The Company’s principal risks

Risk profile

Strategy

Group risk

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

Group risk

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

Economic and market conditions

Group risk

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)

Retail operations

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
- Unqualified staff
- Inadequate or lack of succession planning

Human resources

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 or increase 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

IT performance, continuity

Efficiency

Group risk

Retail operations

Group risk

Economic and market conditions

Group risk

Human resources

IT performance, continuity

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.
The Company’s principal risks

Risk profile

Strategy

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
</table>
| Market and customer value proposition (CVP) | 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 ensure 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 | 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 10-11 |
| Growth and expansion | 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 |

Economic and market conditions

Major changes in the existing business strategy 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 slower supply, shortage of goods and higher purchase prices

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
• Structure reorganisation
• Underqualified staff
• Inadequate or lack of succession planning

Also see “People review” on pages 138-145

IT performance, continuity

The Company’s operating model and scale of business depend 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 increase 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

Also see “Information technologies” on pages 150-151

Efficiency

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 breakdowns 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 inventory and write-offs)

Also see “Retail operations infrastructure” on pages 114-131, as well as the section on each retail format

IT performance, continuity

The Company’s operating model and scale of business depend 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 increase 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

Also see “Information technologies” on pages 150-151

The principal risks that may impede the achievement of KPI 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, described and activities are updated, and risk appetite is indicated for identified risk.
### Efficiency

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cybersecurity</td>
<td>Minimalist to Cautious</td>
<td>Revenue Operation Cost</td>
<td>• Implement policies and procedures to ensure cybersecurity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• The Information Security Unit was established to monitor issues related to cyber-risks</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Use of special hardware and software for protection against malicious software, spam, external and internal cyberattacks, data leaks</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Use of information systems to detect atypical behaviour in the corporate network. Also see “Information technologies” on pages 130-131</td>
</tr>
<tr>
<td>Real estate, rent and maintenance</td>
<td>Minimalist to Cautious</td>
<td>Operation Cost</td>
<td>• Have store refurbishment projects collectively approved on the Company level</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Sign long-term lease agreements, specify rules for their termination, and manage rental rates</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Manage relations with lessors and sub-lessees</td>
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<td></td>
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<td></td>
<td>• Standardise and monitor the utility and technical maintenance of stores and automate store monitoring processes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Optimize selling space and subleased areas, ensure timely refurbishments</td>
</tr>
</tbody>
</table>

### 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 banking fees
- Liquidity risk
- Credit risk

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Averse to Minimalist</td>
<td>See Financial Statements</td>
<td>• Plan and monitor the budget and its performance, introduce changes needed to achieve financial targets</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• 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</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Manage the effective financing rate</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Raise financing in Russian roubles, avoid FX-denominated agreements in operating activities, include a currency clause in agreements</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Implement the KYB (“know your bank”) criteria for partner banks, providing banking or cash-related products, in order to minimize risks related to partner banks</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Ensure continuity of funding on the best available market terms, with a diverse credit portfolio in Russian roubles</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Arrange funding ahead of requirements and maintain sufficient undrawn credit limits in banks</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• 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</td>
</tr>
</tbody>
</table>

### Compliance

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reputation and social responsibility</td>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>• Use X5’s Code of Business Conduct and Ethics; X5’s Policy on Countering Misconduct, Including Fraud and Corruption; X5’s Charity Policy</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• 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</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Use the X5 Retail Group Code of Interaction with Business Partners, review complaints filed by counterparts and engage the Conciliation Commission to look into any incidents that take place</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>• Take disciplinary action in cases of unethical behaviour</td>
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<td></td>
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<td></td>
<td>• Record, arrange and process reports received from the Company’s employees via the hotline</td>
</tr>
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<td></td>
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<td></td>
<td>• Use the Customer Service Standards and the hotline for customers, and work with reports and complaints</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>• Engage in internal and in-house social and charity projects</td>
</tr>
<tr>
<td></td>
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<td></td>
<td>• In emergencies, use dedicated channels of communication and rely on the Crisis Response Team to mitigate financial and non-financial damage to X5</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Ensure accessibility for special-needs customers and employees Also see “Community investment review” on pages 152-155</td>
</tr>
</tbody>
</table>

