

Internal control

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

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

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

Ethics and compliance culture

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

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

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

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

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

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

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

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

Monitoring and assurance

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

The Company's principal risks

Risk profile

Strategy

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Market and customer value proposition (CVP)</p> <p>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:</p> <ul style="list-style-type: none"> Failure to promptly respond to changes in customer preferences, behaviour patterns and lifestyle Failure to promptly respond to new business models, services and technologies used in the retail and related markets Failure to take local consumption and regional economic potential into account in the CVP Investment in inefficient or unproven retail formats and lines of business 	Minimalist to Cautious	Net Sales, Gross Profit	<ul style="list-style-type: none"> Constantly monitor retail and related markets in Russia and internationally Revise the CVP on an annual basis and have it reviewed and approved by the Supervisory Board Strictly adhere to the approved CVP and oversee compliance with it, analyse operating performance indicators and NPS on the parent company level Explore, test and implement new retail technologies and emerging retail market segments <p>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</p>
<p>Economic and market conditions</p> <p>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:</p> <ul style="list-style-type: none"> A sharp drop in consumer demand (structural changes and shrinking consumer demand in money and absolute terms), depending on real income, consumer confidence and the unemployment level Social and demographic developments Excessively low or high consumer inflation Unexpected decline in fiscal revenues, muted business activity, slowdown in manufacturing, and, consequently, lower personal income, shrinking markets for commercial and non-commercial goods and services Political events with a potentially negative impact on markets, resulting in lower supply, shortage of goods and higher purchase prices 	Cautious to Open	Gross Profit	<ul style="list-style-type: none"> 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 <p>Also see "Economic and consumer trends" on pages 30-31</p>
<p>Growth and expansion</p> <p>The Company is committed to opening new stores and providing logistics capacities while also ensuring the efficiency of new openings and refurbishment of existing stores. These business goals are the pillars of the Company's strategy. The Company's growth and development are associated with the following risks:</p> <ul style="list-style-type: none"> Lack of cost-efficient locations for new openings may result in slower growth Higher costs of opening and refurbishment projects can erode margins and net profit Lack of logistics capacities to accommodate expansion of the retail format could bring about higher logistics costs and, consequently, lower margins Suboptimal geographical plan for expansion and overly optimistic expectations for project economics in certain locations Inefficient synergies from M&A deals to acquire local players 	Cautious to Open	Selling Space, Number of Stores, Net Sales	<ul style="list-style-type: none"> 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 <p>Also see "Geography of operations" on pages 46-47, as well as the section on each retail format</p>

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

Efficiency

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Retail operations</p> <p>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:</p> <ul style="list-style-type: none"> Operational disruptions and drawbacks in implementing the CVP Lower efficiency of the logistics network and higher logistics costs Lower efficiency of inventory management at the DCs and stores (reduced availability of goods, increase in inventories and write-offs) 	Minimalist to Cautious	Gross Profit, Operation Cost	<ul style="list-style-type: none"> Ensure an optimal level of decentralisation for operational business processes Manage the product mix across the retail formats in line with the CVP on an ongoing basis, and develop strategic partnerships Develop the logistics strategy, manage supply chains within the existing logistics network Improve and automate processes involving the back office, DCs and stores Monitor the operating performance of stores and DCs based on management accounts Monitor the operations of national and regional competitors on an ongoing basis and ensure a prompt response <p>Also see "Retail operations infrastructure" on pages 114-131, as well as the section on each retail format</p>
<p>Human resources</p> <p>The Company's strategic goals are heavily dependent on the competencies and performance of its officers and employees. Risks related to HR management include:</p> <ul style="list-style-type: none"> High turnover rates Shortage of qualified professionals and employees at the operational level level Strong competition Underqualified staff Inadequate or lack of succession planning 	Cautious to Open	Operation Cost	<ul style="list-style-type: none"> Monitor the labour market and provide employee benefits in line with the market Have a system for employee onboarding, training, and development in place, along with a talent pool Plan the recruitment process, use various employee search and recruitment instruments, rely on outstaffing and outsourcing practices Develop the Company's corporate culture Monitor the level of reliance on selected employees, develop their job descriptions and redistribute their duties Automate operations <p>Also see "People review" on pages 138-145</p>
<p>IT performance, continuity</p> <p>The Company's operating model and scale of business depends on the capabilities and reliability of its IT systems. Changes in the operating processes of retail companies require agile adjustments of the IT infrastructure. The inability to meet business-driven IT requirements can limit expansion and decrease profitability. IT management is subject to the following risks:</p> <ul style="list-style-type: none"> Failure to match IT capabilities, scalability and reliability in relation to business requirements Disruptions of business continuity due to IT issues 	Minimalist to Cautious	Revenue, Operation Cost	<ul style="list-style-type: none"> Engage the best external experts and develop partnerships and in-house expertise in key IT solutions used at X5 Use effective outsourcing practices, introduce an SLA and monitor compliance Ensure corporate governance of IT architecture and the integration of IT systems Ensure sufficient reliability of centralised IT infrastructure Implement policies and procedures to ensure cybersecurity <p>Also see "Information technologies" on pages 130-131</p>

