

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 EBITDA¹ 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&A² 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 profit³ 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.



A professional portrait of Svetlana Demyashkevich, a woman with long blonde hair and blue eyes, wearing a white button-down shirt. She is smiling and holding two halves of a peach. In front of her is a KitchenAid blender with orange juice inside. The foreground is filled with various fresh fruits like lemons, pears, dragon fruit, and pomegranates, along with several glasses and bottles of colorful smoothies. The background is a dark, textured wall.

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.