Remuneration

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

Remuneration policy

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

The objective of X5's remuneration policy is twofold:

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

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

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

Benchmarking with industry peers

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

Total direct compensation

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

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

Base salary

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

Short-term incentive (STI)

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

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

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

Long-term incentive (LTI)

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

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

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

Other remuneration components

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

Contractual arrangements

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

Clawback

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

Severance arrangement

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

Insurance and indemnity arrangements

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

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

2017 Management Board remuneration

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

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

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

Ad (1) - Base salary

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

Ad (2) – Short-term incentive

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

Ad (3) – Long-term incentive

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

Internal pay ratio

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

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

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

Remuneration policy in 2018 and beyond

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

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

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

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

The Supervisory Board

28 March 2018

03

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X5 RETAIL GROUP N.V.

International financial reporting standards

Consolidated financial statements

31 December 2017

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X5 RETAIL GROUP N.V.

Consolidated statement of financial position

at 31 December 2017

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

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

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

X5 RETAIL GROUP N.V.

Consolidated statement of profit or loss

for the year ended 31 December 2017

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

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

X5 RETAIL GROUP N.V.

Consolidated statement of comprehensive income

for the year ended 31 December 2017

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

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

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

X5 RETAIL GROUP N.V.

Consolidated statement of cash flows

for the year ended 31 December 2017
(expressed in millions of Russian Roubles, unless otherwise stated)

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

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

X5 RETAIL GROUP N.V.

Consolidated statement of changes in equity

for the year ended 31 December 2017
(expressed in millions of Russian Roubles, unless otherwise stated)

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

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

X5 RETAIL GROUP N.V.

Notes to the consolidated financial statements

for the year ended 31 December 2017

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

01 Principal activities and the Group structure

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

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

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

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

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

02 Summary of significant accounting policies

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

2.1 Basis of preparation

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

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

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

2.2 Consolidated financial statements

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

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

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

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

02 Summary of significant accounting policies

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

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

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

2.3 Foreign currency translation and transactions

(a) Functional and presentation currency

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

(b) Transactions and balances

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

2.4 Segment reporting

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

2.5 Property, plant and equipment

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

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

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

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

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

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

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

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

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

2.6 Investment property

Investment property consists of buildings held by the Group to earn rental income or for capital appreciation, or both, and which are not occupied by the Group. The Group recognises the part of owned shopping centres that are leased to third party retailers as investment property, unless they represent insignificant portions of the property and are used primarily to provide auxiliary services to retail customers not provided by the Group rather than to earn rental income. After purchase or construction of the building the Group assesses the main purpose of its use and, if the main purpose is to earn rental income or for capital appreciation, or both, the building is classified as investment property.

Investment properties are stated at cost less accumulated depreciation and provision for impairment, where required. If any indication exists that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs of disposal. Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment without changes in the carrying amount and cost of that property for measurement or disclosure purposes. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are 40-50 years.

Fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The Group engaged an independent valuation specialist to assess the fair value of investment properties. The measurement is classified in level 3 of the fair value hierarchy.

02 Summary of significant accounting policies

2.7 Intangible assets

(a) Goodwill

Goodwill is carried at cost less accumulated impairment losses. Goodwill represents the excess of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date over the fair value of the net assets of the acquired subsidiary at the date of exchange. Goodwill is not deductible for tax purposes.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is tested on the operating segment level.

(b) Lease rights

Lease rights represent:

- Rights for favourable operating leases acquired in business combinations. Lease rights acquired in a business combination are recognised initially at fair value;
- Key money payments due to incumbent tenants and other directly attributable costs for entering into lease contracts.

Lease rights are amortised using the straight-line method over the lease term of the respective lease contracts – ranging from 5 to 50 years.

(c) Brand and private labels

Brand and private labels acquired in a business combination are recognised initially at fair value. Private labels are amortised using the straight-line method over their useful lives. In 2017 the Group revised the useful life of its "Pyaterochka" and "Karusel" brands and estimated them to be indefinite-lived as there is no foreseeable limit to the period over which the brands are expected to generate net cash inflows for the Company. Change in estimate was based on the demonstration of the brands' ability to survive changes in the economic environment.

	Useful lives
Private labels	1-8 years

(d) Franchise agreements

Franchise agreements represent rights to receive royalties. Franchise agreements acquired in a business combination are recognised initially at fair value. Franchise agreements are amortised using the straight-line method over their useful lives.

(e) Software and other intangible assets

Expenditure on acquired patents, software and licenses is capitalised and amortised using the straight-line method over their useful lives ranging from 1 to 10 years (5 on average).

(f) Impairment of intangible assets

Where an indication of impairment exists, the recoverable amount of any intangible asset, including goodwill, is assessed and, when impaired, the asset is written down immediately to its recoverable amount. Goodwill and intangible assets not yet available for use are tested for impairment at least annually and whenever impairment indicators exist.

2.8 Operating leases

Leases of assets under which substantially all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease except preopening rentals, which are directly attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management, capitalised as a part of retail store or distribution centre construction costs.

