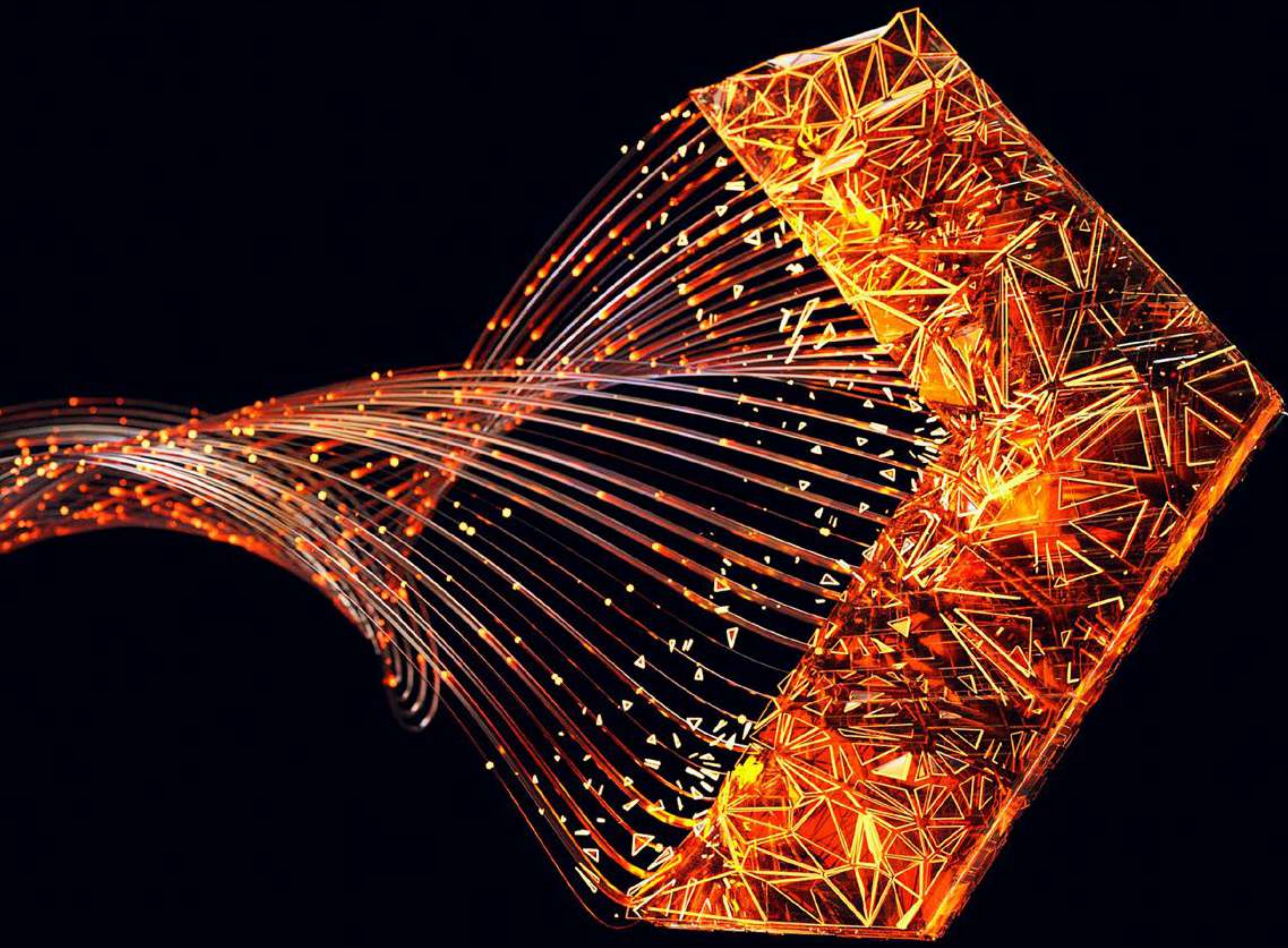


X5 RETAIL GROUP

Annual Report
2018

Leading and evolving

Contents

STRATEGIC REPORT

CORPORATE GOVERNANCE REPORT

FINANCIAL STATEMENTS

All sections under Part 1 "Strategic Report" and Part 2 "Corporate Governance Report", with the exception of the Chairman's statement, Supervisory Board Report and Remuneration Report, together form the Management Report ("bestuursverslag") within the meaning of Section 2:391 of the Dutch Civil Code.

Strategic report

Leading & evolving

This year's report is titled "Leading and evolving", which reflects our strategic priorities of maintaining leadership and strengthening our position in Russia's food retail market while evolving our business to prepare for the technology-driven change and opportunities that lie ahead.

Overview

About this report

This annual report provides a review of our performance and progress in delivering on our strategic objectives and creating value for our stakeholders. We believe the report will enable all relevant stakeholders to assess the sustainability of our business model and our ability to create value.

Report boundary and scope

This report reviews X5 Retail Group's business model and strategy, risks and opportunities, operating and financial performance, non-financial performance and corporate governance for the financial year ended 31 December 2018. The report covers the activities of X5 Retail Group and all its operating subsidiaries. Our consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

While this report covers the 2018 financial year, any significant, material events that occurred between the reporting date and the date on which this report is approved are included.

Materiality

The issues covered in this report were selected based on management's understanding of our business model, risks and opportunities, and stakeholder interests. Management uses a variety of tools to remain informed about the material issues facing the Company, including regular internal analysis and reporting mechanisms, market research, external polling and research products, as well as feedback received directly from key stakeholders. While no formalised polling of stakeholders has been conducted for the purpose of determining material issues, it is the belief of management that this report addresses how we interact with, and create value for, stakeholders in a comprehensive manner.

Alternative performance measures

In this report, we provide alternative performance measures (APMs) that are not defined or specified under IFRS requirements. We believe that these APMs provide important information on the performance of our business. We have included a glossary of the APMs used in this report on pages 122-125. This glossary includes an explanation of how each APM is calculated, why we use it and how it can be reconciled to a statutory measure, where relevant.

Financial and non-financial information

In addition to an analysis of our financial and operating performance, we present information about our non-financial performance in key areas where X5 Retail Group has an impact through its business activities. In this report, we discuss how we manage our performance in areas like consumer safety, the environment, local communities, our people, and business conduct.

Assurance

The Supervisory Board, with the support of the Audit Committee, is responsible for X5 Retail Group's internal controls to provide reasonable assurance against material misstatement and loss.

We apply a combined assurance model, which provides us with assurance obtained from management and from internal and external assurance providers.

Supervisory Board approval

The Supervisory Board of X5 Retail Group confirms that this report addresses all material issues and provides a balanced overview of the Company's performance for the reporting period, as well as an accurate reflection of its strategic commitments. The Board approved the 2018 annual report for publication.

Mission, vision and values

During its more than 20 years as a company, X5 Retail Group, from its roots as an entrepreneurial initiative that brought modern food retail to Russia, has grown into the country's leading food retailer.

We offer our customers a modern food shopping experience in three formats: proximity stores, supermarkets and hypermarkets. We are also constantly innovating and evolving, introducing new and convenient ways for our customers to get the products they need when and where they need them.

As of 31 December 2018, we operated 14,431 modern stores in 64 regions of the Russian Federation, where we received 4.6 billion customer visits during the year. We employed 278,399 people across our operations, which also include logistics, transportation, direct import and even food production.

We aim to become the most valuable company in the eyes of customers, employees, and shareholders, which means:

Customer recognition + **Employee recognition** = **Shareholder recognition**

Focus on strategic KPIs

Customer recognition:
- NPS
- Price perception
- LFL
- Net retail sales

Employee recognition:
- Employee turnover
- Engagement

Shareholder recognition:
- ROIC
- Market capitalisation
- Valuation multiples

Mission

We aim to offer our customers across all our formats accessible food products of good quality and convenient, modern retail services. We achieve this by leveraging our scale and the value propositions of our portfolio of retail brands. This requires us to:

- Address Russian consumer demand for food and related goods
- Correctly estimate the potential size of various market segments where we operate and invest, as well as to identify new areas of growth and new customer value propositions that are relevant to changing consumer demands
- Provide national, regional and international food producers with a convenient and reliable marketplace to sell their goods
- Invest in modern and efficient infrastructure to support our nationwide food retail operations

Vision

We aim to become the most valuable food retail company in Russia in the eyes of customers, employees and shareholders. Our dream is to make our brands the most recognised in Russia, giving a sincere and trustworthy response to all those who engage with them.

Values

In order to achieve our mission and our strategic goals and to make our vision a reality, we adhere to a set of values that we believe are best suited to our business:

- **Customer-oriented**
  - We put the customer at the centre of everything we do and at the centre of all of our decisions
  - We strive to find solutions that meet our customers' needs
  - We build long-term relationships with our customers
- **Respect**
  - We are respectful in our interactions, problem-solving and feedback with customers, business partners, our employees and other stakeholders
  - We consider the opinions, interests and emotions of our stakeholders when making decisions and interacting
  - We help our stakeholders, even if doing so goes beyond the scope of our job responsibilities
- **Driven to achieve results**
  - We set goals for ourselves that require significant effort to achieve
  - We take responsibility for our actions
  - We reward our employees for their achievements, while also acknowledging that we sometimes make mistakes
- **Honesty and integrity**
  - We respect the agreements we sign and honour our obligations to all of our business partners and other stakeholders
  - We provide accurate and complete information about our products, activities and performance in a timely and transparent way
  - We have zero tolerance for corruption, which is backed by strict policies and practices covering every aspect of our business, as well as our supply chain

Delivering results today, preparing for tomorrow

We delivered further expansion in 2018, remaining Russia's #1 food retailer, as our market share exceeded 10% for the first time, reaching 10.7% by the end of 2018. At the same time, we have prioritised the quality of our retail network growth and maintaining margins by focusing on efficiency and further refining our procedures to select new openings.

Our leadership in the food retail market is not just about size: we strive to be #1 in the hearts and minds of Russian consumers by further enhancing our customer-centric approach, providing a convenient and high-quality shopping experience for everyone who enters a Pyaterochka, Perekrestok or Karusel store.

We continue evolving: in 2018 we expanded Perekrestok Online beyond Moscow to a number of territories in the Moscow region and St Petersburg, and piloted last-mile delivery services at Pyaterochka with a network of parcel lockers. Our innovation centre is constantly assessing and piloting projects that aim to both improve efficiency and enhance our ability to meet customer needs every day.

Our big data department currently consists of over 100 employees and is engaged in a number of projects aimed at enhancing our understanding of our customers' needs in order to improve the customer journey as well as to improve the efficiency of our operations.

2018 financial and operating highlights

Revenue

increased by 18.3% year-on-year to RUB 1,533 billion

primarily due to organic growth

Like-for-like sales

improved by 1.5% year-on-year,

led by growth in Pyaterochka and Perekrestok

Adjusted EBITDA margin

totalled 7.2%

Like-for-like traffic

increased by 0.9% year-on-year

Net debt/ EBITDA

decreased to 1.70x

Selling space

grew by 18.0%, or 984.0 thousand m², year-on-year

Growing market share

The rate of X5 revenue growth remained well above growth in the Russian market, which allowed our market share to reach 10.7% in 2018. We see significant opportunity for further consolidation in the years ahead, as the top players with nationwide operations replace smaller and weaker regional players.

Strategic highlights

Russia's #1 food retailer:
reinforced leadership position with a market share exceeding 10%.

Customer-centricty:
constant adaptation of the customer value proposition (CVP) and assortment to customer needs across all formats; best-in-class service reflected in highest net promoter scores (NPS).

Maintained profitability and return on investments:
continued fast growth while maintaining profitability and return on investments above target levels in an environment of tightening competition, supported by an ongoing focus on cost optimisation and operational excellence.

Loyalty programmes across all formats:
expanded the Pyaterochka Helps programme at our proximity format, which is piloting personalised offers and is the only proximity store loyalty programme in Russia.

Omnichannel development:
expanded Perekrestok Online beyond Moscow to a number of territories in the Moscow region and St Petersburg, and piloted last-mile delivery services at Pyaterochka. We plan to leverage our extensive brick-and-mortar network to offer our customers a truly omnichannel service.

Innovation:
Continued to develop technology-based solutions and big data capabilities aimed at gaining a deeper understanding of our customers and enhancing our sustainable and attractive proposition.

Efficiency and optimisation:
continued to improve operational efficiency of stores with a special emphasis on optimisation of in-store business processes and shrinkage reduction.

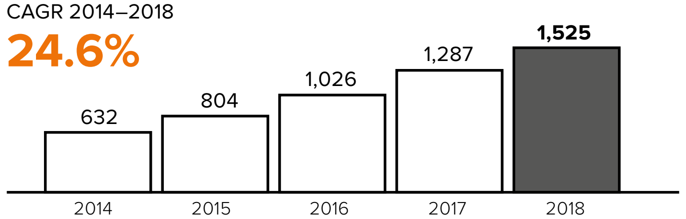
Strong backbone infrastructure:
Continued to develop a reliable and effective IT platform and efficient and mature logistics infrastructure; 4 new distribution centres and an additional 910 new trucks, bringing our total fleet to 3,830 as of 31 December 2018.

Listing on MOEX and MSCI Russia Index inclusion:
In addition to the listing on the London Stock Exchange, X5 listed its GDRs on Moscow Exchange in February 2018, making its securities available to a broader range of both retail and institutional investors in Russia and abroad.

Operational highlights

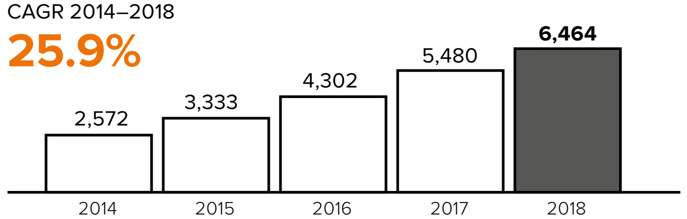
Net retail sales, RUB bln

CAGR 2014–2018
24.6%



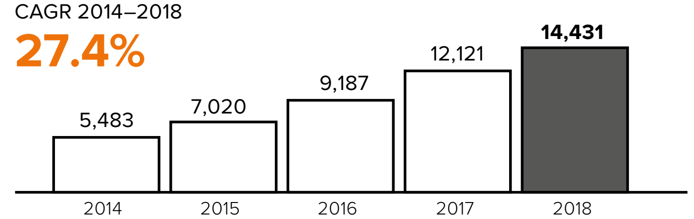
Selling space, ths m²

CAGR 2014–2018
25.9%



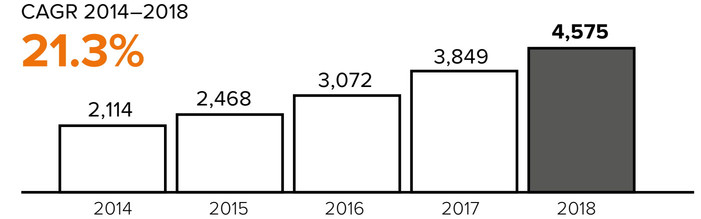
Number of stores

CAGR 2014–2018
27.4%



Customer visits, mln

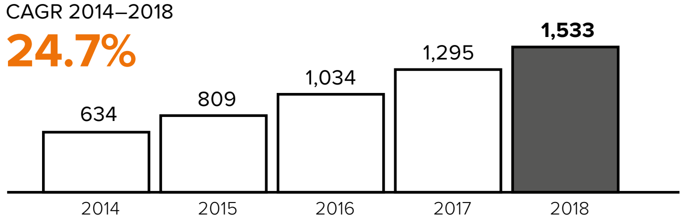
CAGR 2014–2018
21.3%



Financial highlights

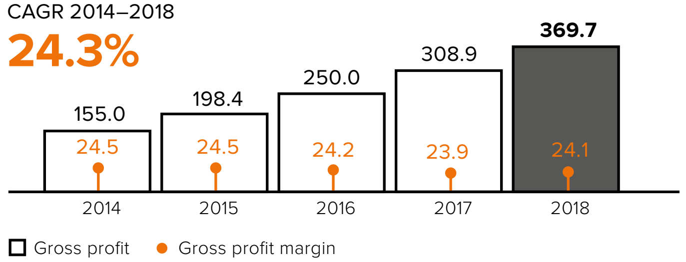
Revenue, RUB bln

CAGR 2014–2018
24.7%



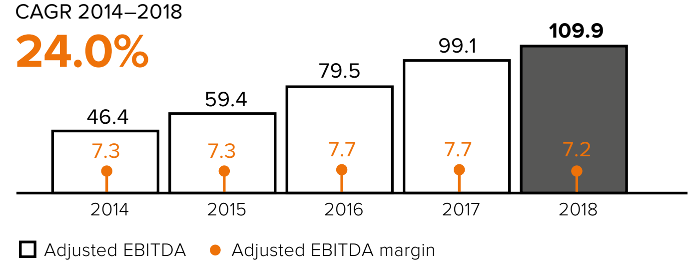
Gross profit, RUB bln / Gross profit margin, %

CAGR 2014–2018
24.3%



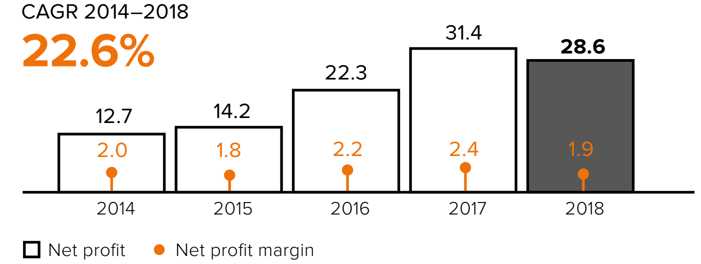
Adjusted EBITDA, RUB bln / Adjusted EBITDA margin, %

CAGR 2014–2018
24.0%



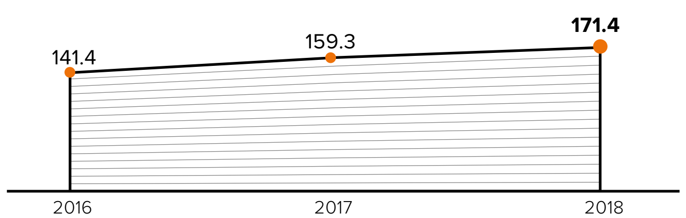
Net profit, RUB bln / Net profit margin, %

CAGR 2014–2018
22.6%

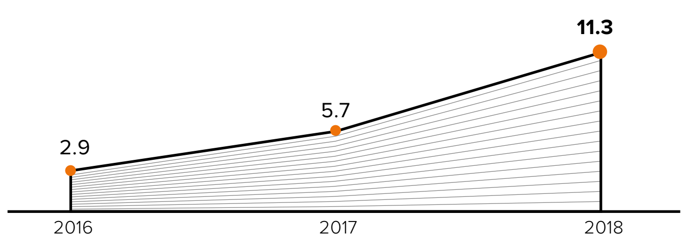


Sustainability highlights

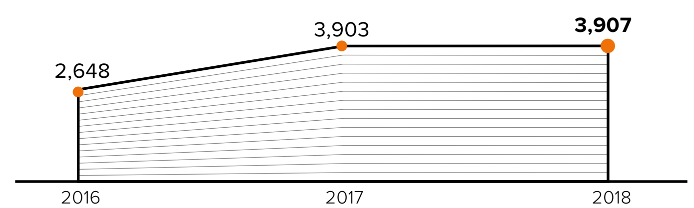
Income from the sale of recyclable waste per store, RUB ths



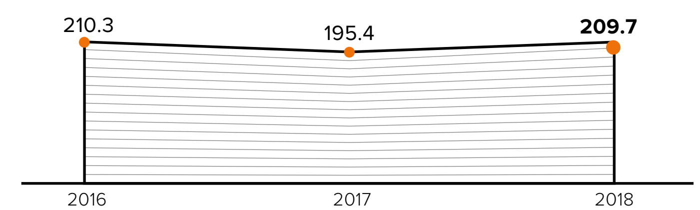
Training hours, per person per year



Number of in-store quality audits



Average monthly utilities costs per store, RUB ths



Smart, balanced growth

Starting in 2018, we took a conscious decision to decelerate our expansion in order to focus on quality and sustainability, and to ensure that we achieve our target returns on investments in new stores.

This approach will enable us to further strengthen the existing business while we continue to invest in new technologies and innovation to prepare for the future of food retail.

Chairman's statement

Dear stakeholders,

It is my pleasure to report that X5 Retail Group delivered strong results for 2018, demonstrating its ability to continue leading the industry and adapting to the current challenging operating environment. Revenue for 2018 rose by 18.3% year-on-year to more than RUB 1.5 trillion, and we kept our EBITDA margin above 7.0%.

This performance means that we further strengthened our position as the top food retailer in Russia by revenue in 2018, with our revenue increasing by 18.3% while Russia's total food retail market expanded by 4.0% during the year, driven largely by 1.7% food inflation. We again outgrew our peers in the top 10, who saw a collective 9.8% rise in revenue for 2018. X5's stores served over 4.6 billion customer visits during 2018, underlining the continuing and evolving attractiveness of our retail offer to the Russian population.

Stephan DuCharme
Chairman of the Supervisory Board

Delivering on an evolving strategy

Our strategy continued to evolve in 2018, focusing on smart growth, innovation and efficiency. Our updated approach calls for measures to strengthen the existing business and enhance our innovation capabilities in the medium term, preparing X5 to become a next-gen retailer. We remain committed to strengthening our leadership position, but as top-line growth rates naturally slow as a function of the size of our business and the maturity of the industry, the importance of operational excellence and efficiency across the business will increase. We aim to share the benefits of any successful efficiency measures with our customers, which will help to drive a qualitatively different form of growth going forward.

I am pleased to note that X5 performed well against the key goals that were set before management for 2018. Last year, I wrote about the importance of technology and innovation in X5's future development. Since then, the Company has grown its online business and launched various omnichannel initiatives, made significant progress in developing its big data capabilities and successfully established an infrastructure that enables it to effectively search for and select promising new technologies.

I am impressed with the level of competence we have already built within our team in these new areas, our effort to improve and apply these competencies is ongoing, which is reflected in the recent new nomination to the Supervisory Board that should bring additional expertise in applied innovation and new technology.

Making customer-centricity a way of life

X5 has been able to achieve sustainable growth thanks to our customer-centric approach. From the Supervisory Board on down, we are constantly seeking ways to make our business more customer-centric, to adapt to the needs of our customers and to meet demand through every channel available and suitable for our business size and structure. Throughout 2018, X5 and our retail formats created more ways to make the customer's shopping experience more useful and convenient by expanding loyalty programmes, developing our omnichannel business and expanding our online offering.

Part of our customer-centric approach is continued evolution and transformation, which is discussed in detail throughout this report. X5 is a business that is not only fine-tuned to current consumer trends in Russia, but we are continuously adapting to future food retail requirements, including taking on new customers and new competitors.

Committed to all stakeholders

X5 is committed to creating value for all of our stakeholders across the entire chain. Given our prominent footprint in Russia's economic life, we aim to ensure that our operations benefit food producers and other suppliers, our employees, the customers that visit our stores and use our online services, and our investors and shareholders.

As part of this commitment, X5 continues to upgrade its reporting on ESG performance, in line with the requirements for disclosure of non-financial information. Throughout this report, we detail how we work with a wide range of stakeholders in order to address their needs and ensure that our business is part of a mutually beneficial relationship with the people and institutions we interact with.

We are also using the scale and depth of our operations to support a variety of aid programmes, including Basket of Kindness, which is a partnership with the Rus Food Foundation, Russia's first food bank. In 2018, Basket of Kindness held citywide food marathons in five metropolitan areas: Moscow, Yekaterinburg, Samara and Kazan, as well as an online marathon in Nizhny Novgorod.

A strong team with a solid pool of talent

People play an extremely important role in our business, and X5's continued success is dependent on having a team with the right skills and motivation to execute our strategic goals. I am proud to say that 2018 proved that we have this team in place and that we have a strong reserve of talented and motivated individuals within X5 Retail Group who will have the opportunity to contribute to the Company's success in the years ahead. We have worked hard to develop a high-quality talent pool in order to ensure smooth successions, withstand turbulent events and make changes when needed, and this will remain a priority going forward.

X5 is creating a culture of leadership, collaboration and customer-centricity at every level of the business. This helped us to achieve the impressive transformation and growth that X5 delivered in recent years, and we have set ourselves ambitious goals for the future. As part of this approach, both short- and long-term incentives support our strategic objectives and align management interests with those of shareholders. At the operational level, we are also fine-tuning employee motivation to help us achieve our targets, including enhanced in-store incentivisation programmes that have increased the focus on NPS to determine employee compensation.

Corporate governance

X5's Supervisory Board is tasked with guiding the Company's performance by contributing a long-term, expert view on the initiatives I have listed above. Our corporate governance system is designed to ensure that all stakeholders are duly represented and their interests taken into account. It complies with global best practices and the requirements of the Dutch Corporate Governance Code.

The eight members of the Supervisory Board, five of whom are independent directors, focus on providing oversight and input on key management issues (pending AGM approval, the appointment of Alexander Torbakhov will increase these numbers to nine and six, respectively). We strive to apply our diverse set of skills to help X5 navigate an industry that is increasingly characterised by disruption, and to ensure that the Company is "future-fit" and remains focused on delivering long-term value.

In 2018, we continued to enhance our Supervisory Board with individuals whose experience will be key to achieving our short-term and long-term strategic goals. Karl-Heinz Holland, who served for six of his 20 years at Lidl as CEO, and Nadia Shouraboura, who served as Vice President for Amazon's global supply chain and fulfilment platforms, have contributed to our work since June 2018. These appointments are strongly aligned with X5's strategic focus areas of strengthening our existing business, implementing new technologies and expanding our omnichannel offering.

Along the same lines, in January 2019, after the end of the reporting period, the Supervisory Board created an Innovation and Technology Committee, which will be chaired by Alexander Torbakhov, who has a strong track record of successfully introducing new initiatives in his previous management roles, following AGM approval.

Capital markets

X5 paid its first dividend in the amount of RUB 21,590 million, or RUB 79.5 per GDR, in June 2018. We continue to adhere to our dividend policy, and based on our 2018 financial results, the Supervisory Board proposed paying dividends in the amount of RUB 25,000 million/RUB 92.06 per GDR, which represents 87.3% of X5 Retail Group's 2018 net profit.

In February 2018, in addition to the listing on the London Stock Exchange, we completed the listing of X5 GDRs on Moscow Exchange. In addition, the Company's GDRs were included in the MSCI index family, including the MSCI Russia Index and the MSCI Emerging Markets Index.

Corporate culture

Our aim is to create a Company-wide culture of long-term value creation at X5, and we aim to lead by example at the Board and management levels. Maintaining a corporate culture that is focused on honesty and integrity, respect, being goal-oriented and focused on the customer will enable us to instil in every employee an approach that will help us to achieve our strategic goals in a sustainable way.

I believe that transforming, growing and adapting X5 into the business that it is today has created significant value for all of our stakeholders. We have developed Russia's leading proximity and supermarket formats. At the same time, we are already evolving for the food retail business of tomorrow. We will never rest on our laurels, and we will forge ahead based on the conviction that change and adaptation are an important part of the continued success of X5 for our customers and our business.

Stephan DuCharme
Chairman of the Supervisory Board

Our business model

X5 Retail Group is Russia's leading food retailer, with a market share of 10.7% and 14,431 stores operating in 64 regions as of 31 December 2018. Our business is evolving from modern offline retail to an omnichannel model that aims to provide consumers with a wide range of convenient ways to achieve their shopping missions, whether in a store, at home or on the go. We are confident in our ability to lead the way to the next generation of retail, supported by our advanced retail operations infrastructure and our robust innovation pipeline.

Suppliers

Our supply chain is the first critical stage in our business. Our operations with suppliers span from handling third-party imported goods and direct imports from international producers to work with domestic federal-level producers as well as local producers in regions where we are present.

Number of suppliers:
5,633

Share of of top 30 suppliers in revenue:
31.3%

We strive to build value for our suppliers by creating partnerships that ensure that our high standards of business conduct and product quality are met.

Corporate Centre

The Corporate Centre provides strategic guidance and supports initiatives aimed at increasing efficiency, improving customer service or testing and introducing innovations. Initiatives like big data analytics, piloting of innovative projects and omnichannel sales development start in the Corporate Centre, along with direct import operations and strategic partnerships with suppliers. The Corporate Centre is also responsible for pooling purchasing power, managing strategic partnerships with suppliers, running and maintaining X5 Retail Group's systems of internal controls and reporting systems, as well as implementing Group-wide IT infrastructure and solutions.

Supply chain infrastructure

Direct imports:
5 import hubs

Logistics:
42 DCs

Transport:
3,830 owned trucks

As of 31 December 2018

Retail formats

We operate three food retail formats, each operating or piloting omnichannel initiatives. Each format is responsible for its own operations, marketing, category management, logistics, distribution and expansion, including developing new sales channels.

Pyaterochka proximity stores

13,522 stores

Leading: Russia's largest proximity store chain and the only one to offer personalised promos through its loyalty programme in proximity format

Evolving: piloting new last-mile delivery services, including a network of parcel lockers for customers to pick up third-party online purchases; launched a lab store to test innovative technologies in real store environment

For more details, please refer to pages 60-77

Perekrestok supermarkets

760 stores

Leading: Russia's largest supermarket chain

Evolving: After launching Perekrestok Online in Moscow in 2017, expanded to St Petersburg and parts of the Moscow region

For more details, please refer to pages 78-97

Karusel hypermarkets

94 stores

Leading: introduced new concept and new brand, with greater focus on a convenient and pleasant experience for shoppers

Evolving: Development of click-and-collect services to be launched in 2019

For more details, please refer to pages 98-111

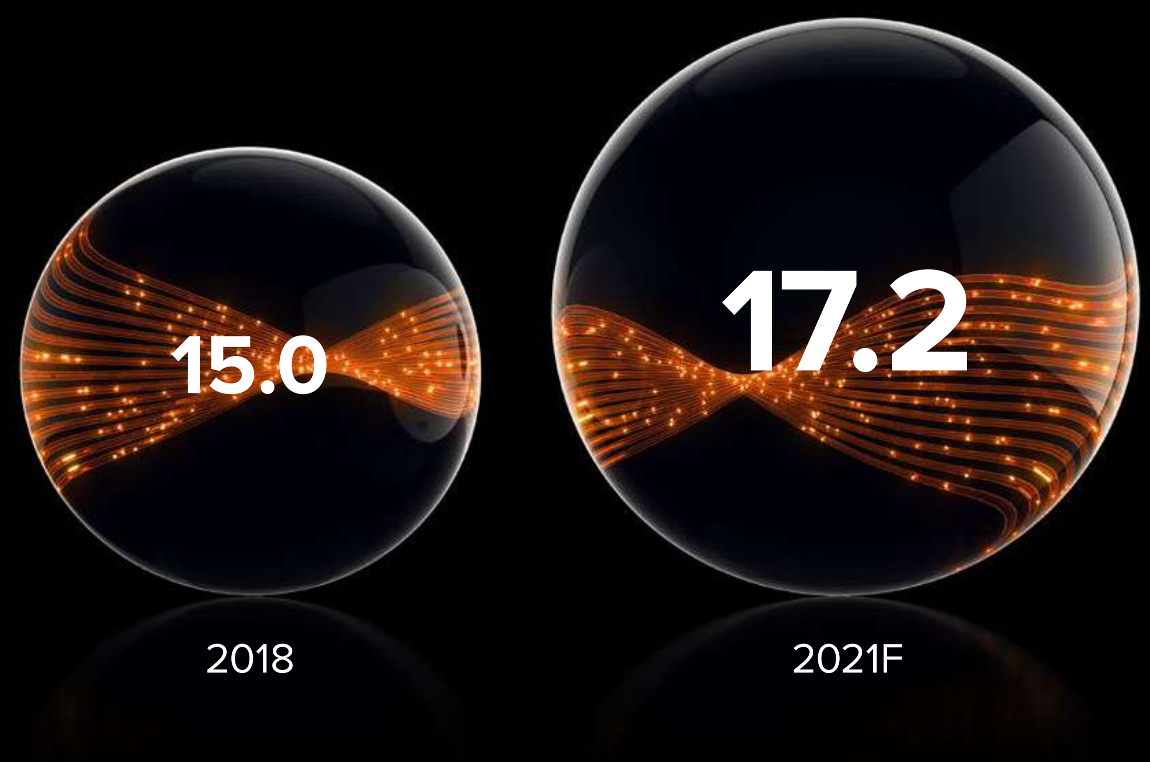
As of 31 December 2018

Our brands

We operate three retail formats in key traditional segments of Russia's food retail market: proximity stores (Pyaterochka), supermarkets (Perekrestok) and hypermarkets (Karusel), as well as an online supermarket. In line with our decentralised business model, each of these formats is independently responsible for its development in line with X5's overall strategy. As the market landscape develops and consumer expectations change, the formats are adapting their business models and CVPs in order to evolve and help X5 remain the leading food retailer in the country.

Potential total market growth, RUB trillion

+2.2



Source: Rosstat, Infoline

Pyaterochka

Pyaterochka, established in 1999, is the largest proximity format in Russia, with 13,522 stores as of 31 December 2018. We aim to provide a wide array of Russian consumers with the goods they need every day, while rolling out our innovative offerings with personalised promos, piloting a network of delivery lockers for online purchases and expanding our range of high-quality, affordable private-label offerings.

Perekrestok

Perekrestok, established in 1995, was Russia's first large supermarket chain and maintains its leadership today. While continuing a large-scale refurbishment programme, we have been expanding in our core regions while also adapting the format to new regional localities. Perekrestok offers customers in key markets like Moscow, the Moscow region and St Petersburg a full online supermarket service: Perekrestok Online. The supermarkets have been adapting their CVP with a greater focus on the fresh and fruits and vegetables assortment.

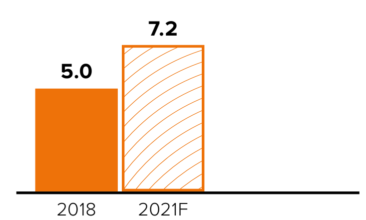
Karusel

Karusel, established in 2004, operates compact hypermarkets that are usually within city limits. The format recently launched a new brand identity and new concept aimed at winning over rational shoppers looking to buy goods for their household for a week or more ahead. With improved navigation and features like in-store dining, the new Karusel hypermarkets are performing well. In addition to in-store shopping, Karusel aims to launch its click-and-collect service in 2019.

	Pyaterochka	Perekrestok	Karusel
Number of stores	13,522	760	94
Selling space, thousand m²	5,291	782	382
Net retail sales, RUB bln	1,198	231	91
Share of X5's net retail sales	78.5%	15.1%	6.0%
Potential market segment growth, RUB trn	Proximity/discounters	Supermarkets	Hypermarkets

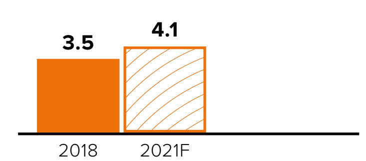
Proximity/discounters

+2.2

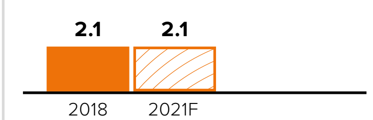


Supermarkets

+0.6



Hypermarkets



Source: X5 data, Rosstat, Infoline

Russia's food retail market

Key highlights

8th largest globally by food retail tunover (RUB 15.0 trillion)

73% share of modern retail

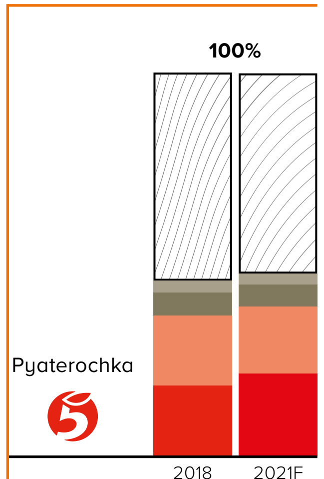
26% market share of top five players

RUB 2.2 trillion potential growth to 2021

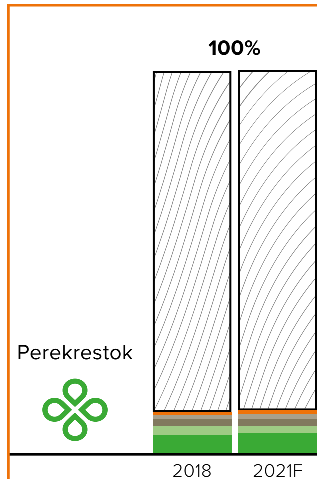
Competitive environment

In both the proximity and supermarket segments, X5 is the #1 player with Pyaterochka and Perekrestok stores, and we have established a solid foothold in hypermarkets with Karusel.

