shares	12,944	2,366
Weighted average number of ordinary shares for the purposes of diluted earnings per share	67,898,775	67,885,972
Basic earnings per share for profit from continuing operations (expressed in RUB per share)	**462.45**	**328.37**
Diluted earnings per share for profit from continuing operations (expressed in RUB per share)	**462.36**	**328.36**

22 Revenue

	2017	2016
Revenue from sale of goods	1,294,481	1,033,320
Revenue from franchise services	29	34
Revenue from other services	498	313
TOTAL	**1,295,008**	**1,033,667**

23 Expenses by nature

	2017	2016
Cost of goods sold	946,044	751,763
Staff costs (Note 26)	114,808	92,947
Operating lease expenses	64,472	51,202
Depreciation, amortisation	33,849	26,927
Impairment of non-current assets	4,586	3,709
Other store costs	20,201	17,773
Utilities	24,976	20,445
Other	36,510	30,230
TOTAL	**1,245,446**	**994,996**

23 Expenses by nature

Operating lease expenses included RUB 61,967 (2016: RUB 49,626) of minimum lease payments and contingent rent of RUB 2,505 (2016: 1,576 RUB).

Impairment of trade, other accounts receivable and prepayments amounted to RUB 522 for the year ended 31 December 2017 (2016: RUB 247).

The fees listed below related to the procedures applied to the Group by E&Y Accountants LLP and Other EY Network as referred to in article 1(1) of the Dutch Accounting Firms Oversight Act (Dutch acronym: Wta):

	2017	2016
Statutory audit of financial statements performed by E&Y Accountants LLP	12	12
Other assurance services performed by E&Y Accountants LLP	11	–
Statutory audit of financial statements performed by Other EY Network	49	43
Other assurance services performed by Other EY Network	1	–
Other non-audit services	35	8
TOTAL	**108**	**63**

The external auditor of the Group is Ernst & Young Accountants LLP.

24 Operating lease / sublease income

The Group leases part of its store space to companies selling supplementary goods and services to customers. The lease arrangements are operating leases, the majority of which are short-term. The future minimum lease and sublease payments receivable under non-cancellable operating leases were as follows:

	31 December 2017	31 December 2016
Not later than 1 year	2,769	2,325
Later than 1 year and no later than 5 years	2,161	1,474
Later than 5 years	1,649	615
TOTAL	**6,579**	**4,414**

The rental income from operating leases recognised in the consolidated statement of profit or loss for the year ended 31 December 2017 amounted to RUB 6,584 (2016: RUB 6,142). The contingent rents recognised in the consolidated statement of profit or loss in the year ended 31 December 2017 amounted to RUB 113 (2016: 170).

25 Finance income and costs

	2017	2016
Interest expense	15,533	17,044
Interest income	(59)	(47)
Other finance costs, net	543	321
TOTAL	**16,017**	**17,318**

26 Staff costs

	2017	2016
Wages and salaries	89,385	73,435
Social security costs	25,352	19,464
Share-based payments expense	71	48
TOTAL	**114,808**	**92,947**

Wages and salaries in 2017 included expenses of RUB 2,470 related to the long-term incentive programme (LTI) for key employees, including members of the Management Board, other key management and other key employees (2016: RUB 2,778).

Social security costs in 2017 included pension contributions amounted to RUB 16,555 (2016: RUB 13,065).

The number of employees as at 31 December 2017 amounted to 250,874 (31 December 2016: 196,128).

Key management personnel

The Group 'key management personnel' consists of members of the Supervisory Board , Management Board and certain members of the Executive Board. The total direct compensation for members of the Management Board and Executive Board including the members of the Management Board consists of a base salary, a performance related short-term incentive and a performance related long-term incentive; members of the Supervisory Board receive an annual base compensation in cash and share-based payments.

26 Staff costs

Management Board

The remuneration of the members of the Management Board, which comprises the CEO and the Company Secretary, is determined by the Supervisory Board within the framework of the remuneration policy as approved by the General Meeting of Shareholders. More details about the remuneration policy are included in the Remuneration Report section on pages 188-191.

Base salaries in 2017

Base salaries of each member of the Management Board are determined in line with compensation levels in peer companies. For the CEO, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr. DuCharme when in office as CEO, thereby securing continuity. As such, Mr. Shekhterman's reward package does not include a severance entitlement and instead, he shall be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman shall be entitled to the difference upon completion of his full term as CEO.

Short-term incentive (STI) for 2017

For 2017 the Supervisory Board has determined that 100% of the total on-target bonus opportunity for the CEO depends on achieving financial and quantitative group targets. Group targets consist of elements related to the Company's operational performance, including net sales and return on invested capital (ROIC), with a profitability threshold as a condition for STI payout. For the Company Secretary the STI is based on achievement of individual targets, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO, and 60% for the Company Secretary. With regard to financial targets, the Group achieved EBITDA above the target threshold. Other group targets, including the net sales target, were partially met, albeit within the target range set by the Supervisory Board. The achievement of individual performance targets was assessed and determined by the Supervisory Board for each Management Board member individually, as reflected in the table below.

Long-term incentive (LTI)

The LTI programme comprises two stages which run until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management. The targets represent the Group's long-term ambitions, with a specific focus on net revenue and market share relative to the competition, without sacrificing EBITDA or incurring undue risk. The total available fund for all payouts under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved i.e. 2017. Each stage of the programme includes a deferred component of conditional payouts in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

The targets set for the first payout under the second stage of the LTI were achieved as per 31 March 2017, as specific comparative performance indicators were met, and EBITDA also exceeded the target threshold. Consequently and in accordance with the rules of the LTI Programme, Mr. Shekhterman is eligible for a payout in 2018, details of which are provided in the table below.

Expenses recognised for remuneration of the members of the Management Board:

Name	Year	Base salary[1]	Short-term incentive[2]	Long-term incentive[3]	Share based compensation[4]	Social security cost[5]	Total
I. Shekhterman	2017	46	36	211	8	43	344
	2016	47	52	296	1	59	455
F. Lhoëst	2017	18	10	–	–	–	28
	2016	20	6	10	–	–	36
TOTAL	**2017**	**64**	**46**	**211**	**8**	**43**	**372**
	2016	**67**	**58**	**306**	**1**	**59**	**491**

Restricted Stock Units (RSU) awarded and outstanding to members of the Management Board:

Name	Tranche	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016	Year of vesting	RSUs vested	Value on vesting date[6]	GDRs locked-up as per 31 December 2017[7]	End of lock-up period	RSUs outstanding as per 31 December 2017	RSUs outstanding as per 31 December 2016
I. Shekhterman	4	7,384	–	–	2016	7,384	9	7,384	2018	–	–
	5	–	15,793	–	2017	15,793	33	15,793	2019	–	15,793
	6	–	–	11,396	2018	–	–	–	2020	11,396	11,396

Supervisory Board

The Annual General Meeting of Shareholders adopted the following remuneration principles for members of the Supervisory Board:

The chairman receives a fee of EUR 250,000, members chairing a committee receive a fee of EUR 200,000 with other members drawing a fee of EUR 100,000. Any member of the Supervisory Board who represents a legal entity or person holding at least thirty per cent of the voting rights in the Company, shall waive his/her entitlement to remuneration for acting as a member of the Supervisory Board.

[1] Mr. Shekhterman's annual base salary is RUB 42 million. The table reflects actual base salary amounts, including adjustments based on number of days spent on vacation, in accordance with Russian labour law.

[2] Short-term incentives are based on results achieved in 2017 and payable in 2018. The short-term incentive levels are based on full achievement of individual targets and partial achievement of the revenue target (though within the target range set by the Supervisory Board), resulting in payouts of 85% of base salary for Mr. Shekhterman (31 December 2016: 123 %), and 55% of base salary for Mr. Lhoëst (31 December 2016: 32%).

[3] For Mr. Shekhterman the expense recognized for the long-term incentive reward is composed of two elements: (i) accrual for the period 2017 with respect to the first payout under the second stage of the LTI programme, and (ii) an accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 December 2018, as described in the Remuneration Report on pages 188-191.