### Environment

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>• Monitor the vehicle fleet, purchase vehicles that meet improved emission standards and optimise transportation by car</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Sell the Company’s used equipment and reuse it in refurbishment and other projects</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Collect waste and send it for recycling, and expand the list of waste suitable for recycling</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Implement energy-efficient technologies and equipment</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Make wider use of paperless document flows</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Monitor contractors in their work for X5 Also see “Environmental review” on pages 149-151</td>
</tr>
</tbody>
</table>
Credit risk

Liquidity risk

Common financial risks include:

- 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

Cybersecurity

The Company understands the rising trend of external threats to information security, including cyber-attacks, viruses and other malicious actions to, for instance, infiltrate our IT systems or damage data.

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

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:

- Increases in interest rates and/or banking fees
- Liquidity risk
- Credit risk

Group risk

Risk appetite Influenced indicator Mitigation

Cybersecurity

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 cyber-attacks, data leaks
- Use of information systems to detect atypical behaviour in the corporate network.

Real estate, rent and maintenance

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

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 minimize 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

Compliance

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

Environment

X5 is committed to preserving and protecting the environment and making sustainable use of natural resources.

- Unsustainable use of natural resources
- Environmental pollution

Group risk

Risk appetite Influenced indicator Mitigation

Reputation and social responsibility

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

Environment

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 “Community investment review” on pages 152-155
Compliance

Group risk

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:

- 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)
- Restrictions of freedom of assembly and association
- Inequality in terms of employees’ rights and opportunities

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

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

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. Unfavorable legislative developments may affect X5’s strategy and margins. Contractual terms that are unfavorable for X5, failure of counterparties to fulfill 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
- Unfavorable changes in retail laws (e.g. market share limitation, sales restrictions introduced for certain types of products) and obsolete requirements
- Unfair and DCO-related fraud, while X5’s actions may 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)

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)

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:

- Unfavorable 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
### Compliance

#### Group risk

<table>
<thead>
<tr>
<th>Human rights</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>X5’s Declaration on Human Rights (available on the Company’s website)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Use the Code of Business Conduct and Ethics, provide training to employees and develop the corporate culture</td>
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<td></td>
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<td></td>
<td>Use the Internal Labour Rules and the Compensations and Benefits Policy and communicate them to employees</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>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</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improvement of the Company’s business processes to eliminate the root causes of complaints received through the hotline monitored by the Audit Committee</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Use the Customer Service Standards and the hotline for customer, and work with reports and complaints</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ensure accessibility for special-needs customers and employees</td>
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<td></td>
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<td></td>
<td>Also see “People review” section on pages 158-145</td>
</tr>
</tbody>
</table>

### 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:

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Provide a safe and comfortable working environment (premises, equipment, uniform) at the Company’s offices, DCs and stores, and carry out workplace assessments</td>
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<tr>
<td></td>
<td></td>
<td>Ensure compliance with employees’ working hours and holiday schedule (work and rest schedule)</td>
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<td></td>
<td></td>
<td>Provide employees with life and health insurance programmes and seasonal vaccinations</td>
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<td></td>
<td></td>
<td>Arrange regular medical examinations for employees and health screenings assessments to confirm if they are fit to work</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Also see “Occupational health and safety” on pages 146-148</td>
</tr>
</tbody>
</table>

### 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:

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Audit suppliers, carry out laboratory tests of product samples before adding the products to the product mix, expanding the product mix. Remove unsupervised suppliers from the product mix</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ensure inspection of incoming products at DCs and stores (for products coming from both suppliers and manufacturers)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Comply with approved rules for product transportation, storage and sale</td>
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<tr>
<td></td>
<td></td>
<td>Comply with sanitation and personal-hygiene rules</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Provide training for employees to ensure quality, including quality assurance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Have products with flaws in production withdrawn or discontinued</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Handle complaints and requests from customers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Also see “Product safety and production quality” on pages 133-135</td>
</tr>
</tbody>
</table>

