

# CEO statement



**Dear stakeholders,**

By the end of 2017, X5 Retail Group had extended its lead as Russia's #1 food retailer, growing rapidly while maintaining a constant focus on the quality and sustainability of our expansion. We continued to deliver on our core strategic goals, maintaining sustainable profitability thanks to intelligent organic growth and a relentless focus on efficiency at every level of our operations.

Some of the key 2017 achievements I would highlight include:

- Revenue grew by 25.3% to RUB 1,295 million, driven by a 27.4% rise in selling space and a 5.4% increase in LFL sales
- Pyaterochka's revenue exceeded RUB 1 trillion for the first time in the format's history in 2017
- Like-for-like (LFL) sales and traffic, which are some of the best indicators of our customers' reaction to how well we are doing, was one of our key achievements in 2017: LFL sales were positive across all three formats and grew 5.4%, while LFL traffic increased by 3.0%, which is the highest level the Company has seen since 2009
- Adjusted EBITDA margin remained stable at 7.7% in 2017, despite a challenging macro environment
- We adopted a dividend policy and recommended our first-ever dividend of RUB 21.6 billion (RUB 79.5 per GDR)
- We developed our omni-channel offering with the launch of the Perekrestok Online e-commerce platform
- We strengthened our focus on innovation, with the full rollout of Pyaterochka's loyalty programme, which leverages big data and machine-learning-based insights into promo impact on customer behaviour
- We adopted a new Logistics and Transportation Strategy to 2025, which aims to efficiently and effectively support X5's rapid growth across Russia, including in remote regions of the country

**Igor Shekhterman**

Chief Executive Officer



This year, we are also extending the way that we report on the value we create for a broader range of stakeholders in order to bring our reporting in line with EU Directive 2014/95 on non-financial information. This is our first step on the path towards a more integrated approach to how we measure and report our performance across a broad set of indicators.

## Customer-centric approach

We put our customers at the centre of everything we do, and meeting customer demand is central to our decision-making. We continued to adapt our value proposition in response to changing demand and shifts in the market environment: our three different formats address different segments of the market and different cohorts of consumers. In addition to a constant focus on service and shopping experience quality, we launched a new, personalised loyalty programme at Pyaterochka in 2017 and expanded Perekrestok's loyalty programme through strategic alliances.

One of our core areas of focus has been on improving the in-store experience, and in 2017 we completed the Pyaterochka refurbishment programme, while continuing to update Perekrestok supermarkets in line with our new concept. Karusel, after approving its new branding and commercial model, began testing elements of the new concept for its stores at one of its locations in St Petersburg, with a new interior design and navigation and a varied food court. Even renovated stores are changing, as we introduce day-to-day improvements on a regular basis.

Our assortment is constantly being refined across all of our formats, with the introduction of private-label and exclusive-label products that offer a growing range of unique and high-quality goods at attractive price points at each of our formats, including a successful new line of exclusive dairy products under the Sarafanovo brand. Our focus in this area is on developing strategic partnerships with high-quality producers that allow us to sell goods at all price points. As we expand across Russia's diverse regions, we are also adapting our business processes to increase the share of locally produced goods in the assortments offered at our stores.

Another customer-centric priority is leveraging greater insights into our customers to help us do more, better and faster to ensure that our value proposition remains the best in the market. We are making increased use of big data to tailor our loyalty schemes and rewards cards, and we have also rolled out a new loyalty scheme that will use automatically generated personalised offers for Pyaterochka customers. We have also announced a partnership to integrate machine learning into marketing campaigns to improve suppliers' ability to effectively measure the impact of promo campaigns on consumers.

I believe that our results show that these measures have been successful: 5.4% LFL growth in 2017 across X5 Retail Group's formats was the fastest pace of growth among our public peers.

## Smart and profitable growth

We continue to focus primarily on organic growth, which accounted for 87% of the increase in selling space in 2017, but we were also pleased to take advantage of several attractive M&A opportunities, such as the acquisition of O'KEY's super-market business, which we agreed in late 2017. As X5 moves into new regions and adds market share where we already have a presence, our entire team remains focussed on ensuring the profitability and sustainability of this expansion, and we are leveraging all of the tools available to achieve this.

