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