[4] Since 2013 members of the Management Board no longer participate in the Company's Restricted Stock Unit Plan. The share based compensation reflects the accrued amounts related to previous awards under the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

[5] For the year ended 31 December 2017 statutory pension contributions amounted to RUB 28 (2016: RUB 39).

[6] Vesting date is 19 May of each respective year of vesting.

[7] Number of GDRs held during lock-up period equal the number of vested RSUs minus GDRs sold to cover taxes, if any.

26 Staff costs

In addition, all remunerated board members are entitled to:

- additional compensation for time and expertise dedicated to specific strategic projects for X5, provided that such compensation (i) relates to work of a temporary, one-off nature, performed as an extension of the statutory non-executive duties of the relevant Board member and (ii) is approved in advance by the Supervisory Board -upon recommendation of the Nomination and Remuneration Committee- which will ensure, on a case-by-case basis, that any such engagement shall under no circumstance compromise the independence of the relevant Board member or the Board collectively.
- equity in the form of Restricted Stock Units (RSUs). The number of RSUs awarded in each given year is based on 100% of the board member's fixed annual remuneration, divided by the average market value[1] of a GDR on the relevant award date. RSU awards are subject to a three-year vesting period and a further two-year lock-in period. RSU awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

In accordance with these remuneration principles, Mikhail Fridman and Andrey Elinson are not remunerated by the Group. In 2017 the remaining Supervisory Board members received remuneration in cash and an annual award of Restricted Stock Units (RSUs). In addition, Michael Kuchment received additional cash remuneration for time and expertise dedicated to specific strategic projects for X5, under the framework approved by the General Meeting of Shareholders.

Restricted Stock Units

In 2017 the Annual General Meeting of Shareholders approved that the Supervisory Board members Stephan DuCharme, Christian Couvreux, Pawel Musial, Geoff King, Peter Demchenkov and Michael Kuchment be awarded a number of RSUs with award date 19 May 2017, equal to 100% of the fixed remuneration in 2017 of the relevant Board member, divided by USD 34.69, the average market value of one GDR as of 19 May 2017. The RSUs awarded under tranche 8 will vest on 19 May 2021, followed by a lock-in period ending on 19 May 2023.

The number of RSUs awarded and outstanding to the members of the Supervisory Board is shown below. For the calculation of the intrinsic value and further details refer to Note 27.

Expenses recognised for remuneration of the members of the Supervisory Board:

	Base remuneration[2]		Additional remuneration[3]		Share-based compensation[4]	
	2017	2016	2017	2016	2017	2016
S. DuCharme	20	32	–	–	14	10
A. Elinson	–	–	–	–	–	–
M. Fridman	–	–	–	–	–	–
C. Couvreux	13	14	–	8	16	10
P. Musial	7	7	–	35	8	4
G. King	17	18	–	8	17	10
P. Demchenkov	12	7	–	–	8	4
M. Kuchment	7	7	13	–	4	2
TOTAL	**76**	**85**	**13**	**51**	**67**	**40**

1 The Average Market Value is defined as "on any particular day the volume weighted average price of a GDR over the thirty immediately preceding calendar days. The volume weighted average price is calculated using the closing price of a GDR taken from the Official List of the London Stock Exchange".
2 The annual membership allowance for independent Supervisory Board members is determined and paid in Euro, as follows: chairman EUR 250,000; members chairing a committee EUR 200,000; other members EUR 100,000. In accordance with the remuneration principles for the Supervisory Board, Messrs. Fridman and Elinson were not remunerated.
3 Additional cash remuneration for time and expertise dedicated to key strategic projects in 2017.
4 The share-based compensation reflects the accrued amounts related to the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

Restricted Stock Units awarded and outstanding to members of the Supervisory Board:

Name	Tranche	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016[1]	RSUs awarded in 2017	Year of vesting	RSUs vested	Value on vesting date[2]	GDRs locked-up as per 31 December 2017[3]	End of lock-up period	RSUs outstanding as per 31 December 2017	RSUs outstanding as per 31 December 2016
S. DuCharme[3]	7	–	–	25,703	–	2019	–	–	–	2021	25,703	25,703
	8	–	–	–	9,631	2020	–	–	–	2022	9,631	–
C. Couvreux	4	14,768	–	–	–	2016	14,768	19	9,747	2018	–	–
	5	–	15,793	–	–	2017	15,793	33	7,996	2019	–	15,793
	6	–	–	11,396	–	2018	–	–	–	2020	11,396	11,396
	7	–	–	11,424	–	2019	–	–	–	2021	11,424	11,424
	8	–	–	–	6,421	2020	–	–	–	2022	6,421	–
P.Musial	4	2,461	–	–	–	2016	2,461	3	2,461	2018	–	–
	5	–	7,897	–	–	2017	7,897	17	5,212	2019	–	7,897
	6	–	–	5,698	–	2018	–	–	–	2020	5,698	5,698
	7	–	–	5,712	–	2019	–	–	–	2021	5,712	5,712
	8	–	–	–	3,210	2020	–	–	–	2022	3,210	–
G. King	6	–	–	13,250	–	2018	–	–	–	2020	13,250	13,250
	7	–	–	14,280	–	2019	–	–	–	2021	14,280	14,280
	8	–	–	–	8,026	2020	–	–	–	2022	8,026	–
P. Demchenkov	6	–	–	5,698	–	2018	–	–	–	2020	5,698	5,698
	7	–	–	5,712	–	2019	–	–	–	2021	5,712	5,712
	8	–	–		5,618	2020	–	–	–	2022	5,618	–
M. Kuchment	7	–	–	5,712	–	2019	–	–	–	2021	5,712	5,712
	8	–	–	–	3,210	2020	–	–	–	2022	3,210	–

[1] In 2016 the RSUs awarded under tranche 7 were awarded in accordance with the amended award schedule, observing the 3 year vesting period prescribed by the RSU Plan.
[2] Vesting date is 19 May of each respective year of vesting.
[3] Number of GDRs held during lock-up period equal the number of vested RSUs minus GDRs sold to cover taxes, if any.

26 Staff costs

Other key management personnel

Other key management personnel comprise certain members of the Executive Board. In accordance with the Remuneration Policy, the total direct compensation of other key management personnel consists of a base salary, a short-term incentive and a long-term incentive.

Base salaries in 2017

Base salaries of members of the Executive Board are determined in line with compensation levels in peer companies as set out in the remuneration policy.

Short-term Incentive

For 2017, the Supervisory Board had determined that 100% of the total on-target bonus opportunity for leaders of the formats would be based on achieving financial and quantitative group targets at company level, with a profitability threshold as a condition for STI payout. For functional leaders 100% of the total on-target bonus opportunity depends on achieving financial group and quantitative group targets at company level with profitability threshold is also a condition for STI payout . The on-target payout as a percentage of base salary is set at a level of 100%. With regard to financial target the Group achieved EBITDA above the target threshold, while other group targets, including net sales target were partially met. With regard to the individual performance targets the cash incentive is approved by the Supervisory Board for each executive individually.

Long-term incentive

As indicated above under "Management Board", the targets set for the first payout under the second stage of the LTI were achieved in 2017, as specific comparative performance indicators were met, with EBITDA exceeding the required threshold. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

Expenses recognised for remuneration of other key management personnel:

	Year	Base salary[4]	Short-term incentive[5]	Long-term incentive[6]	Exit payment	Social security cost[7]	Total
Other key management personnel	2017	165	134	414	14	88	815
	2016	155	141	650	31	144	1,121

[4] Base salary remuneration reflects the increase in salary for some key management personnel, as well as fluctuation in base salary due to the number of days spent on vacation, in accordance with Russian labor law.
[5] Short-term incentive for performance in the year 2017 (2016) paid in cash in 2018 (2017).
[6] The expense recognised for the long-term incentive rewards is composed of two elements: (i) accrual for the period 2017 with respect to the first payout under the second stage of the LTI programme, and (ii) an accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 December 2018, as described in the Remuneration Report on pages 188-191.
[7] For the year ended 31 December 2017 statutory pension contributions amounted to RUB 65 (2016: RUB 83).