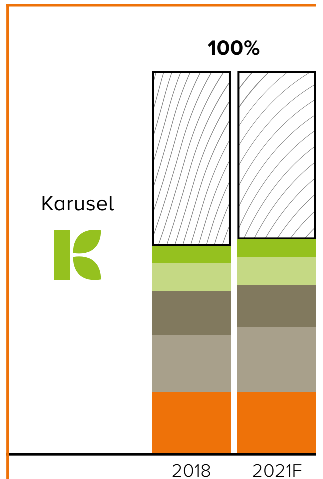
Proximity/discounters



Supermarkets



Hypermarkets



Other players

- Hard discounters
- Gas stations
- Dollar stores

Competitive advantages

Proximity/discounters:
- Strong brand
- Loyalty programme
- Broad assortment
- Focus on fresh

Supermarkets:
- Strong brand in capitals
- Service level, NPS
- Focus on fresh
- Online service

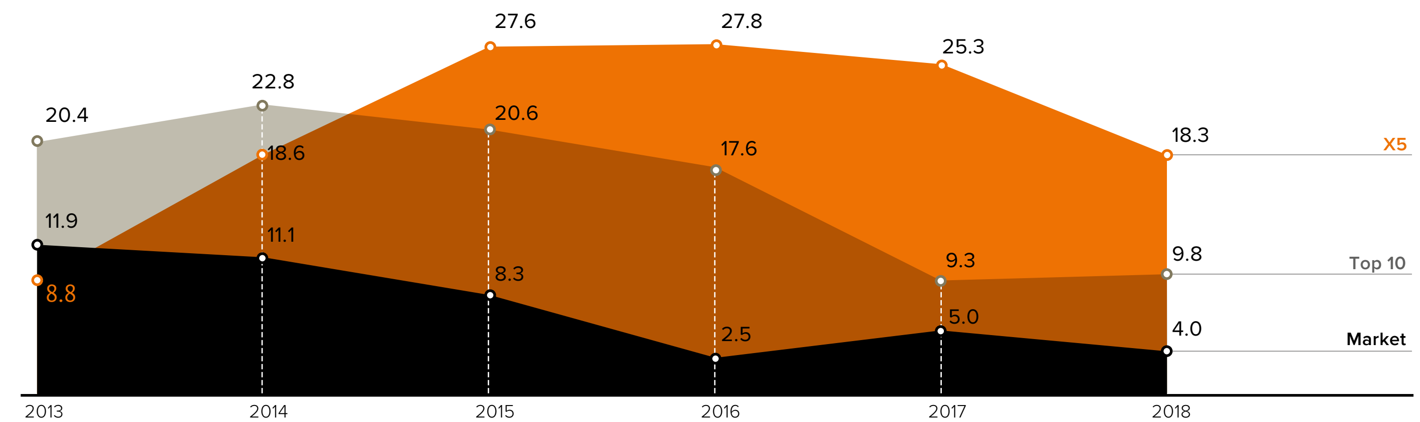
Hypermarkets:
- New CVP
- Good locations

Source: Infoline

Note: Charts above are based on market share by total turnover

X5 vs Russian food retail and top 10 players, %

After the successful transformation of our business into three largely independent food retail formats, each able to grow and develop based on its unique CVP, X5 Retail Group has consistently increased its ranking among its Russian and global peers.



Source: X5 data, Rosstat, Infoline

Note: revenue growth y-o-y

Top 10 Russian food retailers

#	Company name	% market share 2018	% market share 2017
1	X5	10.7	9.5
2	Magnit	7.7	7.5
3	Lenta	2.8	2.5
4	SPS Holding (Red&White)	2.4	1.8
5	Dixy	2.1	2.1
6	Auchan	1.9	2.2
7	Metro	1.3	1.4
8	O'Key	1.1	1.2
9	Monetka	0.6	0.6
10	Globus	0.6	0.6
	TOTAL TOP 10	**31.2**	**29.4**

Source: Infoline

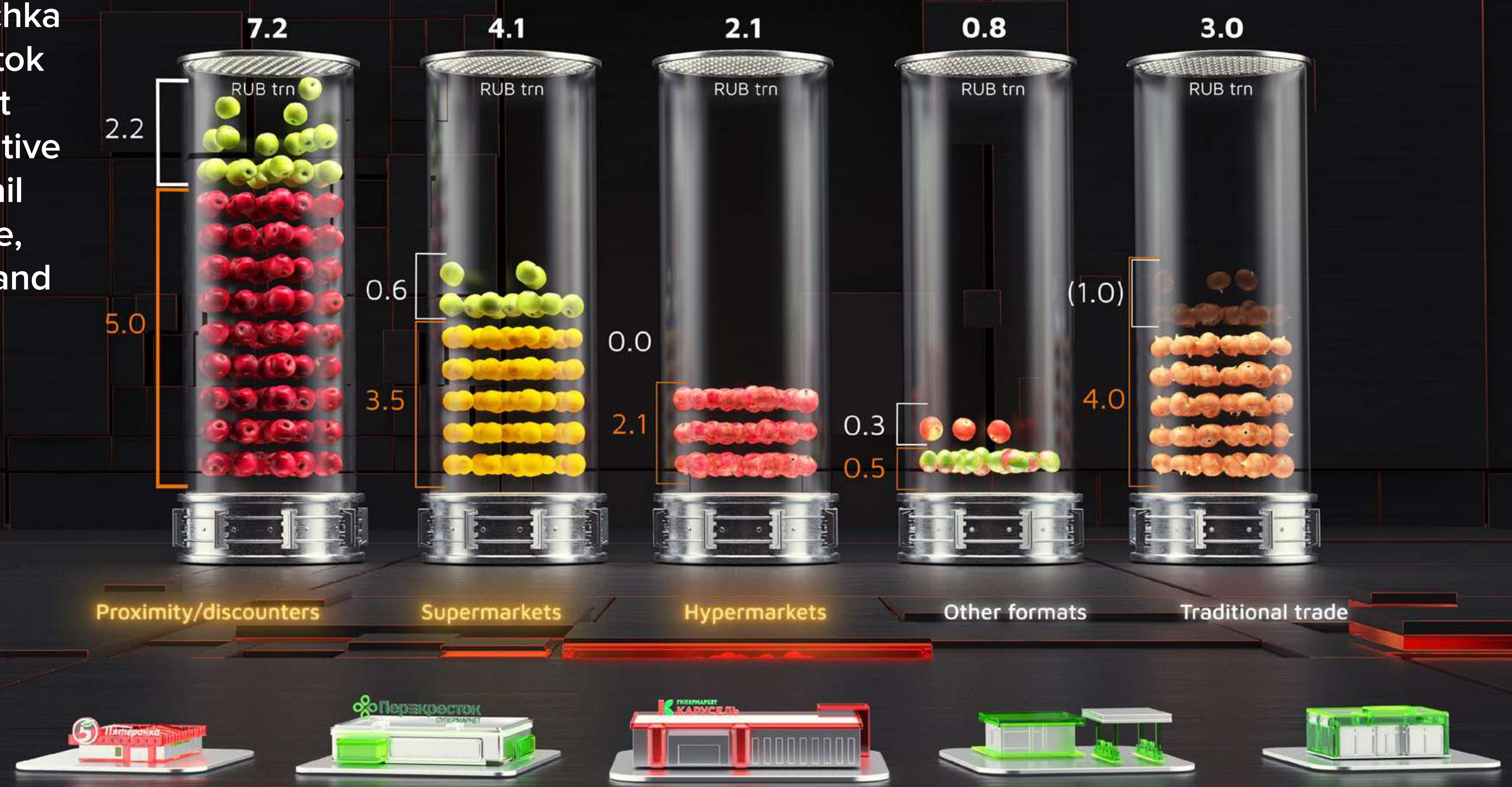
As the Russian food retail market continues to expand, we aim to outgrow the market and our top-10 peers, while at the same time pursuing smart, more targeted growth to ensure the quality and sustainability of every new store that we open and subsequent return on our investments.

Russia's largest food retail segments

Total market size:

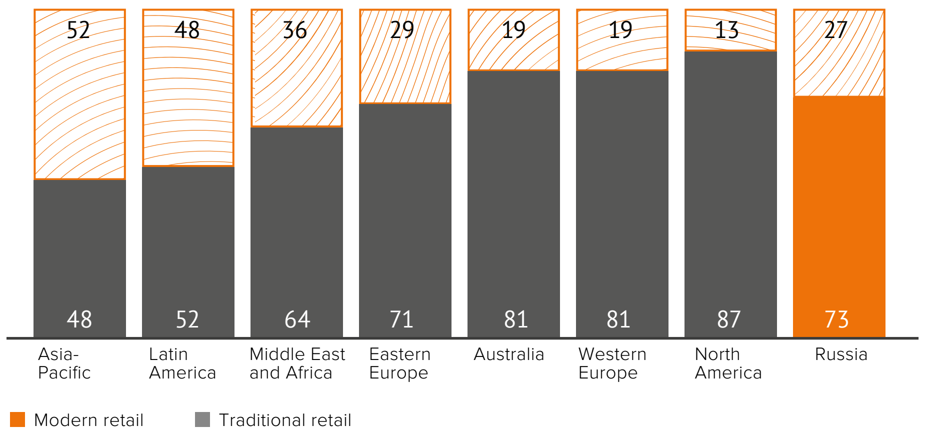
2018: RUB 15.0 trn
2021F: RUB 17.2 trn

We are focused on developing our two core businesses: Pyaterochka proximity stores and Perekrestok supermarkets, which represent the two largest and most lucrative segments of Russia's food retail market today. At the same time, we are evolving our business and introducing new omnichannel approaches.



■ 2018 market size
■ Potential market growth until 2021

Traditional vs. modern trade in 2018, %

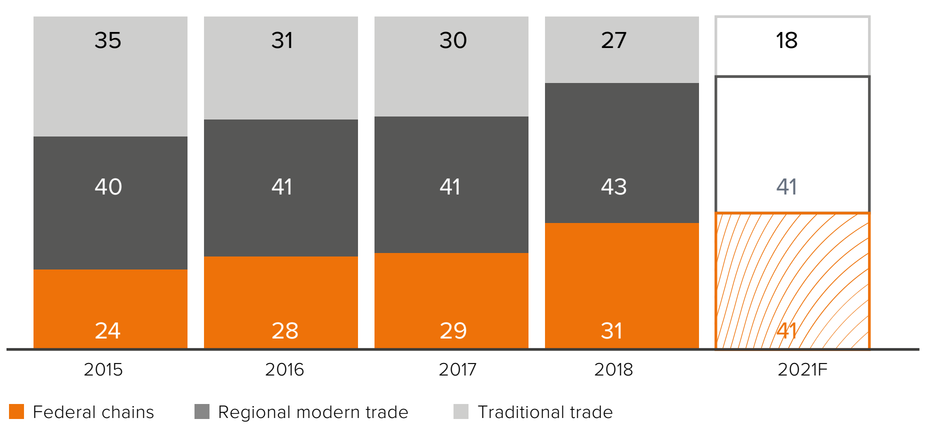


Source: Euromonitor, Infoline

Note: All values used are nominal. All numbers are excluding VAT/sales tax

The share of modern formats in the Russian food retail market has grown significantly in recent years and currently stands at 73%. However, this level still lags behind several developed markets like North America, Western Europe and Australia, where modern formats represent 87%, 81% and 81% of the food retail market, respectively. We believe that the expansion of modern retail formats is one of several drivers of growth in the years ahead.

Russian food retail market development, %

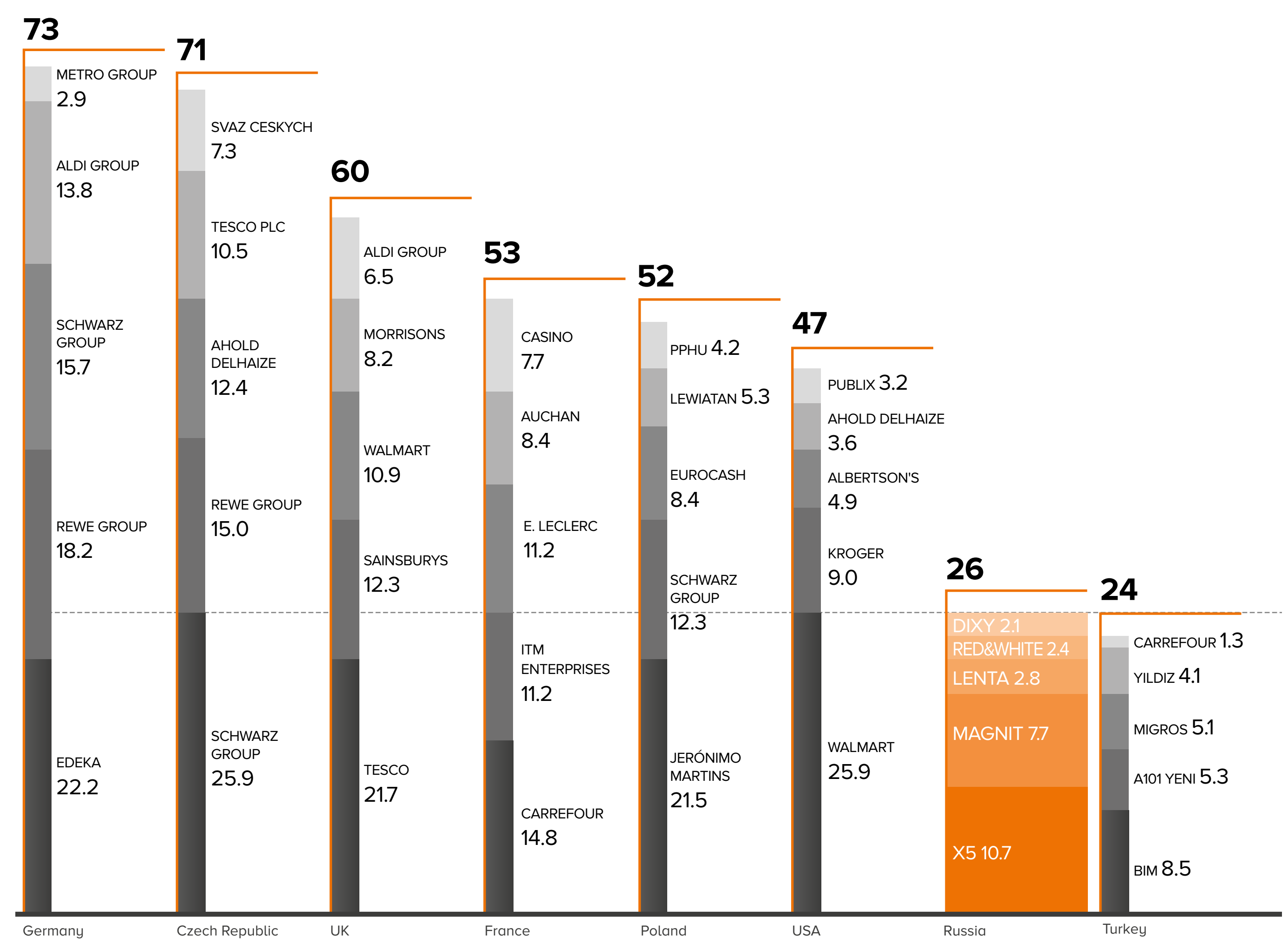


Source: Infoline

Modern formats represented just 64% of the food retail market in 2015, and increased to 73% in 2018. While this represents substantial growth, penetration of modern retail formats is expected to increase further in the years ahead, with a forecast 82% share of the total Russian food retail market expected to be reached by 2021.

In addition to growth driven by the further expansion of modern retail formats, we see significant potential for further growth from market consolidation. The Russian food retail sector remains highly fragmented, with the top five players accounting for around 26% of the market. This is two to three times lower than in developed markets such as Germany, the Czech Republic, the UK, France and Poland. We view this as an additional opportunity for expansion. Despite a slowdown in market growth, larger and more efficient players should continue to grow thanks to the natural replacement of smaller and less efficient players. X5 and other retailers with a nationwide reach and the ability to leverage economies of scale to drive efficiency will be the primary beneficiaries of this change.

Top-5 share of grocery retail globally in 2018, %



Sources: Euromonitor, Infoline (for Russian market only), company reports, X5 analysis

Russian food retail market trends

Increasing competition

After years of rapid growth, the Russian food retail market has experienced the emergence of new players, which has forced market leaders to constantly evolve and adjust their business models in order to stay ahead. New players have emerged to address changing consumer needs, as existing players were too big or too focused on growth to quickly respond to emerging trends.

We are addressing these changes by evolving our own business, with an emphasis on innovation, omnichannel service, operational excellence and constantly adapting the CVPs of our formats to the needs of our customers.

Online delivery

Consumers are becoming more time-sensitive, and online food shopping, including the ready-to-eat segment, is starting to replace regular grocery shopping trips, especially in hypermarkets. Food delivery from restaurants is a growing sector that is often competing with dining-out options.

In response to these trends, we launched the Perekrestok Online service in 2017 in Moscow and expanded it to St Petersburg in 2018. This service has enjoyed very high NPS levels from its users, and it has grown rapidly, with the total number of orders exceeding 408 thousand in 2018.

Changing consumer behaviour

Consumer behaviour is also rapidly changing. Despite the continued focus on rational consumption and spending cuts, consumer expectations are rising with regard to product quality and customer experience.

This means that a more personalised approach to each customer is becoming increasingly valuable. To address this, we are developing our omnichannel business, and each of our formats offers a loyalty programme, with personal offers being refined on an ongoing basis.

Increasing popularity of healthy diets

Trading down has become an important trend for Russian consumers in the face of negative or slow economic growth. At the same time, expectations have shifted with regard to the quality of goods, and fresh fruits and vegetables have become increasingly important to our customers. Demand for high-quality ready-to-eat meals has also grown significantly. We are responding to these changes by adapting the assortment we offer in stores and by improving our own capacity to efficiently handle fresh and ultra-fresh goods in order to ensure consistent high quality.

Aging population

Russia's population is not growing, and the share of groups that receive state support in some form is increasing.

In order to address this challenge, we aim to offer products at reasonable prices for lower-income groups. For example, we offer pensioners additional discounts during non-peak opening hours.

Emergence of non-traditional players

New players that do not rely on traditional retail approaches are entering the market. They are able to challenge and disrupt the status quo and are starting to transform the way we do business. Existing retailers must evolve.

We have already begun to adapt our business model to new trends by launching omnichannel projects across all three formats and maintaining a solid pipeline of pilot projects to introduce innovative new ideas to our business.

Development of specialised retailers

The past two years have seen consumer preferences shift towards assortments that offer unique and local goods, with healthy, ready-to-eat and ready-to-cook options becoming more popular. This trend is especially visible in Moscow.

Throughout 2018, we worked to adapt our assortment and new SKUs in Moscow stores across all formats. In order to improve the Perekrestok CVP and to expand the assortment with unique products, we decided to open our own kitchen factory. This modern production facility, which will produce ultra-fresh ready-to-eat products for delivery to our stores, is scheduled to launch in H1 2019.

Economic and consumer trends

Russia's economy remained on a course of gradual recovery throughout 2018. The main trends that influenced our performance during the year were:

- GDP growth in 2018 reached 2.3%, according to initial estimates
- Weak real disposable income (-0.3% for the year), which still shows no trend towards sustainable recovery, despite steady growth in real wages
- Small incremental growth in food retail trade of 1.7% backed by a cautious recovery in consumer confidence and a moderate decrease in the trend of trading down
- The gradual transition of food inflation from a slowdown in H1 2018 to acceleration in H2 2018: food CPI reached 4.7% year-on-year in December 2018, up from 0.5% in July.
- Unemployment remained low and reached 4.7% in Q4 2018

In 2019, we expect food consumption to continue to recover, despite challenging economic conditions:

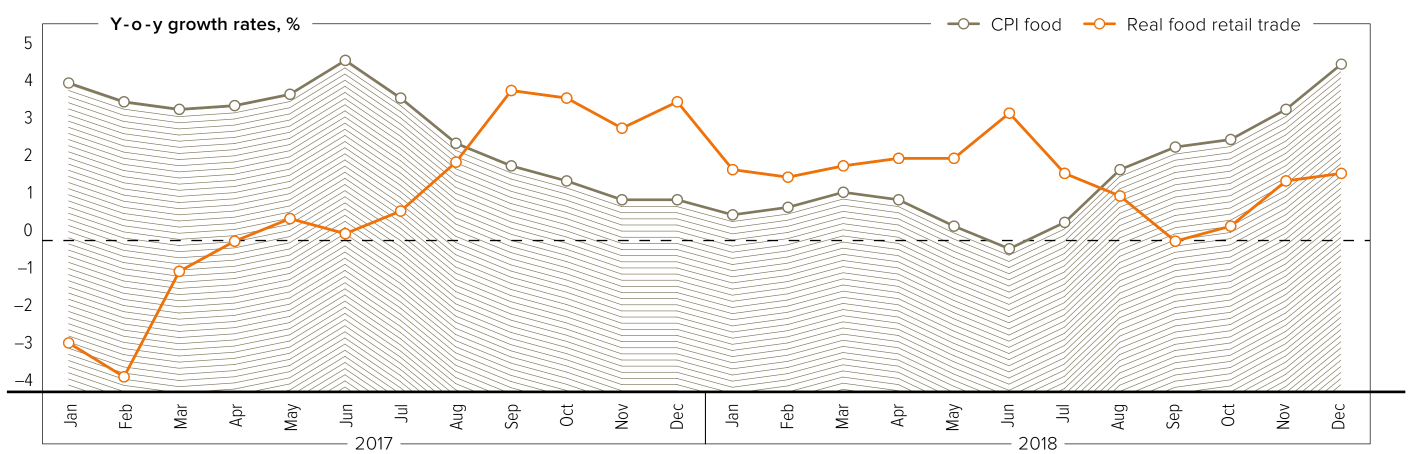
- Despite the VAT rate hike from 18% to 20%, economic growth in 2019 is expected to remain positive
- The consensus within the analyst community is that inflation will accelerate in 2019 on the back of the VAT rate hike, FX dynamics, smaller 2018 grain harvest and global macro-factors
- We believe that real food retail trade will continue its moderate recovery in 2019, supported by favourable labour market conditions (wage growth, low unemployment), but balanced by low and real disposable income dynamics and uncertain economic growth outlook
- Consumer expectations should also resume recovery. Trading down as a trend is moderating but remains high relative to pre-crisis levels

Selected macroeconomic data

	2018					2017				
Russian macroeconomic indicators, year-on-year comparison, %	Q1	Q2	Q3	Q4	**FY**	Q1	Q2	Q3	Q4	**FY**
Real GDP	1.8	2.5	2.2	2.5	**2.3**	0.6	2.5	2.2	0.9	**1.6**
RUB/USD exchange rate, weighted average for the period	56.9	61.8	65.5	66.5	**62.7**	58.8	57.1	59.0	58.4	**58.4**
CPI	2.3	2.4	3.0	3.9	**2.9**	4.6	4.2	3.4	2.6	**3.7**
Food inflation	1.0	0.4	1.6	3.6	**1.7**	3.8	4.1	2.8	1.3	**3.0**
Real wage growth	10.2	7.6	6.3	3.8	**6.8**	1.8	3.4	3.1	5.9	**2.9**
Real income growth	0.3	1.3	(1.6)	(1.1)	**(0.3)**	0.3	(2.2)	(1.3)	(1.1)	**(1.2)**
Unemployment rate	5.1	4.8	4.6	4.7	**4.8**	5.5	5.2	5.0	5.1	**5.2**
Retail turnover	4.6	5.5	6.0	6.9	**5.8**	3.9	5.6	5.6	5.8	**5.3**
Food retail turnover	3.5	4.0	3.1	5.3	**4.0**	3.1	5.1	6.0	5.6	**5.0**

Source: Rosstat, Ministry of Economic Development

Food retail trade and CPI dynamics

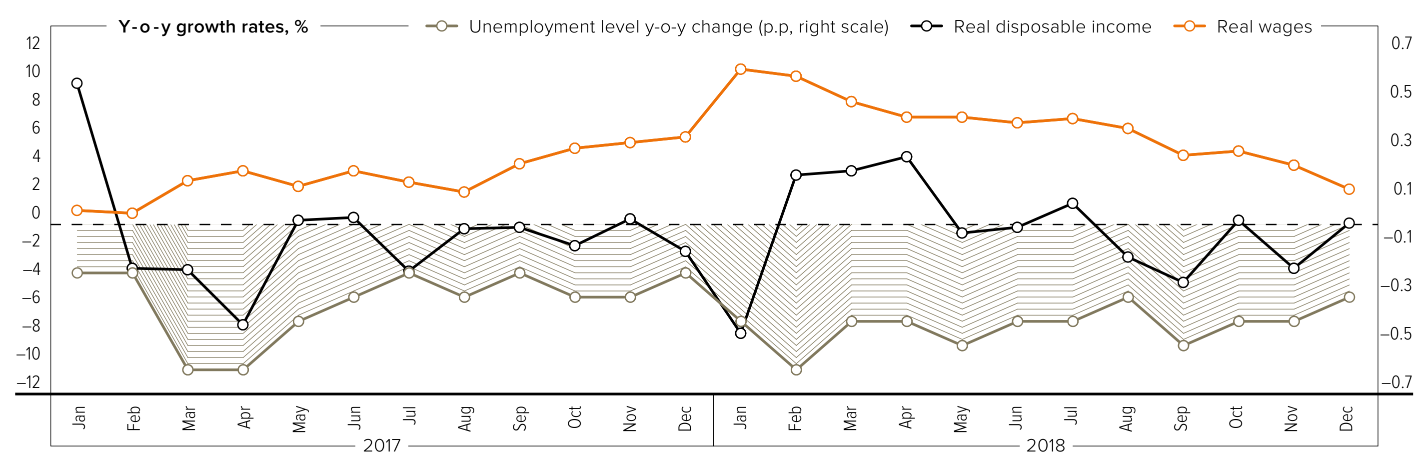


Source: Rosstat

Macroeconomic volatility and increasing competition make cost optimisation a key to success. We are committed to improving operational efficiency and cost controls.

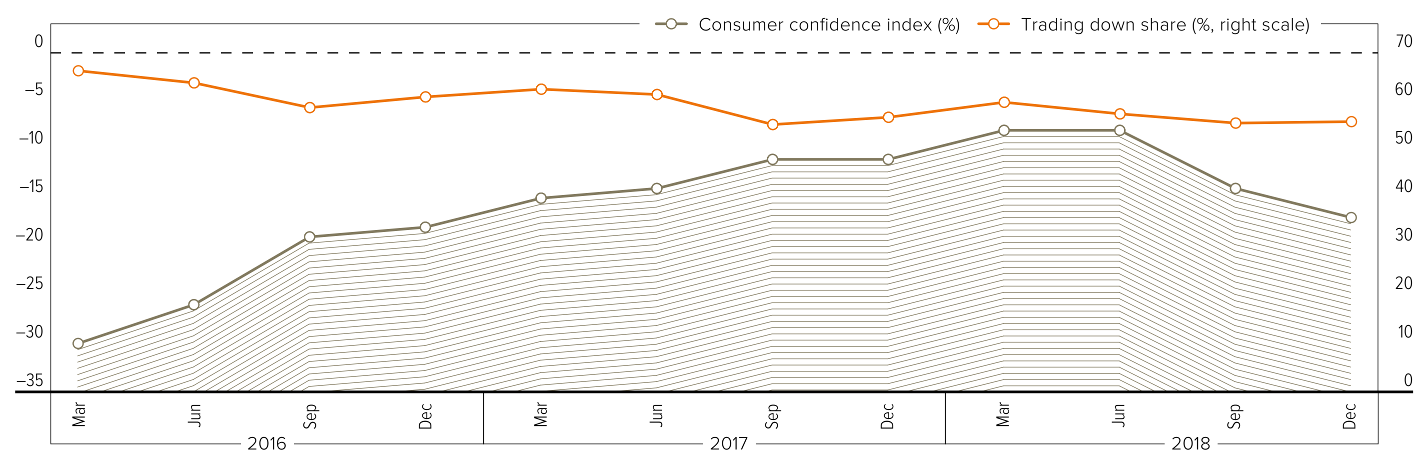
- The key factors affecting our market in 2018 were a record decline in food CPI (to 1.7% year-on-year annual average), which impacted nominal retail trade growth rates, volatile real disposable income dynamics, and a cautious recovery in consumption (which halted in the second half of the year)
- The food retail market increased by 1.7% in real terms and by 4.0% year-on-year in nominal terms to RUB 15 trillion in 2018
- On the back of economic volatility, consumers remain cautious, rational and highly sensitive to prices. Using our scale and market positioning, we offer competitive prices in our stores and support consumers additionally via promo. To maintain our ability to support our consumers, we are increasing our focus on operational efficiency and cost control. Our operational improvements in 2018 include shrinkage reduction, optimisation of our lease portfolio and rental rates, reduction of other store costs, Corporate Centre costs and the cost of debt. We significantly improved purchasing terms and will keep working on optimising every cost item

Personal income dynamics



Source: Rosstat

Consumer behaviour indicators



Source: Rosstat, FOM

Legislative changes

Law	Key changes	Date of entry into force
Change of the procedure for the submission of veterinary documents	As of 1 July 2018, the entire document flow for products of animal origin must be carried out through the Mercury state information system for the registration of electronic veterinary certificates. For more information, please see Federal Law No 243-FZ of 13 July 2015 (as amended on 28 December 2017)	29 December 2017
Law banning the return of unsold goods to suppliers	According to the new law, retailers may not return to suppliers any unsold goods with a shelf life of up to 30 days. For more information, please refer to Federal Law No 446-FZ of 28 November 2018	9 December 2018
VAT rate increase	The VAT rate increase to 20% applies only to those goods previously taxed at 18%. The VAT rate on goods, previously taxed at 0% or 10% on socially important goods, including a number of groceries (bread, dairy, corn, meat, fish, oil, butter etc.) and children's goods, remain unchanged. For more information, please refer to Federal Law No 303-FZ of 3 August 2018	1 January 2019
Mandatory digital labelling for certain products	Mandatory digital labelling of cigarettes will be introduced in Russia from 1 March 2019. A digital data matrix code, which resembles a QR code, must be printed on every pack of cigarettes. It will contain information about the manufacturer and route of the item from factory to store. A list of goods that must add identifying markers to their labels in order to reduce circulation of counterfeit products was approved in 2018. These goods include: • As of 1 July 2019: footwear • As of 1 December 2019: perfumes and colognes, various items of clothing, bed linens, cameras and tyres. For more information, please refer to the amendments to Federal Law No 15-FZ of 23 February 2013	1 January 2019
Conducting control purchases to monitor protection of consumer rights and compliance with sanitary and epidemiological regulations	In the course of monitoring consumer rights protection and ensuring sanitation and disease prevention, oversight (supervisory) bodies are allowed to conduct control purchases of goods. • control purchases are carried out without prior notice, but the prosecution authorities are notified; • if no violations are discovered, an unscheduled inspection on the same grounds is not allowed; • information on any control purchases carried out must be added to the unified inspections register. For more information, please refer to Federal Law No 81-FZ of 18 April 2018	29 April 2019
Introduction of brand-based records on alcohol products	The use of brand-based records makes it possible to track every bottle of alcohol from the moment of production until its sale to the end consumer by using a two-dimensional barcode with EGAIS identifier contained on excise stamps (to mark imported alcohol) or on special federal stamps (to mark alcohol produced in Russia). For more information, please refer to Federal Law No 433-FZ of 28 December 2017	• 1 July 2019
Positioning of dairy products on shelves	Dairy, dairy composite and lactiferous products must be placed in selling areas, or at any points of sale, separately from other products. They must be accompanied with the inscription "Products free from milk fat substitute". For more information, please refer to Decree No 50 of the Government of the Russian Federation of 28 January 2019	• 1 July 2019

CEO statement

Dear stakeholders,

We chose leading and evolving as the theme of the X5 Retail Group 2018 annual report because it fully reflects our core achievements in the past year as well as our goals for the future.

Challenging consumer and macroeconomic conditions made 2018 a difficult year for the entire food retail industry in Russia. While we worked hard to address these external challenges, we also underwent a significant reshuffle in our top-level operational management. Nonetheless, X5 Retail Group managed to deliver positive LFL performance, and we continued to expand our network of stores. In fact, looking back at 2018, I believe we faced these challenges as a cohesive team that evolved through these changes to become even stronger and more motivated to deliver results.

Some of the key areas where we are leading Russia's food retail market include: by the end of 2018, we further strengthened our position as the largest player, with a market share of 10.7%; we continued to expand Perekrestok Online, our online supermarket; and we continued to roll out our data-driven loyalty programmes across all three formats, with Pyaterochka still the only proximity store in Russia to offer customers a loyalty card. By the end of 2018, we had 37.5 million active card holders across our three formats, which represents over 30% of Russia's adult population.

Igor Shekhterman
Chief Executive Officer

CEO statement

At the same time, we are constantly evolving in order to maintain and further strengthen our leadership. We have adjusted our approach to growth at Pyaterochka, which operates in the highly competitive proximity segment, to focus on smart and balanced expansion to maintain margins and returns on investments as opposed to the rapid openings of previous years. At Perekrestok, we are nearing completion of our refurbishment programme, which is a major element of the supermarket format's refreshed CVP. At Karusel, we continue to refine the new branding and operating model aimed at broadening the format's appeal and increasing sales densities.

Some of the key highlights from 2018 include:

- Revenue grew by 18.3% to RUB 1.53 trillion, driven by an 18.0% rise in selling space and a 1.5% increase in LFL sales
- We achieved growth in LFL traffic and basket at the group level. LFL traffic growth accelerated in Q4 2018 at both core formats compared to the previous quarter. We are particularly pleased with the LFL traffic growth of 8.2% at Perekrestok, the highest level achieved since Q2 2011.
- Our adjusted EBITDA margin was in line with our internal target and remained above 7.0% in 2018, despite a challenging macro environment
- We continued to adhere to our dividend policy and recommended a dividend of RUB 25.0 billion (RUB 92.06 per GDR) for 2018
- We expanded our omnichannel offering with the expansion of Perekrestok Online to St Petersburg, as well as parcel lockers and cooperation with delivery aggregators at Pyaterochka and Karusel
- We strengthened our focus on innovation with the creation of the Big Data Department, the launch of a new business process that searches for, reviews, pilots and implements new ideas, as well as by setting up a lab store where we can field-test new technologies

Customer-centricity

Customer-centricity is at the centre of all of our decision-making and is the key to X5's ability to build sustainable value for customers, employees, investors and business partners. We strive to offer our customers what they want, when they want it, at a fair price, of good quality and in a convenient format. This means constantly adapting the CVPs of our store formats while also developing new ways to interact with our customers.

To achieve this, we have launched or are piloting a number of omnichannel initiatives such as Perekrestok Online, in-store lockers for e-commerce purchases and cooperation with delivery services at Karusel. Perekrestok Online was particularly successful in 2018, with expansion into St Petersburg, the opening of two new dark stores and significant growth in the number of orders handled to over 408 thousand for the year.

We regularly fine-tune our assortments in response to changing demand, and we are now piloting technology that will allow us to efficiently and accurately “clusterise” the assortment at Pyaterochka stores, depending on considerations like location, customer income and other demographic factors, as well as competition. We are also working to further improve the quality and range of our private-label offerings across our formats, with a focus on unique and exclusive features that set us apart from our peers.

Finally, our loyalty programmes, which are offered by each of our formats, use big-data-enabled analytical tools to help us understand our customers better and to provide programme members with a convenient and more personalised shopping experience. Loyalty card penetration in traffic in December reached 48% at Pyaterochka, 49% at Perekrestok and 81% at Karusel. As an illustration of the importance and success of our loyalty programmes, 37% of Pyaterochka's customers in 2018 had loyalty cards, and these same customers accounted for 58% of the format's net retail sales for the year.

A new strategy with a focus on the future

We have updated the way that we approach our strategic decision-making to ensure that we focus on achieving long-term leadership and value creation for our stakeholders. As we evolve to address increasing competition and changing customer expectations, we will focus on three key areas:

- **Strengthening the existing business:** This strategic priority has a clear focus on building and further enhancing X5 Retail Group's current offline business by continuing to successfully adapt to customer needs and by increasing operating efficiency
- **Creating new innovative capabilities:** We already have in place an innovative business process that searches for, reviews, pilots and implements innovative technologies that help us build a strong and sustainable business. X5 piloted 37 projects at its stores in 2018 that aim to either increase our top-line sales or to improve bottom-line profitability
- **Creating business competencies to be a next-generation retailer:** We understand that the greatest opportunity for, and threat to, our business is technology-based disruption, and we aim to embrace the possibility of such disruption by developing an omnichannel business for all of our formats and adopting a business model that will enable X5 Retail Group to evolve and remain a leader even as the next generation of food retail emerges

Smart growth and efficiency

Until recently, Russian food retailers were focused on growth by rapidly opening new stores and entering new geographies. The competitive environment, previously defined by low levels of penetration of modern retail, was supportive of such expansion, as was the macroeconomic situation. In the current environment characterised by greater maturity of the retail market and a more challenging macro-backdrop, X5 has adopted a new approach to achieving sustainable growth in its business. Our focus now is on selecting better locations by applying stricter requirements to new openings, improving efficiency and maintaining our return on invested capital. This new approach is reflected in the 21% year-on-year decline in the pace of new openings at Pyaterochka in FY 2018.

CEO statement

In addition to decelerating new openings, we continue to seek out and implement ways to improve operating efficiency across X5 Retail Group. This includes a wide range of initiatives, from renegotiating lease agreements to reducing shrinkage and streamlining store staffing. At the same time, we are leveraging data-enabled tools and innovations to further optimise our business by introducing better and faster analytical tools, as well as deepening the automation of processes.

To further support our efficient operations, X5 opened four new distribution centres and purchased 910 new trucks in 2018. This, combined with optimisation of business processes and the introduction of new, technology-based solutions, helped us to achieve sustainable cost savings across our logistics operations. Logistics costs per box declined by over 10% year-on-year in 2018.

Market environment

Even as the market leader, we remain constantly vigilant in a challenging market environment. Real income growth in Russia was near zero in 2018, and food inflation remained low for the majority of the year, averaging 1.7% for the year and peaking at 4.7% year-on-year in December. Economic growth remains subdued, with GDP expanding at about 1.8-2.3% p.a. At the same time, we are facing growing competition, especially in core markets like Moscow and St Petersburg, from existing players as well as new, specialised niche stores that seek to capitalise on offerings that meet the expectations of Russia's increasingly demanding consumers.

We believe that we have chosen the right path to respond to these challenges, as we lay out in this report: strengthening our leadership position through customer-centricity, continued adaptation of our CVP to meet changing consumer demand and a relentless focus on service quality, while also optimising business processes and innovating to enhance efficiency. We attribute our market leadership first and foremost to the customer value propositions of our three core formats. Other pillars of our success include our well-developed logistics infrastructure and the quality of our management team, which combines vision and the ability to execute.