The Group leases retail outlets and distribution centres under terms of fixed and variable lease payments. The variable lease payments depend on revenue earned by the respective retail outlets. The Group classifies variable lease payments as contingent rents.

Initial direct costs incurred by the Group in negotiating and arranging an operating lease including key money paid to previous tenants for entering into lease contracts are recognised as lease rights.

2.9 Inventories

Inventories at distribution centres and retail outlets are stated at the lower of cost and net realisable value. Cost comprises direct costs of goods, transportation and handling costs. Cost is determined by the weighted average method. Net realisable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

The Group provides for estimated inventory losses (shrinkage) between physical inventory counts on the basis of a percentage of cost of sales. The provision is adjusted to actual shrinkage based on regular inventory counts. The provision is recorded as a component of cost of sales. The Group also provides for aged stock provision where the expected selling price is below cost.

2.10 Financial assets and liabilities

The Group classifies its financial assets into the following measurement categories: loans and receivables and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date, if required under IFRS. The Group designates investments as available-for-sale only when they fall outside the other category of financial assets.

Initial recognition of financial instruments

Financial assets are initially recorded at fair value plus transaction costs. Financial liabilities are initially recorded at fair value minus transaction costs. Fair value at initial recognition is best evidenced by the transaction price.

Impairment

The Group reviews the carrying value of its financial assets on a regular basis. If the carrying value of an asset is greater than the recoverable amount, the Group records an impairment loss and reduces the carrying amount of assets by using an allowance account.

Derecognition of financial assets

The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into the following measurement categories: (a) financial derivatives and (b) other financial liabilities. Financial derivatives are carried at fair value with changes in value recognised in the consolidated statement of profit or loss in the period in which they arise. Other financial liabilities are carried at amortised cost.

2.11 Loans, trade and other receivables

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term. Loans receivable and other receivables are carried at amortised cost using the effective interest rate method. Trade receivables are initially recognised at their fair values and are subsequently carried at amortised cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The Group determines that there is objective evidence of impairment by assessing groups of receivables against credit risk factors established based on historical loss experience for each group. Indications that the trade receivable may be impaired include financial difficulties of the debtor, likelihood of the debtor's insolvency, and default or significant failure of payment. The amount of the provision is recognised in the consolidated statement of profit or loss. Uncollectible receivables are written off against the related impairment provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recovery of amounts previously written off is credited to impairment account within the profit or loss for the year.

02 Summary of significant accounting policies

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments used for meeting short term cash commitments.

2.13 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are measured as the best estimate of the expenditure required to settle the present obligation at the reporting date.

2.14 Value added tax

Output VAT related to sales is payable to tax authorities on the earliest of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice and fulfilment of other conditions in compliance with Russian tax legislation.

The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability, except for VAT, presented within other non-current assets. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

2.15 Employee benefits

Wages, salaries, bonuses, paid annual leave and sick leave are accrued in the period in which the associated services are rendered by the employees of the Group. The Group's entities contribute to the Russian Federation's state pension and social insurance funds in respect of their employees. These contributions are accrued when incurred. The Group's commitment ends with the payment of these contributions.

2.16 Share-based payments

Employee stock plan

The Group receives services from employees as consideration for conditional rights to receive GDRs after vesting period of 3 years and fulfilment of certain predetermined performance conditions.

Share-based payment transactions under the employee stock plan are accounted for as equity-settled transactions.

The fair value of the employee services received in exchange for the grant of the conditional rights is recognised as an expense over the vesting period with the corresponding increase in equity (Share-based payment reserve) and measured by reference to the market price of the GDRs which is determined at grant date.

The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The expense or credit in the statement of profit or loss for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

2.17 Borrowings

Borrowings are initially recognised at their fair value, net of transaction costs, and are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the consolidated statement of profit or loss over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial period of time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised.

2.18 Trade and other payables

Trade and other payables are accrued when the counterparty performs its obligation under the contract and are carried at amortised cost using the effective interest method. Trade payables are recognised initially at fair value.

2.19 Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as share premium.

2.20 Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared on or before the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the consolidated financial statements are authorised for issue.

2.21 Treasury shares

Where any group company purchases the Company's equity share capital, the paid consideration, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any received consideration, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.22 Earnings per share

Earnings per share are determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting period. Diluted earnings per share are calculated by adjusting the earnings and the number of shares for the effects of dilutive options.

2.23 Taxes

Current tax is the amount expected to be paid to, or recovered from, the state budget in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if consolidated financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Current income tax liabilities (assets) are measured in accordance with IAS 12 *Income Taxes*, based on legislation that is enacted or substantively enacted at the reporting date, taking into consideration applicable tax rates and tax exemptions.

Deferred income tax is provided using the reporting liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. In accordance with the initial recognition exception, deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period in which the asset is realised or the liability is settled, based on tax rates which are enacted or substantially enacted at the reporting date.