27 Share-based payments

Restricted Stock Unit plan

Members of the Supervisory Board are entitled to annual awards of restricted stock units (RSUs) under the Company's Restricted Stock Unit Plan (RSU Plan) approved at the AGM in 2010. RSU awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

During the year ended 31 December 2017, a total number of 36,116 RSUs were awarded under tranches 8 of the RSU Plan and will vest in 2020. In 2017 39,483 RSUs awarded in 2015 under tranche 5 vested. Upon vesting these RSUs were converted into GDRs registered in the participant's name, and kept in custody during a two-year lock-in period during which the GDRs cannot be traded.

During the year ended 31 December 2016, a total number of 115,981 RSUs were awarded under tranches 6 and 7 of the RSU Plan, of which 47,438 RSUs awarded under tranche 6 will vest in 2018 and 68,543 RSUs awarded under tranche 7 will vest in 2019. In 2016, 25,843 RSUs awarded in 2014 under tranche 4 vested. Upon vesting these RSUs were converted into GDRs registered in the participant's name, and kept in custody during a two-year lock-in period during which the GDRs cannot be traded.

In total, during the year ended 31 December 2017 the Group recognised expense related to the RSU Plan in the amount of RUB 71 (expense during the year ended 31 December 2016: RUB 48). At 31 December 2017 the equity component was RUB 117 (31 December 2016: RUB 70). The fair value of services received in return for the conditional RSUs granted to employees is measured by reference to the market price of the GDRs which is determined at grant date.

Details of the conditional rights outstanding were as follows:

	2017		2016	
	Number of conditional rights	Weighted average fair value, RUB	Number of conditional rights	Weighted average fair value, RUB
Outstanding at the beginning of the period	155,464	1,030.77	123,123	765.23
Awarded during the period	36,116	2,114.26	68,543	1,272.00
Vested during the period	(39,483)	608.64	(25,843)	577.63
Waived of previously vested	29,851	673.04	18,168	890.28
Forfeited during the period	(29,851)	673.04	(28,527)	785.35
Outstanding at the end of the period	**152,097**	**1,397.63**	**155,464**	**1,030.77**

28 Income tax

	2017	2016
Current income tax charge	10,215	4,154
Deferred income tax charge	207	2,208
Income tax charge for the year	**10,422**	**6,362**

The theoretical and effective tax rates are reconciled as follows:

	2017	2016
Profit before taxation	41,816	28,653
Theoretical tax at the effective statutory rate[1]	**8,363**	**5,731**
Tax effect of items which are not deductible or assessable for taxation purposes		
Effect of income taxable at rates different from standard statutory rates	(2,716)	(1,512)
Expenses on inventory shrinkage	2,386	2,082
Unrecognised tax loss carry forwards for the year	557	181
Deferred tax income arising from the write-down of the deferred tax asset	(85)	(312)
Change in deferred tax liability associated with investments in subsidiaries	1,158	–
Other non-deductible expense	759	192
Income tax charge for the year	**10,422**	**6,362**

As at 31 December 2017 37 Russian subsidiaries of the Group were the members of the CGT (consolidated group of taxpayers) with Trade House PEREKRIOSTOK JSC acting as a responsible CGT member.

In September 2017 the Group approved dividend policy and proposed to the General Meeting to distribute dividends to its shareholders in 2018 based on the results of 2017. As a result the Group estimates that part of temporary difference related to investments in subsidiaries will be reversed in the foreseeable future and therefore accrued related deferred tax liability.

[1] Profit before taxation on Russian operations is assessed based on the statutory rate of 20%.

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2017:

	31 December 2016	Credited/(debited) to profit and loss	Deferred tax on business combinations (Note 7)	31 December 2017
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	4,844	136	–	4,980
Property, plant and equipment and Investment property	622	(118)	81	585
Other intangible assets	21	310	477	808
Inventories	1,604	(578)	–	1,026
Accounts receivable	243	(140)	–	103
Accounts payable	5,106	(14)	–	5,092
Other	173	256	321	750
Gross deferred tax assets	**12,613**	**(148)**	**879**	**13,344**
Less offsetting with deferred tax liabilities	(7,307)	(894)	–	(8,201)
Recognised deferred tax assets	**5,306**	**(1,042)**	**879**	**5,143**
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(8,933)	(2,038)	–	(10,971)
Other intangible assets	(1,521)	1,070	–	(451)
Investments into subsidiary	–	(1,158)	–	(1,158)
Accounts receivable	(2,911)	2,074	–	(837)
Accounts payable	(2)	(8)	–	(10)
Other	(445)	1	–	(444)
Gross deferred tax liabilities	**(13,812)**	**(59)**	**–**	**(13,871)**
Less offsetting with deferred tax assets	7,307	894	–	8,201
Recognised deferred tax liabilities	**(6,505)**	**835**	**–**	**(5,670)**

28 Income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2016:

	31 December 2015	Credited/ (debited) to profit and loss	Deferred tax on business combinations	31 December 2016
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	4,661	183	–	4,844
Property, plant and equipment and Investment property	637	(43)	28	622
Other intangible assets	18	(596)	599	21
Inventories	2,394	(790)	–	1,604
Accounts receivable	193	33	17	243
Accounts payable	5,145	(66)	27	5,106
Other	190	(17)	–	173
Gross deferred tax assets	**13,238**	**(1,296)**	**671**	**12,613**
Less offsetting with deferred tax liabilities	(7,821)	538	(24)	(7,307)
Recognised deferred tax assets	**5,417**	**(758)**	**647**	**5,306**
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(6,730)	(2,197)	(6)	(8,933)
Other Intangible assets	(2,178)	669	(12)	(1,521)
Accounts receivable	(3,629)	818	(100)	(2,911)
Accounts payable	(45)	43	–	(2)
Other	(200)	(245)	–	(445)
Gross deferred tax liabilities	**(12,782)**	**(912)**	**(118)**	**(13,812)**
Less offsetting with deferred tax assets	7,821	(538)	24	7,307
Recognised deferred tax liabilities	**(4,961)**	**(1,450)**	**(94)**	**(6,505)**

Unrecognised deferred tax liability on unremitted earnings of certain subsidiaries amounted to RUB 4,541 (2016: RUB 4,481) for which the deferred tax liability was not recognised as such amounts are being reinvested for the foreseeable future.

Management believes that the future taxable profits in tax jurisdictions that suffered a loss in the current or preceding years will be available to utilise the deferred tax asset of RUB 4,980 recognised at 31 December 2017 for the carry forward of unused tax losses (31 December 2016: RUB 4,844).

The Group estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of RUB 3,316 (2016: RUB 2,759).

Unused tax losses in the amount of RUB 1,031 were available for carry forward for a period not less than four years, starting from 2017 unused tax losses in the amount of RUB 2,285 has no time restrictions for carry forward.

29 Financial risk management

Financial risk management is a part of integrated risk management and internal control framework described in "Corporate Governance" section of this Annual Report. The primary objectives of the financial risk management are to establish risk limits, and then ensure that exposure to risks stays within these limits.

Financial risk management is carried out by Corporate Finance Department. Corporate Finance Department monitors and measures financial risks and undertakes steps to limit their influence on the Group's performance.

(a) Market risk

Currency risk

The Group is exposed to foreign exchange risk arising from foreign currency denominated assets and liabilities with respect to import purchases. As at 31 December 2017 the Group had trade accounts payable denominated in foreign currency in the amount of RUB 2,504 (31 December 2016: RUB 2,409). As at 31 December 2017 the Group did not have any other significant assets and liabilities denominated in foreign currency and the exposure for the Group was estimated as not significant.

Interest rates risk

As at 31 December 2017 the Group had no floating interest-bearing assets and liabilities, the Group's income, expenses and operating cash inflows and outflows were substantially independent of changes in market interest rates.

