Updating our assortment

Under the updated CVP, the Karusel assortment will focus on leader categories and on encouraging customers to buy larger volumes of goods in a single shopping trip. By optimising the assortment and increasing the share of basic and leader categories, we believe that we will be able to better meet our customers' shopping needs.

We will also increase our assortment in fresh categories, while the selection of non-food goods will also contract, with a focus on creating “category worlds” such as “home”, “childhood” and “seasonal offers”.

	CURRENT BRANDS	NEW BRANDS
HIGH		• VERKHOVYE
MEDIUM	• AMPERSAND	• UMNOE RESHENIE
FIRST PRICE	• KRUGLI GOD (YEAR-ROUND)	
NICHE	• SARAFANOVO	• UHTISHKI • HONEY KID

Private labels

Private labels are an efficient way to diversify our assortment and price offerings. The share of private-label goods in net retail sales increased to 3.5% in Q4 2017 from 3.2% in Q4 2016. As of the end of 2017, our hypermarkets had over 800 “Year-Round” (“Krugli God”) private-label PLUs and more than 120 other private-label SKUs. By the end of 2020, we are aiming for private label goods to account for 6-8% of net retail sales.

Our new private label, “Smart solution” (“Umnoe Reshenie”), is being developed in line with the updated CVP, which targets rational shoppers buying goods for the whole family.

Umnoe Reshenie

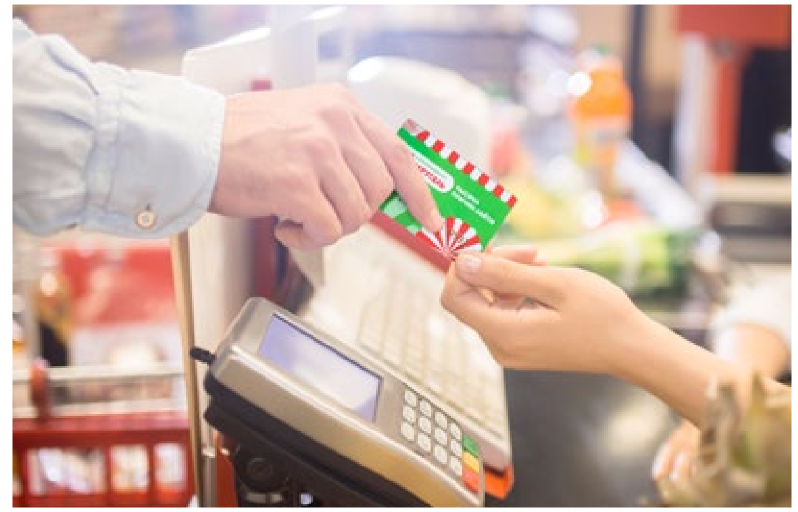
Own production

Karusel's in-store production is a key part of our updated CVP, and we continued to develop this part of the business in 2017. The share of Karusel's own production in net retail sales increased from 13.7% in 2016 to 14.1% in 2017. We aim to increase the share of our own production in the future across a range of products from delicatessen and ready-to-eat to fresh meat and poultry, fish and seafood, bakery and cheeses.

Loyalty programme

Karusel's loyalty programme, which was relaunched in 2015, continues to develop in line with our Group-wide push to leverage data analytics to improve performance. Karusel's loyalty card holders have started receiving personalised offerings and promotions based on their preferences and shopping behaviour. We have also launched the “My Karusel” mobile app for loyalty programme members.

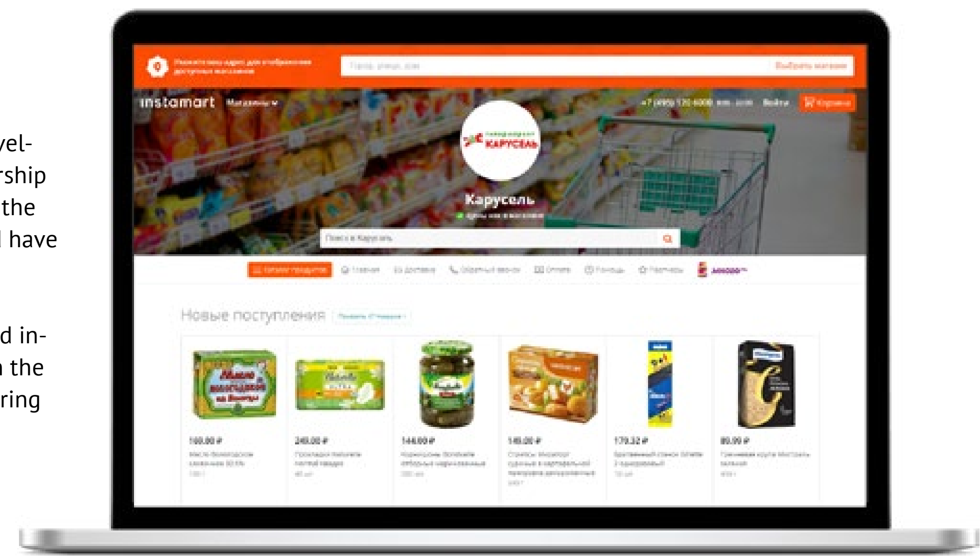
The Karusel loyalty programme accounted for 68% of net retail sales on average in 2017, with almost 80% at the end of the year, increasing from 46% in 2016. The long-term goal is to reach 90-95% by the end of 2020.