Efficiency

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Cybersecurity</p> <p>The Company understands the rising trend of external threats to information security, including cyberattacks, viruses and other malicious actions to, for instance, infiltrate our IT systems or damage data.</p>	Minimalist to Cautious	Revenue Operation Cost	<ul style="list-style-type: none"> Implement policies and procedures to ensure cybersecurity The Information Security Unit was established to monitor issues related to cyber-risks Use of special hardware and software for protection against malicious software, spam, external and internal cyberattacks, data leaks Use of information systems to detect atypical behaviour in the corporate network. <p>Also see "Information technologies" on pages 130-131</p>
<p>Real estate, rent and maintenance</p> <p>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:</p> <ul style="list-style-type: none"> Unplanned increases in lease rates Termination of lease agreements by the lessor Poor technical maintenance of stores and equipment Higher utility rates Higher vacancy rates and a resulting decrease in revenues from subleased areas 	Minimalist to Cautious	Operation Cost	<ul style="list-style-type: none"> 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
<p>Financial risks</p> <p>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:</p> <ul style="list-style-type: none"> Significant volatility of foreign exchange rates Increases in interest rates and/or banking fees Liquidity risk Credit risk 	Averse to Minimalist	See Financial Statements	<ul style="list-style-type: none"> Plan and monitor the budget and its performance, introduce changes needed to achieve financial targets Monitor repayment schedules for long-term and short-term accounts receivable, oversee the use of short-term lending via available credit lines to manage liquidity Manage the effective financing rate Raise financing in Russian roubles, avoid FX-denominated agreements in operating activities, include a currency clause in agreements Implement the KYB ("know your bank") criteria for partner banks, providing banking or cash-related products, in order to minimise risks related to partner banks Ensure continuity of funding on the best available market terms, with a diverse credit portfolio in Russian roubles Arrange funding ahead of requirements and maintain sufficient undrawn credit limits in banks Maintain a strong credit rating so that maturing debt may be refinanced as it falls due <p>Also see "Financial risk management" on pages 94-103</p>

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Reputation and social responsibility</p> <p>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.</p> <p>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:</p> <ul style="list-style-type: none"> Unethical conduct, unscrupulous practices by X5 management and employees in their relations with customers, counterparties, government authorities, non-profit associations, investors and other stakeholders A mismatch between the Company's social responsibility standards and the expectations of communities, market players and stakeholders based on X5's role, scale of business and growth potential Abuse by third parties using X5's trademarks and brands Misleading information about X5 in social and mass media that may damage the reputation of the Company and its retail formats Leakage of critical (sensitive) information onto the Internet or to competitors 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> 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 <p>Also see "Community investment review" on pages 152-155</p>
<p>Environment</p> <p>X5 is committed to preserving and protecting the environment and making sustainable use of natural resources.</p> <ul style="list-style-type: none"> Unsustainable use of natural resources Environmental pollution 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> 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 <p>Also see "Environmental review" on pages 149-151</p>