(b) Credit risk

Financial assets, which are potentially subject to credit risk, consisted principally of cash and cash equivalents held in banks, trade and other receivables (Note 9 and Note 16). Due to the nature of its main activities (retail sales to individual customers) the Group had no significant concentration of credit risk. Cash was placed in financial institutions which were considered at the time of deposit to have low risk of default (Note 9). The Group has policies in place to ensure that in case of credit sales of products and services to wholesale customers and reverse franchise schemes only those counteragents with an appropriate credit history are selected. Although collection of receivables could be influenced by economic factors, management believes that there was no significant risk of loss to the Group beyond the provision already recorded. In accordance with the Group treasury policies and exposure management practices, counterparty credit exposure limits were continually monitored and no individual exposure was considered significant.

(c) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Liquidity risk is managed by the Group Treasury.

The Group finances its operations by a combination of cash flows from operating activities and long and short-term debt. The objective is to ensure continuity of funding on the best available market terms. The policy is to keep the Group's credit portfolio diversified structure, continue to improve the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn available bank facilities, and a strong credit rating so that maturing debt may be refinanced as it falls due.

29 Financial risk management

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities as at the reporting date at spot foreign exchange rates:

Year ended 31 December 2017	During 1 year	In 1 to 3 years
Borrowings	74,928	146,331
Trade payables	130,766	–
Other financial liabilities	56,707	1,166
TOTAL	**262,401**	**147,497**

Year ended 31 December 2016	During 1 year	In 1 to 4 years
Borrowings	58,621	123,058
Trade payables	131,180	–
Other financial liabilities	39,744	1,472
TOTAL	**229,545**	**124,530**

At 31 December 2017 the Group had net current liabilities of RUB 104,902 (31 December 2016: RUB 97,294) including short-term borrowings of RUB 58,674 (31 December 2016: RUB 45,168). At 31 December 2017 the Group had available bank credit lines of RUB 314,838 (31 December 2016: RUB 280,808). At 31 December 2017 the Group had RUB bonds available for issue on MICEX of RUB 25,000 (31 December 2016: RUB 35,000).

Management regularly monitors the Group's operating cash flows and available credit lines to ensure that these are adequate to meet the Group's ongoing obligations and its expansion programmes. Part of the short term liquidity needs is seasonal, with the highest peak in 1st quarter and strong cash generation in 4th quarter, therefore the Group negotiates the maturity of credit lines for those quarters, when the future cash flow allows for the repayment of debts. Part of the existing lines in the local currency (RUB) are provided on rolling basis which is closely monitored by detailed cash flow forecasts and are managed by the Group Treasury.

The Group's capital expenditure programme is highly discretionary. The Group optimises its cash outflows by managing the speed of execution of current capex projects and by delaying future capital extensive programmes, if required.

The Group is carefully monitoring its liquidity profile by optimizing the cost of funding and the drawdown periods within revolving credit facilities as well as extending existing credit facilities or obtaining new credit lines. The Group manages liquidity requirements by the use of both short-term and long-term projections and maintaining the availability of funding. Based on the review of the current liquidity position of the Group management considers that the available credit lines and expected cash flows are more than sufficient to finance the Group's current operations.

30 Operating environment of the Group

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy has been negatively impacted by a decline in oil prices and sanctions imposed on Russia by a number of countries. The Rouble interest rates remained high. The combination of the above resulted in reduced access to capital, a higher cost of capital and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

31 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages total equity attributable to equity holders recognised under IFRS requirements. The Group is in compliance with externally imposed capital requirements.

In accordance with loan facilities the Group maintains an optimal capital structure by tracking certain requirements: the maximum level of Net Debt/EBITDA (4.00/4.25 after acquisition). The Group's Eurobond documentation implies 3.75 leverage ratio threshold but with additional permitted indebtedness baskets and exclusions. Net debt is calculated as the sum of short-term and long-term borrowings less cash and cash equivalents. Reconciliation of EBITDA to operating profit is performed in Note 5. This ratio is included as covenants into some of Group's loan agreements (Note 19). At 31 December 2017 the Group complied with the requirements under the loan facilities.

32 Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value.

Financial assets carried at amortised cost

The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty.

The carrying amount of cash and cash equivalents and trade and other financial receivables approximates their fair value.

Liabilities carried at amortised cost

The fair value of bonds is based on quoted market prices. Fair values of other liabilities are determined using valuation techniques.

The fair value of bonds traded on the MICEX and the ISE is determined based on active market quotations and amounted to RUB 66,545 at 31 December 2017 (31 December 2016: RUB 35,331). The measurement is classified in level 1 of the fair value hierarchy. The carrying value of these bonds amounted to RUB 64,829 at 31 December 2017 (31 December 2016: RUB 34,969) (Note 19). The fair value of long-term borrowings amounted to RUB 76,571 at 31 December 2017 (31 December 2016: RUB 81,919). The measurement is classified in level 3 of the fair value hierarchy and is determined based on expected cash flows discounted using interest rate of similar instruments available on the market. The sensitivity analysis shows that the increase/decrease of the market interest rate by 10% leads to the decrease/increase of fair value of long-term borrowings by RUB 956 at 31 December 2017. The fair value of short-term borrowings was not materially different from their carrying amounts.

33 Commitments and contingencies

Commitments under operating leases

At 31 December 2017, the Group operated 10,303 stores through rented premises (31 December 2016: 7,380 stores). There are two types of fees in respect of operating leases payable by the Group: fixed and variable (contingent rent). For each store fixed rent payments are defined in the lease contracts. The variable part of rent payments is predominantly denominated in RUB and normally calculated as a percentage of turnover. Fixed rent payments constitute the main part of operating lease expenses of the Group as compared to the variable rent payments.

The Group entered into a number of cancellable short-term and long-term lease agreements. The expected annual lease payments under these agreements amount to RUB 36,860 (net of VAT) (31 December 2016: RUB 28,904).

Capital expenditure commitments

At 31 December 2017 the Group contracted for capital expenditure for the acquisition of property, plant and equipment of RUB 9,830 (net of VAT) (31 December 2016: RUB 10,987).

Law regulating the trade of the food products

In 2016 there were amendments in the law regulating the trade of the food products in the Russian Federation ("trade law"). These amendments established certain strict limitations on volume of back margin received from suppliers. At the same time these amendments also established stricter limitations on payments terms to suppliers.

The amendments were effective starting 15 July 2016 for newly concluded contracts and starting 1 January 2017 for the existed contracts and became obligatory for all market participants. The Group may be charged with the fine of from RUB 1 to RUB 5 for each violation in case of failure or improper application of the provisions of this law. Currently the official position of government authorities is continually being reconsidered.

The Group has performed all required procedures in order to amend existing and new contracts in compliance with the new provisions of the law by 1 January 2017 as well as the Group periodically evaluates its obligations under these regulations. As obligations are determined to be probable, they are recognised immediately as liabilities. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant probable liabilities related to compliance with the trade law.

Legal contingencies

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time. Management believes that there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued at 31 December 2017.

Taxation environment

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of these legislative areas as applied to the transactions and activities of the Group may be challenged by the relevant regional and federal authorities. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian authorities decide to issue a claim and prove successful in court, they would be entitled to recover the tax amount claimed, together with fines amounting to 20% of such amount and late payment interest at the rate of 1/300 of the rate of the Central Bank of the Russian Federation (CBRF rate) for each day of the delay during the first 30 days, 1/150 of CBRF rate for each day of the delay if the latter is for more than 30 days to be calculated from the amount of underpaid tax. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Russia has transfer pricing rules generally aligned with the international transfer pricing principles developed by the Organization for Economic Cooperation and Development (OECD). The transfer pricing legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of controlled transactions (transactions with related parties and some types of transactions with unrelated parties), provided that the transaction price is not arm's length. Given that the concept of the Russian transfer pricing rules is rather new and the practice is not yet developed, the impact of any challenge of the Group's transfer prices cannot be reliably estimated; however, it may be significant to the financial conditions and/or the overall operations of the Group. The level of impact is not expected to be significant since the prices of transactions between related parties which are the members of CGT (consolidated group of taxpayers) are not subject to transfer pricing control. Management believes that its pricing policy is arm's length and it has implemented internal controls to be in compliance with the transfer pricing legislation.