Online sales

Omni-channel sales are a key to the future development of Karusel, and we launched a partnership with Instamart in late 2017 to give customers the option to order goods from Karusel online and have them delivered by Instamart.

At present, this partnership covers Moscow and includes 8,500 SKUs that are available online. In the future, we are considering expanding this offering to St Petersburg.



Financial Review

In 2017, X5 Retail Group delivered impressive results despite continued macro-headwinds and continued weakness in consumer behaviour: revenue for the year grew by 25.3% year-on-year to RUB 1,295 billion (despite a slowdown in food inflation from 6.0% in 2016 to 3.0% in 2017), while adjusted EBITDA[1] grew by 24.7% to RUB 99.1 billion, meaning we were able to maintain our adjusted EBITDA margin of 7.7%.

One of the core drivers of our ability to maintain margins, in line with our strategic goal, was our strict control of SG&A costs through ongoing efficiency efforts. Adjusted SG&A[2] grew by just 22.9% year-on-year to RUB 218.0 billion, declining as a share of revenue by 33 basis points year-on-year to 16.8%, which is the lowest level since 2010.

Adjusted net profit[3] for 2017 grew by 51.5% year-on-year to RUB 33.8 billion, meaning that adjusted net profit margin increased by 45 b.p. to 2.6%. This performance is especially positive in light of the Supervisory Board's inaugural dividend recommendation of RUB 21.6 billion (RUB 79.5 per GDR) under the Company's new dividend policy. X5 Retail Group's management and Supervisory Board both believe that the Company can continue to deliver on its established strategic growth targets while also paying out dividends.

X5 Retail Group successfully decreased the average interest rate on its debt portfolio from 11.3% in 2016 to 9.5% in 2017. With a net debt/EBITDA ratio of 1.73x, which is the lowest level in the Company's history, we believe that the Company's debt load is at a comfortable level.

Looking ahead, we will continue to focus on the Company's further profitable growth, while continuing to prioritise efficiency by implementing new systems and projects and controlling operating costs across the business. Our healthy balance sheet and efficient operations put X5 in a good position to continue its rapid growth, even as we distribute profit in line with the new dividend policy.

Svetlana Demyashkevich

Chief Financial Officer

[1] Adjusted EBITDA is EBITDA before costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 104-107.

[2] Adjusted SG&A is SG&A before depreciation, amortisation and impairment costs as well as costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 104-107.

[3] Adjusted net profit is a measure of the Company's earnings for the reporting period, adjusted for the Company's dividend policy and impairment related to Perekrestok Express. For more information on alternative performance measures, see pages 104-107.

Financial review

The financial and operational information contained in this financial review comprises information about X5 Retail Group N.V. and its consolidated subsidiaries (hereinafter jointly referred to as "we", "X5" or the "Company").

The following is a review of our financial condition and results of operations as of 31 December 2017 and for the years ended 31 December 2017 and 31 December 2016. The Consolidated Financial Statements and related notes thereto are available on pages 196-254 of this document and were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Key highlights

Revenue:
RUB 1,295 bln
(25.3% year-on-year increase)

Adjusted SG&A expenses:
16.8% of revenue
(33 b.p. year-on-year decrease)

Adjusted EBITDA margin:
7.7%
(4 b.p. year-on-year decline)

Capital expenditure:
RUB 98.6 bln
(22.3% year-on-year increase)

Net debt/EBITDA:
1.73x
(the lowest level in the Company's history)

Dividends:
RUB 21,590 mln
RUB 79.5 per GDR, 69% of consolidated IFRS net profit (first-ever dividend payment by X5 Retail Group)