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Human rights</p> <p>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:</p> <ul style="list-style-type: none"> Discrimination against employees, customers and representatives of the Company's partners on the grounds of age, gender, sexual orientation, social status, nationality or ethnicity, cultural or political beliefs, etc. X5's involvement in human rights violations by third parties Unethical behaviour on the part of employees in violation of human rights (forced or unpaid labour, harassment or workplace bullying, offensive language, humiliation of human dignity) Restriction of freedom of assembly and association Inequality in terms of employees' rights and opportunities 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> X5's Declaration on Human Rights (available on the Company's website) Use the Code of Business Conduct and Ethics, provide training to employees and develop the corporate culture Use the Internal Labour Rules and the Compensation and Benefits Policy and communicate them to employees Receiving and processing complaints from the Company's employees via the hotline and taking disciplinary actions in case of violations of labour or other legislation, internal Company policies and procedures, revising the Company's business processes to reduce the number of complaints Improvement of the Company's business processes to eliminate the root causes of complaints received through the hotline are monitored by the Audit Committee Use the Customer Service Standards and the hotline for customers, and work with reports and complaints Ensure accessibility for special-needs customers and employees <p>Also see "People review" section on pages 138-145</p>
<p>Health and safety</p> <p>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:</p> <ul style="list-style-type: none"> Accidents causing injuries, including fatal injuries, to employees or individuals at X5 facilities and in adjacent areas Injuries to employees due to an unsafe and uncomfortable working environment Failure to provide first aid on a timely basis as required 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> Provide a safe and comfortable working environment (premises, equipment, uniform) at the Company's offices, DCs and stores, and carry out workplace assessments Ensure compliance with employees' working hours and holiday schedule (work and rest schedule) Provide employees with life and health insurance programmes and seasonal vaccinations Arrange regular medical examinations for employees and health screening assessments to confirm that they are fit to work <p>Also see "Occupational health and safety" on pages 146-148</p>
<p>Product safety and quality</p> <p>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:</p> <ul style="list-style-type: none"> Selling products that fail to meet safety standards and representations about quality Violations of operational process rules that may lead to spoilage and contamination Accepting from suppliers products that fail to meet safety standards and representations about quality 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> Audit suppliers, carry out laboratory tests of product samples before adding the products to the product mix or expanding the product mix. Remove unscrupulous suppliers from the product mix Ensure inspection of incoming products at DCs and stores (for products coming from both suppliers and DCs) Comply with approved rules for product transportation, storage and sale Comply with sanitation and personal-hygiene rules Provide training for employees to ensure quality, including quality assurance Have products with flaws in production withdrawn or discontinued Handle complaints and requests from customers <p>Also see "Product safety and production quality" on pages 108-113</p>