A management team ready to evolve

I am particularly proud of the strong management team that we have at X5 Retail Group, and of the commitment and drive we have seen from within the organisation to help us strengthen our leadership position while growing and transforming the business. In the face of significant changes in the leadership of Pyaterochka and Perekrestok in 2018, we delivered strong results, with many internal candidates stepping up to the challenge and taking on new roles and responsibilities. I am very pleased that X5 was able to offer such excellent career growth opportunities to the talented people who work for the Company. We stand by our strategic objective to develop human capital at all levels of our organisation.

As the market and our customers change, we must stay ahead of these transformations. The management team we present to you in this report is a team that is ready to develop our business and that is committed to success and creating value for all shareholders. The team is motivated with long-term and short-term incentive programmes that we believe align their interests with those of our shareholders.

Sustainable development

At X5, we recognise that we bear responsibility for supporting a wide range of stakeholders, business partners and the communities where we operate our more than 14,000 stores.

As a Company, we are continuously working to reduce our impact on the environment: we have built a fleet of modern, low-emission trucks that keep costs down and pollute less than most fleets on the road in Russia; we have installed energy-efficient lighting and refrigeration equipment across our operations to reduce electricity consumption; and we are one of the largest recyclers in Russia, with over 572 thousand tonnes of materials recycled in 2018.

We aim to create value for more than 270,000 people who work for our Company by offering fair compensation packages with clear motivation programmes, training and development opportunities, as well as a safe and healthy working environment. Every single person who works at X5 Retail Group can play an important role in our success, and we want to ensure that we have established the conditions and inclusive working culture to get the best from all of our people.

We contribute to the development of local food producers as we seek to localise our assortment: by conducting training at DCs and using transparent, electronic document systems, we are helping local businesses expand sales by accessing the X5 Retail Group network.

In social welfare, the aspects of our business that we leverage are our areas of strength, like providing food aid to individuals and families in need or partnering with charities to collect donations across our vast network of stores. We believe that using our own infrastructure and expertise provides added value to such initiatives.

Outlook

We look ahead with optimism and desire to develop and achieve more. We acknowledge a mix of challenges and opportunities that will shape our plans and affect all players in our sector. The macroeconomic outlook is at best uncertain, with no signs of recovery in consumer confidence or household incomes. This means we must remain focused on strengthening our existing business with meaningful new efficiency measures, while continuing to pursue smart and balanced growth. I believe that X5 Retail Group is among the best-positioned in the industry to use its considerable size and resources to achieve our goals.

We have ambitious goals for implementing innovative technologies and developing omnichannel business models. This will be a key to our future growth, as we leverage technology to both help us increase our sales by expanding our audiences or growing the share of wallet among our customers, while at the same time using innovations to improve the efficiency of our business and reduce costs.

What makes me confident that our goals are achievable is the actual business and management competencies that X5 has been developing over the last two years in the fields of big data, innovation, technology and omnichannel service. X5 is today more advanced than many of its local peers in making innovation part of our day-to-day operations, and my goal as CEO is to see that this competitive advantage is secured and developed further.

Whether short-term or long-term strategic goals, all of our decisions will continue to put our customers at the core. We have built Russia's largest modern food retailer, and we aim to maintain our #1 position by making improvements to our CVP an ongoing exercise and building a customer-centric culture through all parts of our business.

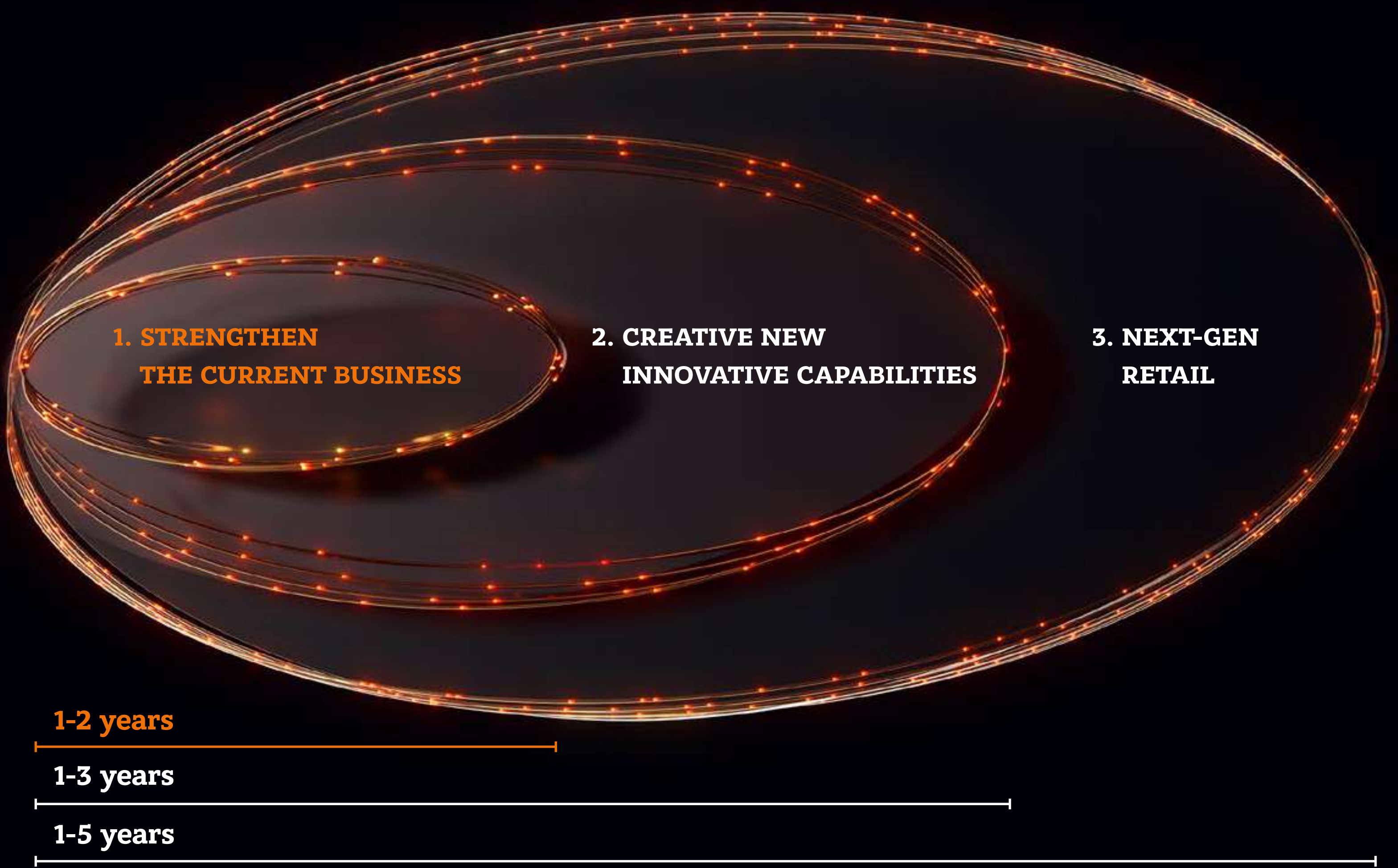
X5 remains committed to building value for its shareholders, customers, employees and business partners by strengthening its leadership position in Russia's food retail industry and by evolving to remain a leader as the next generation of retail emerges. I would like to express my gratitude to our customers for their loyalty, to our employees for helping achieve solid results, and to our shareholders and other investors for their continued support and interest in our business.

Igor Shekhterman
Chief Executive Officer

Our strategy in action

While X5 further secured its position as the leader in the Russian food retail industry in 2018, we are fully aware of the need to continuously evolve and to be prepared for potential disruption in our market as consumer expectations change and technology opens up ever more channels for retailers to reach customers. We have adapted our strategy to reflect the changing market landscape, taking into account factors ranging from persistent macroeconomic challenges and growing competition to emerging technologies and potential disruptive innovations.

Our strategy is evolving



With this in mind, we have three core streams of activity: short-term measures to strengthen the current business, medium-term initiatives to create new innovative capabilities, and our long-term goal of transforming X5 into Russia's leading next-gen retailer.

Within each of these core streams, there are specific goals and targets:

- To strengthen the current business over the next year or two, we will focus on smart and balanced expansion, further enhancing operational efficiency, as well as continuing to adapt our formats' CVPs.
- Over the next three years, we aim to create new innovative capabilities by developing technology-based solutions and further leveraging the possibilities of big-data-enabled tools to bolster the effectiveness and efficiency of our business.
- While next-gen retail has a five-year horizon, we are already actively working towards this goal, with omnichannel business models like Perekrestok Online in its second year of operations, Karusel due to launch a click-and-collect service in 2019, and Pyaterochka preparing to pilot new initiatives in the year ahead.

We believe that this three-pronged strategy aimed at addressing the short-term and long-term needs of our business is the best way to build a company that will create value for all its stakeholders while delivering good returns to shareholders.

We have updated our core strategic goals in response to the changing market landscape. While we remain focused on smart growth, adaptation of our CVP and operational excellence, X5 has elevated the importance of developing its omnichannel business and implementing innovative solutions throughout our operations. At the same time, efficiency and cost optimisation remain top priorities as we deal with the challenging macro-environment and face increasing competition, including from newcomers to the market.

The Supervisory Board believes that these strategic priorities are what X5 Retail Group needs to further secure its leadership position in the medium term, while evolving into a next-gen retailer in the longer term.

Strategic progress

1. Strengthen the current business

Smart and balanced expansion

Strategic goals

- Focus on return on invested capital (ROIC) as the key criteria for expansion, selecting the most attractive locations with the best opportunities for sustainable, profitable operations
- Decelerate openings to balance expansion with profitability and return on investment
- Continued enhancement of technological solutions that inform and accelerate the decision-making process for the selection of new sites
- Continued acquisition of smaller players
- Strengthened position in the most lucrative markets

What we did in 2018

- Opened landmark 14,000th store, ending the year with 14,431 stores
- Added 2,310 stores in 2018 compared to 2,934 stores in 2017 (a 21.3% decrease year-on-year)
- Increased food retail market share from 9.5% in 2017 to 10.7% in 2018
- The number of cities and towns where X5's stores operate grew by 17% year-on-year
- Continued to improve the geo-information system used to evaluate the attractiveness of new sites

Further adaptation of CVP

Strategic goals

- Focus on NPS as a key metric to drive customer orientation as one of our core values
- Adapt value proposition of each format to evolving consumer needs and expectations, including localisation of store assortment to adjacent demographics and customer shopping mission profiles
- Continue to enhance regional store models to reflect differing income levels, population densities as well as local customer needs
- Improve quality of perishables, increase service levels, and continue driving assortment differentiation
- Enhance in-store execution, including improvement of on-shelf availability
- Tie top-to-bottom personnel motivation to service quality and NPS

What we did in 2018

- Increased Pyaterochka Helps (Vyruchai-Karta) loyalty programme penetration in sales to 64%. This is the only proximity format loyalty programme in Russia to provide personalised offers for its customers
- Piloted assortment and pricing clusterisation across the Pyaterochka network to make stores better-adapted to adjacent-area customer needs
- Reached an 86% completion of the Perekrestok format renovation programme by the end of 2018
- Continued to refurbish Karusel hypermarkets in line with the new concept
- Improved quality in perishable categories and continued updating the ready-to-eat offering at Perekrestok
- Enhanced the Karusel hypermarkets assortment, expanding healthy, bio, organic and craft offerings
- Further expanded assortment of private-label and exclusive brands
- Created cross-format import division to implement direct import strategy
- Further focused personnel motivation schemes on NPS as a KPI in all formats down to the store director level
- Enhanced employee engagement with a new incentive programme and specific steps to upgrade working conditions

Operational efficiency

Strategic goals

- Maintain focus on reducing costs in an environment of challenging macroeconomic conditions and growing competition

What we did in 2018

- Launched initiatives aimed at reducing shrinkage, optimising inventories, improving effectiveness of promo planning and control, and enhancing end-to-end cold chain consistency and quality control
- Pyaterochka achieved a positive trend in shrinkage reduction since the new team took over in the middle of 2018
- Reduced rent costs by renegotiating terms with landlords with a focus on revenue-lined rents and rent indexation aligned with food inflation
- Continued development of a multi-echelon logistics system and implementation of a warehouse management system (WMS)
- Over the past three years, we have opened 21 distribution centres and purchased over 3,000 new trucks
- Since 2014, improvements in logistics efficiency have led to an improvement in the warehouse-to-selling space ratio by 32%

Long-term goals

- Deliver top-line growth above the market and competition while maintaining margins and returns
- Focus on both organic expansion and acquisition of smaller players
- Continue optimising costs, including shrinkage, logistics costs and other operating expenses
- Continue to refine data-driven strategy in response to market developments
- Enhance customer-centric decision-making based on data analytics
- Support a self-regulation strategy for Russian retail
- Increase the share of direct imports up to 10% by the end of 2020
- Increase the share of private label

2. Create new innovation capabilities

	Strategic goals	What we did in 2018	Long-term goals
Technology-based solutions and innovations	• Leverage technology to improve operations and efficiency • Actively seek out, test and implement new technologies that will ensure that X5 is at the forefront of the emerging next generation in food retail	• Piloted 37 projects at X5 stores in 2018 (including video monitoring of shelves, smart shelves, facial recognition and Wi-Fi recognition, customer queue video and AI-based monitoring) • Launched an X5 lab store in Moscow in October 2018 for testing and fine-tuning new technologies	• Disrupt our business before new technologies introduced by smaller start-ups do so • Ensure that innovation is not done for its own sake but to improve the sustainability of our business and our competitive market position • Remain at the forefront of technological innovation in retail
Big data	• Use data-driven tools to enhance our ability to meet customer demand	• Created a Corporate Centre-based Big Data Department (headed by Anton Mironenkov) with over 100 professionals coming from some of Russia's leading tech companies • Implemented big data solutions for demand forecasting, assortment adaption, pricing optimisation and customer personalisation	

3. Next-gen retail

	Strategic goals	What we did in 2018	Long-term goals
Omnichannel business model	• Enhance CVPs and customer offerings of existing retail formats by piloting and developing omnichannel capabilities	• Expanded Perekrestok Online into St Petersburg and parts of the Moscow region, increasing the number of dark stores from one to three • Installed a network of parcel lockers at X5 stores to enable customers to pick up third-party online non-food purchases • Prepared a click-and-collect pilot launch at several Karusel hypermarkets	• Evolve X5 into a next-gen retailer by creating a consumer-centric ecosystem by expanding into food and non-food adjacencies

Our investors

	What we did in 2018	Long-term goals
Governance	• Listing on Moscow Exchange, allowing X5 to expand its investor base and improve share liquidity for sustainable growth in the interests of shareholders, customers and partners • Strengthened the Supervisory Board in the area of technical and commercial innovation, and enhanced Supervisory Board practice in terms of induction and ongoing education • Filled vacancies at senior executive level with internal promotions, as part of the Company's systemic succession planning	• Continuously refine X5's governance in support of the Company's long-term value creation for the benefit of all stakeholders • Maintain constructive dialogue with investors, analysts, regulators and other market stakeholders
Risk management	• Impact of key risks was quantified in addition to qualitative assessment • Reorganised Forensic, Compliance, Internal Control and Risk Assessment functions and started to design X5's Assurance Map • Revised approach of Internal Control development • X5 Internal Audit Department successfully completed an independent and external professional evaluation by KPMG	• Emphasis on cost-benefit of risk mitigation activities and controls • Prediction of known and new risks and integration into strategic planning • Efficient and transparent interaction – a three-tier model to establish and maintain internal control • Continuous improvement of risk management and internal control culture and practices at all levels of X5 with the participation of all stakeholders

Our people

	What we did in 2018	Long-term goals
Corporate culture	• Integration of X5's common values into all HR processes • Customer focus as the main feature of the Company's corporate culture • Making the X5 brand more attractive as an employer	• Systematically communicating the Company's updated goals and strategies at all levels • Breaking goals down into cross-cutting key performance indicators
Training and professional development	• Established an approach to the systematic, long-term development of X5 managers • Launched training programme for X5's top managers • Developed basic managerial and professional skills for employees	• Retain talented employees by cross-cutting/cross-format training programmes and expanding opportunities for career growth at X5
Occupational health and safety	• Continued implementation of health and safety standards and ensuring safe working conditions across all operations • Company-wide occupational health and safety policy and training courses for all blue-collar professions at X5	• Involvement of all X5 Retail Group employees in ensuring a safe working environment

Our world

	What we did in 2018	Long-term goals
Environmental management	• Implemented remote monitoring and management systems to optimise in-store electricity use • Continued installation of energy-efficient LED lighting at Karusel format • Continued recycling of own waste and piloted programme to let consumers recycle PET bottles at Pyaterochka stores • Operated and maintained modern transport fleet that adheres to strict environmental standards	• Continue to implement measures that limit our impact on the environment, benefit local communities, and improve the efficiency of our business.
Community commitment	• Introduced new format for Basket of Kindness: citywide food marathons • Expanded cooperation with Life Line Foundation to assist children in need • Continued to support pensioners by offering discounts during off-peak hours • Supported volunteer activities by employees to support socially beneficial projects	• Continue to implement activities that support the communities where we operate, in line with our policies and guidelines

Geography of operations

Leading the national expansion of modern food retail

Russia has a population of over 146 million people spread out across 11 time zones. Operating an effective federal network of proximity stores, supermarkets and hypermarkets requires robust backbone infrastructure and systems in order to ensure reliable and high-quality service at every store we operate every day.

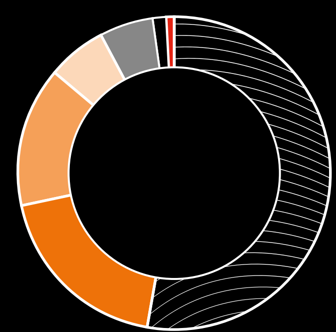
Evolving to meet local needs

Russia is an ethnically and economically diverse country, and we are developing our business model to address the needs of local customers depending on regional preferences and local demand. To better address this diversity, we are piloting clusters of stores that adapt their assortment to meet their customers' needs. We source products from local producers wherever possible, and we engage local suppliers with training programmes to help them reach our customers more effectively. In 2018, the share of local goods across all X5 stores reached 19%.

Smart expansion

We are evolving our approach to expansion in line with the changing food retail market landscape in Russia. After explosive expansion in a low-penetration environment, we will increasingly focus on quality growth. With a well-balanced growth policy, we aim to open fewer stores in order to focus on selecting better locations, which implies higher efficiency without hurting our return on invested capital.

Net retail sales by federal district in 2018, %



Central	53.0
Volga	18.8
North-Western	14.4
Ural	6.2
Southern	5.4
Siberian	1.4
North Caucasus	0.8

Store dynamics, number of stores at year-end

Number of stores at year-end	2018	2017	2016	2015	2014
Central	5,822	5,198	4,077	3,262	2,653
North-Western	1,668	1,416	1,095	845	720
Central and North-Western	7,490	6,614	5,172	4,107	3,373
Volga	3,820	3,169	2,468	1,848	1,368
Ural	1,168	999	764	551	405
Southern	1,222	874	606	418	276
North Caucasus	252	188	137	96	61
Siberian	479	277	40	–	–
TOTAL	**14,431**	**12,121**	**9,187**	**7,020**	**5,483**

Note: based on federal districts of the Russian Federation

Total stores

14,431

X5 today

Multi-format presence in seven federal districts

13,522 Pyaterochka proximity stores

760 Perekrestok supermarkets

94 Karusel hypermarkets

Number of stores and DCs

North Caucasus FD

Pyaterochka	242
Perekrestok	9
Karusel	1
Distribution centres	–

Southern FD

Pyaterochka	1,174
Perekrestok	43
Karusel	5
Distribution centres	4

Central FD

Pyaterochka	5,279
Perekrestok	449
Karusel	39
Distribution centres	17

Volga FD

Pyaterochka	3,676
Perekrestok	119
Karusel	25
Distribution centres	9

North Western FD

Pyaterochka	1,552
Perekrestok	98
Karusel	18
Distribution centres	5

Ural FD

Pyaterochka	1,120
Perekrestok	42
Karusel	6
Distribution centres	6

Siberian FD

Pyaterochka	479
Perekrestok	–
Karusel	–
Distribution centres	1

Leadership team

Our team has led X5 Retail Group through its transformation into Russia's largest modern food retailer and is already helping X5 evolve into a next-generation retailer as innovations, technology and online businesses disrupt our market.

Igor Pletnev
Director for Strategic Business Development

Kirill Kuzmenko
Director of Transport

Svetlana Demyashkevich
Chief Financial Officer

Igor Shekhterman
Chief Executive Officer, Chairman and Member of the Management Board

Ekaterina Lobacheva
General Counsel

Svetlana Volikova
Director for Business Support

Dmitry Agureev
Head of Corporate Security

Denis Maslov
Director of the Large-Format Real Estate Management Department

Elena Konnova
Corporate Communications Director

Johannes Tholey
Commercial Director

Maksym Gatsuts
General Director of Karusel

Vladislav Kurbatov
General Director of Perekrestok

Sergei Goncharov
General Director of Pyaterochka

Anton Mironenkov
Director of Big Data

Fabricio Granja
Chief Information Officer

Tatiana Krasnoperova
Director of Human Resources and Organisational Development

Igor Shekhterman

Chief Executive Officer, Chairman and Member of the Management Board

Igor has served on X5's Supervisory Board since 2013. He has been Managing Partner and CEO of RosExpert, which he co-founded in 1996 and subsequently successfully developed into the Russian alliance 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 Enterprises (France, 1994) and the Danish Management School (1995).

Svetlana Demyashkevich

Chief Financial Officer

Svetlana joined X5 in June 2017. Since 2005, she has held several senior positions at Alfa-Bank, including head of audit and IFRS reporting. She also created and led the financial control service, investor and rating agency relations, the business intelligence centre, and the centralised purchasing service. From 2002 to 2004, she audited financial institutions at PricewaterhouseCoopers and was the Financial Controller at UNICEF Russia. Svetlana graduated with honours from the Financial University of the Government of the Russian Federation and is an ACCA qualified accountant.

Sergei Goncharov

General Director of Pyaterochka

Prior to joining X5 in March 2018, Sergei had been in charge of Magnit's cosmetics stores and had managed Magnit's pharmacy division from 2013. From 2005 to 2013, he was in charge of Sony Corporation's development strategy in Russia and the CIS. Sergei has a proven track record in Russian and US investment companies and holds an MBA from the Wharton School of the University of Pennsylvania.

Vladislav Kurbatov

General Director of Perekrestok

Vladislav joined Perekrestok in 2015 as Operations Director. Throughout the format's transformation, he made a huge contribution to the development of Perekrestok, and in particular to the current CVP, store efficiency improvement and further development of the banner's customer-centric approach. Vladislav has extensive experience in retail, having led operations at O'Key for over 13 years before joining Perekrestok. Vladislav graduated from the Leningrad Higher School of Military Topography.

Maksym Gatsuts

General Director of Karusel

With 20 years of managerial experience at various multinational industry leaders, Maksym has extensive expertise in food retail. From 2002, he worked for the METRO Group, holding positions as Store Manager, District Manager, Operations Director at METRO Cash & Carry Ukraine and Customer Management Director at METRO Cash & Carry Portugal. From 2012 to 2016, he served as Operations Director and as a member of the Management Board at METRO Cash & Carry Russia. Maksym graduated from the Moscow Aviation Institute and holds an MBA from INSEAD.

Anton Mironenkov

Director of Big Data

Anton joined X5 as Deputy Director of the M&A Department in September 2006. In March 2011, he was appointed Director for M&A and Business Development and in 2012 became the Director for Strategy and Business Development. In February 2014, he was appointed as General Director of the Express convenience store format. From 2005 to 2006, Anton managed various projects at Alfa Group, including the merger of Pyaterochka and Perekrestok. He began his business career in 2000 as an auditor at PricewaterhouseCoopers and subsequently spent four years as an investment banker at Troika Dialog before transferring to the Vice President position at Troika Dialog Asset Management in 2005. Anton graduated with honours from Moscow State University in 2000 with a degree in Economics.

Fabricio Granja

Chief Information Officer

Fabricio joined X5 Retail Group in October 2016. Fabricio has an impressive track record in the field of IT. Before joining X5, he worked as Vice President for IT & Projects at Eldorado LLC and was in charge of the company's IT strategy. Fabricio has held management positions at a number of Russian and international IT consulting firms, including Ciber, ABPL Altamiro Borges Planejamento & Logistica, and FQS, focusing on projects for major companies.

Tatiana Krasnoperova

Director of Human Resources and Organisational Development

Tatiana joined the X5 team in February 2016 and has a proven track record in organisational development and HR management. She has over 10 years of experience in various executive positions at major domestic and international companies, including EVRAZ, TNK-BP and Integra Group. Tatiana graduated from the Izhevsk State Technical University with a degree in Economics and Business Administration and was awarded an MBA from the RUDN University.

Igor Pletnev

Director for Strategic Business Development

Igor joined X5 in 2011. Up until July 2018, he was the Director for Development at Pyaterochka and also headed the X5 project office. Igor now holds the position of Director for Strategic Business Development in this newly created business unit. Prior to joining X5, he worked as Deputy General Director of the Kopeyka retail chain. Education: Moscow State University, Belarusian State Pedagogical University.

Johannes Tholey

Commercial Director

Johannes has 30 years of successful experience in retail. From 1987 to 2015, he worked for Globus Group, where he held management positions in Germany, France and Russia. He spearheaded the company's expansion into Russia and served as the Globus Russia CEO for six years. In addition, Johannes has a good understanding of our business, as he has been an advisor to X5 and Karusel since 2017.

Elena Konnova

Corporate Communications Director

Elena joined X5 in January 2015. She has 15 years of experience handling public relations with some of Russia's largest companies. Before joining X5, Elena worked for Volga Group, Gazprom Neft, NIS (Naftna Industrija Srbije), and Ilim Group (a Russian pulp and paper holding). Prior to that, Elena spent more than 10 years working as a journalist for the Russian business press, including at Kommersant and Expert. Elena graduated from St Petersburg State University with a degree in Sociology and Economics.

Dmitry Agureev

Head of Corporate Security

Dmitry has 23 years of experience working in government and corporate security, including leading Russian and international companies. He started his career in the Intelligence Service of the Russian Federation. Prior to joining X5, he was the security director for Volvo Group Russia, Ukraine and Belarus and also held security positions at Gazprom and Transneft. Dmitry holds degrees from the Moscow Suvorov Military School, the Serpukhov Military Command-Engineering College of Nuclear-Missile Forces and the Russian Academy of Intelligence Service, as well as a Volvo MBA.

Ekaterina Lobacheva

General Counsel

Ekaterina joined X5 in October 2016 as the Head of the Corporate Law and X5 Corporate Structure Department. She has over 15 years of successful managerial and practical experience in the field of law. Before joining X5 Retail Group, Ekaterina worked for over five years at Evraz Holding, where she implemented a number of large-scale projects in legal support for business. During her term at Evraz Holding, she held numerous positions, including Director of Corporate and Property Relations; Vice President, Legal, Law; and Corporate Law Director. Ekaterina worked at MDM Bank as the Corporate Secretary from 2007 to 2011. She began her professional career in the legal field in 1999, working in several private and government entities before joining MDM Bank. Ekaterina graduated from the Russian Academy of State Service with a degree in Law in 2005 and received an additional degree in Finance and Credit from the Plekhanov Russian University of Economics in 2011.

Svetlana Volikova

Director for Business Support[1]

Svetlana joined the X5 team in 2007. She has held various positions within X5's Corporate Centre and retail formats, including the General Director of Karusel. From 1996 to 2007, she held positions at Auchan and Danone. Svetlana graduated from the Higher Institute of Management in Paris, France. She qualified as an ACCA accountant in 2009.

[1] Director for Business Support from February 2019. In 2018, Svetlana held the position of Director of Risk Management and Internal Control (until April 2018) and General Director of Perekrestok Express (May 2018 – January 2019).

Denis Maslov

Director of the Large-Format Real Estate Management Department

Denis joined X5 in December 2018. He has 15 years of managerial and hands-on experience in real estate planning, construction and refurbishment. Prior to joining X5, he held executive positions in major companies like Sheremetyevo International Airport, Gazprom Neft and Vostokneftezavodmontazh.

Kirill Kuzmenko

Director of Transport

Kirill joined X5's Finance Department in 2009 as a consolidation manager and was promoted to the position of Head of IFRS and Management Reporting in just two years. In October 2012, he was appointed Finance Director of the Logistics Department. In April 2014, following the inception of a new Transport Department, Kirill became its Finance Director. In 2017, he was included in X5's talent pool. During his time with the Company, Kirill implemented a number of effective projects and initiatives that enabled X5 to cut logistics costs and make its own fleet more competitive. Kirill's previous work experience included a stint in finance as a KPMG employee. He graduated with honours from the Faculty of Computational Mathematics and Cybernetics of Lomonosov Moscow State University

Pyaterochka
proximity stores

Pyaterochka has reached a crossroads in its development, and the time has come to focus on strengthening the core business while also laying the foundations for new types of growth. In previous years, Pyaterochka focused on its record-setting pace of new store openings. We have already started to decelerate openings in order to focus more on smart expansion and improving investment returns. Going forward, Pyaterochka aims to find new sources of growth on the basis of our existing stores by further adapting its assortment to the changing needs of our customers.

In the years ahead we will continue to adapt our CVP, including further developing our Pyaterochka Helps (Vyruchai-Karta) loyalty programme. In line with X5 Retail Group's updated strategic priorities, we are already developing and preparing to pilot new omnichannel business ideas, while also actively seeking out new innovations that will help Pyaterochka develop its business and remain at the forefront of our sector as the next generation of food retail emerges.

Sergei Goncharov
General Director of Pyaterochka

Pyaterochka is Russia's largest proximity store network, and we have worked hard to make Pyaterochka the market leader, not only in terms of size but also in the minds of our customers. Just a few of our key achievements in recent years include the complete refurbishment of every store we operate, the launch of the only proximity store loyalty programme in Russia, the introduction of a new CVP aimed at a wider group of customers and the introduction of greater flexibility to adapt what our stores offer with assortments that include locally produced goods and the clusterisation of assortments based on the needs of certain types of customers in the area where a store is located.

The average Pyaterochka store has 391 square metres of selling space, with more than 4,500 stock-keeping units (SKUs) on offer.

2018 performance highlights

Stores in operation:

Stores
as of 31 December 2018

13,522
+20.5% year-on-year

Selling space
as of 31 December 2018

5,291 m²
+19.5% year-on-year

New stores added
as of 31 December 2018

2,297
and 865 thousand square metres of new selling space added

Net retail sales:

RUB 1,198 bln
+19.7% year-on-year

Pyaterochka Helps loyalty programme:

Cards issued

>65 mln
more than 29 million active users

Traffic penetration
as of 31 December 2018

48%
and 64% of retail sales attributable to loyalty card holders

Customer visits:

3.9 bln
+19.8% year-on-year

2018 strategic highlights

Decelerated new store openings
in order to focus on smart growth and maintaining investment returns

Stable share of stores in "clinic"
indicating current business performance is sustainable

Enhanced management model
to address the Company's significantly increased scale by delegating decision-making powers to macro-regions

Pyaterochka Helps loyalty programme,
the only loyalty programme for proximity stores in Russia, continues to expand and has piloted personalised offers for customers

Continued pilot of assortment clusterisation
to enable groups of stores to better meet customer needs based on local demographics and competition

Reduced shrinkage,
especially in H2 2018, after establishing a shrinkage committee for the Moscow macro-region and focusing on optimising the assortment, inventories and business processes to address shrinkage, especially in fruits and vegetables

Improved brand perception and expanded target audience
thanks to continued adaptation of the CVP

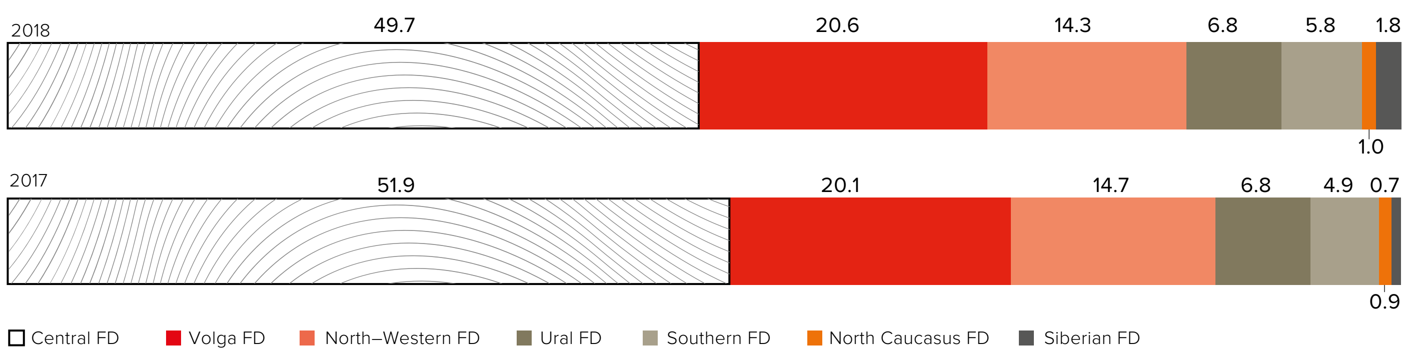
Improved promo planning and effectiveness
with advanced analytics

Improved operational efficiency
with continued enhancements to logistics, reduction in store capital costs and operating expenses, optimisation of rental agreements

Key operating results

	2018	2017	2016	2015	2014
Number of stores, eop	13,522	11,225	8,363	6,265	4,789
Selling space '000 m², eop	5,291	4,427	3,329	2,423	1,754
Net retail sales, RUB bln	1,198	1,001	776	585	436
Customer visits, mln	3,913	3,267	2,543	1,990	1,645

Pyaterochka net retail sales by region, %



Strategic Priorities

<table>
<tr><th>Our priorities</th><th>What we are doing</th><th>What we plan to do</th></tr>
<tr><td>Smart expansion</td><td>• Prioritise maintaining target ROIC level over pace of expansion
• Focus on growth in existing regions
• Aim to replace smaller existing retailers as market consolidates
• Number of new stores and new selling space grew by 20.5% and 19.5% year-on-year, respectively, compared to 34.2% and 33.0% growth in 2017</td><td rowspan="5">• Further adaptation of CVP and assortment
• Leadership in NPS and service level
• Improvement in operational efficiency, including shrinkage
• Decrease personnel turnover and improve loyalty
• Improve efficiency of regional model
• Rollout of personalised promotions</td></tr>
<tr><td>Efficient loyalty and promo programmes</td><td>• Further develop analytics-driven loyalty programme and personalised promo offerings
• Focus on increasing number of Pyaterochka Helps (Vyruchai-Karta) participants
• Increase share of wallet among our existing loyalty card holders
• More balanced approach to promo activity to support sales without undue pressure on margins
• Further develop advanced analytics system that enables partners to track the effectiveness of promo activity on consumer behaviour</td></tr>
<tr><td>Further adaptation of CVP and assortment</td><td>• Client-centric assortment management: piloted clusterisation of stores, smart management of shelf space, used big-data-enabled tools to regularly review assortment
• Enhanced fresh category with reduced supply chain cycle, improved quality and expanded offering to include fresh bread
• Improved private-label programme, increasing quality and enhancing customer feedback
• Continue to expand assortment of locally produced goods: over 1,300 new producers from 68 Russian regions began to supply Pyaterochka stores in 2018
• Improve pricing process with automated pricing, cluster-based pricing and enhanced pricing policy tools
• Pilot and roll out advanced analytics system that enables partners to track the effectiveness of promo activity on consumer behaviour</td></tr>
<tr><td>Improve operational efficiency</td><td>• Adjusted operations to address shrinkage: changed assortments to better suit store format, cut inventories, improved promo planning and control, identified temperature issues during storage or transportation of goods
• Launched shrinkage committees in macro-regions and remote fruit and vegetables acceptance at DCs, resulting in a decline in shrinkage starting in Q3 2018
• Continued development of multilayer logistics infrastructure with three new DCs and four cross-docking stations
• Completed integration of the WMS, decreasing logistics expense per box by over 11% year-on-year, while the overall working rate increased by 14% year-on-year
• Improved "lean store" operating model with optimised processes, smart reduction in assortment, better staff planning and less inventory
• Further reduced rent costs and renegotiated rent agreements</td></tr>
<tr><td>Strategic focus on customer satisfaction and employee engagement</td><td>• Introduced new values and incentives system to encourage customer-centric culture throughout the Company, not only in stores
• Introduced new organisational structure for customer feedback analysis and continuous improvements
• Increased efficiency of hiring and personnel management
• Redistributed functions among in-store personnel to enhance productivity and maintain cost controls</td></tr>
</table>

Customer-centric approach to everything we do

Our success and sustainability is based on our ability to understand our customers and adapt our offering to meet their needs on an ongoing basis while also developing and implementing innovations that help us to evolve our overall business as the market landscape changes.

Smart expansion and balanced growth

We dialled back the pace of expansion in 2018 to 865 thousand square metres, which is 21.2% less than in 2017. While this still represents significant growth, our focus going forward will be on ensuring quality and sustainability in order to strengthen the existing business. This will be achieved by adhering to the following principles:

- **Focus on ROIC:** Achieving target ROIC levels and maintaining profitability will be key criteria as we adapt our approach to new openings.
- **Natural replacement of smaller players:** While the previous years of expansion can be described as a “land grab”, the next stage of growth in Russian food retail will be defined by consolidation, and we aim for a significant portion of Pyaterochka’s growth to be through the acquisition of existing smaller players.
- **Develop and leverage our geographic information system (GIS):** GIS has been one of our core tools for selecting the right location for our new stores. In order to increase the quality of the system, we are constantly adding new data and algorithms to further enhance its accuracy.
- **Focus on existing regions:** In order to leverage existing logistics and transport infrastructure more efficiently, we aim to prioritise strengthening our presence in existing regions, while taking a more cautious approach to expanding into new markets.

Continued enhancements to CVP

We remain focused on adapting our CVP to evolving customer needs, with the goal of increasing the efficiency of our own operations. Some of the areas we are focused on include improving our client-centric assortment management process, using a clear assortment strategy and category roles. Since 2017, we have been piloting the clusterisation of stores, which will enable us to adapt the assortment at groups of stores based on demand in different types of locations.