Starting 2015 the "de-offshorization law" came into force introducing the following rules and concepts which may have an impact on the Group's operations:

The concept of beneficial ownership

The possibility to apply the reduced tax rates to the income paid to foreign companies of the Group allowed under double tax treaties (DTTs) will depend on whether the company receiving such income is its beneficial owner. When determining the beneficial owner status of a foreign company the functions it performs and the risks it undertakes should be tested. It will be also considered whether such income was transferred (fully or in part) to another company. Given that there was negative court practice for a number of taxpayers, the impact of any challenge may be significant and have an effect on the financial conditions and/or the overall operations of the Group.

Management believes that the Group's foreign companies receiving income from Russia are beneficial owners of that income and the reduced tax rates are correctly applied in accordance with the relevant DTTs.

Additionally starting 2017 the Russian company should have a written confirmation that the foreign recipient of funds is the beneficial owner of income. This means that if a foreign company fails to provide that confirmation, the application of lower rates may be denied by the tax authorities. The Tax Code specifies that both the confirmation and the residence certificate must be presented to the tax agent (i.e. the company responsible for withholding tax at source) before the date on which income is paid.

According to such law changes management organised the receipt of mentioned written confirmation from foreign counteragents to the Russian companies paying passive income abroad.

Broader rules for determining the tax residency of legal entities

Starting 2015, more specific and detailed rules were put in place establishing when foreign entities can be viewed as managed from Russia and consequently can be deemed Russian tax residents. Russian tax residency means that such legal entities' worldwide income will be taxed in Russia. The Group comprises companies incorporated outside of Russia. The tax liabilities of the Group were determined on the assumption that these companies were not subject to Russian profits tax, because they did not have a permanent establishment in Russia and were not Russian tax residents by way of application of the new tax residency rules. This interpretation of relevant legislation in regard to the Group companies incorporated outside of Russia may be challenged. Given that the concept of the Russian broader rules for determining the tax residency of legal entities is rather new and the practice is not yet developed, the impact of any such challenge cannot be reliably estimated currently; however, it may be significant to the financial position and/or the overall operations of the Group.

Tax contingencies, commitments and risks

Russian tax legislation does not provide definitive guidance in many areas. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in past may be challenged as not having been in compliance with Russian tax laws applicable at the relevant time. In particular, the Supreme Court issued guidance to lower courts on reviewing tax cases providing a systematic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed.

33 Commitments and contingencies

From time to time, the Group adopts interpretations of such uncertain areas that reduce the overall tax rate of the Group. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices; the impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial condition and operations of the entity.

Management regularly reviews the Group's taxation compliance with applicable legislation, laws and decrees and current interpretations published by the authorities in the jurisdictions in which the Group has operations. Furthermore, management regularly assesses the potential financial exposure relating to tax contingencies for which the three years tax inspection right has expired but which, under certain circumstances, may be challenged by the regulatory bodies. From time to time potential exposures and contingencies are identified and at any point in time a number of open matters may exist.

Management estimates that possible exposure in relation to the aforementioned risks, as well as other profits tax and non-profits tax risks (e.g. imposition of additional VAT liabilities), that are more than remote, but for which no liability is required to be recognised under IFRS, could be several times more than accrued liabilities and provisions reflected on the statement of financial position at that date. This estimation is provided for the IFRS requirement for disclosure of possible taxes and should not be considered as an estimate of the Group's future tax liability.

In 2017 the Group made net accrual of provisions and liabilities for tax uncertainties attributable to income tax and non-income tax risks in amount of RUB 542 including net accrual of non-income tax provision of RUB 231, income tax provision of RUB 387 with simultaneous release of respective indemnification asset of RUB 76.

In 2016 the Group made net release of provisions and liabilities for tax uncertainties attributable to income tax and non-income tax risks in amount of RUB 3,242 including net release of non-income tax provision of RUB 1,732, income tax provision of RUB 522 with simultaneous release of respective indemnification asset of RUB 988. In 2016 indemnification asset of RUB 91 was impaired.

At the same time management has recorded liabilities for income taxes in the amount of RUB 389 (31 December 2016: RUB 399) and provisions for taxes other than income taxes in the amount of RUB 494 at 31 December 2017 (31 December 2016: RUB 499) in these consolidated financial statements as their best estimate of the Group's liability related to tax uncertainties as follows:

Balance at 31 December 2015	**3,740**
Release of provision	(3,772)
Accrual of provision	530
Offset of provision	400
Balance at 31 December 2016	**898**
Release of provision	(604)
Accrual of provision	1,146
Offset of provision	(557)
Balance at 31 December 2017	**883**

34 Subsequent events for the Group

In March 2018 the Group issued RUB 10 bln exchange corporate bonds series 001P-03 with 6.95% coupon rate and 2-years oferta (put-option).

X5 Retail Group N.V.

Company Financial Statements

31 December 2017

X5 RETAIL GROUP N.V.

Company Statement of Financial Position

at 31 December 2017 before appropriation of profit

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2017	31 December 2016
ASSETS			
Non-current assets			
Financial fixed assets	36	178,614	145,462
		178,614	**145,462**
Current assets			
Financial assets	36	19	1
Amounts due from subsidiaries		7,128	6,047
Prepaid expenses		1	2
VAT receivable		10	–
Other receivables		81	75
		7,239	**6,125**
TOTAL ASSETS		**185,853**	**151,587**
EQUITY AND LIABILITIES			
Paid up and called up share capital	37	4,675	4,332
Share premium account	37	46,212	46,251
Share-based payment reserve	39	117	70
Other reserves		76,044	54,096
Result for the year		31,394	22,291
Total equity		**158,442**	**127,040**
Provisions			
Deferred tax liabilities	41	1,158	–
		1,158	–
Non-current liabilities			
Loan from group company	38	17,175	17,036
		17,175	**17,036**
Current liabilities			
Amounts due to group companies		9,021	7,451
Accrued expenses and other liabilities		37	43
VAT and other taxes payable		20	17
		9,078	**7,511**
		27,411	**24,547**
TOTAL EQUITY AND LIABILITIES		**185,853**	**151,587**

The accompanying notes are the integral part of these Company financial statements.

X5 RETAIL GROUP N.V.

Company Statement of Profit or Loss

for the year ended 31 December 2017

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2017	2016
General and administrative expenses	40	(268)	(298)
Other income / (expenses)		97	(254)
Operating loss		**(171)**	**(552)**
Finance costs		(1,709)	(1,705)
Finance income		852	1,517
Net foreign exchange gain/(loss)		54	234
Loss before tax		**(974)**	**(506)**
Income tax expense	41	(1,158)	–
Income on participating interest after tax		33,526	22,797
Profit for the period		**31,394**	**22,291**

The accompanying notes are the integral part of these Company financial statements.

X5 RETAIL GROUP N.V.

Notes to the Company Financial Statements
for the year ended 31 December 2017
(expressed in millions of Russian Roubles, unless otherwise stated)

35 Accounting principles

General

The Company was incorporated as a limited liability Company under the laws of The Netherlands on 13 August 1975 and has its statutory seat in Amsterdam. The Company is publicly owned. The principal activity of the Company is to act as the listed holding company for retail chains operating mainly in Russia. The number at Chamber of Commerce is 33143036.

Basis of presentation

The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the Netherlands, in accordance with Part 9 of Book 2 of the Dutch Civil Code (art 362.8).

Accounting principles

Unless stated otherwise below, the accounting principles applied for the Company accounts are similar to those used in the IFRS *Consolidated Financial Statements* (refer to Note 2.1 to the *Consolidated Financial Statements*). The consolidated accounts of companies publicly listed in the European Union must be prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and adopted by the European Commission.