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Legislation and litigation</p> <p>X5's activities are governed by a wide range of laws and regulations. By complying with these, the Company maintains its reputation and manages operating expenses. Unfavourable legislative developments may affect X5's strategy and margins. Contractual terms that are unfavourable for X5, failure of counterparties to fulfil their obligations and court action against X5 due to contract violations may have a negative impact on the Company's performance and reputation. Risks related to legislation and protection of X5's interests can include:</p> <ul style="list-style-type: none"> Non-compliance with applicable laws, including failure to change or adjust the Company's activities on a timely basis in line with new developments Unfavourable changes in retail laws (e.g. market share limitation, sales restrictions introduced for certain types of products) and obsolete requirements Unfavourable changes in legislation that result in higher operating expenses for the Company Risk of legal action against X5 initiated by regulators and counterparties Counterparties taking advantage of laws and contractual provisions that fail to properly protect X5's interests Issues related to violations of data protection compliance (see Cybersecurity risk). 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> Interaction with government agencies as prescribed by applicable laws, participation in public organisations, representation of interests Monitoring of draft laws, timely initiation of internal projects to alter and adjust X5's activities to legislative developments Implementation of X5's Compliance Policy: assessment of compliance risks, rollout and improvement of compliance procedures to integrate them into the Company's processes, consistent efforts to identify violations and non-compliance with laws, and disciplinary action Personnel training to ensure compliance with laws Legal support, audit of contracts, development and use of contract templates
<p>Fraud and corruption</p> <p>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:</p> <ul style="list-style-type: none"> Theft, fraud, acts of corruption and abuse on the part of X5 employees Hidden conflicts of interest Fraud, commercial bribery and theft by third parties (customers, counterparties) 	Averse to Minimalist	Operation Cost	<ul style="list-style-type: none"> Use the Code of Business Conduct and Ethics and X5's Policy on Countering Misconduct, Including Fraud and Corruption Promote among employers zero tolerance of abuse, and provide personnel training Implement automated and manual controls in business processes, and separate the rights to access information systems (SoD) Ensure security of the Company's assets and inventories Conduct background checks on counterparties and employees Identify abuses, fraud and theft by independent units (Inspection and Audit Division, Risk and Monitoring Department, Security Department), carry out internal checks, take disciplinary action, initiate administrative or criminal proceedings against employees, counterparties or customers Record, arrange and process reports received from the Company's employees via the hotline, from counterparties in the Conciliation Commission and from the Security Department Required declaration of a conflict of interest for all employees
<p>Taxation</p> <p>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:</p> <ul style="list-style-type: none"> Unfavourable changes in tax calculation rules, introduction of new taxes and fees Federal and regional authorities interpreting tax laws in a way that is adverse for X5 Developments in case law involving tax disputes Attempts to challenge previous transactions and amounts of associated tax payments 	Averse to Minimalist	See Financial Statements	<ul style="list-style-type: none"> Monitoring of taxation-related legislative initiatives and case law, changes to business processes Tax planning with preliminary reviews and advisory sessions Tax risk assessment before executing transactions and signing contracts Tax budgeting, provisioning for tax risks Tax control during transactions