Pyaterochka’s fresh category and private-label goods have also been central to our CVP, and we are focused on improving the quality of both. In the fruits and vegetables and ultra-fresh categories, we have achieved a 39% reduction in supply chain processing time, while also piloting new offerings such as fresh bread. Our private-label offering, which consists of 120 brands, accounted for 12% of Pyaterochka’s 2018 net retail sales.

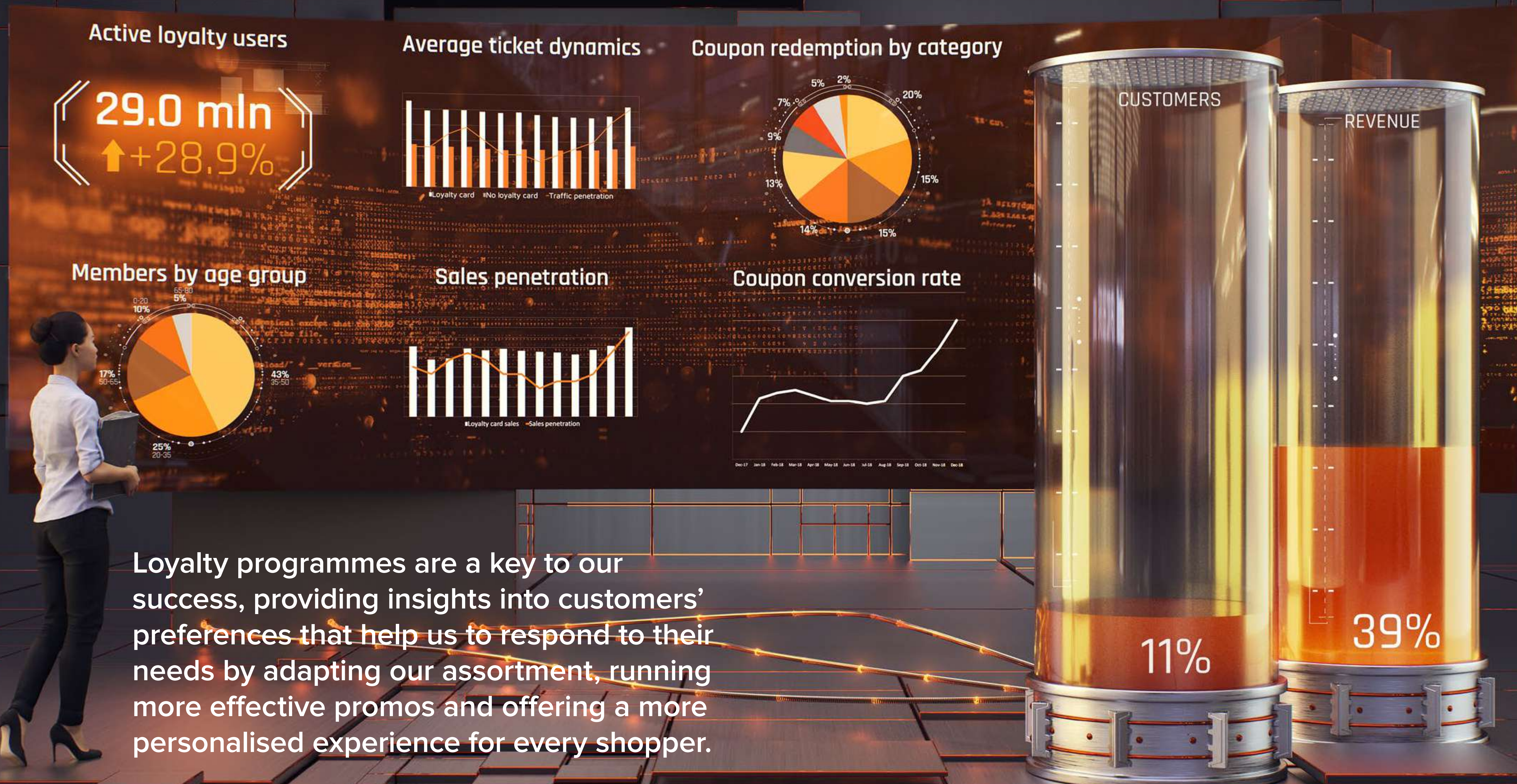
Private-label quality has been supported by the formation of a dedicated private-label team, as well as increasing analysis of customer feedback and customer needs to develop new products.

One of the core elements of Pyaterochka’s CVP is price perception, and we are improving pricing processes with automated systems, cluster-based pricing and the implementation of pricing policy tools.

We believe that promo activities represent an area for potential improvements in both our CVP and operational efficiency. To achieve this, we are rolling out promo efficiency solutions and piloting a new system that enables us to more accurately measure promo performance across our stores.

Loyalty programme

11% of our high-value customers with loyalty cards account for 39% of revenue.



Loyalty programmes are a key to our success, providing insights into customers' preferences that help us to respond to their needs by adapting our assortment, running more effective promos and offering a more personalised experience for every shopper.

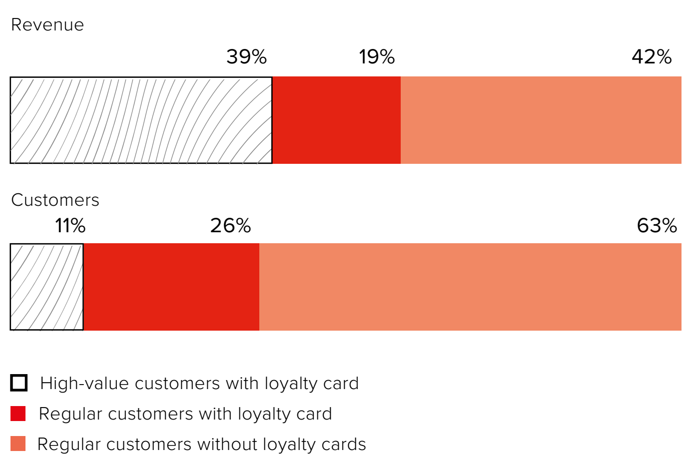
Loyalty programme – a key to growth

Pyaterochka's loyalty programme, Pyaterochka Helps (Vyruchai-Karta), has delivered impressive results to date, and we view it as a key to potential future growth. Pyaterochka is the only proximity store format in Russia to offer customers a loyalty programme, and we are committed to further enhancing the programme to make it even more attractive.

Penetration of the loyalty programme in traffic reached 48% in 2018, up from 42% a year earlier.

We had 29 million active programme members as of 31 December 2018, and our Pyaterochka Helps card holders accounted for 64% of sales for the year. These customers are key contributors to our business: 11% of our high-value customers with loyalty cards account for 39% of revenue.

Revenue by loyalty segment



Operational efficiency

Ongoing improvements to our operational efficiency is an important cornerstone of our strategy. One of our key areas of focus in 2018 was reducing shrinkage: in the second half of 2018, thanks to measures introduced by the new team at Pyaterochka, we managed to cut shrinkage by several dozen basis points.

Another priority area is the continued development of our efficient, multilayer logistics infrastructure, which will help us to keep operating costs to a minimum while supporting our growing federal network of proximity stores.

Pyaterochka has also launched a lean store initiative to help further improve efficiency. This initiative involves gathering insights into how operations can be optimised in order to improve processes, product quality and labour efficiency. We aim to develop a set of recommendations and policies that will enable us to implement key learnings from this process across our stores.

In addition to these measures, Pyaterochka has continued to reduce rent costs by renegotiating rental contracts with a focus on rental rates being variable as a percentage of revenue. These renegotiated contracts accounted for 38% of Pyaterochka's selling space at the end of 2018.

Omnichannel business and innovations

Pyaterochka, like all of our formats, aims to develop its own omnichannel retail business lines. One area where Pyaterochka, together with all of X5 Retail Group's formats, has already begun to implement this strategic priority is the installation of parcel lockers. By installing these lockers, we are providing customers a convenient way to pick up orders from third-party online retailers when they visit one of our stores.

The rollout of these lockers is expected to bring incremental increases in traffic to our stores. By the end of 2018, 1,599 such lockers had been installed in 1,531 Pyaterochka stores. We are constantly reviewing new ideas, and additional omnichannel business lines are due to be introduced at our Pyaterochka stores in 2019 and beyond.

Our focus on innovations also led Pyaterochka to become the first X5 format to open a lab store. We use this store to test innovative technologies and ideas in a real store operating environment. This enables us to gain a better understanding of how potential new technologies or processes could impact on operations. The lab store is currently testing a range of new technologies, including video analytics to automate monitoring queues at tills and shelf availability.

Human resources and recruitment

Pyaterochka is a major employer in Russia with over 176,000 people working across all of the format's operations (excl. outstaffing). This includes the X5 head office, as well as stores and logistics. One of the most important challenges that we deal with when opening a new store is finding the right people to hire. This can sometimes be significantly more challenging than the process of selecting a location and preparing the store for opening.

In order to address this challenge, and to encourage all of our employees to focus on customer needs, Pyaterochka is introducing new values and incentive schemes to further enhance customer-centricity. We believe that this is a key element of putting our customers at the centre of everything we do, in addition to initiatives like updating the CVP, adapting assortment and implementing loyalty programmes.

The new organisational structure that we have put in place at Pyaterochka will help us to implement a culture of continuous improvement based on analysis of customer feedback. Among other things, we have introduced NPS performance as an element of the motivation schemes for in-store personnel, including for store directors.

Perekrestok

supermarkets

Perekrestok delivered impressive results in 2018, with a record 122 new stores opened and the highest LFL performance in X5 Retail Group. Our ongoing improvements in CVP, adaptation of the assortment, effective marketing and promo, as well as the refurbishment programme, which brought 86% of the store base to the updated concept, all contributed to Perekrestok's success last year. With improved quality for our fresh and fruits and vegetables assortments, expanded ready-to-eat offerings, an increased focus on healthy foods and popular private-label brands, Perekrestok is offering Russian consumers a high-quality and convenient shopping experience combined with attractive prices.

Our omnichannel offering, Perekrestok Online, has grown very quickly as well, with over 2,600 orders per day being handled from customers in Moscow and St Petersburg in December. While improving the in-store experience and expanding online, we are also developing Perekrestok's popular loyalty programme with more personalised offers, a focus on the mobile app and partnerships with a wide array of leading Russian companies.

As we grow our operations, we remain vigilant about efficiency and service quality, with an increased emphasis on our NPS performance.

Vladislav Kurbatov

General Director of Perekrestok


Перекресток
СУПЕРМАРКЕТ
Перекресток
СУПЕРМАРКЕТ

Perekrestok was one of the first modern food retailers in Russia, and it remains Russia's largest supermarket chain. With a focus on Russia's most affluent regions, Perekrestok has updated its CVP to meet customers' ever-changing needs and is nearing completion of a network-wide refurbishment programme. Perekrestok added 122 stores and 144,296 square metres of net selling space in 2018, setting yet another new record. Our omnichannel offering, Perekrestok Online, also expanded into St Petersburg and finished the year with three dark stores. Our supermarket format is constantly innovating and leveraging big data analytics to improve performance, with big-data-driven targeted marketing initiatives and planned implementation of technologies like automated video queue monitoring.

Perekrestok supermarkets offer an assortment of 8,000-15,000 SKUs, with an average selling space of 1,028 square metres.

2018 performance highlights

Net retail sales:

RUB **231** bln
+23.5% year-on-year

Stores in operation:

as of 31 December 2018
760
+19.1% year-on-year

Selling space:

as of 31 December 2018
782 ths m²
+22.6% year-on-year

LFL traffic growth:

6.2%
the highest growth rate among X5 Retail Group formats for the second year in a row

Stores refurbished:

37

Customer visits:

505 mln
+24.2% year-on-year

2018 strategic highlights

Record pace of expansion of the supermarket format: the 122 stores added in 2018 is the largest number in Perekrestok's history and significantly ahead of the format's peers

Refurbishment programme nearing completion with 37 stores refurbished in 2018 and 86% of the store base operating under our new concept as of 31 December 2018 (vs. 73% as of 31 December 2017)

Highest-potential regions remain our main focus (Central and North-Western Federal Districts) due to their economic potential, with approximately 60% of stores opened in Moscow, the Moscow region and St Petersburg and the Leningrad region

Adapted assortment and CVP with a focus on quality and assortment in fresh, fruits and vegetables, and development of the ready-to-eat category

Expanded private label accounted for 6.5% of revenue in 2018, with unique and exclusive brands that cover all price segments

Efficiency initiatives brought about improvements in operational expenses, shrinking costs and selling, general and administrative (SG&A) expenses

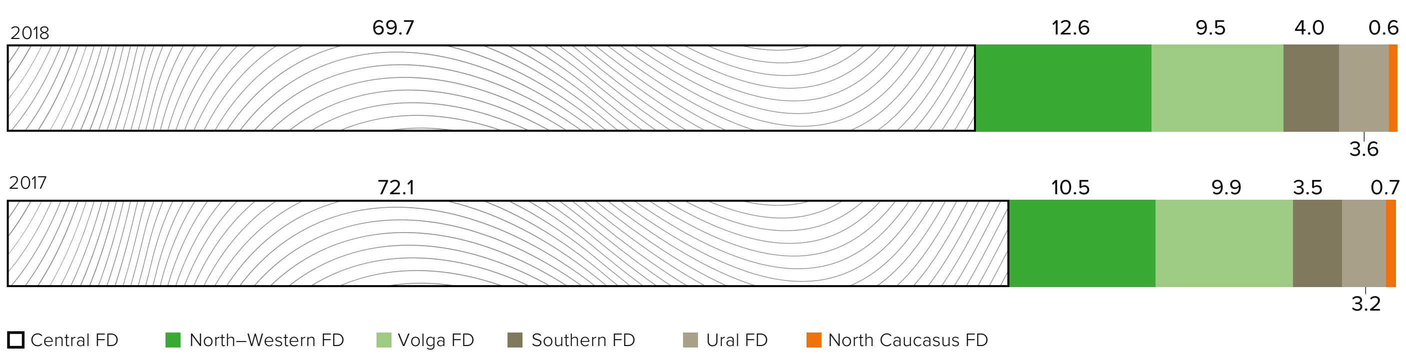
Online service growth continued, with the opening of two additional dark stores, expansion into St Petersburg and a total of 408 thousand orders in 2018

The loyalty programme continued to grow, with 5.5 million active cards and 49% penetration in traffic in December 2018

Key operating results

	2018	2017	2016	2015	2014
Number of stores, eop	760	638	539	478	403
Selling space '000 m², eop	782	637	549	484	416
Net retail sales, RUB bln	231	187	155	130	116
Customer visits, mln	505	407	350	304	302

Perekrestok net retail sales by region, %



Strategic Priorities

Our priorities	What we are doing
Continue expansion with focus on strengthening position in most attractive markets	• Added 122 new stores in 2018 vs. 99 in 2017 • Focused on most attractive regions for Perekrestok's supermarket CVP, with 63% of new openings in Moscow, St. Petersburg and other cities with a population of over 1 million people • Growth remains sustainable, with Perekrestok delivering record LFL performance and impressive traffic growth to 505 million visits in 2018, up from 407 million in 2017
Continue to implement refurbishment programme	• 37 stores were refurbished in 2018, with 86% of Perekrestok stores operating under the new concept as of 31 December 2018 • Average LFL revenue growth for a refurbished store (after recovery period) is 14%-16%
Focus on CVP to meet demand from core customers, while expanding the overall base	• Further adapted assortment to differentiate from competition • Expanded and optimised key categories like fresh, fruits and vegetables, healthy food • Expanded private-label offering with unique assortment • Upgraded and expanded offering in ready-to-eat category • Client-centric metrics added to employee motivation programme
Implement updated private-label strategy	• Expanded customer feedback with regular tastings and surveys • Optimised assortment to improve customer retention • Enhanced communication with customers on private-label assortment • Focused on product quality
Focus on operational efficiency	• Fine-tuned regional model by assigning store format based on selling space and net retail sales • Reduced opening capex and ongoing opex for regional stores • Improved logistics with reduced cost per box and better shelf availability • Developed new incentivisation scheme for in-store personnel with focus on productivity • Set up educational centre for cashiers • Improved accuracy of promo planning
Move towards omnichannel approach, with online supermarket in core markets	• Successfully expanded online offering to St Petersburg • Currently operating two dark stores in Moscow and one in St Petersburg to support online operations • NPS of 83% reflects high level of customer satisfaction • Handled over 2,600 orders per day in December 2018 • Further extended assortment to 25,000 own SKUs and another 25,000 partner SKUs in St Petersburg
Further develop loyalty programme	• Expanded loyalty programme to 5.5 million active card holders, and 49% penetration in traffic • Loyalty customer average ticket is RUB 705 vs. RUB 521 for non-loyalty customers • Loyalty programme is accessible through mobile app, enhancing omnichannel customer experience

What we plan to do

- Further expand the business with the aim of being closer to customers
- Continue adapting assortment to meet target audience demand with focus on fresh, fruits and vegetables and ready-to-eat categories
- Strive to ensure customers feel comfortable and have a positive shopping experience
- Achieve best-in-class service and further increase NPS
- Develop omnichannel business
- Implement targeted loyalty programme with personalised promos

Accelerating growth with successful CVP

Perekrestok remains one of the fastest-growing supermarket chains in the market. We set a record for new openings in 2018 with 122 net new stores. While accelerating the pace of expansion, we have enjoyed strong consumer demand for our CVP and have continued to deliver the best LFL performance in X5 Retail Group, with sales and traffic up by 5.9% and 6.2%, respectively. We also achieved record growth in traffic in 2018, with 505 million customer visits, compared to 407 million in 2017.

While we have increased the pace of expansion, our primary focus is on further adapting Perekrestok's CVP and opening stores in major urban centres in our core regions of Central and North-West Russia. Our December 2017 purchase of 32 O'Key supermarkets, 18 of which were in St Petersburg, has also produced strong results, with net retail sales at the rebranded stores performing at approximately 17% above target levels.

Refurbishments delivering results

Perekrestok's refurbishment programme is one of our strategic priorities as we continue to upgrade the format to meet the latest standards in modern retail, providing high-quality and comfortable service to our customers in every supermarket we operate.

Our refurbishment programme continued in 2018, with 37 stores opened after refurbishment during the year. Together with new openings, this brought the total share of stores operating under our new concept to 86%. Refurbishments are key to our CVP and can have a significant impact on store performance. In 2018, we saw the average recovery period for a store take about five months, after which LFL sales grew by 14%-16% on average.

2018 highlights

Number of stores refurbished in 2018	**37** vs. 76 stores in 2017
Share of stores operating under new concept (as of 31 December 2018)	**86%** vs. 73% at year-end 2017
Average duration of store closure	**41 days** in line with 2017
Average sales recovery period	**5 months**
Average LFL sales growth (after recovery period)	**14%-16%**

Adapting CVP to evolving customer needs

Client-centricity is a core element of Perekrestok's CVP, and we are constantly adapting our offering in response to demand. We also strive to ensure that all of our employees share these values, which is why we introduced a new in-store employee incentivisation programme that includes client-centric metrics, including NPS.

At the same time, assortment is key to our CVP: we are innovating and adapting our offering to further differentiate Perekrestok from its competition. We have expanded the fresh, fruit and vegetables and healthy food categories in response to consumer trends in Russia.

Ready-to-eat is another important and growing category for X5, and for Perekrestok in particular. While we have taken steps to increase and improve the assortment in this category, we also plan to launch our own kitchen factory in mid-2019, which will allow us to significantly expand and adapt our offering for customers.

These measures have helped us to deliver continued growth in NPS performance, and Perekrestok is perceived as having one of the best price/quality ratios among supermarket peers.

Improving operational efficiency

Operational efficiency is a constant priority for Perekrestok. Some of the key areas that we focused on in 2018 included improving our regional model, logistics, personnel and inventory planning.

Our efforts have produced results:

- Regional store openings now require less capex, and we are testing stores with reduced opex
- Logistics costs per box have declined by 9.5% year-on-year to RUB 26.5 per box, and we have improved shelf availability
- Our incentives scheme for in-store personnel and our educational centre for cashiers have contributed to a significant decrease in staff turnover, which dropped 14 percentage points during the year
- We have improved the efficiency of promo planning, helping us to keep inventories in line with demand

These successful efforts have helped us to achieve sustainable cost savings, and we continue to seek more ways to further enhance Perekrestok's efficiency.

Private label for all price segments

Perekrestok has a well-developed private-label assortment that contributed 6.5% to the format's net retail sales in 2018, up from 5.4% a year earlier. Our private-label goods cover all price segments, from Prosto! at the lower end to exclusive offerings like Verkhovye dairy products and Green Line health foods.

Green Line, which was introduced in response to growing demand for healthy foods from our customers, is currently on offer in 148 Perekrestok stores. Stores that offer this new product line are seeing customers visiting more often, specifically seeking this brand.

We are also setting ourselves apart from the competition by offering exclusive, high-quality goods like the Verkhovye line of dairy products. Exclusive private labels like this are an important part of our strategic partnerships with suppliers.

With a wide range of private-label goods on offer, we are constantly focused on improving quality, while also organising regular tastings and surveys to get customer feedback.

	CROSS-CATEGORY BRANDS	CATEGORY BRANDS				
HIGH AND ABOVE-AVERAGE PRICE		Dairy: Верховье от фермы до полки	Confectionary: Крем бюро	Healthy: Зеленая линия	For kids < 3 years: KOKORO	UNIQUE ASSORTMENT
MEDIUM PRICE	Маркет Перекресток	Dairy: Сарафаново	Ready-to-eat and Ready-to-cook: Шеф Перекресток	Homeware: Home Story	For kids < 3 years: Honey Kid	WIDE ASSORTMENT OF EASILY ACCESSIBLE QUALITY PRODUCTS
		Confectionary: BONTÉ	Fish: Новый океан	Beauty: Beauty Story	For kids 4-7 years: Ухтышки!	
LOW PRICE	ПРОСТО!					OPPORTUNITY TO SAVE ON EVERYDAY PURCHASES

Bringing Russia’s #1 supermarket online

We launched Perekrestok Online in Moscow in 2017, and it has quickly grown, expanding to St Petersburg in 2018 and operating three dark stores. Our online supermarket handled more than 408 thousand orders in 2018, with the number more than doubling from 93 thousand in Q3 2018 to 200 thousand in Q4 2018.

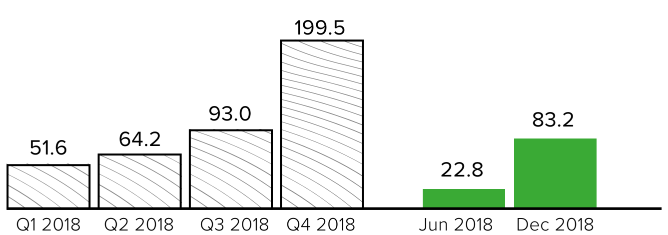
Perekrestok Online and other omnichannel initiatives

With the launch of Perekrestok Online in 2017, we became the first supermarket chain in Russia to implement a full omnichannel sales model. With operations in Moscow and St Petersburg, Perekrestok Online has been highly successful across all key metrics. Customers who use our online service spend more on average, with an average spend per month of RUB 6,700, increasing to RUB 11,600 among online store users.

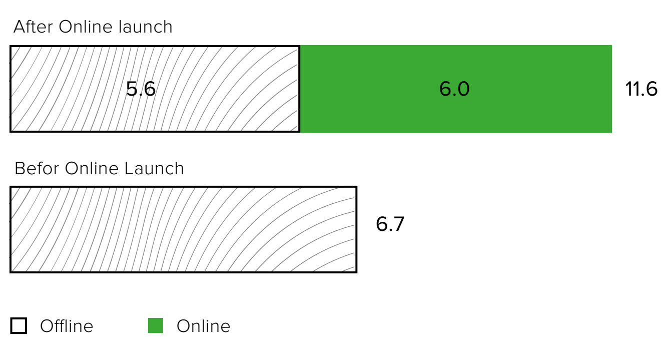
In order to support Perekrestok Online's growing operations, two dark stores (warehouses located within city limits that are specially designated to support online orders) were opened in 2018: one in Moscow and one in St Petersburg. In 2018, we expanded our assortment, with Perekrestok Online in St Petersburg offering around 30,000 SKUs. The service handled a total of 408 thousand orders during the year, with nearly half (close to 200 thousand) coming in the fourth quarter. In December 2018, Perekrestok Online handled an average of over 2,600 orders per day.

Going forward, we aim to pilot a click-and-collect service, express delivery with orders assembled in-store to offer a better variety of services to our customers and determine the most profitable operating model for the Company. We also aim to develop a B2B service to supply food to restaurants or offices. We plan to further increase the assortment with new categories like pet food, baby goods, health and beauty products and alcoholic beverages.

Number of orders, ths



Average customer spending per month, RUB ths



2.3 times
increase in website traffic
(compared with 2017)

3.2%
conversion rate
(vs. 1.3% in 2017)

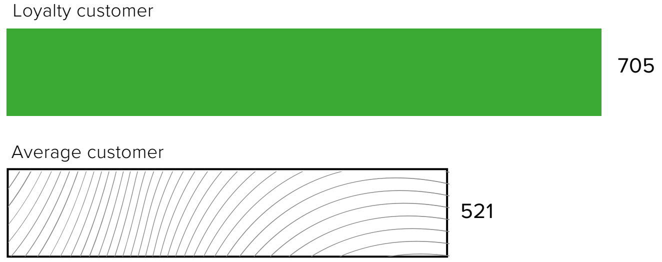
Expanding our loyal customer base

Perekrestok's loyalty programme grew to 5.5 million cards issued as of the end of 2018, with 49% penetration in traffic and 63% penetration in sales.

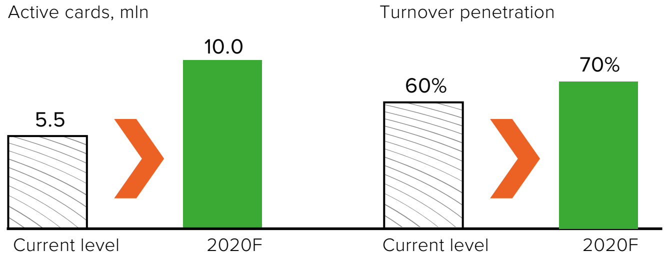
Partnerships are one of our key tools for expanding the Perekrestok loyalty programme: we currently have over 120 partners, including Aeroflot Russian Airlines, Alfa-Bank, S7 airlines, Tinkoff and other major Russian consumer companies.

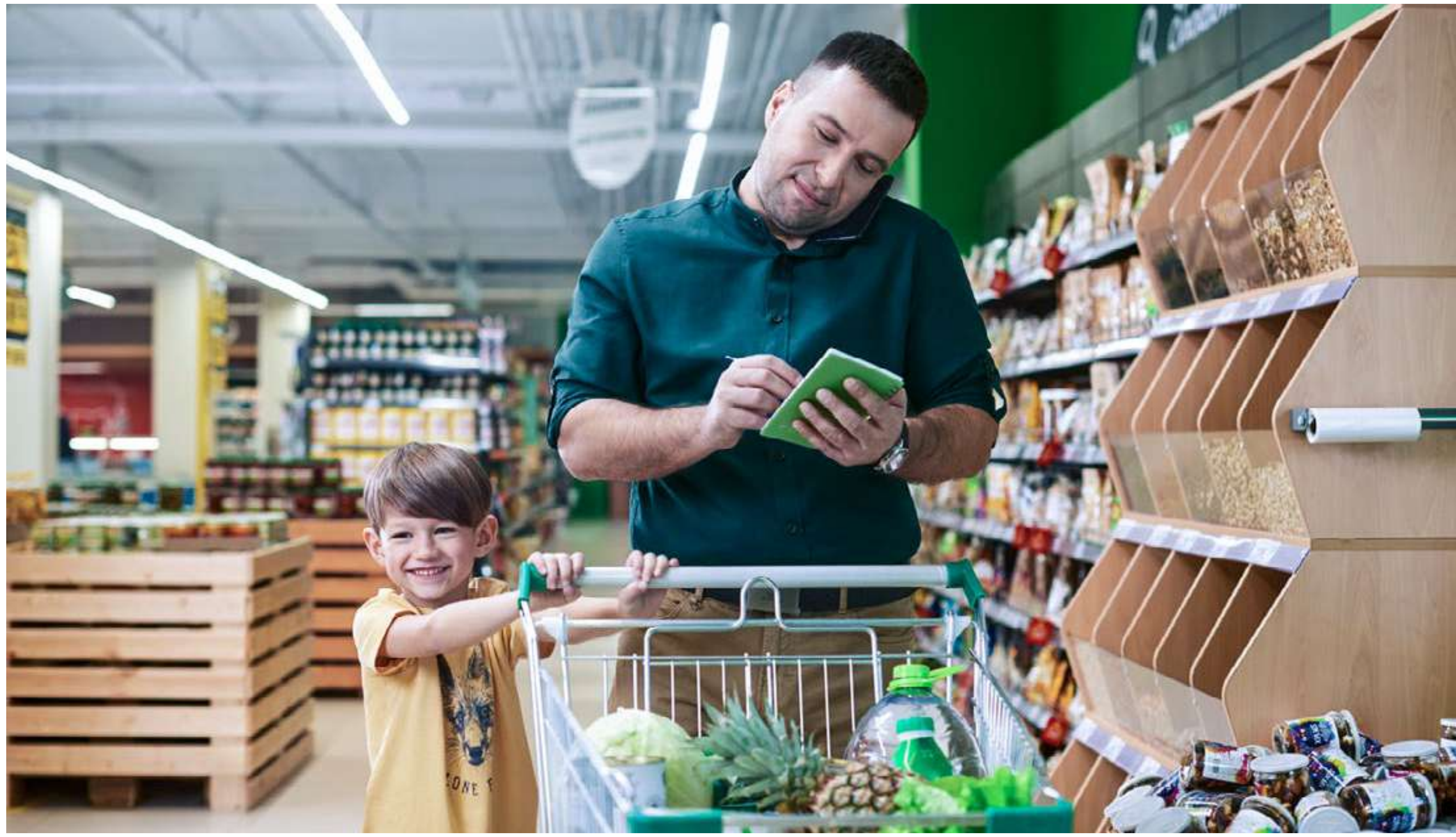
We are developing our loyalty programme in step with our expanding omnichannel offering: the Perekrestok mobile app, which customers can use to order goods online and get information in-store, also provides information about loyalty points and offers.

Average ticket, RUB



Loyalty card penetration





Targeted marketing

Perekrestok's targeted marketing campaigns, which are run through the Club Perekrestok loyalty programme, have contributed to growing sales, increased traffic and higher average checks. As a form of promo, targeted campaigns also offer a higher commercial margin than traditional promotions. With 5.5 million active users at the end of 2018, the Club Perekrestok loyalty programme grew by 31% year-on-year.

Perekrestok's targeted marketing and Club Perekrestok loyalty programme helped the format earn an additional RUB 5 billion in retail turnover in 2018, which is 2% of its net retail sales for the year. This represents a 47% increase over the impact on sales in 2017.

For our personalised promos, we work with suppliers to develop tailored marketing partnerships. These enable suppliers to inform Perekrestok loyalty card holders about new products or promos, helping them improve loyalty among existing customers while also reaching new audiences. We work together with over 80 suppliers from a wide range of sectors, ranging from dairy and soft drinks producers to personal hygiene products and even computer games.

Karusel
hypermarkets

Karusel worked hard to roll out its new CVP in 2018, with eight hypermarkets refurbished under the new concept and a renewed assortment that meets the needs of modern shoppers, who are increasingly interested in a convenient shopping experience, including in-store entertainment. While making our value proposition more attractive to customers, we have also succeeded in increasing sales densities and have focused on efficiency with new staffing structures, better quality control and standardised processes across all hypermarkets we operate.

Karusel aims to reach modern consumers with a rational approach to shopping: they are well-informed, want to get the most out of each trip, with a wide range of goods and competitive prices to stock up for a week or more. Karusel hypermarkets are evolving to meet our customers' needs and broaden their appeal to new groups of consumers. Our focus on sales densities and increasing customer loyalty means that we will maintain a cautious approach to new openings.

Maksym Gatsuts
General Director of Karusel

Karusel hypermarkets aim to offer customers a unique and comfortable shopping experience, with an updated brand concept that includes in-store dining, a wider selection of healthy foods and electronic customer communications. As we roll out this model, we continue to innovate and adapt to customer needs, with omnichannel offerings like convenient click-and-collect services, as well as a successful loyalty programme that is highly popular among our customers.

Karusel hypermarkets offer an assortment of 22,000 to 30,000 SKUs of food and non-food items, with an average selling space of 4,064 square metres.

2018 performance highlights

Net retail sales:

RUB **91** bln

Stores in operation:

as of 31 December 2018

94

Selling space:

as of 31 December 2018

382 ths m²

Customer visits:

132 mln

Stores refurbished:

8

2018 strategic highlights

Began full-scale rollout of new CVP and branding with refurbishment of eight stores in 2018

Updated assortment with focus on modern trends, healthy foods, ready-to-eat assortment

Further improved private label with enhanced quality and breadth of offering, including newly created private labels in the middle price segment

Expanded own production with a focus on products that differentiate Karusel from competitors

Improved sales densities and reduced share of stores in "clinic"

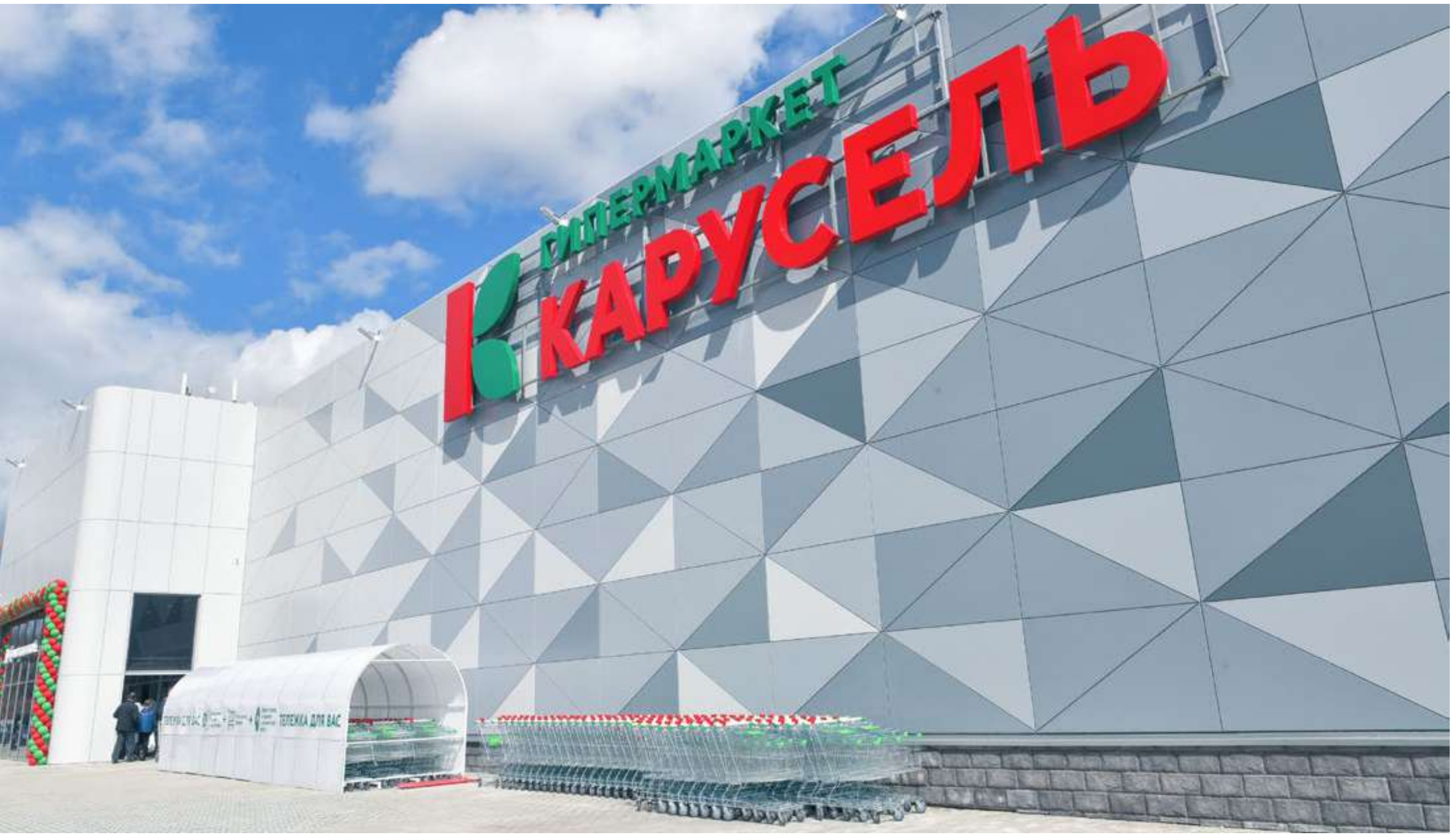
Continued modernisation of Karusel mobile app and new website launched

Continued to develop loyalty programme with penetration in traffic reaching 81% in December 2018

Shifting focus to personalised offers (SMS, apps, email) and coupons

Adapted business processes to reduce shrinkage and improve quality of fresh goods

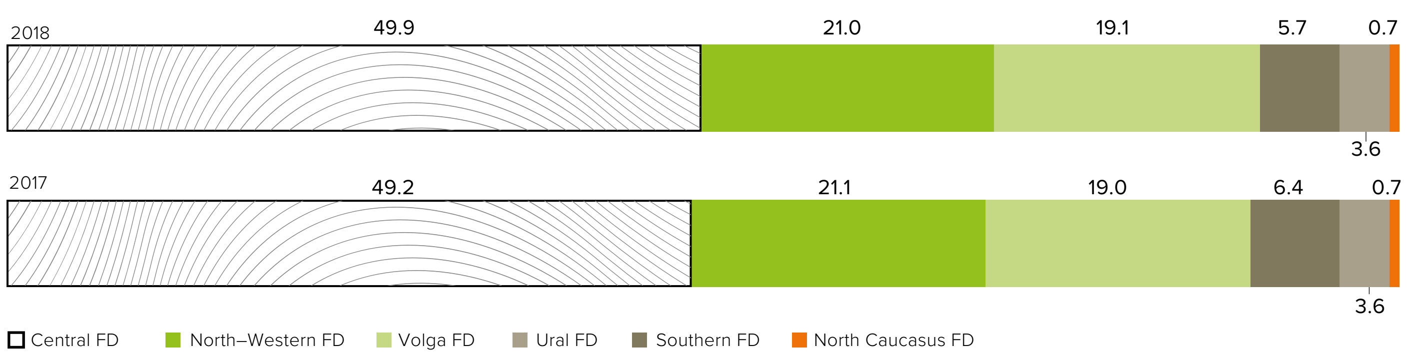
Optimised staff structure and improved quality of employees



Key operating results

	2018	2017	2016	2015	2014
Number of stores, eop	94	93	91	90	82
Selling space '000 m², eop	382	385	387	390	359
Net retail sales, RUB bln	91	89	84	77	69
Customer visits, mln	132	135	134	129	123

Karusel net retail sales by region, %



Strategic Priorities

Our priorities	What we are doing	What we plan to do
Continue rollout of new branding and CVP	• Increased assortment in fresh categories • Focus on assortment innovation, with new lines of health food, bio, organic and craft offerings • Implemented concept of "category worlds" such as "home", "childhood" and "seasonal" for non-food assortment • Completed refurbishment of eight Karusel hypermarkets • Continuously reviewed opportunities to optimise refurbishment process	• Further adapt assortment to meet customers' changing needs and keep pace with current trends • Increase share of private-label assortment in revenue • Improve price perception, including through further expansion of private-label offering • Improve employee engagement • Reduce lease costs and shrinkage, increase operational efficiency • Continue gradual renovation of stores using new branding • Expand omnichannel offering and digital innovations
Develop private label and own production	• Focus on modern trends, healthy food and food to go • Further developed own production offering, with a focus on differentiating Karusel from competition • Continued development of private-label lines Krugliy God, Umnoye Resheniye and BeHome with a focus on supporting Karusel's price perception and NPS with high-quality goods • Revised pricing policies and reduced costs of own production	
Focus on efficiency in management of people and processes	• Implemented programme for training and development of high-potential employees • Launched HR brand project • Optimised staff structure • Implemented measures to reduce shrinkage, such as monitoring of acceptance of goods, monitoring of cashier operations, and quality control checks at DCs	
Develop programmes to enhance customer loyalty	• Continued to refine loyalty programme based on data analytics with special promotions for cardholders • Launched updated version of My Karusel mobile app with new features: catalogues, promo banners, special offers	
Expand omnichannel model and digital innovations	• Digital communications with customers installed for several stores • Introduced digital tools to increase employee engagement • Launched cooperation with delivery aggregator iGooods (Moscow, St Petersburg and Kazan)	

Further adaptation of CVP

We began to roll out our new CVP in 2018, with updated branding. Our goal is for our customers to associate our hypermarkets with favourable pricing, honesty and transparency. One area of focus in 2018 was on optimisation of our assortment: as Russian consumers become more and more concerned about the quality and healthiness of their food, we are aiming to provide them with new assortments of healthy foods and unique goods for discerning buyers. We have also worked to make the in-store experience more convenient and comfortable, with simpler internal navigation and more modern visualisations.