As the Company mainly exploits Russian grocery stores in four formats (proximity stores, supermarket, hypermarket and convenience stores), the functional currency of the Company is the Russian Rouble as this is the currency of its primarily business environment and reflects the economic reality. Unless stated otherwise all amounts are in millions of Russian Rouble ("RUB").

Investments in group companies

Investments in group companies are entities (including intermediate subsidiaries and special purpose entities) over which the Company has control, because the Company (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. Group companies are recognised from the date on which control is transferred to the Company or its intermediate holding entities. They are derecognised from the date that control ceases.

The Company applies the acquisition method to account for acquiring group companies, consistent with the approach identified in the consolidated financial statements. Investments in group companies are presented in accordance with the net asset value method. When an acquisition of an investment in a group company is achieved in stages, any previously held equity interest is remeasured to fair value on the date of acquisition. The measurement against the book value is accounted for in the statement of profit and loss.

When the Company ceases to have control over a group company, any retained interest is remeasured to its fair value, with the change in carrying amount to be accounted for in the statement of profit or loss. When parts of investments in group companies are bought or sold, and such transaction does not result in the loss of control, the difference between the consideration paid or received and the carrying amount of the net assets acquired or sold, is directly recognised in equity.

When the Company's share of losses in an investment in a group company equals or exceeds its interest in the investment (including separately presented goodwill or any other unsecured non-current receivables being part of the net investment), the Company does not recognise any further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the investment. In such case the Company will recognise a provision.

Amounts due from group companies

Amounts due from group companies are stated initially at fair value and subsequently at amortised cost. Amortised cost is determined using the effective interest rate.

Shareholders' Equity

Issued and paid up share capital, which is denominated in Euro, is restated into Russian Rouble ("RUB") at the official exchange rate of the Central Bank of the Russian Federation as at reporting date in accordance with section 373 sub 5 of book 2 of the Dutch Civil Code. The difference is settled in the other reserves.

36 Financial fixed assets

	31 December 2017	31 December 2016
a. Movements in the interests in group companies have been as follows		
Opening balance	138,150	111,227
Acquisitions/capital contribution	9,228	4,126
Divestment of group companies/ capital repayments	(9,592)	–
Profit from group companies for the year	33,526	22,797
Closing balance	**171,312**	**138,150**

A complete list of group companies has been disclosed in the consolidated financial statements (refer to Note 6 of the consolidated financial statements).

	31 December 2017	31 December 2016
b. Movements in the loans to group companies have been as follows		
Opening balance	7,313	11,194
Settlement/repayment	–	(8,638)
Additions	14	4,761
Foreign exchange differences	(6)	(4)
Closing balance	**7,321**	**7,313**
Non-current financial assets	178,614	145,462
Current financial assets	19	1
TOTAL FINANCIAL FIXED ASSETS	**178,633**	**145,463**

31 December 2017				
Borrowing group company	**Loan currency**	**Carrying value**	**Interest rate, % p.a.**	**Maturity date**
GSWL Finance Ltd	RUB	4,598	11%	December 2022
GSWL Finance Ltd.	RUB	2,570	Mosprime1m + 3.6%	December 2021
Perekrestok Holdings Ltd.	USD	133	11%	December 2022
X5 Capital S.A.R.L	EUR	19	4.5%	December 2022
X5 Capital S.A.R.L	EUR	1	4%	December 2018
TOTAL LOANS TO GROUP COMPANIES		**7,321**		

36 Financial fixed assets

31 December 2016				
Borrowing group company	**Loan currency**	**Carrying value**	**Interest rate, % p.a.**	**Maturity date**
GSWL Finance Ltd	RUB	4,598	Mosprime1m + 3.6%	December 2021
GSWL Finance Ltd.	RUB	2,569	11%	December 2022
Perekrestok Holdings Ltd.	USD	140	11%	December 2022
X5 Capital S.A.R.L	EUR	5	4.5%	December 2018
X5 Capital S.A.R.L	EUR	1	4%	December 2017
TOTAL LOANS TO GROUP COMPANIES		**7,313**		

The total amount of the loans provided to group companies was RUB 7,321 (2016: RUB 7,313) and it approximated the fair value. The loans have not been secured.

37 Shareholders' equity

	Share capital[1]	Share premium	Other reserves	Profit/ (loss)	Share-based payment (equity)	Total
Balance as at 1 January 2016	**5,410**	**46,253**	**38,844**	**14,174**	**37**	**104,718**
Share-based payment compensation (Note 27)	–	–	–	–	31	31
Transfer	–	–	14,174	(14,174)	–	–
Currency translation	(1,078)	–	1,078	–	–	–
Transfer of vested equity rights	–	(2)	–	–	2	–
Result for the period	–	–	–	22,291	–	22,291
Balance as at 1 January 2017	**4,332**	**46,251**	**54,096**	**22,291**	**70**	**127,040**
Share-based payment compensation (Note 27)	–	–	–	–	71	71
Transfer	–	–	22,291	(22,291)	–	–
Currency translation	343	–	(343)	–	–	–
Transfer of vested equity rights	–	(39)		–	(24)	(63)
Result for the period	–	–	–	31,394	–	31,394
Balance as at 31 December 2017	**4,675**	**46,212**	**76,044**	**31,394**	**117**	**158,442**

[1] Share capital translated at the year end exchange rate EUR/RUB of 68.8668 (2016: 63.8111).

Share capital issued

As at 31 December 2017 the Group had 190,000,000 authorised ordinary shares (31 December 2016: 190,000,000) of which 67,886,748 ordinary shares were outstanding (31 December 2016: 67,884,340) and 6,470 ordinary shares held as treasury stock (31 December 2016: 8,878). The nominal par value of each ordinary share is EUR 1.

The acquisition price of the shares purchased was charged against other reserves. Other reserves as at 31 December 2017 included translation reserve of RUB 2,217 (2016: RUB 1,874) and legal reserves of RUB 517 (2016: RUB 276).

Statutory profit appropriation

The Supervisory Board proposed to the General Meeting to distribute in 2018 current year profit in the amount of RUB 21,590 (318.03 RUB per ordinary share) to shareholders.

38 Loan from group company

	Loan currency	31 December 2017	Interest rate, % p.a.	Final maturity date
JSC Trade House Perekriostok	RUB	15,628	10%	December 2020
JSC Trade House Perekriostok	USD	1,235	10%	December 2020
JSC Trade House Perekriostok	EUR	312	10%	December 2020
TOTAL		**17,175**		

	Loan currency	31 December 2016	Interest rate, % p.a.	Final maturity date
JSC Trade House Perekriostok	RUB	15,629	10%	December 2020
JSC Trade House Perekriostok	USD	1,300	10%	December 2020
JSC Trade House Perekriostok	EUR	107	10%	December 2020
TOTAL		**17,036**		

The loan payable to JSC Trade House Perekriostok denominated in RUB/USD/EUR. RUB facility amounted to 15,628 (2016: RUB 15,629), USD 21.4 million (2016: USD 21.4 million) and EUR 4,5 million (2016: EUR 1.7 million).

39 Share-based payments

X5 Retail Group N.V. operates equity settled share based compensation plan in the form of its Restricted Stock Unit Plan.

The Restricted Stock Unit Plan consists of performance based awards and awards subject to the employment condition only. For employees of the Company an expense is recorded in the profit and loss account.

The receivable or expense is accounted for at the fair value determined in accordance with the policy on share-based payments as included in the consolidated financial statements, including the related liability for cash settled plans or as equity increase for equity settled plans (Note 27).

39 Share-based payments

The following is included in the entity's accounts for the Restricted Stock Unit Plan:

	2017	2016
Equity share-based payment reserve as at 31 December	117	70
Expenses for the year ended 31 December	71	48

40 General and administrative expenses

	2017	2016
Other expenses	194	248
Audit expenses	12	12
RSU + LTI programme	62	38
TOTAL	**268**	**298**

In accordance with the Dutch legislation article 2:382a the total audit fees related to the accounting organisation Ernst & Young Accountants LLP amounted to RUB 12 (2016: RUB 12).