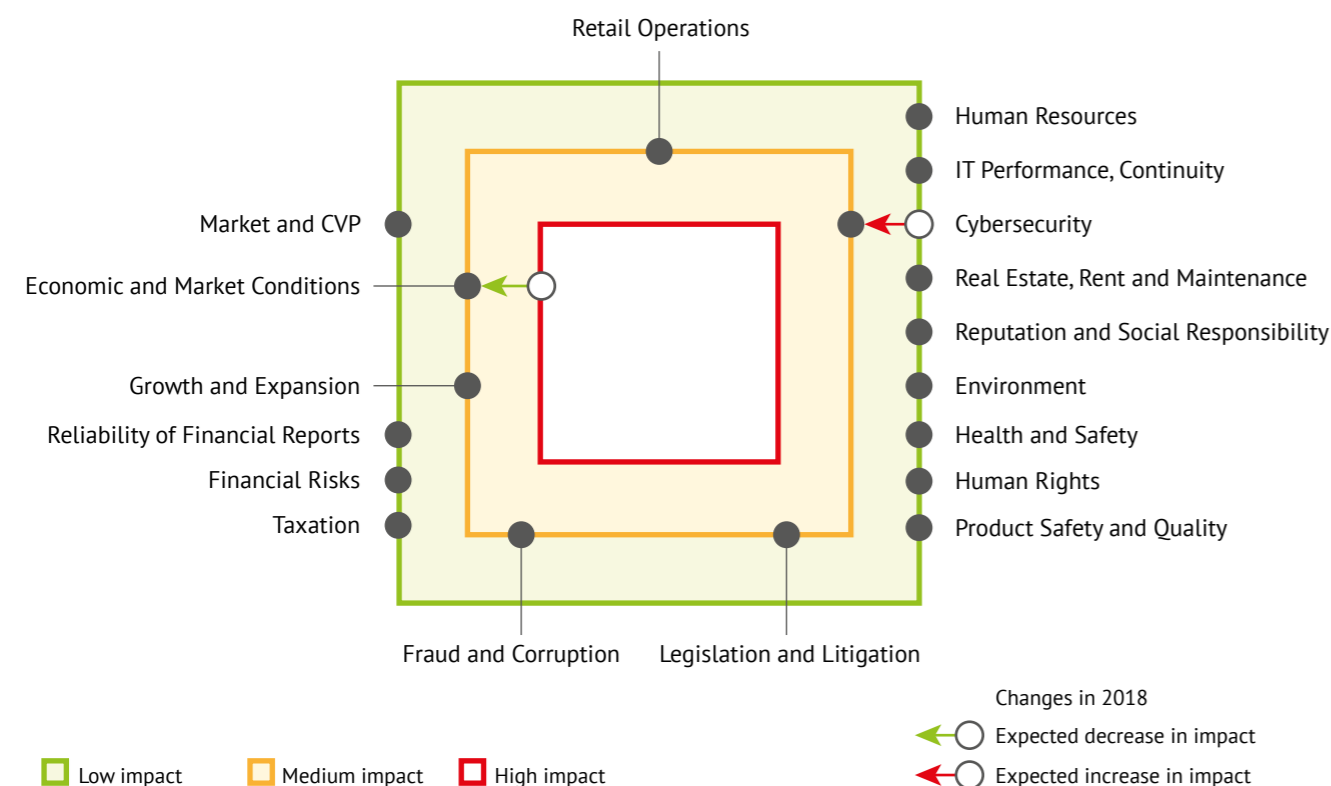
Reporting

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Reliability of financial reports</p> <p>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:</p> <ul style="list-style-type: none"> • Non-compliance with statutory requirements on financial reporting • Misrepresentation of management accounts and financial statements • Ambiguity of management accounts and financial statements • Disclosure level not in line with shareholder, lender and market expectations 	Averse to Minimalist	N/A	<ul style="list-style-type: none"> • Monitoring of legislative initiatives and case law regarding financial statements, changes in reporting methodologies • Audit by external auditors • Management of the methodology used in preparing management accounts • Internal controls for the preparation of financial statements • Internal audit to assess the effectiveness of the internal controls used for the preparation of financial statements

Expected risk tendency

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

Expected risk tendency



Statement of the Management Board

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

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

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

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

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

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

Supervisory and Management Boards



1. Stephan DuCharme

Chairman of the Supervisory Board

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

2. Mikhail Fridman

Member of the Supervisory Board

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

3. Peter Demchenkov

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

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

4. Andrei Elinson

Member of the Supervisory Board

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

5. Geoff King

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

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

6. Christian Couvreur

Member of the Supervisory Board

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

7. Michael Kuchment

Member of the Supervisory Board

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

8. Pawel Musial

Member of the Supervisory Board

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

Management Board

9. Igor Shekhterman

Chief Executive Officer, Chairman and Member of the Management Board

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

10. Frank Lhoëst

Company Secretary, Member of the Management Board

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

Report of the Supervisory Board

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

Composition and profile of the Supervisory Board

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

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

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

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

Composition of the committees

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

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

Induction

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

Meetings of the Supervisory Board

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

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

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

Activities in 2017

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

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

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

Meetings of the committees

Board evaluation

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

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

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

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

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

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

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

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

Audit Committee

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

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

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

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

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

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

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

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

The Audit Committee also discussed other issues, including:

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

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

Nomination and Remuneration Committee

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

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

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

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

Related-Party Committee

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

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

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

Financial statements

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

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

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

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

The Supervisory Board

28 March 2018