We are considering options to improve space utilisation and increase traffic by inviting partners to our hypermarkets.

We are also testing the “large supermarket” format. We currently have two Karusel stores being managed by the Perekrestok team, and we plan to transfer three more stores over to Perekrestok this year.

Private label. Tailored to customer needs

Our private-label brands are an opportunity to support Karusel’s price perception by offering customers quality goods at lower prices. Our current private-label offering reached 4% of Karusel’s revenue in 2018, and we plan to expand this to as high as 10% by 2020. With a number of private-label brands already on shelves, including our three key cross-category offerings (Krugliy God, Umnoye Resheniye and BeHome), we plan to launch a new non-food line under the Uniline brand in 2019.

In further development of our private labels, one of the key areas we will focus on is introducing unique features that will differentiate our assortment from other brands.

Cross category – **First price** — Круглый год

Cross category – **Medium price** — КАРУСЕЛЬ УМНОЕ РЕШЕНИЕ

Separate categories – **Medium price** — Be home В заботе о доме

Own production and in-store catering

Our own production offering is a key part of Karusel's updated CVP. We have completely renewed the assortment for our own production, with a more modern selection, more healthy offerings and a wider array of food to go. At the same time, we have focused on optimising the staffing structure and bringing down production costs in order to achieve more sustainable margins.

Our aim is to develop a full-scale food service offering in-store, with pizzas, a cafeteria or restaurant available to customers without leaving the premises. In order to further optimise costs, Karusel plans to centralise its own production for certain regions. Our target is to increase the share of our own production in revenue by 1.0%-1.5% by 2020.

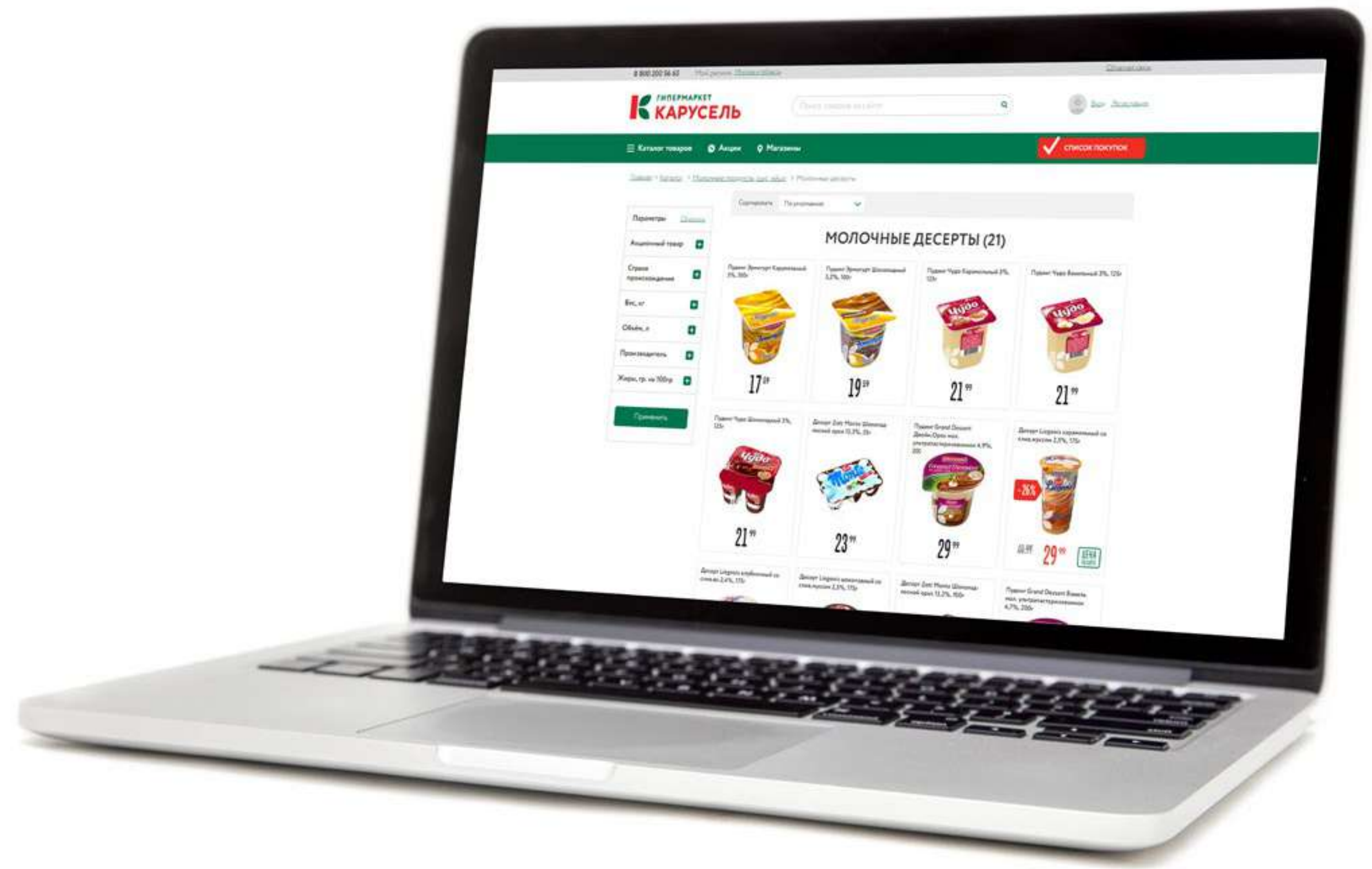
Operational efficiency

Our top priorities for increasing operational efficiency are in the areas of personnel, in-store processes and shrinkage.

We have already launched an HR brand project, as well as a learning and development programme for high-potential employees. Going forward, we aim to introduce initiatives that will improve staff engagement, to refine the incentivisation system and offer better working conditions.

Our in-store efficiency efforts to date have focused on standardisation of business processes across all hypermarkets, optimising staff structures and introducing schedules for regular maintenance and upgrades for equipment and engineering systems. In the years ahead, we will focus on further optimisation and productivity enhancements that leverage IT tools, and we will continue to close inefficient stores.

Shrinkage is currently being addressed with the monitoring of acceptance of goods and cashier operations, as well as optimisation of business processes and improvements to quality control checks at DCs. We aim to further develop our quality control practices, including the introduction of trust-based acceptance at DCs and further development of our direct supplier base for fruits and vegetables.



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. The programme currently enjoys the highest level of penetration in traffic and sales among all of X5's formats.

Karusel's loyalty card holders receive personalised offerings and promotions based on their preferences and shopping behaviour. We have also updated the My Karusel mobile app for loyalty programme members, with a new user interface design and the addition of promo banners. Future updates will include an online catalogue to better inform customers about what they will find in our stores, as well as some interactive features.

Highlights:

- Active cards as of 31 December 2018: 2.9 million (as of 31 December 2017: 2.4 million)
- Share of net retail sales for loyalty cards in December 2018: 94% (2017: 80%)
- Penetration of loyalty programme in traffic in December 2018: 81% (2017: 63%)

Omnichannel and digital innovations

In keeping with our move towards digital innovations, we have moved all communications with customers to electronic formats, from email to text messages and our own website and mobile app. We are also digitising in-store processes by setting up distance modules for employees.

As we continue to develop omnichannel sales, we have expanded our cooperation with delivery aggregators like iGooods (Moscow, St Petersburg and Kazan). We aim to expand to new cities in the years ahead. Around 14,000 SKUs are currently available to our hypermarket customers through aggregators.

To further develop our omnichannel sales, we aim to launch a click-and-collect service in 2019. We believe that the click-and-collect model is right for Karusel because most of our stores are located in shopping centres within city limits, and customers frequently visit Karusel as one stop on their shopping trip. Click-and-collect is the perfect way for these shoppers to save time while also being able to achieve their personal shopping missions.

Financial review

X5 Retail Group continued to perform well in 2018, with results that reflect the strategic priorities that the Company has approved. We demonstrated balanced growth, with revenue increasing by 18.3% year-on-year to RUB 1,533 billion. We increased our gross margin thanks to our reduced reliance on promo, as well as our focus on operating efficiency, including successful measures to control shrinkage by the new team at Pyaterochka, which had an impact on our profitability starting from the third quarter.

X5 worked hard to implement efficiency measures throughout the year: we further developed a leaner logistics structure, renegotiated lease agreements and leveraged technology-driven solutions throughout our business to help optimise costs. At the same time, 2018 was a year when average annual food inflation amounted to just 1.7% year-on-year, while non-food and services inflation amounted to 3.4% and 3.9% year-on-year, respectively. This contributed to SG&A costs (excl. D&A and impairment costs) rising at a faster rate than our sales, increasing by 83 b.p. to 17.9% of revenue.

Our adjusted EBITDA[1] performance was in line with our targets, rising by 10.8% year-on-year to RUB 110 billion. X5 Retail Group's adjusted EBITDA margin was 7.2%. Net profit for 2018 amounted to RUB 28.6 billion. In line with X5's dividend policy, the Board of Directors has recommended a dividend of RUB 25.0 billion for 2018, or RUB 92.06 per GDR, which represents 87% of net profit.

While continuing to invest in smart and balanced growth, we have maintained a strong balance sheet, and the Company's net debt/EBITDA ratio at the end of 2018 was 1.70x. We reduced the weighted average effective interest rate on our total debt from 9.51% for FY 2017 to 8.39% for FY 2018 as a result of ongoing efforts to reduce interest expenses and reflecting declining interest rates in Russian capital markets in the first half of the year.

We look forward to another year of balanced growth in 2019. While we expect the food retail sector to continue to face a difficult environment, with no growth in real disposable income and stiff competition in the retail sector, X5 Retail Group is up to the challenge and will continue to focus on further adapting to customer needs, while making the business more efficient.

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 122-125.

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 2018 and for the years ended 31 December 2018 and 31 December 2017.

The consolidated financial statements and related notes thereto are available on pages 226-292 of this document and were prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

Key highlights

Revenue

RUB **1,533** bln
18.3% year-on-year increase

Gross profit margin

24.1%
27 b.p. year-on-year increase

Adjusted EBITDA margin

7.2%
49 b.p. year-on-year decrease

Net debt/EBITDA

1.70x

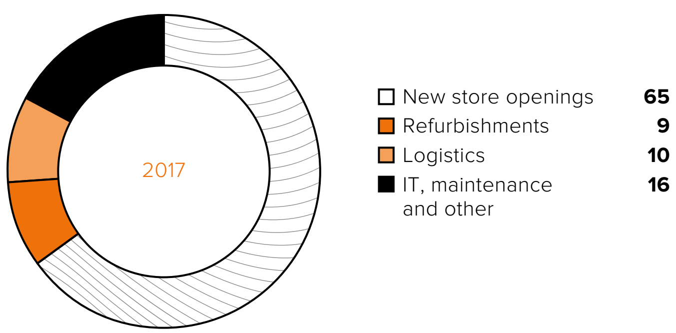
Capital expenditure

RUB **83.7** bln
15.2% year-on-year decrease

Dividends

RUB **25** bln
RUB 92.06 per GDR, 87.3% of consolidated IFRS net profit

Capital expediture structure, %



RUB **98.6** bln

RUB **83.7** bln

Results of operations for the year ended 31 December 2018 compared to the year ended 31 December 2017

The following table and discussion provide a summary of our consolidated results of operations for the years ended 31 December 2018 and 31 December 2017.

Profit and loss statement: highlights

Russian roubles (RUB), mln[1]	2018	2017	% change, y-o-y
Revenue	1,532,537	1,295,008	18.3
incl. net retail sales[2]	1,525,015	1,286,949	18.5
Pyaterochka	1,197,772	1,000,942	19.7
Perekrestok	230,848	186,936	23.5
Karusel	90,818	89,302	1.7
Gross profit	369,720	308,938	19.7
Gross profit margin, %	24.1	23.9	27 b.p.
Adj. SG&A[3]	(271,641)	(217,773)	24.7
Adj. SG&A, % of revenue	17.7	16.8	91 b.p.
Adj. EBITDA	109,871	99,131	10.8
Adj. EBITDA margin, %	7.2	7.7	(49) b.p.
Operating profit	58,154	57,758	0.7
Operating profit margin, %	3.8	4.5	(67) b.p.
Net profit	28,642	31,394	(8.8)
Net profit margin, %	1.9	2.4	(56) b.p.

[1] 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.
[2] Net of VAT and revenue from wholesale operations and revenue from franchise services and other services
[3] 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 122-125.

Revenue and net retail sales

In 2018, X5's revenue increased by 18.3% year-on-year to RUB 1,533 billion. Net retail sales for 2018 grew by 18.5% year-on-year, driven by a 1.5% increase in LFL sales and a 17.0% sales growth contribution from an 18.0% rise in selling space.

The Company's proximity store format, Pyaterochka, was the main driver of growth in 2018: Pyaterochka's net retail sales rose by 19.7% year-on-year, driven by a 0.9% increase in LFL sales and an 18.8% contribution to sales growth from a 19.5% expansion in selling space.

The Company's supermarket format, Perekrestok, had the highest pace of growth among the Company's formats on the back of successful adaptation of the format's CVP to consumer needs: Perekrestok's net retail sales rose by 23.5% year-on-year, driven by a 5.9% increase in LFL sales and a 17.6% contribution to sales growth from a 22.6% expansion in selling space.

Karusel's net retail sales growth decelerated to 1.7% year-on-year mainly due to the closure of eight hypermarkets for refurbishment in 2018.

The Company demonstrated positive LFL traffic for both core formats, Pyaterochka and Perekrestok, reaching 0.9% at the Group level in 2018.

Gross profit

The Company's gross profit margin in 2018 increased by 27 basis points year-on-year to 24.1%, primarily due to improvement in the commercial margin as a result of a more balanced approach to promo and the format mix effect from proportionally more sales at Perekrestok, which has a higher commercial margin than the X5 average. Management initiatives focused on reducing shrinkage levels in H2 2018 also had a positive impact on gross profit margin.

Summary of operational results

2018 net retail sales results, % change y-o-y	Average ticket	Number of customers	Net retail sales
Pyaterochka	(0.3)	19.8	19.7
Perekrestok	(0.7)	24.2	23.5
Karusel	3.9	(2.3)	1.7
X5 Retail Group	(0.5)	18.9	18.5

Selling space at end of period, square metres	31-Dec-18	31-Dec-17	% change, y-o-y
Pyaterochka	5,291,421	4,426,808	19.5
Perekrestok	781,538	637,242	22.6
Karusel	382,024	385,271	(0.8)
X5 Retail Group	6,463,735	5,479,741	18.0

2018 LFL[1] results, % growth y-o-y	Sales	Traffic	Basket
Pyaterochka	0.9	0.4	0.5
Perekrestok	5.9	6.2	(0.4)
Karusel	(0.0)	(3.1)	3.2
X5 Retail Group	1.5	0.9	0.6

[1] 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	2018	2017	% change, y-o-y
Staff costs	(119,883)	(99,124)	20.9
% of revenue	7.8	7.7	17 b.p.
incl. LTI and share-based payments	(2,243)	(2,938)	(23.7)
staff costs excl. LTI % of revenue	7.7	7.4	25 b.p.
Lease expenses	(75,392)	(60,080)	25.5
% of revenue	4.9	4.6	28 b.p.
Utilities	(31,942)	(23,795)	34.2
% of revenue	2.1	1.8	25 b.p.
Other store costs	(17,208)	(15,450)	11.4
% of revenue	1.1	1.2	(7) b.p.
Third-party services	(12,463)	(10,854)	14.8
% of revenue	0.8	0.8	(2) b.p.
Other expenses[2]	(16,996)	(11,408)	49.0
% of revenue	1.1	0.9	23 b.p.
SG&A (excl. D&A&I)	(273,884)	(220,711)	24.1
% of revenue	17.9	17.0	83 b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	**(271,641)**	**(217,773)**	**24.7**
% of revenue	**17.7**	**16.8**	**91 b.p.**

[2] As a result of the adoption of IFRS 9, the Company changed the presentation of its condensed consolidated interim statement of profit or loss by reclassifying net impairment losses on financial assets out of selling, general and administrative expenses.
The Company made a decision to reclassify income from the sale of recyclable materials from other expenses (SG&A) to lease/sublease and other income.

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

In 2018, adjusted SG&A expenses as a percentage of revenue increased year-on-year by 91 basis points to 17.7%, mainly due to increased staff costs, lease expenses, utilities costs and other expenses on the back of low food inflation as well as non-food and services inflation exceeding food inflation.

Staff costs (excluding LTI and share-based payments) in 2018, as a percentage of revenue, increased year-on-year by 25 basis points to 7.7% due to the Company's decision to increase compensation for in-store personnel in line with market benchmarks in Q3 2017, with nominal wage growth outpacing shelf inflation.

Lease expenses as a percentage of revenue in 2018 increased year-on-year by 28 basis points to 4.9%, mainly due to the growing share of leased space in X5's total real estate portfolio, which accounted for 76% as of 31 December 2018, compared to 73% as of 31 December 2017, as well as lease inflation rising faster than shelf inflation.

Utilities expenses as a percentage of revenue increased year-on-year by 25 basis points to 2.1% due to tariffs growing faster than shelf inflation.

In 2018, other store costs as a percentage of revenue declined year-on-year by 7 basis points to 1.1%, driven by lower security costs, materials and maintenance expenses.

In 2018, third-party services as a percentage of revenue changed immaterially compared to 2017, totalling 0.8%.

Other expenses as a percentage of revenue increased by 23 basis points year-on-year in 2018 to 1.1%, primarily due to reclassification of proceeds from the sale of recyclable materials to other income in 2018, an increase in acquiring costs driven by a 7 percentage point rise in the penetration of card payments during the course of 2018, and the low base effect in 2017 associated with the release of provisions.

Long-term incentive (LTI) programme

Accruals have been made in the consolidated financial statements for the year ended 31 December 2018 related to the old LTI programme, which focused on achieving leadership in revenue terms, while the new LTI programme is aimed at maintaining leadership in revenue terms and achieving leadership in terms of enterprise value multiple relative to peers. In total, RUB 2,171 million was accrued in 2018 for both LTI programmes.

The new LTI programme is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred and conditional payouts in order to maintain the focus on long-term goals and to provide for an effective retention mechanism. In comparison to the old LTI programme, it is designed for a wider group of participants within the Company and aims to create greater balance between short- and long-term compensation of the programme participants.

Targets under the new LTI programme are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and, as an additional long-term objective, leadership in terms of enterprise value multiple relative to peers. Additionally, the LTI programme includes triggers related to the EBITDA margin to ensure that profitability is not sacrificed and related to the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management.

As described in the Remuneration Report on pages 221-225, the targets under the second stage of the old LTI programme were achieved in 2017. Therefore, an accrual of RUB 1,552 million has been made in the consolidated financial statements for the year ended 31 December 2018 related to the old LTI programme.

The Company also accrued a liability of RUB 619 million for the probable achievement of the target to maintain revenue leadership from the new LTI programme. All LTI accruals and attributable social taxes since the beginning of the old programme are summarised in the table below.

LTI programme expenses,
including social security contributions (SSC)

RUB mln	2018	2017	2016	2015
Old programme	1,552	2,876	3,053	3,607
New programme	619	–	–	–
TOTAL LTI	**2,171**	**2,876**	**3,053**	**3,607**

EBITDA and adjusted EBITDA

RUB mln	2018	2017	% change, y-o-y
Gross profit	369,720	308,938	19.7
Gross profit margin, %	24.1	23.9	27 b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	(271,641)	(217,773)	24.7
% of revenue	17.7	16.8	91 b.p.
Lease/sublease and other income	12,293	8,196	50.0
% of revenue	0.8	0.6	17 b.p.
Adj. EBITDA	**109,871**	**99,131**	**10.8**
Adj. EBITDA margin, %	**7.2**	**7.7**	**(49) b.p.**
LTI, share-based payments and other one-off remuneration payments expense and SSC	(2,243)	(2,938)	(23.7)
% of revenue	0.1	0.2	(8) b.p.
EBITDA	**107,628**	**96,193**	**11.9**
EBITDA margin, %	**7.0**	**7.4**	**(41) b.p.**

Lease/sublease and other income

As a percentage of revenue, the Company's income from lease, sublease and other operations increased by 17 b.p. year-on-year, totalling 0.8% primarily due to reclassification of income from the sale of recyclable materials in 2018.[1]

EBITDA analysis

As a result of the factors discussed above, X5's EBITDA in 2018 grew year-on-year by 11.9% and totalled RUB 107,628 million, while the adjusted EBITDA margin decreased by 49 b.p. year-on-year to 7.2%.

Analysis by segments

Pyaterochka

RUB mln	2018	2017	% change, y-o-y
Revenue	1,200,457	1,004,406	19.5
EBITDA	92,910	82,891	12.1
EBITDA margin, %	7.7	8.3	(51) b.p.

Pyaterochka's EBITDA margin decreased by 51 b.p. year-on-year to 7.7% due to increased shrinkages in H1 2018, increased compensation for in-store personnel in line with market benchmarks in Q3 2017, growth in lease expenses due to the growing share of leased space, non-food and services inflation increasing at a faster pace than shelf inflation, and the high base effect in 2017 associated with the release of provisions in H1 2017.

Perekrestok

RUB mln	2018	2017	% change, y-o-y
Revenue	232,490	188,501	23.3
EBITDA	15,550	13,012	19.5
EBITDA margin, %	6.7	6.9	(21) b.p.

Perekrestok's EBITDA margin decreased by 21 b.p. year-on-year in FY 2018 to 6.7% mainly due to aligning in-store personnel compensation to market benchmarks, higher lease expenses due to the growing share of leased space, growth in utilities costs and non-food and services inflation increasing at a faster pace than shelf inflation.

Karusel

RUB mln	2018	2017	% change, y-o-y
Revenue	92,458	90,608	2.0
EBITDA	4,423	4,618	(4.2)
EBITDA margin, %	4.8	5.1	(31) b.p.

Karusel's EBITDA margin declined by 31 b.p. year-on-year to 4.8% on the back of a higher share of promo, increased compensation for in-store personnel, the closing of eight stores for refurbishment in 2018 and non-food and services inflation increasing at a faster pace than shelf inflation.

Other segments

RUB mln	2018	2017	% change, y-o-y
Revenue	7,132	11,493	(37.9)
EBITDA	(235)	(68)	245.6
EBITDA margin, %	(3.3)	(0.6)	(270) b.p.

Other segments include Perekrestok Express. In 2017, X5 made the strategic decision to sell this format. In Q1 2019, the Company plans to close all remaining stores.

Corporate Centre

RUB mln	2018	2017	% change, y-o-y
EBITDA	(5,020)	(4,260)	17.8

Corporate expenses rose by 17.8% year-on-year in 2018, mainly due to increased lease expenses from the new office building and additional costs arising from X5's investments in innovations, omnichannel development and big data.

Depreciation, amortisation and impairment costs

Depreciation, amortisation and impairment costs in 2018 totalled RUB 49,474 million (RUB 38,435 million for 2017), increasing as a percentage of revenue by 26 b.p. year-on-year to 3.2%. This was due to continuous changes in the composition of buildings, with a growing share of fixtures and fittings versus foundation and frame driven by the growing share of leased space in X5's total real estate portfolio and low level of food inflation.

[1] The Company made a decision to reclassify income from the sale of recyclable materials from other expenses (SG&A) to lease/sublease and other income.

Non-operating gains and losses

RUB mln	2018	2017	% change, y-o-y
Operating profit	58,154	57,758	0.7
Operating profit margin, %	3.8	4.5	(67) b.p.
Net finance costs	(18,667)	(16,017)	16.5
Net FX result	(447)	75	n/m
Profit before tax	39,040	41,816	(6.6)
Income tax expense	(10,398)	(10,422)	(0.2)
Net profit	**28,642**	**31,394**	**(8.8)**
Net profit margin, %	**1.9**	**2.4**	**(56) b.p.**

Non-operating gains and losses analysis

Net finance costs in 2018 amounted to RUB 18,667 million, a 16.5% increase from 2017. The effect from the higher level of gross debt as of 31 December 2018 compared to 31 December 2017 was partially offset by the decreased weighted average effective interest rate on X5's total debt from 9.51% for FY 2017 to 8.39% for FY 2018 as a result of declining interest rates in Russian capital markets and actions taken to minimise interest expenses.

Income tax expenses decreased by 0.2% in 2018, and profit before tax decreased by 6.6% year-on-year. In 2018, X5's effective tax rate increased to 26.6% from 24.9% in 2017. In 2017, the Company had a positive effect from the application in foreign jurisdictions of rates other than the standard statutory rate of 20%.

Consolidated cash flow

RUB mln	2018	2017	% change, y-o-y
Net cash from operating activities before changes in working capital	**107,827**	**96,830**	**11.4**
Change in working capital	19,609	(11,386)	n/m
Net interest and income taxes paid	(29,402)	(26,786)	9.8
Net cash flows generated from operating activities	**98,034**	**58,658**	**67.1**
Net cash used in investing activities	**(92,760)**	**(87,274)**	**6.3**
Net cash (used in)/generated from financing activities	**(8,436)**	**38,017**	**n/m**
Effect of exchange rate changes on cash and cash equivalents	(75)	14	n/m
Net (decrease)/increase in cash and cash equivalents	**(3,237)**	**9,415**	**n/m**

Cash flow analysis

In 2018, the Company's net cash from operating activities before changes in working capital increased by RUB 10,997 million, or 11.4%, year-on-year, totalling RUB 107,827 million and reflecting the overall growth of the business. The positive change in working capital was primarily due to business growth and the subsequent increase in accounts payable, while initiatives to improve the collection of accounts receivable yielded positive results. Inventory management also improved as the Company continued to optimise its assortment and business processes.

Net interest and income tax paid in 2018 increased year-on-year by RUB 2,616 million, or 9.8%, totalling RUB 29,402 million, driven by higher weighted average gross debt during the period compared to the period-end. The effect from increased gross debt as of 31 December 2018 compared to 31 December 2017 was partially offset by the lower weighted average effective interest rate on X5's debt for 2018.

As a result, net cash flows generated from operating activities in 2018 totalled RUB 98,034 million, compared to RUB 58,658 million for the same period in 2017.

Net cash used in investing activities, which generally consists of payments for property, plants and equipment, totalled RUB 92,760 million in 2018, compared to RUB 87,274 million in 2017, mainly due to the cash payment for O'Key's supermarket business that was made in 2018, while capital expenditures for the same deal are reflected in 2017 financial statements.

Net cash used in financing activities totalled RUB 8,436 million in 2018, compared to net cash generated from financing activities of RUB 38,017 million in 2017. This was related to growth of net cash flow from operating activities.

Liquidity update

RUB mln	31-Dec-18	% in total	31-Dec-17	% in total	31-Dec-16	% in total
Total debt	207,764		194,296		156,033	
Short-term borrowings	60,435	29.1	58,674	30.2	45,168	28.9
Long-term borrowings	147,329	70.9	135,622	69.8	110,865	71.1
Net debt	**183,396**		**166,691**		**137,843**	
Net debt/EBITDA	**1.70x**		**1.73x**		**1.81x**	

Liquidity analysis

As of 31 December 2018, the Company's total debt amounted to RUB 207,764 million, 29.1% of which was short-term debt and 70.9% was long-term debt. The Company's debt is 100% denominated in Russian roubles. As of 31 December 2018, 100% of X5's debt had fixed interest rates. Net debt/EBITDA was at 1.70x as of 31 December 2018.

As of 31 December 2018, the Company had access to RUB 341,502 million in available credit limits with major Russian and international banks.

Dividends

The dividend policy was approved by the X5 Supervisory Board in September 2017. When considering a dividend recommendation to the General Meeting of Shareholders, the Supervisory Board will be guided by a target consolidated net debt/EBITDA ratio of below 2.0x, in line with the Company's financing strategy.

Based on the Company's 2018 financial results, the Company's Supervisory Board has made a recommendation to pay dividends for 2018 in the amount of RUB 25,000 million/RUB 92.06 per GDR, which represents 87.3% of X5 Retail Group's 2018 net profit. This proposal will be considered by the AGM, which will be held on 10 May 2019.

Information on alternative performance measures

In this report and other public disclosures, X5 Retail Group presents certain alternative performance measures (APMs) that it believes provide readers with a more detailed and accurate understanding of the Company's financial and operating performance. In accordance with European Securities Markets Authority guidelines, a list of definitions, explanations of the relevance of APMs, comparatives and reconciliations are provided below.

EBITDA
(including EBITDA margin)

Earnings before interest, tax, depreciation and amortisation (EBITDA) is a measure of the Company's operating performance. It is a way to evaluate X5 Retail Group's performance exclusive of financing, accounting and taxation factors. X5 believes that showing EBITDA and EBITDA margin performance provides greater detail about the Company's performance.

RUB mln	2018	2017
Operating profit	58,154	57,758
Depreciation, amortisation and impairment	49,474	38,435
EBITDA	**107,628**	**96,193**

RUB mln	2018	2017
Revenue	1,532,537	1,295,008
EBITDA	107,628	96,193
EBITDA margin, %	**7.0**	**7.4**

Adjusted EBITDA
(including adjusted EBITDA margin)

Adjusted earnings before interest, tax, depreciation and amortisation (adjusted EBITDA) is a measure of the Company's operating performance. It is a way to evaluate a company's performance exclusive of financing, accounting and taxation factors, and also excluding the effects of the LTI programme, which does not represent an ongoing cost of doing business. X5 believes that showing adjusted EBITDA and adjusted EBITDA margin performance provides a more accurate reflection of the Company's ongoing performance.

RUB mln	2018	2017
EBITDA	**107,628**	**96,193**
Adjustments:		
LTI, share-based payments and other one-off remuneration payments expense and SSC	2,243	2,938
Adj. EBITDA	**109,871**	**99,131**

RUB mln	2018	2017
Revenue	1,532,537	1,295,008
Adj. EBITDA	**109,871**	**99,131**
Adj. EBITDA margin, %	**7.2**	**7.7**

Adjusted SG&A
(including adjusted SG&A as % of revenue)

Selling, general and administrative expenses (SG&A) are reported on the income statement as the sum of all direct and indirect selling expenses and all general and administrative expenses of the Company. X5 Retail Group reports adjusted SG&A, which excludes the effects of the LTI programme, as well as depreciation, amortisation and impairment. The Company believes that adjusted SG&A provides additional detail regarding the long-term SG&A costs of the business.

RUB mln	2018	2017
SG&A[1]	**323,358**	**259,146**
Adjustments:		
LTI, share-based payments and other one-off remuneration payments expense and SSC	(2,243)	(2,938)
Depreciation, amortisation and impairment	(49,474)	(38,435)
Adjusted SG&A	**271,641**	**217,773**

RUB mln	2018	2017
Revenue	1,532,537	1,295,008
Adjusted SG&A	271,641	217,773
Adjusted SG&A expenses as % of revenue	**17.7**	**16.8**

[1] As a result of the adoption of IFRS 9, the Company changed the presentation of its condensed consolidated interim statement of profit or loss by reclassifying net impairment losses on financial assets out of selling, general and administrative expenses.

Net debt/EBITDA

The net borrowings to earnings before interest depreciation and amortisation (EBITDA) ratio is a measurement of leverage. It is calculated as the Company's long-term and short-term borrowings, minus cash and cash equivalents, divided by EBITDA. The net debt to EBITDA ratio is a commonly used indicator that provides additional clarification regarding the Company's debt burden.

RUB mln	31-Dec-18	31-Dec-17
Total debt, incl.:	207,764	194,296
Short-term borrowings	60,435	58,674
Long-term borrowings	147,329	135,622
Cash and cash equivalents	24,368	27,605
Net debt	**183,396**	**166,691**
EBITDA	107,628	96,193
Net debt/EBITDA	**1.70x**	**1.73x**

Net retail sales

Net retail sales shows the amount of sales generated by the Company after the deduction of revenue from franchise services, wholesale operations and other services. Because food retail is X5 Retail Group's core business, net retail sales are provided to give a clearer picture of the performance of the Company's core business activity.

RUB mln	2018	2017
Revenue	**1,532,537**	**1,295,008**
Adjustments:		
Revenue from wholesale operations and other services	(7,480)	(8,030)
Revenue from franchise services	(42)	(29)
Net retail sales	**1,525,015**	**1,286,949**

Like-for-like (LFL)

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 calculation starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period. This is a commonly used indicator in the retail industry that helps illustrate the sustainability of a company's growth by focusing on the performance of stores that have already been operating for more than 12 months and by removing the effect of new stores opened during the period.

%	2018	2017
Net retail sales growth	18.5	25.5
Contribution from an increase in selling space	17.0	20.1
LFL	**1.5**	**5.4**

Retail infrastructure

We are constantly refining our logistics, transport and IT systems in order to ensure that we can provide high-quality goods to our customers in an efficient and reliable way as we continue to expand the business in existing and new regions of Russia.

Our robust retail operations infrastructure helps us to implement our unique customer value proposition at each of our stores on a daily basis.