Selected macroeconomic data

Russian macroeconomic indicators, year-on-year comparison, %	2017					2016				
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY
Real GDP	0.5	2.5	1.8	1.3*	**1.5***	(0.4)	(0.5)	(0.4)	0.3	**(0.2)**
RUB/USD exchange rate, weighted average for the period	58.8	57.1	59.0	58.4	**58.4**	74.6	65.9	64.6	63.1	**67.0**
CPI	4.6	4.2	3.4	2.6	**3.7**	8.4	7.3	6.8	5.7	**7.1**
Food inflation	3.8	4.1	2.8	1.3	**3.0**	7.0	5.7	6.4	5.3	**6.1**
Real wage growth	1.8	3.4	3.1	5.9	**3.5**	(0.6)	0.3	1.2	1.8	**0.8**
Real income growth	(0.6)	(2.9)	(1.8)	(1.1)	**(1.7)**	(3.3)	(5.4)	(6.9)	(6.6)	**(5.8)**
Unemployment rate	5.5	5.2	5.0	5.1	**5.2**	5.9	5.7	5.3	5.4	**5.5**
Retail turnover	3.9	5.7	5.8	5.5	**5.3**	3.6	2.5	3.7	1.7	**2.9**
Food retail turnover	2.4	4.6	5.5	5.0	**4.4**	3.6	1.8	3.4	1.3	**2.5**

*First Rosstat estimate

Results of operations for the year ended 31 December 2017 compared to the year ended 31 December 2016

The following table and discussion provide a summary of our consolidated results of operations for the years ended 31 December 2017 and 31 December 2016.

Profit and loss statement: highlights

Russian roubles (RUB), millions[3]	2017	2016	% change, y-o-y
Revenue	1,295,008	1,033,667	25.3
incl. net retail sales[4]	1,286,949	1,025,589	25.5
Pyaterochka	1,000,942	775,580	29.1
Perekrestok	186,936	155,404	20.3
Karusel	89,302	83,558	6.9
Express	9,769	11,048	(11.6)
Gross profit	308,938	249,985	23.6
Gross profit margin, %	23.9	24.2	(33) b.p.
Adj. SG&A	(218,003)	(177,426)	22.9
Adj. SG&A, % of revenue	16.8	17.2	(33) b.p.
Adj. EBITDA	99,131	79,519	24.7
Adj. EBITDA margin, %	7.7	7.7	(4) b.p.
Operating profit	57,758	45,631	26.6
Operating profit margin, %	4.5	4.4	5 b.p.
Adj. net profit	33,768	22,291	51.5
Adj. net profit margin, %	2.6	2.2	45 b.p.
Net profit	31,394	22,291	40.8
Net profit margin, %	2.4	2.2	27 b.p.

[3] Please note that in this and other tables and text, immaterial deviations in the calculation of percentage changes, subtotals and totals are explained by rounding.
[4] Net of VAT and revenue from wholesale operations and revenue from franchise services and other services.

Revenue and net retail sales

In 2017, X5's revenue increased by 25.3% year-on-year and amounted to RUB 1,295 billion. Net retail sales for 2017 grew by 25.5% year-on-year, driven by a 5.4% increase in like-for-like (LFL) sales and a 20.1% sales growth contribution from a 27.4% rise in selling space. Net retail sales growth of RUB 261.4 billion was the highest in X5's history.

The Company's proximity store format, Pyaterochka, was the main driver of growth in 2017: Pyaterochka's net retail sales rose by 29.1% year-on-year, driven by a 4.6% increase in LFL sales and a 24.5% contribution to sales growth from a 33.0% expansion in selling space.

Net additional selling space of 1.2 million square metres, driven primarily by organic expansion (87% of net selling space added), represents the largest annual opening programme delivered by X5.

X5's LFL traffic growth improved to 3.0% in 2017, up from 2.5% in 2016, the highest level since 2009. The Company demonstrated positive LFL traffic for all three major formats.

Gross profit

The Company's gross profit margin in 2017 decreased by 33 basis points year-on-year to 23.9%, primarily due to investments in our customers to support loyalty, including updating our customer value proposition, expanding our fresh assortment with growing direct import operations, widening the share of our local assortment, development of loyalty programmes across all formats. Another important factor for gross profit margin reduction was the format mix effect of proportionally more sales coming from Pyaterochka.

Summary of operational results

2017 net retail sales results, y-o-y % change	Average ticket	Number of customers	Net retail sales
Pyaterochka	0.4	28.5	29.0
Perekrestok	3.5	16.2	20.3
Karusel	6.7	0.2	6.9
Express	(2.5)	(9.6)	(11.6)
X5 Retail Group	0.1	25.3	25.5

Selling space end-of-period, square metres	31 Dec. 2017	31 Dec. 2016	% change, y-o-y
Pyaterochka	4,426,808	3,329,273	33.0
Perekrestok	637,242	548,473	16.2
Karusel	385,271	386,897	(0.4)
Express	30,420	37,110	(18.0)
X5 Retail Group	5,479,741	4,301,752	27.4

2017 LFL[5] results, % growth y-o-y	Sales	Traffic	Basket
Pyaterochka	4.6	2.8	1.7
Perekrestok	10.1	6.7	3.2
Karusel	5.4	0.1	5.3
Express	(8.6)	(6.3)	(2.4)
X5 Retail Group	5.4	3.0	2.3

[5] LFL comparisons of retail sales between two periods are comparisons of retail sales in the local currency (including VAT) generated by relevant stores. The stores that are included in LFL comparisons are those that have operated for at least 12 full months. Their sales are included in the LFL calculations starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period.