Through further refinements of our GIS system, we have improved our ability to select the most attractive locations for new store openings, including identifying locations where cannibalisation is likely from other stores. While primarily a tool for organic growth, the GIS system also helps us to more effectively analyse potential M&A transactions.

## Moving towards innovative transformation

Technology is coming to retail, and at X5 we have started a new transformation into a technology-based company. Innovation and big data are now a core focus of our long-term strategy, and as a leader in the food retail sector we aim to be at the forefront of our industry's transformation using big data, automation, online sales channels and other tools to enhance our ability to meet customer needs while growing our business. Our aspirations in this area are also reflected in the IT roadmap to 2020 that was approved in the summer of 2017 and is now being implemented, with a focus on supporting rapid, organic growth and increasing the efficiency of IT processes.

The Company views big data as an important tool to boost the efficiency of business processes and as a source for developing potential new areas of business. X5 plans to refine its data analysis capabilities by integrating data from various internal and external sources, creating a portfolio of information products to enhance the Company's CVP and increase sales densities. This can be achieved by establishing detailed data on customers, making it possible to create more personalised offerings and tailor assortments to customers' evolving needs.



We are gearing up for a future where customers will demand even greater convenience and more personalised services, which will be made possible by emerging technologies and AI. Our ability to offer these services effectively and efficiently will play an increasingly important role in consumers' choice of where to shop and what to buy. X5 intends to be at the forefront of the AI- and technology-driven transformation of our sector, and we have established X5 Lab as a way to support, develop and manage internal and external innovative developments that can help us enhance our business.

## Multi-format and omni-channel operating model

We remain committed to our multi-format operating model, which is designed to capture a greater share of wallet across the three largest segments of the Russian food retail market.

In 2017, we delivered 27.4% growth in selling space, adding a record 1.2 million square metres and 2,934 new stores, including our 12,000th store, a Pyaterochka in the Arkhangelsk region. We also announced plans to streamline our portfolio with the disposal of the Perekrestok Express format, which represented a narrow segment of Russia's modern food retail market, in order to further strengthen our focus on our three core banners.

A significant development in 2017 was the launch of Perekrestok Online, covering all of Moscow and due to launch in St Petersburg in 2018. X5's shift to an omni-channel model gives us additional possibilities to capture more customers and expand our share of wallet by increasing customer loyalty, meeting growing demand for online grocery shopping in key markets in Russia. While the development of online food retail is several years behind certain other markets, we see enormous potential for this segment to develop, with growing demand from customers and the opportunity to apply business models that have already proven themselves to be successful.

## Operational efficiency

We reduced SG&A costs to just 16.8% of revenue, the lowest level since 2010. Our focus on efficiency in every single aspect of our operations is a key to maintaining sustainable profitability while we continue our rapid expansion. We regularly review all expense lines at our stores, logistics and transport divisions, as well as at the head office in an effort to minimise inefficiencies and cut costs.

In the last year, some of our key efficiency efforts included negotiating improved terms with suppliers, replacing old and inefficient logistics operations with new, state-of-the-art DCs, automation of high-volume and routine tasks, as well as across nearly all SG&A lines.

Several years ago, we recognised that our logistics operations failed to provide us with the competitive advantages needed to be #1 in Russia. Since then, we have made significant efforts to build a cutting-edge logistics and distribution infrastructure, using technology in our warehouses and trucks to improve efficiency, cut losses and make sure our operations are safe for consumers and for the environment. In the last three years, we have opened 23 DCs, and 10 in 2017 alone. Last year we also approved X5's Logistics and Transportation Strategy to 2025 and purchased 1,231 new trucks to add to our existing fleet. While X5's successful decentralised model has enabled each of our formats to grow rapidly, the new strategy represents an excellent example of how the Corporate Centre and three formats can work together to significantly improve efficiency and support growth.