41 Income tax expense

	2017	2016
Current income tax charge	–	–
Deferred income tax charge	1,158	–
Income tax charge for the year	**1,158**	–

The theoretical and effective tax rates are reconciled as follows:

	2017	2016
Loss before taxation	(974)	(506)
Theoretical tax at the effective statutory rate[1]	**(244)**	**(127)**
Tax effect of items which are not deductible or assessable for taxation purposes		
Unrecognised tax loss carry forwards for the year	119	110
Change in deferred tax liability associated with investments in subsidiaries	1,158	–
Other non-deductible expense	125	17
INCOME TAX CHARGE FOR THE YEAR	**1,158**	**–**

No deferred tax asset has been recognised due to uncertainty of future taxable income to offset the current tax losses.

[1] Profit before taxation on operations in Netherlands is assessed based on the statutory rate of 25%.

Deferred income tax

Deferred tax liabilities and the deferred tax charge in the company statement of profit or loss were attributable to the following items for the year ended 31 December 2017:

	31 December 2016	Credited/ (debited) to profit and loss	31 December 2017
Tax effects of taxable temporary differences			
Investments into subsidiary	–	(1,158)	(1,158)
Gross deferred tax liabilities	–	(1,158)	(1,158)
Recognised deferred tax liabilities	**–**	**(1,158)**	**(1,158)**

In September 2017 the Group approved dividend policy and proposed to the General Meeting to distribute dividends to its shareholders in 2018 based on the results of 2017. As a result the Group estimates that part of temporary difference related to investments in subsidiaries will be reversed in the foreseeable future and therefore accrued related deferred tax liability.

There were no deferred tax liabilities and the deferred tax charge in the company statement of profit or loss for the year ended 31 December 2016.

The Company estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of RUB 794 (2016: RUB 675). Unused tax losses are available for carry forward for a period not less than five years (for 2016 – six years).

42 Staff numbers and employee expenses

The number of persons having a contract with the Company is four: one of them has a services contract, and three of them have a contract of employment. One of them was posted outside of the Netherlands. For the remuneration of past and present members of the Management Board, please refer to note 26 Staff Cost in the consolidated financial statements, which is deemed incorporated and repeated herein by reference. Incurred wages, salaries and related social security charges in relation to the other two employees comprise RUB 9 (2016: RUB 10).

43 Contingent rights and liabilities

Reference is made to the commitments and contingencies as disclosed in Note 33 in the consolidated financial statements. Guarantees are irrevocable assurances that the Company will make payments in the event that another party cannot meet its obligations.

The Company had the following guarantees issued under obligations of its group companies:

	31 December 2017	31 December 2016
Irrevocable offer to holders of X5 Finance LLC bonds	45,000	35,000
Irrevocable offer to holders of X5 Finance B.V. eurobonds	20,000	–
Suretyship for JSC Trade House Perekriostok	62,400	23,500

44 Related party transactions

Refer to Note 8 of the consolidated financial statements; all group companies are also considered related parties.

Statutory director's compensation

The Company has a Management Board and a Supervisory Board. The total remuneration of all board members as well as key management is disclosed in Note 26 and Note 27 of the Consolidated Financial Statements.

Loans to group companies

For loans issued to and interest income from the group companies refer to Note 36.

Loan from group company

For loan received from and interest expenses to the group company refer to Note 38.

45 Subsequent events for the company

There were no significant events after the reporting date.

Amsterdam, 28 March 2018	
Management Board:	Supervisory Board:
Frank Lhoëst	Stephan DuCharme
Igor Shekhterman	Mikhail Fridman
	Andrei Elinson
	Christian Couvreux
	Pawel Musial
	Geoff King
	Peter Demchenkov
	Michael Kuchment

OTHER INFORMATION

Auditor's report

The auditor's report is included on pages 265-275.

Statutory profit appropriation

In Article 28 of the Company's statutory regulations the following has been stated concerning the appropriation of result:

On proposal of the Supervisory Board, the General Meeting shall determine which part of the profits earned in a financial year shall be added to the reserves and the allocation of the remaining profits.

The Supervisory Board proposed to the General Meeting to distribute in 2018 current year profit in the amount of RUB 21,590 (318.03 RUB per ordinary share) to shareholders.

Subsequent events

For subsequent events, please refer to note 45 of the financial statements.

Independent auditor's report

To: The Supervisory Board and Shareholders of X5 Retail Group N.V.

Building a better working world

Report on the audit of the financial statements 2017 included in the annual report

Our opinion

We have audited the financial statements 2017 of X5 Retail Group N.V., based in Amsterdam, the Netherlands. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

- the accompanying consolidated financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2017, and of its result and its cash flows for 2017 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- the accompanying company financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2017, and of its result for 2017 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the following statements for 2017: the consolidated statement of profit or loss, the consolidated statements of comprehensive income, cash flows and changes in equity;
- the notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

- the company statement of financial position as at 31 December 2017;
- the company statement of profit or loss for 2017;
- the notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the “Our responsibilities for the audit of the financial statements” section of our report.

We are independent of X5 Retail Group N.V. in accordance with the EU Regulation on specific requirements regarding statutory audit of public-interest entities, the “Wet toezicht accountantsorganisaties” (Wta, Audit firms supervision act), the “Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten” (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore we have complied with the “Verordening gedrags- en beroepsregels accountants” (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Materiality

Materiality	RUB 2.4 billion
Benchmark	2.5% of EBITDA
Explanation	Based on our professional judgment, we consider an earnings-based measure as the most appropriate basis to determine materiality. On the basis of our analysis of stakeholders' needs and main KPIs set for the Management Board, we believe that EBITDA is an important benchmark for the financial performance of the Group. The materiality and applied benchmark are in line with the 2016 audit.

We have also taken misstatements into account and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of RUB 114 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

X5 Retail Group N.V. is established in the Netherlands and is head of a group of subsidiaries operating food retail stores in Russia ("the Group"). The financial information of all these entities is included in the consolidated financial statements of the Group.

We are responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out. The Group accounting function is centralized in Moscow and Nizhny Novgorod and the Group is primarily managed as a single operating unit with multiple operating segments. We have used the work of EY Moscow to perform full-scope audit procedures to obtain sufficient coverage for financial statement line items from a consolidated financial statement perspective. We executed a program of regular communication that has been designed to ensure that the audit progress and findings were discussed between us and the audit team of EY Moscow. We have visited EY Moscow during planning and execution phases, as well as held meetings with the Group's Management Board, finance and reporting, risk management, internal audit and legal representatives.

By performing the procedures mentioned above, we have been able to obtain sufficient and appropriate audit evidence of the group's financial information to provide an opinion on the consolidated financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of goodwill
(see note 12 to the financial statements)

Risk	As a result of past acquisitions, the Group carries capitalized goodwill with a value of RUB 90 billion as at 31 December 2017. In accordance with the requirements of IAS 36 Impairment of Assets, management performs an impairment assessment on an annual basis. The Group identifies separate operating segments for each of its retail formats. The goodwill impairment assessment is performed at the level of the operating segments. The impairment assessment includes the assessment of the recoverable amount based on expected cash flows. These cash flows are based on current budgets and forecasts approved by the Management Board and are extrapolated for subsequent years based on consumer price index. Key assumptions used are revenue growth, projected EBITDA margin and the discount rate. We consider this to be a key audit matter as the goodwill amount is significant, the assessment requires significant judgment and there is complexity in the valuation methodologies used to determine whether the carrying value of goodwill is appropriate, which includes the assumptions used within models to support the recoverable amount of goodwill.
Audit approach	We obtained an in-depth understanding of the Group's methodology used for performing the goodwill impairment test and ensured it is in accordance with EU-IFRS. We challenged management's key assumptions used in the goodwill impairment test and compared the assumptions used with industry trends and forecasts developed by independent analysts. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias. Regarding the key assumptions used and methodology applied, we involved internal valuation experts, who compared assumptions used in the model with observable market data and verified the methodology applied is compliant with EU-IFRS. We tested mathematical accuracy of the impairment testing model, reconciled internal inputs in the model with audited accounting records and ensured consistency of data used for goodwill impairment testing with other information obtained during the audit. We considered the adequacy of the disclosures to the financial statements.
Key observations	We consider the Management Board's key assumptions to be within a reasonable range of our own expectations and the related disclosures in note 12 to the financial statements to be adequate.