Logistics

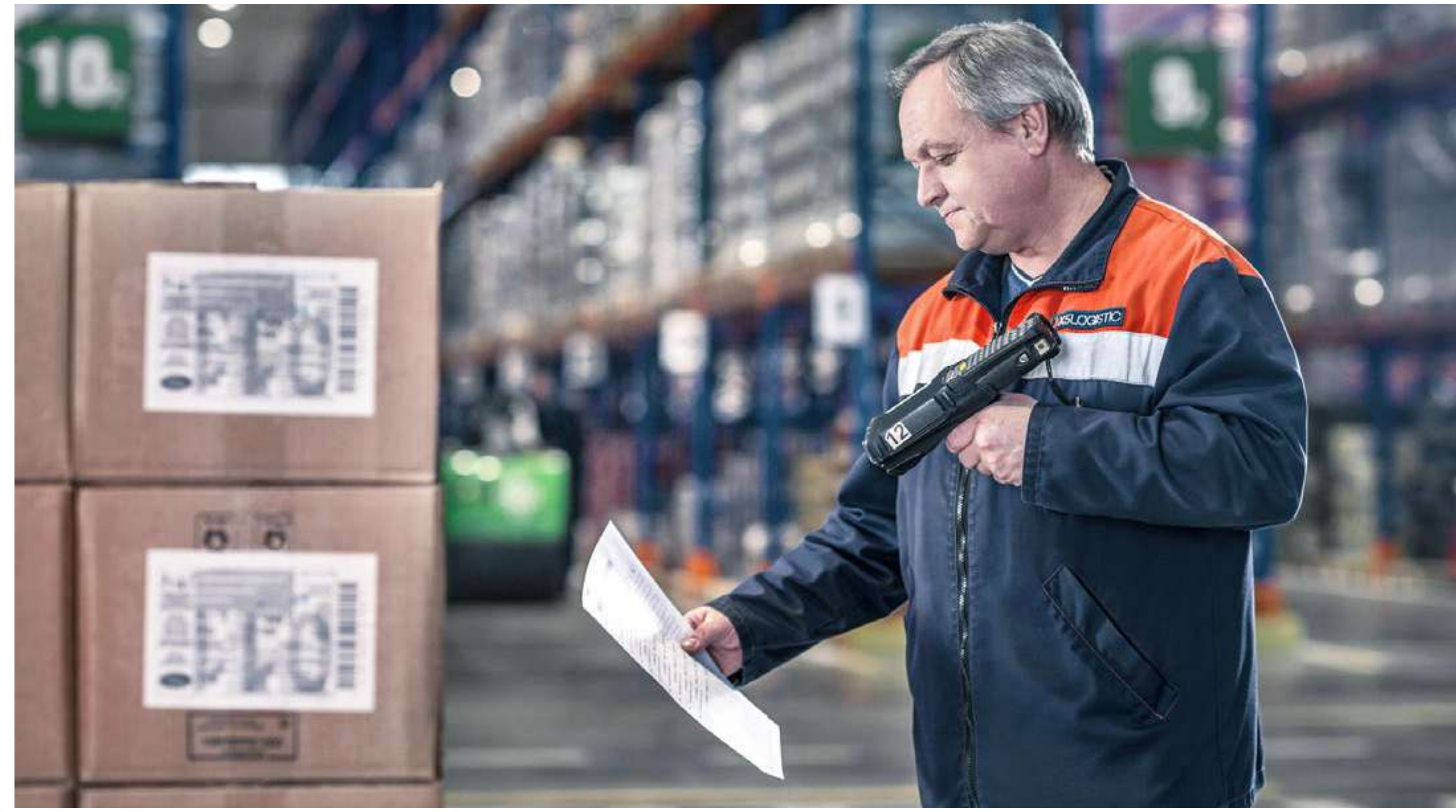
Our logistics operations play a vital role in providing efficient, reliable support to each of our format's CVPs. Pyaterochka runs its own logistics, while Perekrestok and Karusel share infrastructure, but we are also leveraging synergies between the logistics infrastructures of our formats in remote regions.

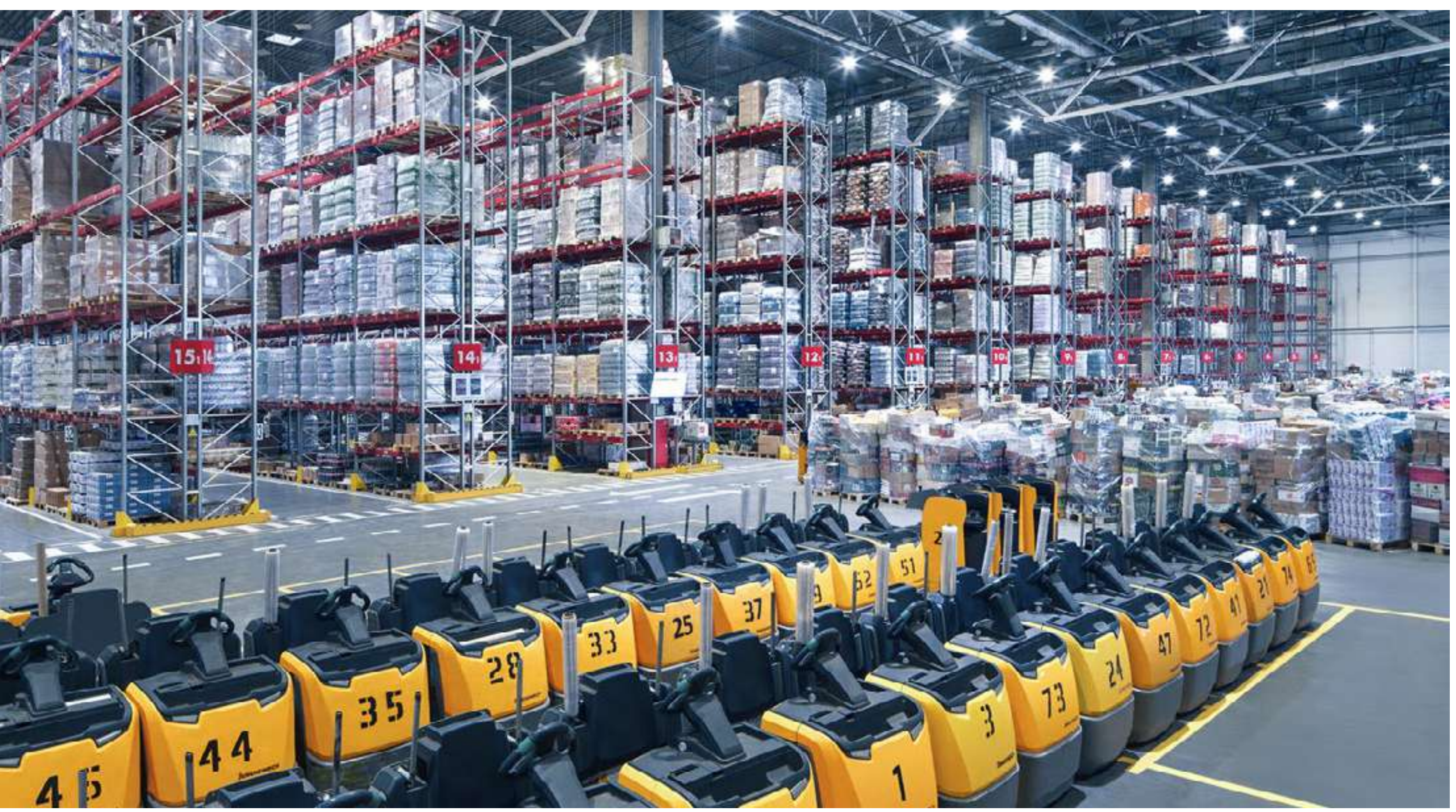
As of 31 December 2018, we operated 42 DCs with a total floor space of 1,179 thousand square metres, providing sufficient coverage for the Company's rapidly expanding operations.

X5 Retail Group's company-wide SLT level (order processing based on timely deliveries) remained stable at 90%, while centralisation increased from 93% in 2017 to 95% in 2018.

How we manage logistics

Logistics are managed from the X5 Corporate Centre, which sets standards for, and monitors the performance of, our DC operations. The head office also acts as a hub for the sharing of best practices and technologies between formats, as well as the centralised analysis and planning for logistics infrastructure expansion. X5 Retail Group DCs all utilise an automated warehouse management system (WMS) that includes features like voice picking and weighing technology.





General approach to Logistics and Transportation Strategy development

CVP
(elements related to the supply chain)

Demand forecast 2018-2025

Logistics and Transportation Strategy

Network optimisation

Transport Strategy

KPIs (standardisation)

End-to-End Logistics and Transportation Strategy
(analysis of current situation, future requirements, gaps in competencies, roadmaps)

Logistics and Transportation Strategy

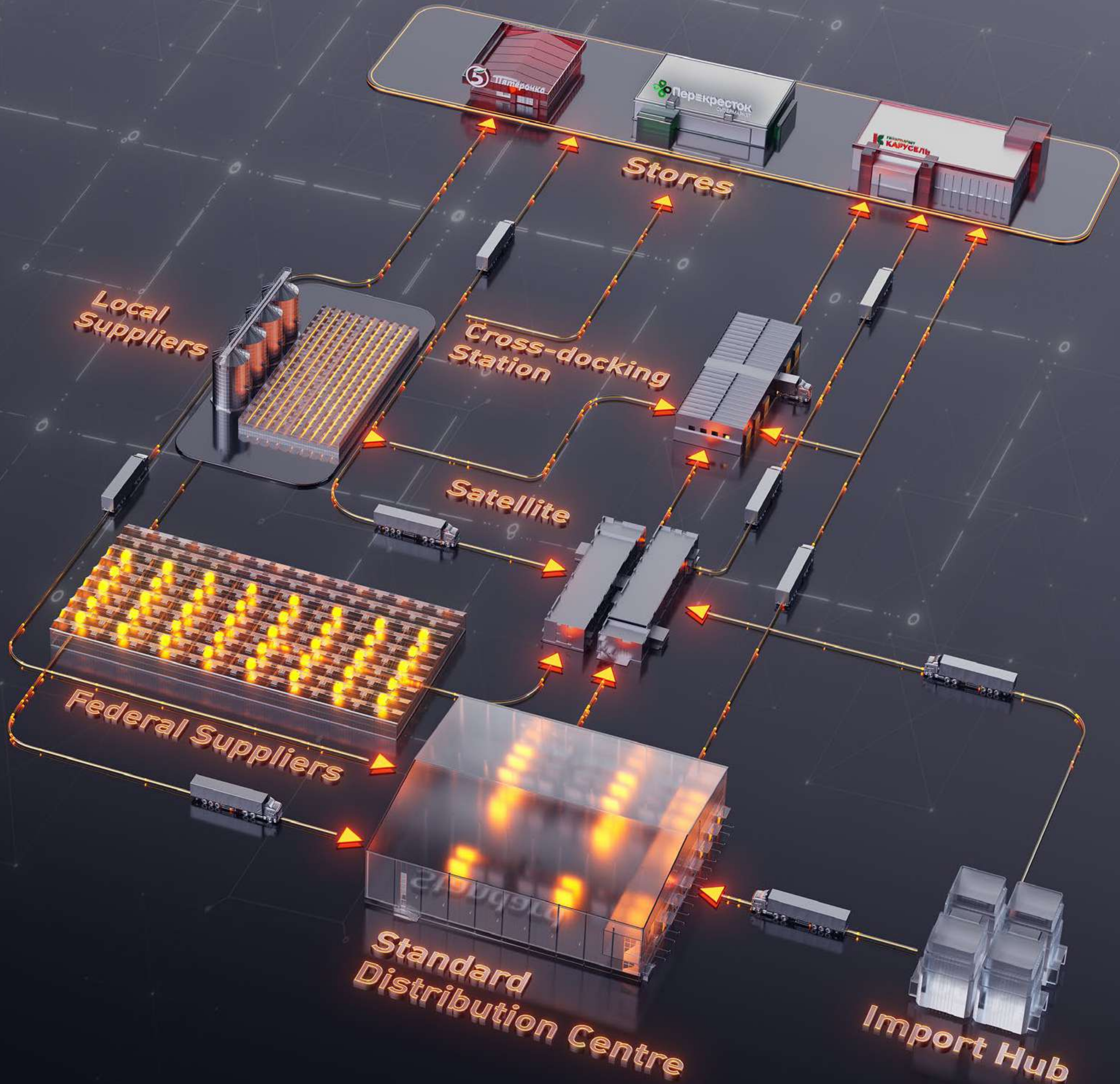
Throughout 2018, we worked to implement X5 Retail Group's Logistics and Transportation Strategy to 2025, which was adopted in 2017 and covers plans for the development of our logistics operations.

The strategy focuses on reducing costs, cutting delivery times and ensuring the availability of a wide assortment of goods on our stores' shelves. The strategy was developed to enable X5's logistics to:

- Support the unique CVP of each retail format
- Respond to forecast demand through 2025 for each specific location
- Enable each format to achieve target market share, expanding operations based on the planned number of stores while reducing share of costs
- Allow formats to manage their own supply chain operations while in parallel seeking and implementing opportunities to achieve synergies

Logistics infrastructure

X5's logistics infrastructure is growing and developing to respond to the changing needs of our business. We are introducing new technologies that help enhance planning and efficiency, while also building new capacities and processes that help us to further enhance the quality of our offering.



Pyaterochka

Pyaterochka operated a total of 30 DCs with an area of 892 thousand square metres as of 31 December 2018. The format opened three DCs with a total area of 70,036 square metres in 2018. Pyaterochka's scale and geography of operations require a well-run, modern and efficient logistics infrastructure to enable the format to provide a reliable supply of high-quality goods to the shelves of 14,431 stores (as of 31 December 2018) in 64 Russian regions for every one of the 4.6 billion customer visits that we enjoyed in 2018.

Key highlights for 2018

- Total throughput at existing DCs rose by 93% year-on-year
- Opened three new DCs, increasing total DC area for the Pyaterochka format by 70 thousand square metres year-on-year
- Improved operational efficiency of DCs: per-unit costs declined by 11% year-on-year, while the overall working rate reached a record 87 boxes per hour
- Leveraged synergies with other X5 Retail Group formats: our DC network increased the volume of boxes handled for large-format stores by 91% year-on-year to 2.2 million

Optimising transportation costs

One key area of focus in 2018 was optimisation of transportation costs, with a focus on further development of the Transportation Management System and increasing the share of automated route planning, which was launched in 2018 and reached 50% by the end of the year. This has significantly improved planning and routing accuracy:

- The vehicle activity ratio increased from 65% at the beginning of 2018 to 73% by the end of the year
- Turnover in the areas within 150 km from DCs improved by an average of 18% in 2018 following the introduction of multisectional resource planning
- Warehouse planning processes have been enhanced:
  - Planning now covers the entire 24-hour throughput of goods, as opposed to 3-6-hour intervals in 2017
  - The time required for route planning decreased from 16 hours to 10 hours, which improved plan fulfilment monitoring
  - Planning algorithms have been introduced to even out the hourly loads on DCs and to analyse performance
  - Delivery planning within a 6-hour window reached 91% in 2018, up from 67% in 2017
  - Reduction in labour time required for the planning process has enabled route-planning staff to focus on monitoring standards and optimisation of transportation costs

Personnel development

- We focused on personnel development in 2018 with the launch of the Logistics Academy, a joint project with METRO Cash & Carry and Coca-Cola HBC that trains promising managers from the Logistics Department in leadership and effective project management. Candidates are nominated from the selected talent pool by macro-region heads. Programme students are required to develop projects that are presented to an expert jury upon graduation from the Academy.

Improving processes

- We updated our logistics business processes in 2018 with a focus on reliability, stability and coordination. These affected product life-cycle processes, as well as places where these processes intersect with management processes.
- We also developed our electronic document interchange (EDI) systems in 2018, extending the integration with suppliers to include seven new protocols. Pyaterochka currently has the broadest integration of EDI among retailers in Russia.

Plans for 2019

- One of our key areas of focus for 2019 will be innovations. We are already testing a new WMS in our Saratov DC, and we plan to migrate our first DC to the new system in the second half of 2019.
- We are also testing the robotisation of the storage of fruits and vegetables, autopilot for forklifts and automated assembly of small items.
- We are also working with the Commercial Department to launch a new packaging line in Krasnodar, which will add to Pyaterochka's existing facilities, which include 14 banana ripening stations (eight owned and six external), as well as a watermelon binning service.

Perekrestok and Karusel

Our larger-format stores share logistics infrastructure that is fine-tuned to their needs. As of the end of 2018, Perekrestok and Karusel jointly operated 12 DCs. We are constantly modernising and expanding our logistics infrastructure to support the growth of our business, enhance efficiency and ensure that we can provide customers with a reliable supply of high-quality goods at every store that we operate.

Key highlights for 2018

- Further developed and optimised the efficiency of our regional logistics, with the share of supplies delivered directly to regional DCs increasing by 8% in 2018
- Expanded synergies with Pyaterochka for supplies to remote regions
- Increased DC productivity with the use of new technologies
- Improved availability of goods
- Increased the share of direct imports, especially in fruits and vegetables from 23% in 2017 to 28% in 2018
- Launched a banana ripening complex at the Sofino DC in Q1 2018

DC network and supply chain management

- Launched the new Businovo DC in Moscow for the storage and processing of frozen products
- Temperature-controlled facilities for fruits and vegetables were built or refurbished at regional DCs
- Expanded shared use of DC infrastructure with Pyaterochka in regional hubs
- Continued transferring suppliers to direct deliveries in regional hubs: the share of direct deliveries to regional DCs increased by 8% year-on-year
- Improved DC load management and kept intra-week volume fluctuations within the maximum threshold of 15%
- Introduced a new supply chain that enables optimisation of inter-branch transport
- Implemented a methodology for differentiated management of delivery schedules to adjust for seasonal volumes without disrupting the overall capacity of the DC
- Continued to increase the share of direct imports: direct imports of fruits and vegetables at Perekrestok accounted for 28% of volume in 2018
- Implemented the Collaborative Planning, Forecasting and Replenishment (CPFR) project together with suppliers

Inventory management

- Reduced DC inventory levels by 8% (0.6 days) on average year-on-year, and by 23% (1.7 days) in Q4 2018 year-on-year
- Further developed the Sales and Operations Planning process with the launch of demand planning for regions, which helped increase forecast accuracy by 2% year-on-year
- Completed rollout of JDA for the fresh category, with implementation planned for ultra-fresh and fruit and vegetables in Q1 2019
- Increased availability of goods that are in the top 30 in terms of turnover by 7% year-on-year
- Achieved target of 95% availability of promo goods in Q4 2018
- Launched big data analytics to improve the accuracy of sales forecasting
- Reduced store opening time by one day thanks to packaging based on merchandising groups of similar goods

Plans for 2019

- Implementation of JDA across the entire assortment
- Start implementation of the new WMS
- Upgrade store shelf replenishment management with the help of the WMS targeted storage system
- Transition to the new Transportation Management System to standardise all transport management across X5 Retail Group
- Strengthen focus on availability in the fresh and fruits and vegetables categories
- Automate replenishment for promo goods
- Continue development of CPFR project with suppliers
- Launch project to create a shared global master data register of goods together with suppliers
- Launch fruit and vegetables packing lines for direct imports at the Sofino DC

Transport

Efficient and reliable transport is essential to our successful operations, with stores in five time zones across Russia. We are investing in transport infrastructure in order to ensure that we have the capacity to deliver high-quality goods on time. In doing so, we are leveraging technology and innovations to maximise the capacity and usage of our trucks.

X5's transport fleet consisted of 3,830 trucks as of 31 December 2018, and we were capable of handling 85% of our transportation needs during the year. Our own fleet constitutes a key element of our retail operations infrastructure, which has to support our retail formats as they expand across Russia's vast territory. At the same time, we are developing new modes of transportation to help us access new areas and transport goods faster and more efficiently across Russia's long distances.

Progress against our strategy

In 2017, we approved a Logistics and Transportation Strategy that aims to ensure that these operations contribute to the sustainable growth of X5 Retail Group's business. The core elements of this strategy are laid out below:

- **The best offering in a competitive market:** we have invested in equipment, technology and people to help ensure that our own transportation services are at the forefront of what the market has to offer.
- **Establish 4PL operations in remote regions:** we are successfully developing our own integrated multimodal logistics in order to support ongoing regional expansion, including in remote regions of Russia.
- **Technology-driven:** we are using technology for a variety of applications, from improved route planning to delivery services like GoCargo and the ability to source trucks, drivers and trailers separately in order to increase efficiency and reduce idle or excess capacity.
- **Focus on service quality:** our goal is to achieve a 98% success rate in meeting delivery windows and temperature requirements for deliveries, and we have established business processes that enable us to respond quickly to the changing requirements of X5's retail formats.

How we manage transport

The Director for Transport operates from X5's Corporate Centre and is responsible for implementing and monitoring performance targets, as well as implementing the strategic goals that have been set for X5's transport operations.

In 2018, the Transport Department established six macro-regions aligned with Pyaterochka's updated organisational structure in order to synchronise operations with the format's retail operations.

We use centralised transport management systems to maintain a real-time view of the location, condition and storage temperatures of our entire fleet. Thanks to GPS/GLONASS systems, X5 is able to efficiently plan routes, monitor the movement of shipments from DCs, and help stores plan for arrivals and be alerted to delays.

What we did in 2018

- **Increased fleet size and capacity** with 910 new trucks, bringing the total fleet size to 3,830 as of 31 December 2018 and the average age of the fleet to 2 years. Reviewed new types of trucks with petrol and diesel motors, as well as new types of trailers (new couplers, doppelstock semi-trailers, extended semi-trailers with greater cargo capacity, city trailers); approved the purchase of 300 couplers and 25 semi-trailers with greater cargo capacity for 2019
- **Developed multimodal delivery** to remote regions in Russia, including coverage of the entire Komi Republic, including Vorkuta, Usinsk, Pechora and Ukhta. Launched multimodal transportation between St Petersburg and Novosibirsk (fruit and vegetables) and Moscow and Novosibirsk (dry food products)

- **Improved efficiency and flexibility of operations** with interbranch transportation between DCs and new types of trucks, which helped balance the load in low/high seasons; launched new cross-docking sites in Pyatigorsk, Vorkuta, Usinsk, Yugorsk, Krasnoyarsk and Izhevsk (for the Perekrestok format).
- **Reduced delivery time for fruit and vegetables** from ports to DCs by four days, helping reduce shrinkage by 20%.
- **Continued development of GoCargo.** In Q4 2018, X5 began to develop delivery services for external customers (our suppliers + less-than-load delivery). X5 entered St Petersburg, Yekaterinburg, Chelyabinsk, Nizhny Novgorod, Samara, Voronezh, Rostov and Krasnodar with this service. This LTL service was launched in 2016 to give producers the opportunity to transport small lots of goods using the X5 fleet to any of our DCs. In two years, more than 500 thousand pallets of various goods were handled. At present, X5 delivers about 7 thousand tonnes of LTL cargo every month

Plans for 2019

- **Continue development of fleet:** transition to more efficient and environmentally friendly gas and diesel equipment across almost our entire transport fleet
- **Develop new piggyback transportation**. Pilot dispatch of a semi-trailer with a basket without a truck is expected in Q2 2019
- **Expand cross-docking and cross-docking light** sites for both Pyaterochka and Perekrestok
- **Boost self-delivery:** increase the volume of tender fruit and vegetables (weekly and daily), expand dry, fresh and drinks categories and add alcohol
- **Further expand multimodal transportation:** St Petersburg to Yekaterinburg/Chelyabinsk routes are to be launched in February 2019; add Inta and Novy Urengoy domestic destinations, as well as international delivery of goods from Uzbekistan and China
- **Launch GoCargo – MVP,** further develop delivery services for external customers, increasing the share of external deliveries; launch three LTL sites in Kazan, Samara and Voronezh
- **Continue to pilot international shipments** with its own transport, including shipments from Poland and Serbia, and shipments from China and Kazakhstan may possibly be about to begin
- **Digitalisation of business processes** with the transport micro-service platform
- **Personnel motivation:** develop an intangible motivational scheme, as well as launch a professional training initiative for line managers

Direct imports

As X5 grows in size, updates its formats' CVPs and expands its supply chain, we also need to enhance our import operations. With the share of fruits and vegetables in total imports exceeding 80%, we believe that having our own import operations is especially important. By increasing our control over the operation of our supply chain, we are better able to ensure consistent volumes and quality of imported goods that end up in our stores, while also reducing costs at each stage of the supply process.

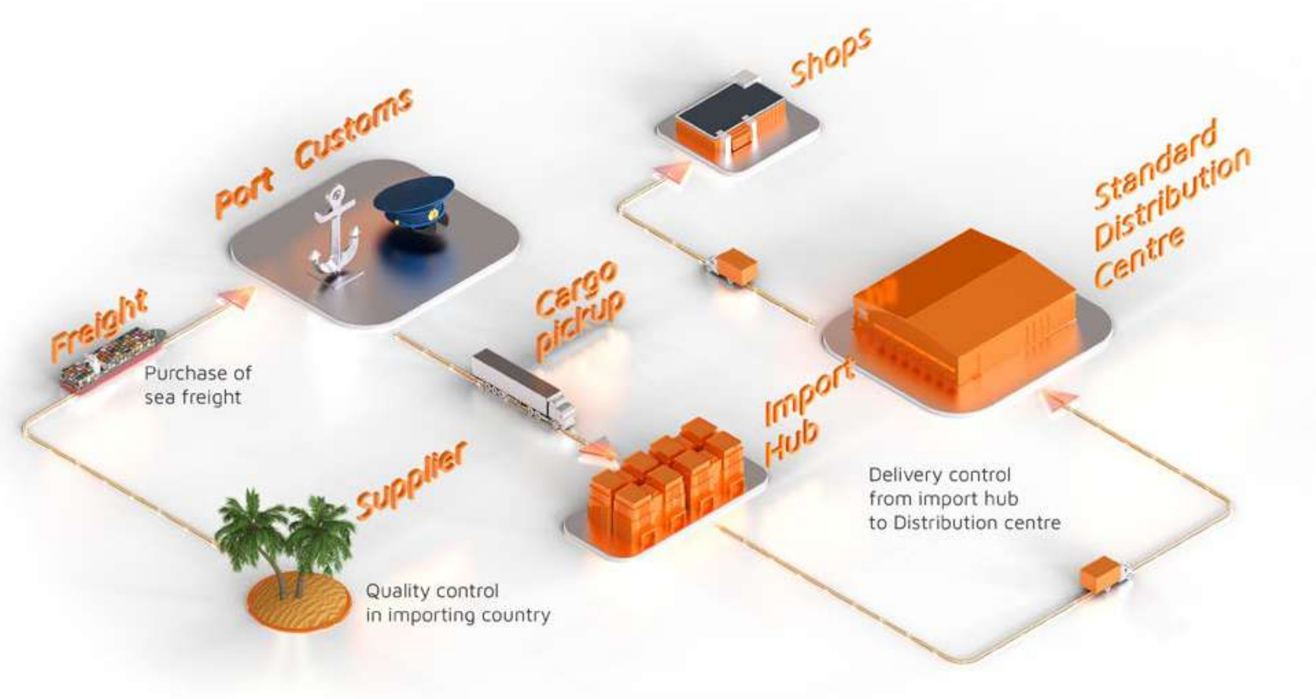
The next stage in our direct import operations was launched in 2018 with the creation of a new cross-format Import Division that aims to implement X5's direct import strategy.

The Import Division's key strategic priorities are:

- expanding the assortment and ensuring stable volumes of unique imported goods across all formats;
- improving the quality of imported goods, including through the implementation of the leading logistics technologies;
- improving sourcing terms;
- building long-term strategic partnerships with producers of imported goods;
- identifying and sourcing new assortment items in the non-food category;
- automation of all import processes, including procurement, operations and quality control;
- further development of trade representative offices in key import locations.

We see significant potential in enhancing our direct imports operations and plan to increase the share of direct imports from 3.5% in 2018 up to 10% by the end of 2020.

Direct imports supply chain



Information technologies

Our reliable and efficient IT platforms are a key element of the long-term sustainability of X5's business. In addition to serving as a vital backbone for the business, our IT systems contribute to top-line sales by enabling us to collect and analyse customer shopping data, while also supporting efficiency by helping us to make better decisions faster, automate processes and implement innovative technologies.

The Information Technology Department manages X5 Retail Group's IT systems from the Corporate Centre. The Department is responsible for ensuring both the integrity and scalability of the IT architecture and infrastructure to support business growth as well as innovations and new technologies.

The innovation team sits with the IT Department, ensuring that we have a good understanding of how innovative solutions can be implemented within the existing architecture.

2018 highlights

Reliable and resilient infrastructure: in 2018, we ensured 100% uptime for critical business systems and 99.74% uptime for all IT services. We launched our reserve data storage facility to ensure greater resilience in our systems. We also established a data management desk that is responsible for optimising X5's data storage and data management systems. This area of work is especially important, as X5's SAP BW on HANA cluster is one of the 10 largest systems using this platform worldwide.

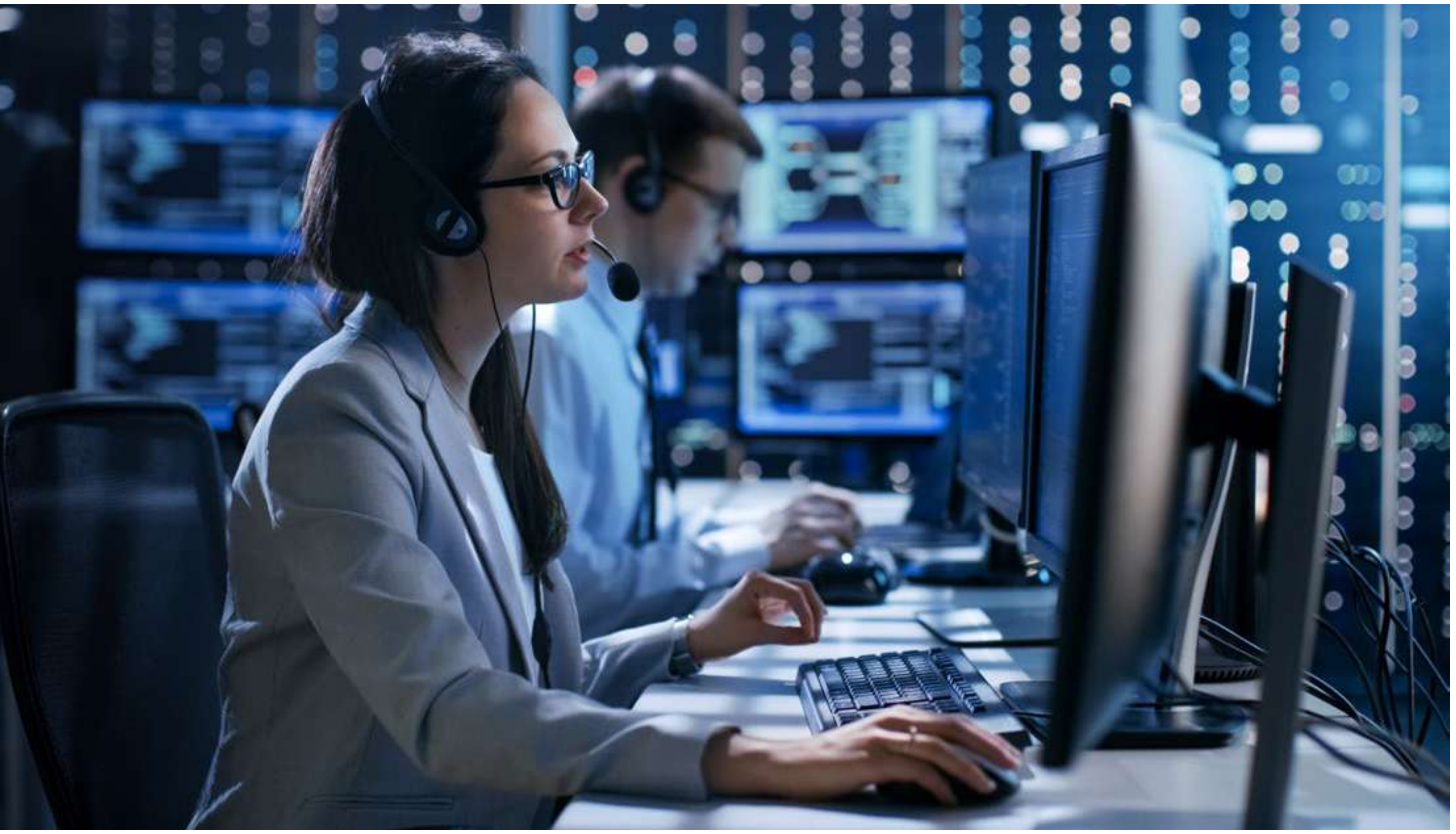
Supporting growth: One of our key achievements in 2018 was the completion of the modernisation of the network core, which will enable growth for at least another three years and support up to 18,000 stores.

Compliance and reporting: we continued to strengthen regulatory and reporting compliance systems, including automation of certificates for suppliers through the Mercury system. We also continued implementation of systems for monitoring tobacco and alcoholic goods. We updated our SAP systems to prepare for the introduction of the 20% VAT rate and IFRS 16 implementation in 2019.

Efficiency and innovations: We implemented and automated processing power and configuration management procedures, which, according to estimates, will save RUB 200 million in 2019. The IT Department has established business monitoring and robotisation competency centres that identify business processes that can be automated: this made it possible to automate nine routine processes in the X5 service centre in 2018.

Plans for 2019

We aim to focus on measures to speed up the implementation and integration of new IT solutions at X5 while maintaining the high level of reliability of our systems. We plan to transition to a product team-based approach in 2019, while continuing to develop tools and practices like Agile, DevOps, CI/CD and MSA.



Innovations

Innovations are a core element of our long-term success and sustainability. Consumers in Russia, and globally, are changing as technology influences ever more aspects of our everyday lives. We see greater demand for convenient and time-saving services that enable customers to get what they need on the go. The largest shift in behaviour and business models is the growing availability of omnichannel retail, where consumers increasingly expect access to any goods and services, anywhere and anytime.

While technology is enabling many changes in consumer behaviour, it is also playing a major role behind the scenes in retail operations in a way that helps first-movers become more competitive by improving the quality of goods and services while lowering costs.

Search and implementation of innovative technologies

	STAGE 1 SCOPING	STAGE 2 BUSINESS CASE	STAGE 3 PILOTS	STAGE 4 ROLLOUT
DECEMBER 2017	350 STARTUPS	130 STARTUPS	33 PILOTS	3 PROJECTS
ADDED IN 2018	+209	+157	+35	+6
DECEMBER 2018	559 STARTUPS	287 STARTUPS	68 PILOTS	9 PROJECTS

Pilots across the X5 value chain

	BACK OFFICE	SUPPLY CHAIN	STORES	CUSTOMER
NUMBER OF PILOTS	6	3	45	14

X5 RETAIL GROUP

68 PROJECTS
IN INNOVATIONS ARE CURRENTLY BEING PILOTED AT X5

How we manage innovations

X5 has created and funded an internal process to search for, pilot and implement tech innovations. This process focuses on finding innovative technologies that will help us to enhance our customer experience, improve and automate business processes and drive greater efficiency.

2017-2018 highlights

By teaming up with some of Russia's largest funds and accelerators, in 2017-2018 we analysed technologies from over 500 startups; launched 68 pilots in our stores, DCs and Corporate Centre; and had nine tech innovations in rollout phase by the end of 2018 in areas like pricing, process automation, energy efficiency and personalisation.

Plans for 2019

Our work on innovations will continue to focus on both our top line by helping increase sales and our bottom line by improving efficiency across the business.

In the year ahead, we aim to further expand and enhance our innovation search and implementation process by increasing the number of projects that we review, while improving the effectiveness of the integration process. Key areas of focus will be shelf availability, self-service points of sale, process automation, energy savings, etc. At the same time, we aim to launch a variety of omnichannel approaches in order to better understand customer preferences and to gain a better understanding of related business processes.

Examples of the innovations we are currently testing

Shelf video monitoring

- Shelf video monitoring uses cameras located throughout the store to automatically notify personnel when shelves need replenishing. This technology has the potential to reduce in-store personnel costs while improving shelf availability for customers.

Queue video control

- Queue video monitoring enables us to track queue lengths and notify a store manager to open additional check-outs or close idle ones. Customers receive faster service, while the store manager can plan cashiers' schedule more flexibly.

IoT

- We installed smart sensors in stores that send information to a smart energy control centre that helps to optimise energy consumption in accordance with constantly changing store needs.

Virtual reality

- We use virtual-reality (VR) tools to train our store assistants who serve customers over the counter in the meat, fish, and cheese categories. Shop assistants regularly use VR sessions where they go through typical conversations with virtual customers. The training system recognises the user's voice and matches his or her speech with the script. This training technology has helped us to raise customer service quality and cross-sales.

Big data

Our Big Data Department was established in 2018 and is headed by Anton Mironenkov, who has been with X5 for more than 10 years. Anton was previously Director of Strategy at X5. The Big Data Department currently consists of over 100 professionals.

Big data helps us improve efficiency through the use of data in all areas of the business and for decision-making at all levels.

In 2018, X5's Big Data Department rolled out a technology platform for data collection, storage and processing. Its basic, underlying principles – fast scaling, support for multiple data processing technologies, a high level of security, low storage and computing costs – have made data available to the entire Company.

This has established an optimal production process for our current business goals. The Corporate Centre's Big Data Department is building analytical systems for the benefit of all our formats, as well as creating and developing a single data storage and processing centre for all our formats, where analysts from all of X5's formats and functions can do their analytical work.

Get to know your customers by engaging with them

The transition from analysis of quantitative indicators, such as sales receipts and revenue, to understanding the qualitative characteristics of every customer – their socio-demographic characteristics, loyalty to our formats, consumption profile, consumer missions – has allowed us to switch to a customer-centric business management model and to put into practice various tools for customer interaction.

The Big Data Department has developed a library of more than 40 million unique customer profiles.

Ten segments are broken down according to socio-demographics, loyalty levels, lifestyles and missions to help us better understand the structure of our client base and predict the future behaviour of our customers.

The knowledge we have accumulated about our customers (around 100 indicators for every profile) helps increase the impact of regular targeted marketing campaigns.

Big data is primarily leveraged to drive improvements in business operations

Data everywhere – efficiency in everything

Integrated business planning

Existing data and technologies to work with that data enable us to implement an integrated analytical platform for business management called integrated business planning.

The main goal of the platform is a single agreed sales plan at all levels of the Company that is focused on meeting consumer demand, improving the Company's main indicators and reducing unforeseen budget expenditures by means of optimal resource management.

The integrated platform allows us to make informed business decisions in terms of managing our pricing and product assortment, predicting demand and making promotions more impactful.

Product assortment

One of the keys to our customers' hearts is having the right product assortment at our stores. By using a vast amount of purchase data to analyse our customers' consumer missions, we have been able to develop a tool for evaluating the effectiveness of our current product assortment. This tool enables us to identify grey areas in terms of how representative various customer demands are in respect of our product assortment, and it allows us to back up decisions concerning the development of our assortment in a way that achieves the desired effect.

Promotions

Machine learning algorithms enable us to identify promotional offers that are attractive to our customers and profitable for the Company. Promotions that have been launched based on the recommendations generated by these algorithms are already beginning to show greater impact than campaigns planned through traditional methods. The use of big data algorithms enables us to evaluate the effect of promotions not only within categories but also on the entire consumer basket.