## A strong and diverse team

X5's results for 2017 again demonstrated the strength of the Group's management and the high calibre of people in key positions across the organisation, as well as our ability to get the best out of them. While retaining our core team, we welcomed Svetlana Demyashkevich as our new Chief Financial Officer. Svetlana completed a seamless transition into the role and has already contributed significantly to the growth and success of X5.

## Operating environment

While we strengthened our leadership among Russian food retailers in 2017, X5 continues to operate in a highly competitive market with several well-developed players in each of the segments where we operate. X5 aims for each of its stores to be #1 in the hearts of Russian consumers by offering the best customer value proposition and best shopping experience to our customers.

While personal consumption began showing the first signs of recovery in 2017 along with Russia's economy, decelerating food CPI put a damper on nominal retail sales growth throughout the year, with inflation growth reaching its record lowest level in the fourth quarter. Real growth in disposable income remained negative in 2017, and the recovery in consumer confidence slowed towards the end of the year. In the current environment of slow economic growth, significant risks to the sustainability of the recovery remain, with consumption growth still weak, consumers' behaviour remaining rational, price-sensitive and promo-oriented.

We have responded to the challenging market conditions by concentrating on encouraging customer activity, for example by leveraging data analytics at Pyaterochka to deliver personalised promotions as part of our new loyalty programme and through continued innovation to improve the effectiveness of targeted marketing efforts. With a constant focus on ensuring that our CVP best addresses the needs of our target consumers, we are confident that X5 Retail Group is prepared to continue to lead the increasingly competitive food retail landscape.

## Developments in capital markets

X5 Retail Group has proven itself to be a reliable partner for public markets thanks to our ability to deliver on strategic targets and to build value for our investors. The Supervisory Board adopted the Company's first-ever dividend policy in 2017, which envisions paying out at least 25% of consolidated IFRS net profit if our financial position allows for it.

After the end of the reporting period, we also completed the listing of X5 GDRs on Moscow Exchange on 1 February 2018. This is the same instrument that trades on the London Stock Exchange, and we believe the additional listing in Moscow will help to expand the pool of investors and should have a positive impact on liquidity in the future.

## Outlook

Looking ahead to 2018, we continue to have ambitious targets for rapid, sustainable and profitable growth that the entire team must work hard to achieve. While we remain cautious about the likelihood of any sustainable economic recovery in Russia in the near term, X5 will continue to innovate and to refine its CVP to best meet the needs of consumers in Russia in the most efficient and effective way possible.

We are committed to increasing the use of advanced technologies like machine learning and automation to both make our business more efficient and to make what we offer our custom-



ers more effective. X5 will also further develop its omni-channel offering, bringing Perekrestok Online to St Petersburg. We also hope to see benefits from innovative projects in areas like logistics that will further enhance our business.

Intensifying competition combined with contradictory macroeconomic forecasts mean that the consumer is likely to retain rational behaviour and demand accessible prices. This will be the key motivating factor for us to further increase the efficiency of our business through an even greater focus on reducing costs, as well as further development relationships with suppliers to offer consumers high-quality products at affordable prices.

We remain committed to our goal of growing our business faster than the market and competition, and we believe that the food retail market leader will see significant benefits due to scale and influence. Our primary focus for this expansion will be on organic growth, which has proven to be highly successful and efficient, but we also remain well-positioned to quickly analyse and finance potential M&A deals to expand our presence.

At X5, we aim to meet demand from every Russian consumer through our multi-format, omni-channel business model. Our customers are at the heart of everything that we do and every decision that we make, and they are the key to the success of every store that we open. This customer-centric approach to business will remain one of our guiding principles as we continue our rapid growth in the years ahead.

We delivered impressive growth in 2017, and this would not have been possible without the support of our investors, our Supervisory Board, X5's own management and employees, as well as our suppliers and business partners. I want to thank everyone who contributed to this success and wish everyone a productive and fruitful year ahead!

**Igor Shekhterman**

Chief Executive Officer