Impairment of stores and other non-current assets
(see notes 10,11,13 to the financial statements)

Risk	The Group operates more than 12,000 retail stores in Russia. The associated valuation of stores and other non-current assets, such as property, equipment and intangible assets, approximated RUB 303 billion as at 31 December 2017 and is considered a key audit matter due to the magnitude of the carrying value as well as the judgment involved in assessing the recoverability of the invested amounts. Management assesses annually the existence of triggering events for potential impairment of assets, or reversals thereof, related to underperforming stores. For the impairment assessment that is performed in accordance with Group policies and procedures, management first determines the value in use for each store and compares this to the carrying value. Where the carrying value is higher than the value in use, the fair value less cost of disposal is determined. The judgment involved focuses predominantly on the discount rate and future store performance, which is, among others, dependent on the expected revenue and the local competition. The expected revenue is determined based on strategic growth plan prepared with reference to macroeconomic forecasts. Management assesses the impairment and impairment reversal on an annual basis using an internal calculation model. Judgment is also involved in determination of the fair value of property undertaken on the basis of internal and external property valuation reports. We consider this to be a key audit matter as the total amount of other non-current assets, such as property, equipment and intangible assets, is significant. Furthermore, the assessment requires significant judgment and there is complexity in the valuation methodologies used.
Audit approach	Among other audit procedures, we assessed appropriateness of the Group's policies and procedures to identify triggering events for potential (reversal of) impairment of assets related to underperforming stores. We challenged management's key assumptions used in the cash flow forecast such as revenue growth and corroborated these assumptions through comparison to management's internal forecasts, external data and historical performance. We assessed accuracy of management's forecasts used in prior year to identify potential bias. We involved our internal valuation experts to evaluate the methodology, inputs and assumptions used in the model for consistency with general practice and market observable data. The audit of the model also included verification that the impairment methodology is consistently applied and that the model is mathematically accurate. We involved our internal real estate valuation experts to assess the (market) property valuations performed by the Group. We also assessed objectivity and competency of external appraisers engaged by the Group. We considered the adequacy of the disclosures to the financial statements.
Key observations	We consider the Management Board's key assumptions to be within a reasonable range of our own expectations and the related disclosures in notes 10, 11 and 13 to the financial statements to be adequate.

Recognition of vendor allowances
(see note 2.25 to the financial statements)

Risk	The Group receives various types of vendor allowances such as rebates and service fees. Rebates largely depend on volumes of products purchased and service fees are received for promotional activities that the Group undertakes with respect to certain products. These allowances represent a significant component of cost of sales and are recognized as a reduction of the inventory cost value. While the majority of the allowances are settled during the financial year, a substantial amount remains outstanding at each year-end and is recognized as part of trade receivables. We consider this to be a key audit matter because allowances are individually different, can be complex and recognition of vendor allowance income and receivables requires a certain level of judgment by management, for example, timing of delivery of the service and evidence thereof. Moreover, the allocation of the allowances to inventory cost value also has an element of judgment. The Group evaluates all required disclosures for vendor allowances and determines that they are appropriately included in the financial statements.
Audit approach	Our procedures included testing of internal controls related to occurrence, completeness and measurement of the allowances recognized in the accounting system and covered both, IT application and manual controls, including controls related to periodic reconciliations with vendors. We verified that the Group is in compliance with relevant laws and regulations in relation to these vendor allowances, including the new trade law implemented in 2017. We selected a sample of vendors and obtained direct confirmations from vendors of their settlements with the Group. We tested on a sample basis documents supporting journal entries regarding the recognition of vendor rebates and service fees. In addition, we performed margin analysis and we reviewed subsequent collections on prior period vendor allowance receivables and subsequent collections of the vendor allowances receivable in the current year. We verified that the policy for the reduction of inventory cost related to vendor allowances is appropriate and has been applied correctly.
Key observations	We did not identify material exceptions and we found the Management Board's recognition of vendor allowances to be supported by available evidence.

Depreciation of buildings
(see note 2.5 to the financial statements)

Risk	The Group's buildings category of property, plant and equipment includes own real estate objects and improvements of leased ones. During 2016 the Group split these buildings into several components, as a result of which buildings are now categorized into foundation and frame, with a depreciation period of 40-50 years, and other parts with a depreciation period of 7-8 years. During 2017 this process was completed, with all components now being separately accounted for in the accounting system of the Group. Furthermore, the Management Board continued to assess the reasonableness of the useful lives of these assets on an ongoing basis. We consider this to be a key audit matter because the carrying amount of buildings is significant and determination of appropriate components and their useful lives requires management to exercise significant judgment.
Audit approach	We analysed the composition of the Group's buildings category of property, plant and equipment and challenged the reasonableness of the depreciation of the buildings (both foundation and frame as well as other parts) as well as the useful lives assigned. We tested the correctness and completeness of the transfer of the aforementioned components into the Group's accounting system during 2017 and tested the correctness of automated depreciation charge calculations for these building components.
Key observations	We consider the Management Board's key assumptions in relation to the useful lives to be within a reasonable range of our own expectations and did not identify evidence of material misstatements in the depreciation charges for the year.

Long-term incentive programme (LTI)
(see note 26 to the financial statements)

Risk	The Group has a long term incentive plan in place. The long-term incentive programme (LTI) is a programme in several stages which runs until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management. The targets represent the Group's long-term ambitions, with a specific focus on revenue and market share growth relative to the competition, without sacrificing EBITDA margin. The total available fund for all pay-outs under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. Each stage of the programme includes a deferred component of conditional pay-outs in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI pay-out may be adjusted downwards based on individual performance during the period of the programme. We consider this to be a key audit matter due to significant judgment involved in determination of appropriate accounting policies and estimates used in LTI calculations.
Audit approach	We obtained an in-depth understanding of the Group's LTI program and methodology used for recognition of LTI expense. We challenged management's key assumptions used in the LTI expense calculations. This included the period over which the expenses should be accrued in relation to both the LTI phases and targets achieved in 2017 as well as those expected to be achieved in future years. We tested accuracy of prior year estimates and assumptions used by management to identify possible bias. We tested mathematical accuracy of LTI expense calculations, reconciled internal inputs in the calculations with audited accounting records and ensured consistency of data used for LTI calculations with other information obtained during the audit.
Key observations	We did not identify material exceptions in the LTI expenses and we consider the Management Board's key assumptions to be within a reasonable range of our own expectations.

In prior year we included a key audit matter in relation to the impact of the Russian economic crisis. We consider this no longer a key audit matter as a result of the improvements in the economic environment.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- the Chairman's statement;
- the Management Report;
- the Supervisory Board Report;
- the Remuneration Report;
- Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Based on the following procedures performed, we conclude that the other information:

- is consistent with the financial statements and does not contain material misstatements;
- contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.

The Management Board is responsible for the preparation of the other information, including the Management Report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

Following the appointment by the extraordinary general meeting of shareholders on 12 November 2015, we were engaged by the Supervisory Board on 15 December 2015 as auditor of X5 Retail Group N.V. as of the audit for the year 2016 and have operated as statutory auditor since that date.

No prohibited non-audit services

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

Other non-prohibited services provided

In addition to the statutory audit of the financial statements we provided assurance services in relation to the Group's Eurobonds offering in 2017 (see note 19).

Description of responsibilities for the financial statements

Responsibilities of the Management Board and the Supervisory Board for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Management Board is responsible for such internal control as the Management Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Management Board is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Management Board should prepare the financial statements using the going concern basis of accounting unless the Management Board either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Management Board should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included e.g.:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Concluding on the appropriateness of the Management Board's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit. In this respect we also submit an additional report to the audit committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, 28 March 2018

Ernst & Young Accountants LLP

Signed by G.A. Arnold

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