Pricing

Another objective of our big data algorithms is to offer a price that meets customers' expectations and that, at the same time, is satisfactory in terms of business performance.

Our algorithms allow us to determine those goods whose prices differentiate us from our competitors and to identify conditions that are sufficiently advantageous to shoppers. Daily monitoring and pricing flexibility (right up to the individual store) are tools that help us manage our competitive advantage.

Sustainable development

We aim to engage in meaningful interactions with all our stakeholders in order to ensure that we understand their needs and are able to create value for them and continue to grow a profitable, evolving food retail business in Russia.

Our key stakeholders include customers, employees, investors, suppliers and local communities.

Stakeholder engagement

	Consumers	Suppliers	Employees	Society and local communities	Shareholders/Investors
Why we interact	• Ensure customers are aware of the value propositions of X5's retail formats • Differentiate ourselves from other food retailers • Meet customer demand, addressing their shopping needs and improving their shopping experience • Encourage customer loyalty and increase share of wallet by offering more of what they truly need • Get customer feedback that may help us improve our business • Provide customers with answers to their questions through direct engagement • Evolve our business in response to changing demand • Reduce food waste	• Ensure the timely and reliable supply of high-quality products • Increase cooperation with local producers across the regions where we operate • Partner with suppliers to engage in effective promo and other sales activities • Ensure that our customers are getting the solutions they need or want • Maintain mutual trust and respect in our business relationships • Protect the health and safety of end consumers • Increase efficiency while reducing waste and shrinkage • Maximise the efficiency of the way we supply goods to customers	• Facilitate the professional growth and support the social well-being of employees • Develop a corporate culture that helps us achieve our strategic goals • Engage in productive dialogues with trade unions • Ensure employees are regularly informed about health and safety procedures in the workplace • Create an atmosphere where employees are encouraged to help us identify opportunities to further improve our operations • Retain and develop a workforce of skilled and motivated employees • Improve employee motivation, help them build their professional skills • Maintain a reputation as an attractive employer for current and potential employees	• Understand and address community needs and social or environmental concerns • Protect the health and well-being of communities where we are present • Build, maintain and protect our image and reputation • Increase recognition of our brands and offering • Keep local, federal and international media informed about our achievements and performance • Develop productive relationships with local authorities • Gain a better understanding of the business opportunities within local communities • Stay informed about government policies or regulatory changes that could impact our business	• Keep the investment community informed about X5, our strategy, financial and operating performance, and other significant events • Constantly enhance corporate governance systems • Build sustainable long-term value as an enterprise • Seek out new ideas that may help improve the running of the business and our ability to create value • Demonstrate our commitment to openness and transparency • Support investor participation in X5's activities in capital markets • Ensure long-term growth in the Company's market capitalisation
How we interact	• Maintain a customer hotline (each retail format has a dedicated customer hotline) • Interact via social media and messenger platforms • Use big data analytics of customer behaviour to understand how we can meet our customers' needs in the most efficient and reliable way • Develop loyalty programmes across all our formats	• Adhere to fair and transparent business policies and practices • Implement measures to make it easier for small local producers to work with X5 • Encourage the supply of locally produced goods across our formats • Hold training events to help suppliers work efficiently with X5's logistics infrastructure • Integrate nationwide transport and logistics operations with both large federal and smaller local suppliers • Focus on collaborative relationships and finding mutually beneficial solutions	• Provide stable, fair and transparent salaries and motivation schemes to X5 Retail Group employees • Encourage career development and offer competitive compensation packages • Enact strict occupational health and safety policies across our business • Provide access to in-house and external training and development programmes • Offer social support for employees with regard to long-term illness or accidents, bereavement, or loss of property • Recognise significant contributions to X5's successful performance	• Support charity and social initiatives that leverage X5's position as Russia's leading food retailer, including food bank initiatives like Basket of Kindness • Provide support to initiatives that are priorities for local communities • Manage our environmental footprint in a responsible way, including by reducing emissions, consumption and waste generated by our activities • Keep members of local communities informed about decisions that impact them • Maintain relationships with local authorities and community leaders	• Execute our strategy as it evolves to address current and expected market trends • Adhere to best practice standards of transparency and disclosure • Implement corporate governance practices that are in line with recognised best practice standards • Facilitate open access to information via our investor website with annual reports, financial statements, press releases, presentations • Roadshows • Investor conferences • Conference calls • Group meetings with analysts and investors • Five independent non-executive directors on the Supervisory Board ensure that the interests of public shareholders are represented
Performance in 2018	• Expanded omnichannel initiatives like Perekrestok Online and in-store parcel lockers for customers to pick up online purchases, making it more convenient for customers to shop with X5 • Expanded loyalty programmes and the use of personalised offers that are tailored to customers' interests through big data solutions • Ongoing adaptation of the CVPs of our retail formats to meet changing demand	• Established relationships with 1,426 new suppliers in 74 regions • Development of new exclusive private-label lines with selected suppliers, including Green Line at Perekrestok • Over 19% of assortment on average from local suppliers, with up to 30% in some regions in Pyaterochka stores	• Invested around RUB 151 million in professional training and development • Conducted over 300 employee engagement events – sports, informational, and entertainment – attended by more than 176,000 people • Continued to implement and refine occupational health and safety policies and rules • Upheld diversity and human rights policies across all of X5's operations	• Opened new stores and DCs, adding over 27,000 jobs in more than 60 Russian regions • Paid over RUB 49.4 billion in local, regional and federal taxes • Provided convenient, modern and reliable food retail services to people in around 2,900 cities and towns in Russia (over 4.6 billion customer visits)	• Adhered to dividend policy adopted in 2017 • Implemented award-winning investor relations practice • Held hundreds of conference calls and meetings with investors and analysts • Held two roadshows and participated in no fewer than 11 investor conferences • Held Capital Markets Day in London for the first time in October 2018 • Posted around 46 RNS press releases • Significantly enhanced direct communications with investors following the introduction of MIFID II, held our first virtual roadshow

Please see more information on supplier-related matters in the Compliance and Ethics section on pages 156-159, the Product Safety and Production Quality section on pages 150-155

Please see more information on employee matters in the People Review section on pages 160-167

Please see more information on social matters in the Community Investment Review section on pages 180-185

Please see more information on shareholder matters in the Corporate Governance section on pages 186-225

Product safety and production quality

Our goal is to offer our customers nothing but fresh, high-quality products at every store we operate. In order to achieve this, we implement and adhere to rules and regulations that cover the entire supply chain, from before products are delivered to a warehouse or a store, and all the way through until they are in the hands of the consumer. The policies and systems that we implement and operate are in full compliance with Russian legislation and regulatory requirements and also aligned with global best practices in the food retail sector.

2018 in numbers

Pyaterochka

1,085 suppliers audited in 2018 by Pyaterochka and external auditors
(vs. 977 suppliers in 2017)

1,240 stores audited in 2018

Perekrestok

225 suppliers audited in 2018 by external auditors
(vs. 174 suppliers in 2017)

1,068 items from suppliers were tested in 2018 at accredited laboratories
(vs. 1,031 in 2017)

Karusel

8,517 samples of in-house products tested at accredited laboratories in 2018
(vs. 6,331 samples in 2017)

6,950 random samples taken from employees' hands for lab-based hygiene testing in 2018
(vs. 5,303 random samples in 2017)

Policy highlights

Across all of our formats, we implement a clear set of rules and guidelines regarding the quality and safety of the products we sell. Our quality control systems cover our entire operations, from supplier audits to monitoring and checking the goods on store shelves.

We strive to constantly improve safety and quality control practices throughout our supply chain and retail operations. In order to do this, we seek, on a regular basis, recommendations from leading inspection, verification, testing and certification companies and then implement them in our day-to-day work.

As the largest food retailer in Russia, X5 works closely with federal regulators and decision-makers to draft documents, including food standards.

Each of our retail formats maintains its own quality and safety monitoring policies, but they are all based on the following principles:

- Ensuring food safety and social responsibility
- Understanding the current and future needs of consumers, meeting their stated and unstated goals, and aspiring to exceed their expectations
- Specifying the target quality level based on the demands of the consumer
- Establishing and developing mutually beneficial partnerships with producers and suppliers
- Creating and maintaining a corporate culture in which all employees are fully engaged and interested in using their knowledge and experience to achieve established goals
- Running all of our formats by using a process- and systems-based approach to the various stages of a product's life cycle: starting with the development and entry of goods into our product range through production and sale to the consumer
- Introducing modern quality control methods to improve efficiency and effectiveness in terms of ensuring food safety
- Continuous improvement as an ongoing requirement

In order to maintain a dialogue with all business partners, X5 also works with industry associations, including the Consumer Market Participants Union, the Russian Union of Industrialists and Entrepreneurs, the All-Russian Association of SMEs (Opora), the Civic Chamber of the Russian Federation, the National Dairy Producers Union, the RusBrand Association of Branded Goods Manufacturers, the Seafood Processors Union and the RusProdSoyuz Association of Food Manufacturers and Suppliers.

System highlights

Each of our formats has its own Quality Department that is responsible for establishing safety and quality standards and product specifications at the format level, and all of these requirements are agreed with the respective Commercial Departments. The Quality Department receives and analyses the results of internal inspections and supplier audits and monitors whether standards are met. It is the shared responsibility of the Quality and Commercial Departments to respond to incidents of non-compliance by taking measures to eliminate shortcomings and help suppliers develop their systems or products properly. The two departments prepare periodic reports for management review. In addition, our retail formats regularly engage accredited international auditors to conduct audits of their suppliers, and they update quality specifications and standards for food products, private-label goods and packaging on an ongoing basis. X5 deploys the principles of hazard analysis and critical control points to ensure that its products are safe for consumers and the environment, and that they meet retail standards and customer needs.

Other quality assurance practices that we use include:

- lab testing and analysis of products at independent research and development centres and accredited research laboratories;
- staff training;
- safe storage and transportation of products;
- modern monitoring methods, innovative technologies; and
- supplier audits.

How it works in practice

Introducing goods into our product range

When introducing products into our product range, provided samples undergo comprehensive testing for compliance with our internal requirements and the laws and regulations of the Russian Federation:

1. Verification of a range of documents that certify the quality and safety of products, as well as the protection of consumer rights.
2. A tasting commission conducts a blind organoleptic evaluation of products and raw materials and assigns a score to each item.
3. Accredited laboratories check compliance with the established requirements (microbiology, physical and chemical indicators), determine whether or not products are genuine, and issue test reports. Tests are carried out both for new products and during the process of monitoring goods that have already been supplied.
4. Production status and a producer's ability to deliver the required amount of a given product while meeting quality and safety standards is assessed (audited) by certified, independent experts together with management. Based on the results of an audit, a checklist with a comprehensive assessment is completed. Audits are divided into primary audits (pre-contract) and inspections (during the supply process).

Based on the results, management takes a decision about whether or not to introduce a product into the product range.

Management pays particular attention to the quality of private-label goods: for these goods to be introduced into the product range, a separate checklist is completed, and a different procedure is followed that involves more in-depth and stricter testing of suppliers.

Acceptance at distribution centres

Our DCs carry out testing to ensure that all incoming food products comply with X5's standards, including regarding their appearance, as well as with Customs Union and Russian national regulatory requirements. X5's quality control for fruits, vegetables and exotic fruits meets national standards and those of the United Nations Economic Commission for Europe, as well as X5's own quality catalogue and acceptance criteria, including calibre, size and ripeness.

In 2018, Pyaterochka continued implementing its "Remote Acceptance" project at DCs and hubs. This project enabled the format to reduce losses of fruits and vegetables by using video monitoring and random sampling, and also by reducing corruption risks. Also in 2018, an upgrade of the "Remote Acceptance by Quality" project was launched, with additional control points established at every DC, which made it possible to speed up the acceptance of fruits and vegetables.

In 2018, Pyaterochka implemented a project to improve the monitoring of the supply of chilled goods from the supplier to the store shelf. As part of the project, all of Pyaterochka's DCs and hubs were equipped with sensors that measure temperature and humidity data in real time. Also, all incoming deliveries of fruits and vegetables are accompanied by similar temperature sensors, and when the goods are accepted, the quality manager has access to information on the transport conditions; in case of critical deviations, the information is recorded by the sensor, and delivery is not accepted. Another project was launched in 2018 to integrate all temperature and humidity monitoring systems into a single operational monitoring system that will make it possible to monitor storage and transportation conditions for fruits and vegetables and fresh produce supplies in one place and to take prompt corrective measures in case of violations.

In order to improve the monitoring and analysis of product acceptance at DCs, a tablet-based system for accepting goods was developed, together with Perekrestok's Logistics Department, and is being implemented for the following purposes:

- Product traceability (responsible inspector)
- Automation of the acceptance process: information is automatically entered into the system
- Optimisation of the work process (elimination of technical operations related to paper acceptance)

Quality control in stores

Under our Quality Hour programme, all products on our shelves are sorted and checked for quality and freshness every morning between 9 a.m. and 10 a.m. Pyaterochka store directors are personally responsible for product freshness in their additional role as “freshness directors”.

All of our formats regularly audit stores to monitor compliance with safety and quality standards, which means we are able to address issues quickly as they arise and improve the quality of the service we offer our customers.

Store audits

	2018	2017	2016	2015
Pyaterochka	1,240	2,268	1,956	702
Perekrestok	880	907	427	305
Karusel	447	728	265	212
X5 TOTAL	**2,567**	**3,903**	**2,648**	**1,219**

Audit of producers, including of private-label items

X5 Retail Group works with over 5,600 suppliers from Russia, the CIS, Europe, Asia, Africa and Latin America (over 1,400 new suppliers in 2018). As part of the selection and rating of suppliers, a supplier audit is required. The Supplier Audit Programme is available on the supplier portal along with a requirements checklist. All new suppliers undergo a mandatory audit to confirm that their production facilities are compliant with quality and food safety requirements.

In 2018, Pyaterochka launched a project to automate the supplier audit process, to refine its information systems for requesting an audit, to complete checklists and maintain audit schedules, and to automatically block suppliers that have not been audited. This will enable the Company to maintain audit statistics, to make sure that low-quality and unsafe goods do not end up on store shelves, and to simplify work with suppliers and to maintain a rating for them.

During the year, all of X5's formats conducted audits of suppliers, when samples of product items were sent to independent, accredited testing facilities for analysis. This analysis was aimed at verifying products' organoleptic, physical, chemical and microbiological properties and, in some cases, the declared ingredients, specifically to identify any that had been replaced with cheaper alternatives, as well as any use of food additives, artificial colourants, sweeteners or preserving agents not indicated on the label. Supplier audits by Pyaterochka resulted in 190 suppliers being barred from selling goods to the format, while Perekrestok's audits led to 25 goods being barred from the assortment and one supplier being disallowed.

X5's supplier evaluation criteria are applied across the group, so that all of our brands are able to use the audit results from one format. In addition, our call centres have established procedures for handling customer complaints about private-label products.

Number of supplier audits

	2018	2017	2016
Pyaterochka	1,085	977	939
Perekrestok	225	174	167
Karusel	28	33	14

Interaction with consumers

In addition to a customer hotline (each format has a dedicated hotline), X5 regularly monitors social networks, blogs and online forums for potential complaints. We thoroughly investigate all customer comments and complaints about product safety and quality. This verification process may involve making control purchases and sending samples for analysis.

Interaction with public authorities and self-regulating organisations

In 2018, the Company conducted a pilot project called Svetofor (traffic light), which was initiated by the Federal Service for Supervision of Consumer Rights Protection (Rospotrebnadzor). Voluntary labelling under the Svetofor system involved color-coded information on food packaging depending on the levels of salt, sugar and fatty acids, based on recommended daily allowances of these substances. For these purposes, Rospotrebnadzor prepared guidelines on the colour indicators to be used for the labelling of food products in order to better inform consumers.

In 2018, paper veterinary documents were replaced by electronic versions that are completed in the Mercury Federal State Information System. This change not only made it possible to trace goods that are being monitored, but it also reduced the paper workflow and thus the costs associated with the process, resulting in tangible savings.

Compliance and ethics

When conducting business, X5 Retail Group aims to ensure that its actions and the actions of its employees comply with the Company's values, ethical standards and legal requirements.

Key documents

- Declaration on Human Rights
- Code of Business Conduct and Ethics
- Compliance Policy
- Code of Interaction with Business Partners
- Policy on Countering Misconduct, Including Fraud and Corruption
- Policy on Processing Personal Data

Stakeholders

- Investment and finance community
- Regional governments and local communities
- Employees and trade unions
- The general public and media
- Business partners
- Customers

Policy highlights

Code of Business Conduct and Ethics

We introduced our **Code of Business Conduct and Ethics in 2015.** This is an internal regulatory document that outlines a set of basic principles that guide X5's business practices. This document serves as a guideline for Company employees, helping them make proper, informed decisions in various ethical situations related to the performance of official duties, and as the basis for a number of the Company's other internal regulatory documents. The Code of Business Conduct and Ethics covers areas such as responsibility to the state and society, protection of the Company's interests, upholding personnel and business ethics, and it also explains the process for reporting violations of the Code. The provisions of the Code of Business Conduct and Ethics are mandatory for senior management and all other Company employees.

Code of Interaction with Business Partners

Since 2015, the **Company has had a Code of Interaction with Business Partners,** which sets the standards for doing business that the Company expects both its employees and partners to comply with. As an industry leader, X5 is aware of its responsibility to the state, society, shareholders and partners, and aims to fully comply with legal and ethical standards, as well as best corporate practices, in order to serve as an example for other market participants. The Company expects its employees and partners to adhere to the provisions of the Code in their work and also to report violations of the Code. The Company set up a Conciliation Commission in 2015 for the purposes of handling complaints about violations of the provisions of the Code of Interaction with Business Partners.

Policy on Countering Misconduct, Including Fraud and Corruption

In 2017, X5 adopted a **Policy on Countering Misconduct, Including Fraud and Corruption** (the Anti-Corruption Policy). X5's Anti-Corruption Policy is the Company's main internal document that establishes the approach and principles used by the Company in fighting corruption (bribery and corrupt business practices) involving Company employees and partners. The anti-corruption system includes a set of tools aimed at preventing, uncovering, investigating and responding to possible cases of misconduct. The Anti-Corruption Policy also establishes roles and responsibilities for departments and management bodies. Our principle of zero tolerance for corruption and fraud is enshrined in the Policy.

The provisions of the Anti-Corruption Policy are obligatory for the management team and for all other Company employees.

One of the key objectives of X5's Anti-Corruption Policy is to ensure that our activities comply with legal requirements in the area of countering bribery and corrupt business practices.

The system's main objectives are:

- establishing effective procedures and initiatives to prevent corruption
- forging a corporate culture of honesty and zero tolerance for corrupt behaviour
- minimising the risk of the Company's involvement in corrupt activities

Compliance with these rules is mandatory for the Company's management, retail formats and other business units, as well as for all Company employees. All Company contracts with suppliers are also prepared in accordance with the Policy.

Declaration on Human Rights

At the end of 2017, the Company adopted a **Declaration on Human Rights,** which specifies principles and rules on compliance with, and promotion of, international standards for the advancement of human rights at all stages of the Company's activities. These principles are based on respect for the inherent dignity of every human being, as well as the freedom and equality of all people.

The Declaration deals with the following issues:

- Respect for cultural values
- Respect for the right to freedom of assembly and association
- Occupational safety
- Working conditions
- Prohibition of discrimination and forced labour
- Prohibition of harassment

The goals and objectives of the Declaration are implemented through other Company bylaws, including the Code of Business Conduct and Ethics.

Compliance Policy

In order to ensure compliance with the requirements of regulators, stakeholders, established business practices, voluntarily adopted standards and rules of business conduct and ethics, X5 also adopted a **Compliance Policy** in 2017.[1] Compliance risks are assessed and reassessed on an ongoing basis.

Policy on Processing Personal Data

In accordance with legislative requirements, X5 has a **Policy on Processing Personal Data** in accordance with applicable legislation of the Russian Federation on personal data and other regulatory documents. This policy applies to all processes involving the collection, storage, retrieval and transfer of personal data within the Company.

Code of Conduct on Insider Information and Operations with Securities

In order to comply with the new EU regulation on market abuse, we updated our **Code of Conduct on Insider Information and Operations with Securities** in 2016 in an effort to prevent misconduct.

All key documents reflect X5's values, and are reviewed and updated on a periodic basis as necessary and in response to changes in legislation.

[1] In accordance with ISO 19600:2014 (Compliance Management Systems).

Key processes for ensuring ethical compliance

Ethics Committee

The Company has had an Ethics Committee since 2016.
The Ethics Committee:

- Reviews disputes associated with violations of the Code of Business Conduct and Ethics, the Declaration on Human Rights and the Anti-Corruption Policy
- Resolves disputes and conflicts of interest
- Approves measures aimed at combating fraud and corruption
- Adopts overarching rules for further implementation within the Company's internal documents in the areas of business conduct and ethics

Responsibility for investigating various types of misconduct is assigned to the Security Division.

Enforcement of established policies is enshrined in the KPIs for management of the Security Division in order to encourage:

- carrying out projects to improve activities in the field of combating misconduct within X5
- preventing, uncovering and investigating cases of misconduct, including fraud
- identifying and bringing criminal charges against any individuals engaged in the commission of criminal acts involving corruption

Responsibility for investigating violations in the areas of human rights, labour rights and occupational safety, and for taking the necessary measures is assigned to the Directorate for Organisational Development and Personnel.

Hotline

X5 Retail Group has established communication channels through which employees and partners can report violations of legal requirements and internal regulatory documents, including the Code of Business Conduct and Ethics, the Code of Interaction with Business Partners, the Anti-Corruption Policy and the Declaration on Human Rights.

Ethics hotline. The ethics hotline is managed by the Compliance Department and is intended for Company employees. Use of the ethics hotline is anonymous. The ethics hotline is the main channel of communication for reporting human rights violations, legal violations and corruption. The hotline can be accessed by telephone, email and, since 2018, also through the Company's website and intranet. Personnel awareness has been enhanced, and the quality of investigations has improved. Complaints are analysed for systemic problems/deficiencies as well, and action plans are then developed together with the relevant business units.

Security Director's hotline for reporting misconduct by employees of X5 Retail Group. The hotline is intended for Company employees, contractors and third parties.

Violations of the Code of Interaction with Business Partners are investigated by X5's **Conciliation Commission,** which serves as a corporate arbitrator in disputes with business partners. The Commission was established for the purpose of resolving conflicts and disputes in X5's interaction with partners on the basis of the principles of the Code of Good Practice. The Commission's tasks also include improving the efficiency of contractual work done for the Company, creating a platform for direct dialogue between the Company and its partners, and resolving disputes. Violations can be reported through the feedback form on X5's website.

Any report of corruption or human rights violations is subject to an internal investigation. When conducting official internal reviews, the information collected is analysed in its entirety, taking into account evidence confirming one allegation or another, as well as evidence refuting it. The Company guarantees that there will be no retribution against any employees who report violations.

Conflicts of interest

In 2018, we developed a new electronic service for declaring conflicts of interest and also approved an updated **Procedure for Declaring, Reviewing and Resolving Conflicts of Interest** to expand on the provisions of the Code of Business Conduct and Ethics and the Anti-Corruption Policy. Intended for the declaration, review and resolution of conflicts of interest, the service is administered by the Compliance Department.

The approval of the Procedure in 2018 was aimed at having all office staff redeclare any conflicts of interest, as well as directors of retail facilities and their deputies, which will minimise the risk of misconduct through the use of the new automated service for declaring conflicts of interest. Our goal is to see that all conflicts of interest among employees are redeclared through the service by 1 September 2019.

Insider trading

Responsibility for granting permission for operations with securities, the investigation and escalation of incidents involving violations of the Code of Conduct on Insider Information is assigned to the Head of X5's Compliance Department.

Training

New employees are required to familiarise themselves with the Code of Business Conduct and Ethics as part of their introductory training. The main provisions of the Code can be found on the Company's intranet site as part of a distance learning programme.

Employees who interact directly with business partners also receive training on interaction with business partners.

In 2019, updated training on anti-corruption rules and conduct is planned for all employees. Training will be mandatory for all Company employees.

The determination of standards and requirements and the development of training programmes in the areas of ethics, anti-corruption rules and compliance are entrusted to the Compliance Department.

2018 Key highlights

- As of 31 December 2018, 100% of Company employees had been informed about the Anti-Corruption Policy.
- In 2019, we plan to complete the automation of the ethics hotline in order to further reduce compliance risks, to support and reinforce ethical behaviour on the part of employees, and to improve morale.
- In May 2018, the classification of complaints was updated, and monitoring is now ongoing, and statistics are being kept regarding confirmed violations based on the results of investigations.
- Additional pages about the ethics hotline were created on the intranet and public websites for X5 and its formats.
- Employees periodically receive internal notifications regarding gifts, the ethics hotline and other issues related to the Company's position on combating fraud and corruption. Management is focused on communicating with employees regarding our values, including our zero-tolerance policy concerning corruption and other misconduct.
- In 2018, additional training was developed on the Code of Interaction with Business Partners. The training is designed for employees who interact directly with business partners.

Handling of complaints submitted to X5's ethics hotline

Category of violation	2018		2017	
	Total received	Violations confirmed and resolved	Total received	Violations confirmed and resolved
Violations of the Labour Code of the Russian Federation	3,856	823	3,011	197
Violations of the Code of Business Conduct and Ethics	2,196	407	1,836	248

People review

Key highlights

Headcount

2018 **278,399**

2017 **250,874**

2016 **196,128**

Male/female

2018 **27%/73%**

2017 **26%/74%**

2016 **26%/74%**

Investments in training

2018 **RUB 150.7 million**

2017 **RUB 139.3 million**

2016 **RUB 84.6 million**

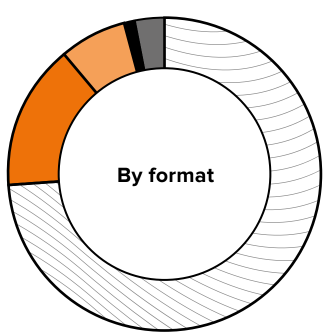
Number of training participants

2018 **422,846**

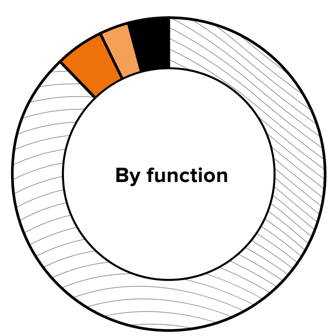
2017 **234,899**

2016 **44,626**

Personnel structure in 2018, %



Pyaterochka	74
Perekrestok	15
Karusel	7
Corporate centre	1
Other	3



Retail operations	88
Logistics	5
Transport	3
Office	4

New HR strategy: X5 – YOUR FIRST CHOICE

One of X5 Retail Group's key goals is to build sustainable value for our employees, as well as our customers and shareholders. Building and strengthening X5's human capital is part of the Company's strategic development plan and key to its long-term success.

We aim to become the best-in-class employer for both current and future employees. X5 and its business divisions will use common metrics—levels of staff turnover and engagement—to assess the effectiveness of actions taken in order to achieve this goal.

We are currently putting together a team capable of driving the creation of a retail industry of the future that is technology-based, personalised and more customer-friendly than ever before. At the same time, we promote the principles of humanity, sincerity and concern for one another. The professionalism on the part of our staff and their engagement in their work is key to achieving our goal of becoming the most customer-oriented company in the Russian retail industry.

Values

As part of our updated strategy, we have adopted and integrated a new set of Company values, which set out cultural and ethical guidelines and reflect our approach to our customers, employees and shareholders. These values are: **honesty and fairness, respect, commitment to achievement, and customer focus.** Our main objective is to be guided by these values in our daily lives and in the choices we make when taking decisions.

Integrity

As part of our updated strategy, we have identified shared values for all of X5's formats. Respect, honesty, fairness, commitment to achievement and customer-centricity are the foundations of the cultural transformation that we need in order to achieve our strategic goals. We have integrated these values into all HR processes and practices, including training and development, recruitment and corporate communications. In 2018, we established our first general award for X5 employees, the Most Valuable Employee award, which was given to 20 individuals across all of our retail formats and business units.

Engagement

"Your voice", a study of employee engagement conducted in the spring of 2018, enabled us to learn what needs to be changed and improved to make X5 the best possible employer in each of its divisions. The study involved more than 35,000 Company employees. Improving working conditions, changing existing managerial practices and further strengthening a strong, talented team are key tasks for working with X5 personnel in 2018 and 2019.

Evolving

In 2018, our HR function carried out extensive work to support innovative aspects of our strategy: we bolstered our IT team, and divisions for working with big data and omnichannel content were created from scratch. These new teams bring together top-tier professionals from the best Russian and international companies in the IT and high-tech sectors.

Approach to personnel management

Human rights

We support the four fundamental principles outlined in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work.

Regulatory requirements

We fully align all of our personnel policies with Russian labour law, providing the appropriate rights, benefits and compensation to all employees.

Labour safety and working conditions

We aim to create a comfortable working environment for our people through an integrated occupational health and safety programme, continuous monitoring and improvement of labour conditions, as well as by accelerating efforts to upgrade work processes.

Effective motivation and fair remuneration

Our processes are designed to uphold a fair, consistent and transparent remuneration and incentive system that reflects individual performance and the Company's financial results. This system has been developed in line with best market practices.

Training and development

We strive to provide ample opportunities for professional and personal growth for employees at every level through high-quality learning tools. All employees, from top managers to retail staff, are offered training programmes in accordance with their job requirements, performance assessments and the specific needs of the Company.

Internal growth

The promotion and development of employees with high potential is one of the key aspects of the Company's work in terms of personnel management and development.

Development of management potential

For the successful implementation of our strategy and the achievement of our goals, a strong management team is needed that is capable of taking on and quickly meeting challenges related to the economy, the market and the changing needs of customers. In 2018, we introduced a systematic, long-term approach to the development of our executives.

Employer brand

Our goal is to become the most attractive possible employer for both our current and future employees. The Company's size, ambitious projects and innovations offer great potential for professional development and career growth. We collaborate with leading universities and youth NGOs, arrange internships for students and provide the best performers with an opportunity to continue working for the Company.

Corporate culture and values

As part of our updated strategy and goals, we have identified common values for all our divisions. They should be reflected in all our business processes and in our relations with employees, customers, suppliers, shareholders, the state and local communities in regions of our presence.

Understanding the strategy and our overall goal

In order to successfully implement our strategy and achieve our goal, it is important that our employees understand the contribution each of them makes to our results and that they share our aspirations. We take a systematic and in-depth approach to communication with staff, constantly expanding the range of channels and tools available for constructive dialogue between managers, employees and the Company's various divisions.

Automation and digitalisation of HR processes

As one of the largest employers in Russia, we employ efficient, state-of-the-art tools in our HR work, and we are constantly making our processes faster and easier to use. We aim to use big data technologies and in-depth analysis of all personnel information for more efficient and more rational decision-making in the area of HR management.

Performance highlights

Working conditions based on best Russian and international practices

Effective motivation and fair remuneration

- In 2018, we adopted uniform policies on benefits and relocation, as well as a regulation on job assessment and grading; we also introduced a cross-format grading system and launched a new long-term remuneration programme for key executives.
- We updated our retail incentive system for productivity growth at Perekrestok; at Karusel, we revised the rewards structure for retail employees and launched a pilot programme to enhance the remuneration system.

Workplace safety and working conditions

- Since 2018, updated standards on staff facilities have been in place that are to be applied during the renovation of Karusel hypermarkets. Perekrestok adopted a new policy on workplace safety and launched a project called “Comfortable Environment” with the aim of upgrading staff canteens to make them more comfortable for personnel.

Automation and digitalisation of HR processes

- In 2018, key HR metrics were identified, an audit of HR processes was conducted, and priorities for automating HR processes were determined. At Pyaterochka, a project focused on electronic document distribution and digital signatures was launched. A system for automated planning of vacation schedules is now operating at all Perekrestok stores, and the Mobile Personnel app was piloted, enabling the format’s Moscow-based locations to request cashiers in exceptional circumstances.
- Pyaterochka and Perekrestok made their HR services more accessible: retail staff can now request and receive HR documents online.

X5 – a company of opportunities

Internal promotions

- In 2018, we solidified our work with our internal talent pool and achieved impressive results in terms of promoting high-potential employees. Some 70% of appointments to management positions in 2018, including to positions reporting directly to the CEO, were existing X5 employees.

Recruitment and adaptation

- As part of the development of our recruitment and adaptation processes for X5 employees, we have implemented a number of helpful initiatives, such as our referral programme at the Corporate Centre level, internship programmes, attracting potential employees through social networks, the Perekrestok Express project for staff migration to other X5 divisions, chat bots, job radars and landing pages for the recruitment of personnel for our Karusel format.
- Our Transport Department has partnered with DOSAAF driving schools to provide new resources for drivers, while the logistics specialists at Perekrestok have added a mentoring programme for new staff.

Training and development

- As part of our updated strategy, our retail formats launched training projects in 2018 for retail and administrative personnel, e.g., an online game and a programme to identify candidates for our internal talent pool at Pyaterochka stores, a new distance learning portal at clever.x5.ru, and virtual-reality training for sales staff at Perekrestok.
- The Category Management Academy, which opened in 2018, became our first general training project for all X5 retail formats.

Development of management potential

- Training seminars and business simulation games were held in 2018 on team-building and decision-making skills for a number of employees in senior positions in our retail formats and logistics divisions.
- Together with the IMD Business School in Switzerland, a team-building programme for managers called “X5 Leaders” was launched; a series of programmes for various management levels will be created in 2019.

Cultural reset

Common cultural and information space

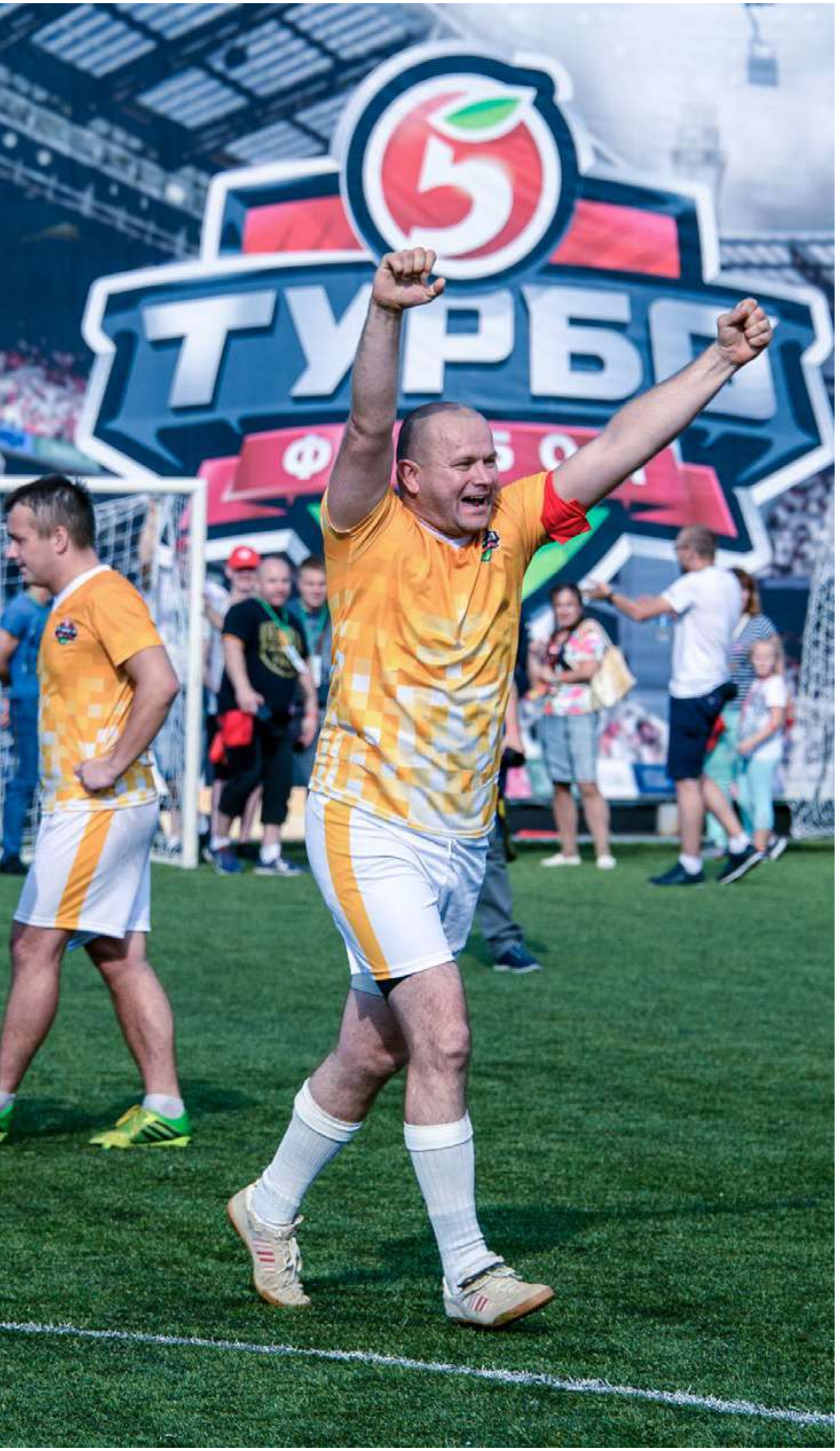
- In October 2018, the X5 Connect information event was held for the first time for employees of our retail formats, business divisions and the Corporate Centre. More than 1,000 people watched video broadcasts of executive presentations, and some 500 questions were asked. In 2019, X5 Connect will be held twice: in April and in October.
- Turbo FM corporate radio appeared in Pyaterochka stores; Perekrestok launched the first X5 mobile application for operational staff; Karusel and our Transport Department continued to arrange regular meetings for employees and top executives.