### 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. Unfavorable legislative developments may affect X5’s strategy and margins. Contractual terms that are unfavorable for X5, failure of counterparties to fulfill 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:

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Non-compliance with applicable laws, including failure to change or adjust the Company’s activities on a timely basis in line with new developments</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unfavorable changes in retail laws (e.g. market share limitation, sales restrictions introduced for certain types of products) and obsolete requirements</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unfavorable development in legislation that results in higher operating expenses for the Company</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk of legal action against X5 initiated by regulators and counterparties</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Counterparties taking advantage of laws and contractual provisions that fail to properly protect X5’s interests</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Issues related to violations of data protection compliance (see Cybersecurity)</td>
</tr>
</tbody>
</table>

### 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 businesses and operations can result in fraud risks and corruption. These risks include:

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Theft, fraud, acts of corruption and abuse on the part of X5 employees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hidden conflicts of interest</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fraud, commercial bribery and theft by third parties (consumers, counterparties)</td>
</tr>
</tbody>
</table>

### 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:

<table>
<thead>
<tr>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unfavorable changes in tax calculation rules, introduction of new taxes and fees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Federal and regional authorities interpreting tax laws in a way that is adverse for X5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Developments in case law involving tax disputes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Attempts to challenge previous transactions and amounts of associated tax payments</td>
</tr>
</tbody>
</table>

### Interaction with government agencies as prescribed by applicable laws, participation in public organizations, 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, rollback 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

- 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 in a conflict of interest for all employees

### 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
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

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

Reliability of financial reports

<table>
<thead>
<tr>
<th>Group risk</th>
<th>Risk appetite</th>
<th>Influenced indicator</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reliability of financial reports</td>
<td>Averse to Minimalist</td>
<td>N/A</td>
<td>Monitoring of legislative initiatives and case law regarding financial statements, changes in reporting methodologies, non-compliance with statutory requirements on financial reporting, internal audit to assess the effectiveness of the internal controls used for the preparation of financial statements</td>
</tr>
</tbody>
</table>

Economic and Market Conditions

Ambiguity of management accounts and financial statements are exposed to the following risks:

- Low impact
- Medium impact
- High impact

Fraud and Corruption

- Low impact
- Medium impact
- High impact

Retirement

Market and CVP

Reliability of Financial Reports

Expected increase in impact

Expected decrease in impact

Human Resources

IT Performance, Continuity

Cybersecurity

Real Estate, Rent and Maintenance

Reputation and Social Responsibility

Environment

Health and Safety

Human Rights

Product Safety and Quality

The Management Board

28 March 2018

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 be 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.
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

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

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<th>Group risk</th>
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<tbody>
<tr>
<td>Reporting</td>
<td>Averse to Minimalist</td>
<td>N/A</td>
</tr>
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</table>

Mitigation

- 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

Economic and Market Conditions

Misrepresentation of management accounts and financial statements are exposed to the following risks:

- Reliability of financial reports
- Misuse of management accounts and financial statements
- Ambiguity of management accounts and financial statements
- Disclosure level not in line with shareholder, lender and market expectations

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<td>Economic and Market Conditions</td>
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Mitigation

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Financial Risks

Misrepresentation of management accounts and financial statements are exposed to the following risks:

- Reliability of financial reports
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<td>Financial Risks</td>
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Mitigation

- Monitoring of legislative initiatives and case law regarding financial statements, changes in reporting methodologies
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- 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

Taxation

Misrepresentation of management accounts and financial statements are exposed to the following risks:

- Reliability of financial reports
- Misuse of management accounts and financial statements
- Ambiguity of management accounts and financial statements
- Disclosure level not in line with shareholder, lender and market expectations

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<td>Taxation</td>
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Mitigation

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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:

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Mitigation

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- 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 be 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