Adjusted selling, general and administrative (SG&A) expenses

RUB mln	2017	2016	% change y-o-y
Staff costs	(99,124)	(80,786)	22.7
% of revenue	7.7	7.8	(16) b.p.
incl. LTI and share-based payments	(2,938)	(3,252)	(9.7)
staff costs excl. LTI % of revenue	7.4	7.5	(7) b.p.
Lease expenses	(60,080)	(47,020)	27.8
% of revenue	4.6	4.5	9 b.p.
Utilities	(23,795)	(19,590)	21.5
% of revenue	1.8	1.9	(6) b.p.
Other store costs	(15,450)	(14,112)	9.5
% of revenue	1.2	1.4	(17) b.p.
Third-party services	(10,854)	(8,181)	32.7
% of revenue	0.8	0.8	5 b.p.
Other expenses	(11,638)	(10,989)	5.9
% of revenue	0.9	1.1	(16) b.p.
SG&A (excl. D&A&I)	220,941	(180,678)	22.3
% of revenue	17.1	17.5	(42) b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	**(218,003)**	**(177,426)**	**22.9**
% of revenue	**16.8**	**17.2**	**(33) b.p.**

Selling, general and administrative (SG&A) expenses analysis

In 2017, adjusted SG&A expenses as a percentage of revenue declined year-on-year by 33 basis points to 16.8%, primarily due to the positive impact of ongoing projects to improve operational efficiency and as a result of operating leverage. Other store costs, other expenses and utilities were the main sources of this improvement.

Staff costs (excluding LTI and share-based payments) in 2017, as a percentage of revenue, declined year-on-year by 7 basis points to 7.4%, mainly due to the positive operating leverage effect. At the same time, this was slightly offset in Q3 2017 when we decided to fine-tune the motivation scheme for in-store personnel in line with market benchmarks to improve service levels and reduce staff turnover.

Lease expenses as a percentage of revenue in 2017 increased year-on-year by 9 basis points to 4.6%, mainly due to the growing share of leased space in X5's total real estate portfolio, which accounted for 73% as of 31 December 2017, compared to 68% as of 31 December 2016.

Utilities expenses as a percentage of revenue declined year-on-year by 6 basis points to 1.8% due to the continued effect from installation of energy-efficient equipment in stores and distribution centres.

In 2017, other store costs as a percentage of revenue declined year-on-year by 17 basis points to 1.2%, driven by a reduction in security costs and lower maintenance and repair expenses.

Third-party service expenses as a percentage of revenue increased year-on-year by 5 basis points in 2017 to 0.8% due to increased expenses for marketing services related to promo activities, including the development of the recently launched Pyaterochka loyalty programme.

Other expenses as a percentage of revenue declined by 16 basis points year-on-year in 2017 to 0.9%, primarily due to higher income from sales of recyclable materials and the release of provisions.

Long-term incentive (LTI) programme

As described in the Remuneration Report on pages 188-191, a two-stage LTI programme is being run in the Company until 31 December 2019. The LTI programme targets have been structured to substantially align the long-term interests of shareholders and management.

Each stage of the programme includes a deferred component of conditional payouts, maintaining focus on long-term goals throughout the programme and also providing for an effective retention mechanism.

After meeting the targets for the first stage of the LTI programme in 2015, additional performance indicators in line with the strategic objectives set by X5's Supervisory Board were met in 2016, and therefore all targets set for the deferred payout under the first stage of the LTI programme were achieved as of 31 December 2016. Part of the deferred payout expense from the first stage of the LTI programme was accrued at the beginning of 2017. Accordingly, expenses for this stage of the LTI programme amounted to RUB 373 million in 2017.

LTI programme expense

RUB mln	2017	2016	2015
LTI	2,494	2,648	3,184
SSC attributable to accrued LTI	382	405	423

Based on Q1 2017 results, the Company successfully achieved the targets of the second stage of the LTI programme. Therefore, an accrual of RUB 955 million has been made in the Consolidated Financial Statements for the year ended 31 December 2017 related to the second stage of the LTI programme.

In addition, based on management's assessment that the targets under the deferred component of the second stage of the programme are likely to be achieved in 2018, an accrual of RUB 1,166 million has been made in the Consolidated Financial Statements for the year ended 31 December 2017.

Social taxes related to the LTI programme amounted to RUB 382 million in 2017.

All LTI accruals and attributable social taxes since the beginning of the programme are summarised in the table below.