Maintaining the prestige of working in retail and operations

- In 2018, our Pyaterochka format held a number of contests: for the best store team, for increasing sales in various divisions, and for the best staff in various professions at distribution centres.
- The “Logistics Superman” competition was held for the first time at Perekrestok, and an operational competition called “Champions League” was organised for the format’s stores.
- The “League of Professional X5 Drivers” was named the “Event of the Year” in a national industrywide competition.

Events with meaning

- During the World Cup, more than 700 Company employees received tickets to matches throughout the country as a reward for their professional achievements.
- Throughout the summer of 2018, Pyaterochka staff from all over the country competed in the Turbo football corporate championship. The event brought together more than 27,000 people from no fewer than 17 cities. While Perekrestok held its first-ever volleyball championship, Karusel hypermarkets celebrated stores’ birthdays and New Year’s Eve, and also organised sports competitions to go along with the World Cup.
- “Special Wednesday: The Weekend”, organised in partnership with the Liza Alert search-and-rescue team and dedicated to child safety, brought together more than 400 X5 employees and their children. They took part in a quest developed by the Liza Alert School on safety advice. Instructors from the search-and-rescue team gave a lecture for parents on child safety, and they also explained how parents should talk with their children about safety.



Turbo football

One of the key corporate events for Pyaterochka employees last year was the Turbo football championship. Russia hosted the World Cup in 2018, and X5 organised football matches in a number of cities across the country. Cashiers, warehouse operators, lawyers, financiers—employees from various departments demonstrated their teamwork and ball-handling skills.

Highlights for 2018

25,000 fans

23,000 kilometres run by football players

2,216 players

17 cities

4 months of football matches

Occupational health and safety

Occupational Health and Safety Strategy

Protecting the health and well-being of our employees is a top priority for X5. Occupational Health and Safety (OHS) measures aim to reduce injuries and occupational diseases, as well as improve working conditions, which ultimately leads to greater efficiency.

The main objectives of our OHS strategy are:
- Protecting the health and safety of our employees
- Ensuring that our OHS performance is in line with corporate standards and applicable laws
- Ensuring the best possible protection for workers in emergency situations
- Reducing the number of accidents at our facilities

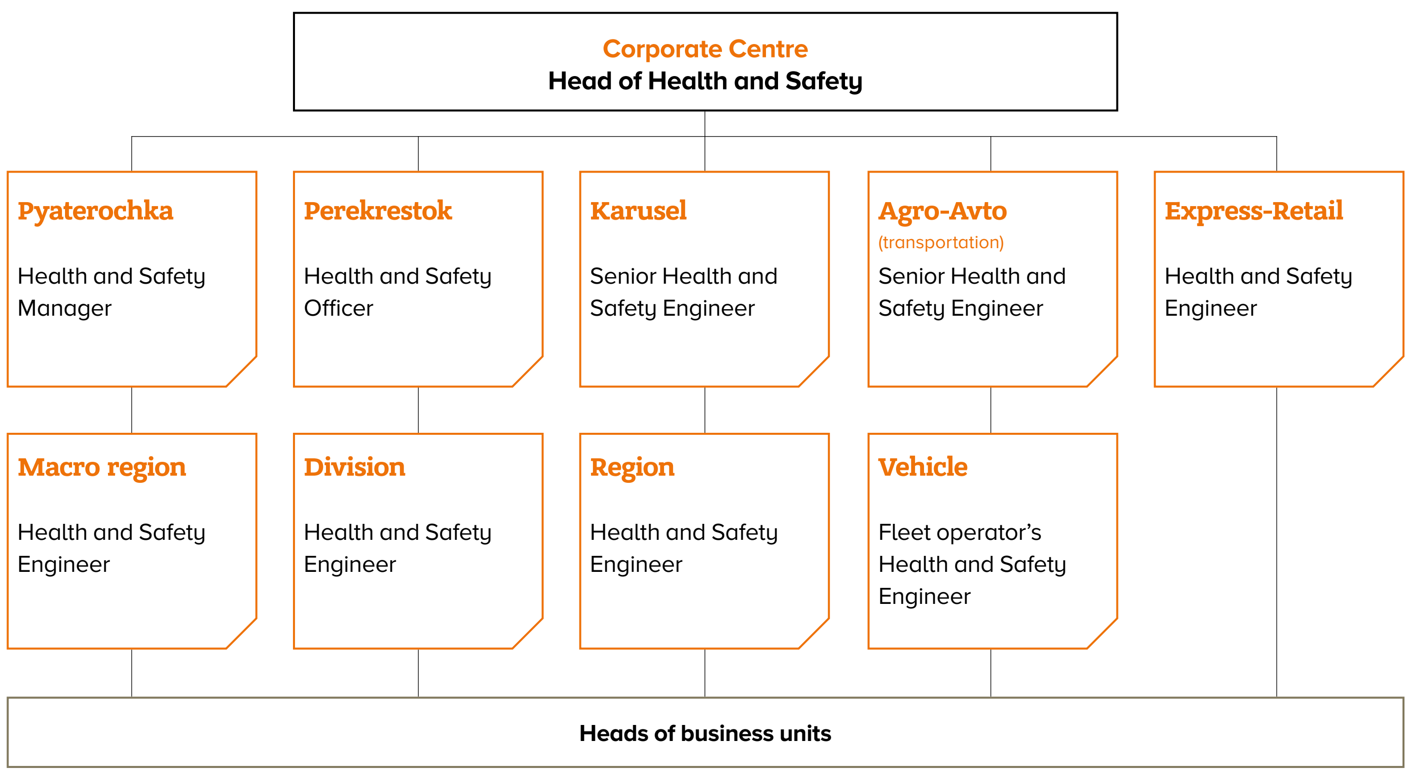
Policy highlights

The main internal document governing occupational health and safety at X5 is the **Occupational Health and Safety Policy.**

The main aspects covered by our OHS Policy are:

- Ensuring OHS for our employees by taking preventive measures to avoid injuries and health impairments
- Ensuring that we have a functioning OHS management system and continuously improving it in accordance with changing legislative and other regulatory requirements in the area of occupational health and safety
- Ensuring that employees are informed about working conditions and OHS in the workplace, about health risks and any compensation and benefits they are entitled to
- Improving employee training in the area of occupational health and safety

OHS organisational chart



Implementation of our Occupational Health and Safety Policy is the purview of the **Corporate Centre's Occupational Health and Safety Department,** together with key managers in each of our retail formats. Each retail format has its own occupational health service that employs from five to 40 people (see the organisational chart on the opposite page).

These services are mainly responsible for the following:
- Ensuring that workplaces are safe and secure
- Sharing information about workplace health and safety
- Supporting X5's Occupational Health and Safety Policy by studying and analysing occupational risks

All of the Company's work in the area of OHS complies with Russian Federation regulations. We have developed a system of corporate standards and regulations on OHS that form a unified set of organisational, technical, sanitary and preventive measures aimed at ensuring safety and protecting the health of employees and their working capacity.

Company-wide KPIs to improve labour efficiency and to motivate employees to achieve better results also include elements related to OHS.

For example, one of the goals of the KPIs for our key OHS specialists is to conduct a special assessment of working conditions. This enables the Company to identify dangerous or potentially harmful workplaces and makes it possible to take corrective measures in a timely manner in order to rectify OHS violations, which in turn minimises the administrative penalties assessed by state regulatory agencies. Our policies also entail considerable monetary penalties for OHS violations.

System highlights

Improving OHS competencies

- We have made considerable efforts to establish a culture of responsible behaviour in the areas of OHS, fire safety and road safety
- In accordance with applicable legislation, all X5 personnel must undergo every type of compulsory OHS training in a timely manner through specialised organisations, distance learning courses and/or OHS briefings
- An important aspect of our activities is the engagement and motivation of employees to comply with safety requirements, as well as training and informing employees about safe working methods. Training is aimed at improving the competencies of employees in accordance with internal standards and best practices in the development of an OHS management system
- Training for blue-collar personnel takes place through special corporate courses that complement legally required training on OHS issues; a significant number of programmes and instructions on OHS issues have been issued, which are designed for high-volume staff training and for a variety of target audiences
- X5's main OHS documents are accessible to employees on each retail format's intranet site
- We ensure that best industry and global practices are studied and applied as part of our process of continuous improvement

Prevention of workplace injuries

- We pay special attention to conducting assessments of working conditions
- To assess the impact of hazardous and potentially harmful conditions in every workplace within X5, health and safety engineers across all divisions in the Company carried out a special assessment of working conditions. The results of the assessment indicate that all workplaces meet the requirements of OHS legislation, with the exception of 200 potentially hazardous ones where loading and unloading work is carried out in warehouse refrigerators at distribution centres. Employees are entitled to compensation and benefits in accordance with applicable legislation for working in hazardous conditions. We are working towards further improvement of working conditions and additional vacation time for these employees.
- All X5 employees are provided with modern protective gear designed for the specific working conditions at each workplace.

Protecting the health of employees and customers

- In order to protect public health and the health of employees, as well as to prevent the occurrence and spread of infectious and occupational diseases at X5, mandatory pre-employment and periodic medical examinations are carried out for all employees of commercial facilities and the Transport Department. Should signs of an infection be discovered, the employees concerned are not allowed to come to work and are sent for further treatment.
- For preventive purposes, flu and other legally required vaccinations are provided.

Managing occupational risks

- The occupational risk management system developed in 2018 makes it possible to minimise the likelihood of accidents and emergencies. The system establishes risk ratings, determines the responsible parties for various risks, and allows for the development of risk management action plans and oversight of their implementation.
- Risk assessment involves an annual review and, if necessary, the addition or removal of a risk in order to achieve the required degree of control over those factors that entail an occupational health risk, the establishment of an advanced occupational risk management system that covers every workplace within X5, and keeping the system up to date
- Work is under way to develop a risk register for all workplaces, which will enable all managers and personnel to focus on eliminating or reducing the impact of potential hazards on employees, as well as to draw up, in a timely manner, corrective plans aimed at improving working conditions
- In order to achieve this goal, X5's OHS Department intends to develop innovative approaches to the implementation of regulations and methods aimed at protecting workers' health and labour rights

Investigating incidents and accidents at our facilities

- We have developed and introduced an incident/accident investigation procedure, whereby every case is investigated and a plan is developed for further action aimed at eliminating the causes of the incident and preventing a recurrence of the incident in future
- We provide accident insurance for our employees. All employees are covered by insurance as part of their employment agreement
- The insurance indemnity is paid out to employees in case of serious accidents or to their family members in the event of a fatal accident
- The accident rate is analysed on a quarterly basis, which acts as a mechanism for recording and providing notification in case of accidents and occupational diseases, as well as a mechanism for the regular collection of the statistical data needed to determine priorities when implementing preventive and protective measures. In 2018, X5 registered 19,291 incidents/accident cases. In 68% of cases, the issue was resolved within five working days.

Monitoring compliance with OHS legislation

- X5 has in place a system for monitoring working conditions and occupational health and safety at every facility that is based on the principles of self-monitoring, mutual monitoring and managerial oversight, while the system status is constantly monitored, and preventive measures are constantly being taken to reduce injuries
- To prevent accidents and emergencies at X5 facilities, internal audits are carried out, the main task of which is to identify violations of state regulations and standards, as well as Company regulations
- To reduce labour costs when conducting audits, we use checklists that were introduced by Russia's Labour Ministry in July 2018 and integrated into X5's OHS management system
- Based on the results of these audits, measures are developed to improve the safety of workplaces and to prevent risks to the life and health of employees; the monitoring of compliance with the safety requirements established by federal laws and other regulations is improved, as is the monitoring of discipline in the workplace
- At X5, monitoring of compliance with OHS legislation and financial oversight related to the implementation of OHS measures are carried out by the Department of Occupational Health and Safety and the authorised OHS personnel in each retail format. The Department systematically reports on the following to the Company's management:
  - the results of internal audits and assessments of compliance with the requirements of OHS legislation
  - the results of external audits conducted by oversight bodies, including complaints and claims
  - the results of incident investigations, as well as corrective and preventive actions
  - measures taken by the retail format in question based on the results of previous audits
  - information on changes in OHS legislation
  - quarterly and annual injury reports

2018 performance highlights

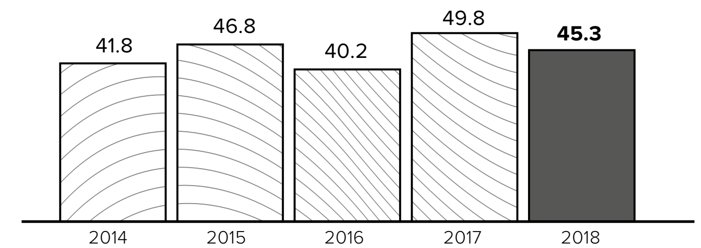
- The Company strictly adhered to OHS and sanitation standards, as a result of which no cases of occupational diseases were reported
- In 2018, we recorded a decrease in the severity and frequency of injuries compared to previous years, which is associated with ongoing activities that contribute to the prevention of injuries and accidents and that are aimed at compliance with the requirements of state regulations concerning the minimum conditions for safe work
- State regulatory bodies conducted 38 external inspections of compliance with OHS legislation and found 32 OHS violations, which was fewer than in 2017, and issued orders to rectify violations of labour legislation within the established period
- Special corporate training courses were developed for distance learning on occupational health and safety for all blue-collar positions. In 2018, 62,828 blue-collar workers were trained, in addition to managers and specialists
- A safety Gemba walk was carried out in the Logistics Department, and an internal OHS audit was carried out at commercial facilities using checklists approved by Russia's Labour Ministry, which will make it possible to avoid routine on-site inspections by state regulatory bodies and to reveal and eliminate OHS violations in a more comprehensive manner
- The Automated Medical Examination project ensured that nearly 100% of employees underwent examinations, thereby minimising administrative penalties assessed by regulatory authorities
- Projects were introduced in the Logistics Department that ensured safe working conditions and increased labour productivity: this involved the mechanisation and automation of warehousing, reducing manual operations to the maximum extent possible (especially strenuous manual labour during loading and unloading operations), the installation of additional protective devices and BlueSpot warning alarms on electric vehicles, and many other projects that improved working conditions and the safety of employees in warehousing operations
- Thanks to X5's participation in a state programme that provides financial support for preventive measures to reduce workplace injuries, a special assessment of working conditions was carried out at X5 that was financed by the Social Insurance Fund of the Russian Federation, which saved the Company about RUB 16 million

The increase in the number of inspections was due to the introduction of electronic checklists within the Company as part of the optimisation of business processes. The significant increase in the number of OHS violations was due to the expansion of the checklist as recommended by the Ministry of Labour. The main violations found were of an organisational nature:

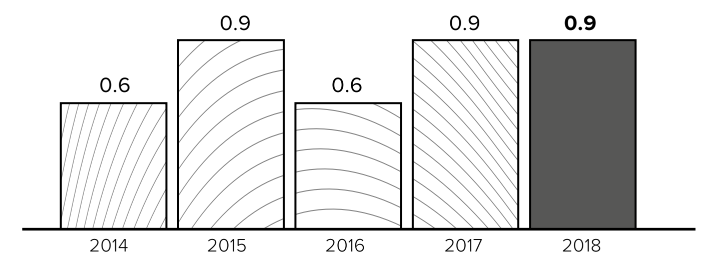
- 80% involved improper documentation for staff briefings, lack of signatures in OHS journals
- 20% of violations were technical: the lack of fencing around equipment, the lack of warning signs, etc.

All violations are rectified as quickly as possible by technical services and department heads.

Severe accident ratio
Total number of employee work days lost per accident



Accident frequency ratio
Number of accidents per 1,000 employees



Scheduled inspections in 2018

Retail format	Number of inspections (external and internal)	Number of identified violations	Number of violations resolved within 5 days	Number of violations resolved in more than 5 days
Perekrestok	741	6,346	3,663	2,683
Karusel	77	35	25	10
Pyaterochka	6,227	11,334	8,584	2,750
Transport	343	1,576	928	648
TOTAL	**7,388**	**19,291**	**13,200**	**6,091**

X5 injury statistics

	Number of accidents						Total		Work days lost	
	Fatal		Severe		Minor					
Format	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Karusel	0	0	1	3	12	35	13	38	859	1,158
Perekrestok	0	0	1	2	24	11	25	13	936	600
Pyaterochka	0	0	13	9	127	107	140	116	5,798	6,251
Transport	1	0	2	4	18	17	21	21	1,428	1,247
TOTAL	**1**	**0**	**17**	**18**	**181**	**170**	**199**	**188**	**9,021**	**9,256**

Environmental review

Key objective

As our business grows and develops, so does our environmental footprint. Taking a responsible approach to our impact on the environment is one of the keys to the Company's successful and sustainable long-term development.

Environmental strategy

As a leader in Russia's food retail market, we are aware of the extent of our impact on the environment, and we strive to fully comply with Russian legislative requirements and the highest international environmental protection standards. At the same time, we take every opportunity to improve our business efficiency while implementing our environmental policy and to generate additional profit.

Policy highlights

- At the Corporate Centre level, we set Group-wide strategic priorities that impact our environmental footprint.
- Our management team is responsible for setting goals and objectives in terms of our environmental performance and for carrying out regular monitoring of measures aimed at achieving those goals.
- Each of our retail formats and our logistics and transport divisions are independently responsible for implementing their environmental policy and for complying with Russian regulatory norms regarding waste disposal and emissions.
- We aim to minimise any negative environmental impacts associated with waste generation and harmful emissions from our operations, and we carry out a variety of activities in our stores, distribution centres and offices that focus on three main areas: energy efficiency, secondary raw materials (recyclable waste) and waste management. In doing so, we are guided by the following principles:
  - We try to reuse and recycle all sorts of materials, including cardboard, shrink wrap, plastic boxes, banana boxes, waste vegetable oil, scrap metal and pallet scrap
  - We strive to minimise the risk of violating sanitary regulations or rules for the collection, storage and disposal of waste
  - We are reducing energy consumption by introducing energy-saving technologies in our stores, distribution centres and offices
  - We welcome all stakeholders to play a part in determining our approach to our environmental strategy
- Our distribution centres and logistics facilities strictly adhere to pest control and de-infestation procedures
- Internal audits enable us to evaluate the effectiveness of the measures taken and to set new goals for our environmental policy
- To ensure the participation of every manager and employee in our environmental actions, we have developed special training and courses.
- Waste generated by our stores is transferred to third parties either for burial at landfill sites or for further recycling. We have established a list of recyclable waste to be disposed of by third parties, significantly reducing the quantities to be discarded and, as a result, the negative environmental impact of landfills

2018 performance highlights

Goals and targets

	Pyaterochka	Perekrestok	Karusel	Logistics
Energy efficiency	• Using LED lighting in all stores • Installing energy-efficient equipment in stores • Enhancing data collection mechanisms to minimise energy use, including through internal process automatisation • Tariff optimisation			• Using modern energy-saving technologies to optimise energy use in DCs
Recycling	• Collect and sell 100% of recyclable waste • Continue to launch new initiatives to enhance culture of recycling in the Company			
Waste management	• Smart waste management • Minimising waste disposal costs • Compliance with Russian legislation in terms of waste disposal	• Efficient storage and disposal of organic waste, including using special equipment • Compliance with veterinary rules and regulations in waste management process		• Smart waste management • Minimising waste disposal costs • Compliance with Russian legislation in terms of waste disposal
Emissions				• Compliance with Russian legislation in terms of emissions • Reducing emissions through truck fleet improvement and supply chain optimisation

Energy efficiency

Electricity consumption accounts for around 56% of our total utilities costs, which makes it the most important area of focus. X5 continued implementing a number of initiatives aimed at optimising electricity usage throughout 2018.

Monitoring energy consumption

- In 2018, we completed a pilot project and began equipping stores with an automated data collection system (ADCS) as part of a project to monitor and record the volume and quality of electricity usage at Pyaterochka. This system enables the use of an online system to automatically reduce electricity consumption, analyse data flows and calculate optimal tariffs. By the end of December 2018, more than 7,000 Pyaterochka stores had been equipped with smart meters that saved the Company RUB 75 million during the year. We currently plan to install the system in another 756 existing stores in 2019 and also to equip all newly built stores that come online with smart meters as well. The installation of the system is expected to save the Company at least RUB 150 million per year from 2019.
- In addition, the ADCS enables Pyaterochka to take advantage of every opportunity available in the wholesale and retail energy markets in terms of tariff management by moving its purchase of electricity to a retail provider. Electricity prices offered by retail providers are at least 2% lower than the current prices offered by guaranteed suppliers.
- In 2018, Perekrestok launched a project called “Energy-Efficiency Upgrade of the Automated Commercial Energy Metering System” (ACEMS). The ACEMS project allows us to obtain reliable information on electricity consumption, to check our meters on the spot and to conclude direct contracts for energy supply on the basis of multi-tariff payments. As of the end of 2018, more than 400 of the format’s stores had been equipped with this system, and the project is due to be completed in July 2019.

Remote operation

- All Pyaterochka sites operated remote-controlled refrigeration systems in 2018, and we are able to remotely monitor control and maintenance of refrigeration equipment. In 2018, the savings amounted to RUB 70 million due to reductions in service calls for repairs to refrigeration equipment and for adjustments of the settings for optimal conditions in terms of cooling capacity.

Lab store

- In developing and introducing innovations based on Pyaterochka’s lab store, a smart store project was developed and piloted in three locations. The purpose of the project is to enable remote, automatic monitoring and control of the operation of all electrical systems at a particular location. This is the first such project in the market; there were no ready-made solutions available; instead, everything was developed specifically to meet our needs. The expected result will be energy savings equal to about 7% of current consumption.

LED lighting

As part of our efforts to improve energy efficiency throughout our Karusel format, the lighting was upgraded at a number of sites:

- During reconstruction works, 16 sites were completely switched over to LED lighting. As of the end of 2018, 24 stores had been completely switched over. All Perekrestok and Pyaterochka stores already have LED lighting installed.
- Fluorescent lights were replaced with LED lighting at 16 sites.
- Neon signs were replaced with LED signs at four sites.

Recyclable waste

- The Pyaterochka, Perekrestok and Karusel retail formats sell 100% of their recyclable waste. Our retail formats and distribution centres do not carry out their own independent processing of secondary raw materials and waste. Our stores and distribution centres collect and compress cardboard. All secondary raw materials are then centrally collected and sold to specialised companies or suppliers for further use or recycling. All contractors are audited by the Company as part of the tender process, after which the best specialised company is chosen in terms of reliability, capacity and price.
- In addition, Pyaterochka operates a portal for returnable packaging that suppliers can use to purchase recycled materials from distribution centres.
- At Perekrestok, all the containers, pallets and plastic boxes that are to be reused are sent back to distribution centres.
- In 2018, Pyaterochka worked on developing a project to use recycling kiosks to collect PET bottles from the general population. A pilot project to install recycling kiosks in stores is scheduled to launch in 2019, which will be used to determine how much demand there is for this service among shoppers.
- The central offices of our retail formats also run separate waste collection for used batteries, plastic, polyethylene, paper and aluminium cans. Collection points are available for batteries and waste paper.

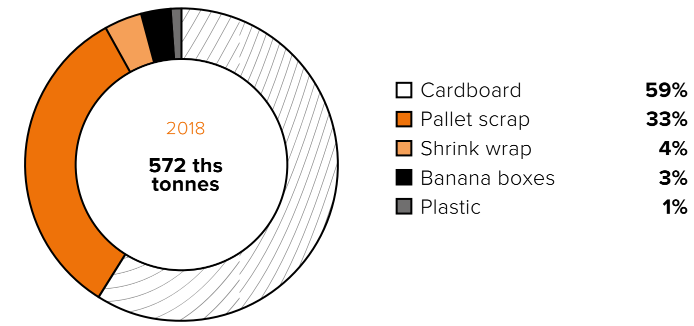
Organic waste management

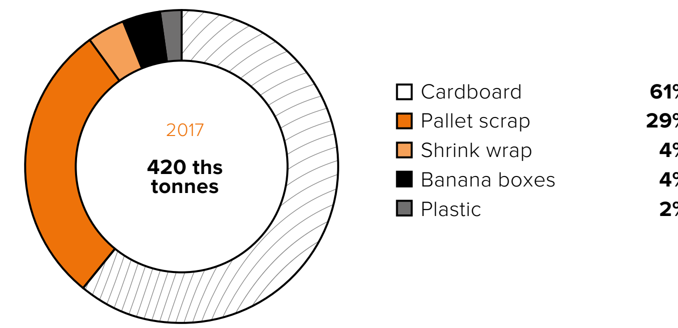
- Both renovated and newly built Karusel hypermarkets have installed biocompactors for processing and compressing organic waste. Thanks to the special design of these hermetically sealed containers, the compressor is protected from moisture, which helps minimise the decay of rotting food waste, keeping the area clean and in line with sanitary standards.
- Karusel hypermarkets and Perekrestok supermarkets are also equipped with special refrigerators for the temporary storage of food and biological waste. This enabled the Company to set up a process for collecting, storing and disposing of waste in accordance with veterinary rules and regulations.

Total income from sale of recyclable waste, RUB mln

	2018	2017	% change, y-o-y
Pyaterochka	1,817	1,386	31.1%
Perekrestok	314	172	82.4%
Karusel	145	139	4.3%
TOTAL	**2,276**	**1,697**	**34.1%**

Amount of recyclable waste sold, tonnes





- As part of a project to reduce the cost of Pyaterochka’s solid waste collection, arrangements were made in 2018 to sell food waste in the fruit and vegetable and bread categories from stores and distribution centres. As a result of the pilot project, expenditures on solid waste collection were reduced by RUB 4 million, as we were able to start selling waste to farms and zoos etc. instead of sending it to landfills. Pyaterochka became the first company in the industry to start selling food waste, which gave rise to a demand market and the appearance of new partners. We now expect to see a positive price trend in 2019.
- At Perekrestok stores, all food and biological waste must be destroyed or processed into animal feed. Perekrestok arranges centralised monthly removal of food and biological waste.

Supply chain environmental strategy

As the scale of our business grows, so does our supply chain network: we are continuously expanding our distribution centres and fleet of trucks, as well as our use of outsourced transportation services. While implementing our environmental strategies, we strive to reduce our footprint by optimising our logistics network, managing the solid waste we generate responsibly and using the most environmentally efficient technologies in our supply chain operations.

Policy highlights

Distribution centres

X5 is implementing eco-development principles for its logistics network and is fully compliant with Russian legislation. The main goals of our DCs are to reduce the consumption of energy and materials, while also increasing the quality of buildings and reducing operating costs, thereby reducing our environmental impact. At our distribution centres, we also collect and sell cardboard, plastic shrink wrap, packing materials and pallets as recyclable waste and dispose of domestic solid waste in accordance with Russian legislation.

Transport

Our Transport Department has a significant environmental impact, and we use a variety of tools to minimise the footprint of our transport services from distribution centres to stores, including investments in a modern and efficient truck fleet, optimising itineraries and disposing of car tyres and tubes, batteries, ferrous and non-ferrous metals, car oil and other materials in line with Russian law.

2018 performance highlights

Reducing mileage

- The Company strives to optimise transport itineraries, thereby decreasing logistics costs and reducing the environmental impact. Through this optimisation, the Company managed to decrease the share of empty-car miles as a percentage of total miles from 47% in 2016 to 35% in 2017 and 31% in 2018.

	2018	2017	2016
Total miles, mln km	443.8	344.9	242.3
Empty-car miles, mln km	156.3	142.6	113.1
Share of empty-car miles as % of total miles	35.2%	41.3%	46.7%

- As 85% of our distribution centres are leased, we are flexible at changing DC locations depending on current needs and store base, which enables us to choose the most efficient locations in terms of transportation.
- In 2018, the Company launched a project to use vehicles with increased cargo capacity, which will reduce fuel consumption and vehicle mileage, thus increasing the efficiency of cargo transportation, in terms of both cost and environmental impact.
- In 2018, we launched a project to switch our supply chain from road to rail for transportation over long distances, which also has a positive effect on our environment impact.

Improving truck fleet

- Improving our truck fleet is one of the Company's key priorities. Our truck fleet covered 85% of our transport needs in 2018, compared to 74% in 2017, and it is newer than the fleets of most of our external contractors.
- In 2018, the Company launched a full-scale process to re-equip its own fleet with hybrid gas-diesel engines. At the end of 2018, there were 280 vehicles with hybrid engines in the truck fleet, and by the end of 2019, the Company plans to have over 3,400 hybrid-engine vehicles in its fleet, taking into account planned purchases of new trucks.
- We only use certified service stations to provide regular maintenance for our trucks in line with legislation and the norms established by truck manufacturers. We also monitor the condition of our vehicles, including their exhaust systems on a daily basis, which is part of our mechanics' and drivers' responsibilities.
- We do not purchase used or outdated vehicles, nor do we use vehicles that have reached the end of their service life in accordance with the manufacturer's recommendations. By the end of 2018, the average age of our fleet was two years, compared to an average age of three years at the end of 2016. As of year-end 2018, 90% of our truck fleet met Euro 4 or Euro 5 standards, while 10% met Euro 3 standard. Since 2018, we have been purchasing only Euro 5 or higher-class vehicles, and we have been using only high-quality fuel from leading producers. We purchased 916 Euro 5 standard trucks in 2018, compared to 314 in 2017. Our ongoing updates to our fleet have had a positive impact on our emissions performance:

Type of emission	2018	2017	% change, y-o-y
CO (carbon monoxide), grams/kW/hour	1.50	1.55	-3.2
HC (hydrocarbon), grams/kW/hour	0.46	0.48	-4.2
NOx (nitrogen oxide), grams/kW/hour	2.00	3.12	-35.9
Suspended particles, grams/kW/hour	0.02	0.03	-33.3

- In 2018, we launched a project to install thermo-curtains and PVC curtains on trucks, which enables us to implement strict standards for our cold chain, as well as to reduce fuel costs and the use of cooling materials, especially when there are significant temperature differences between the vehicle and the environment.
- In 2018, 100% of the tyres and batteries used by our transport fleet were recycled.

Transportation fleet solid waste disposal

	2018	2017	% change, y-o-y
Number of tyres disposed for recycling, units	3,976	3,136	26.8
Batteries disposed of for recycling, kg	64,227	48,756	31.7

- Transportation contractors are responsible for compliance with environmental requirements, and our transport service agreements stipulate that trucks must meet all legislative requirements, including environmental requirements.

Recycling and waste management

We aim to reduce the use of disposable packaging materials. Starting from 2018, X5 has been implementing a project to use pooling containers, thereby reducing the waste of cardboard, wood and plastic.

As part of X5's optimisation of business processes and the implementation of the Digital Economy state project, we launched a project to use electronic transportation documentation, which will make it possible to reduce paper use by more than 20 tonnes per year, given the current fleet size.

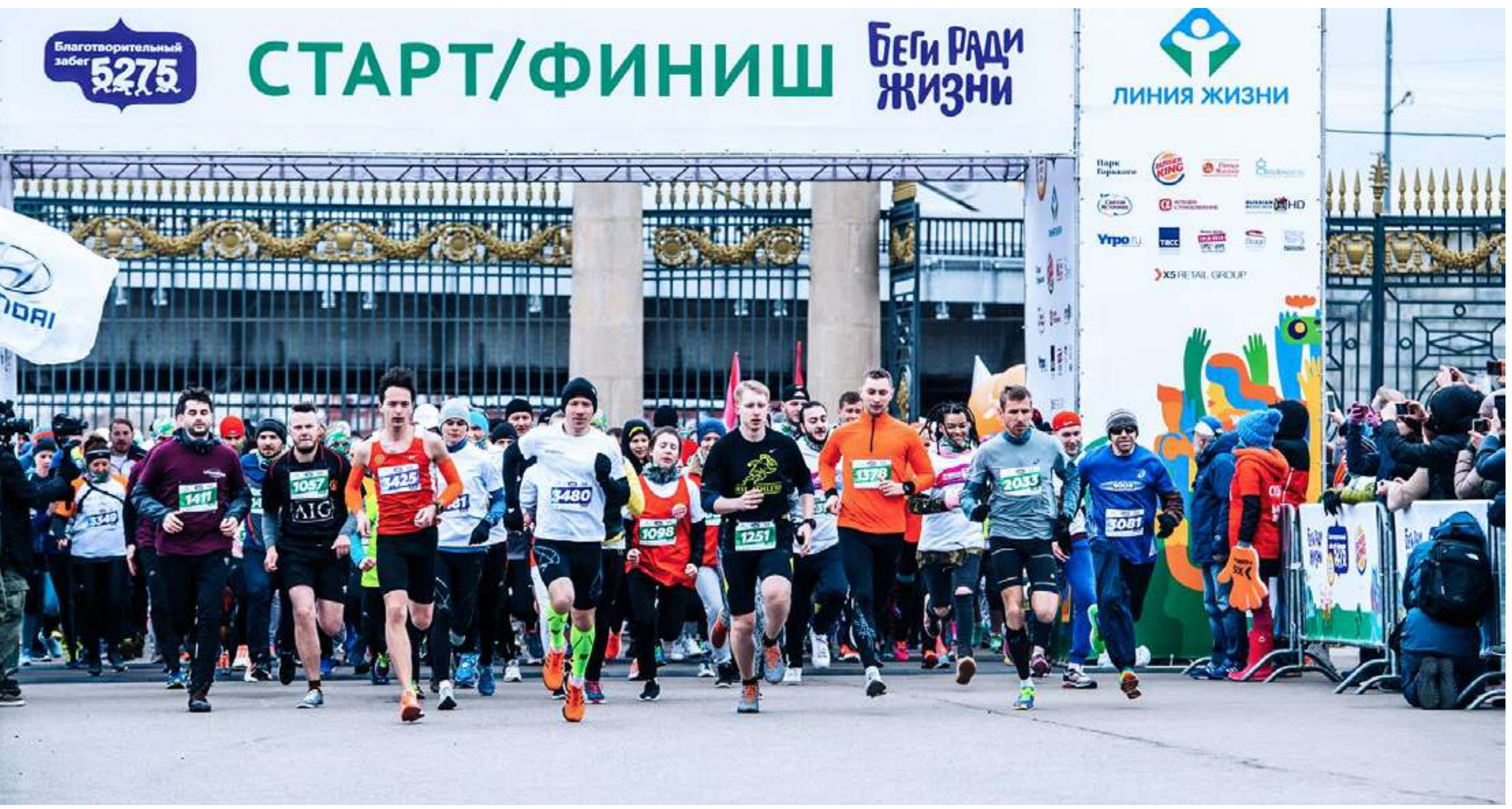
Community investment review

Community strategy

X5 is Russia's leading food retailer, and we understand that our activities have a social impact. We strive to have a meaningful and positive impact on society through both our day-to-day business activities and through targeted charity and social work. An effective dialogue with the communities and the public authorities of all levels in the areas where we operate is key for us to build value for all of our stakeholders.

Policy highlights

- X5 strives to comply with relevant local and national regulations, frameworks, guidelines, globally applicable standards and best practices at all times.
- The Company's senior management team and Board of Directors monitor and regularly review X5's community investment activity and its performance against set targets.
- X5's community investment activities are designed to be focused and targeted in three key areas: food aid, support for children's causes and helping those with disabilities.
- X5 implements its community investment activities in such a way as to facilitate the implementation of national development programmes, contribute to raising living standards and to provide support to vulnerable groups in society.
- We do not provide financial or other forms of support to non-charitable organisations or activities, nor do we provide financial assistance on an individual basis.
- X5 does not seek commercial or other benefits from its community investment activities, nor does it undertake such activities as a way of exerting influence over public authorities, political figures, or private companies.



System highlights

- In 2017, a new corporate policy was adopted governing the Company's charity activities. It establishes the key priorities, roles and responsibilities of Company departments and individual employees involved directly or indirectly in charity work.
- Responsibility for day-to-day implementation of our community investment activities lies with X5's different business units, depending on the specific tasks and responsibilities required.
- The community investment activities of X5's individual retail formats are determined jointly between the formats themselves and the Corporate Centre, which provides support and advice on best practices and ensures that all activities are coordinated to create value for all stakeholders.
- KPIs are determined in conjunction with experienced external consultants as part of the advancement of the Company's sustainable development programme. The KPIs are primarily aimed at developing food aid on the federal level and are integrated in incentivisation programmes for the responsible X5 employees.
- We regularly monitor our community relationships and conduct periodic audits and assessments to ensure that our aims are being achieved while meeting the needs of local communities. We use surveys to receive feedback from all participants in our charity programmes, including partner non-governmental organisations, local authorities and aid recipients.
- X5 is committed to maintaining a regular dialogue with local communities and other stakeholders in our regions of presence, as well as with authorities at all levels, including the Ministry of Social Development to ensure our community investment activities dovetail with local, regional and national priorities.
- Oversight of X5's community investment activities lies with the Company's Corporate Communications Department.

2018 performance highlights

Food aid

X5 carries out a number of food aid programmes for people in need.

Since 2015, the Company, together with the Rus Food Foundation, has been implementing a project called Basket of Kindness, where shoppers at X5 retail chains can purchase and donate groceries for those in need.

In 2018, X5 and the Rus Food Foundation held citywide food marathons in five metropolitan areas: Moscow, Yekaterinburg, Samara and Kazan, as well as an online marathon in Nizhny Novgorod.

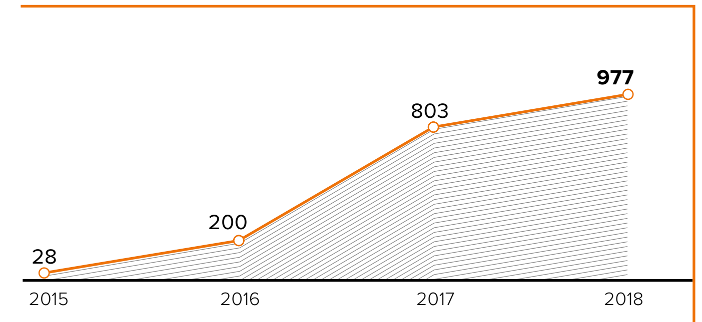
The first event was held in Kazan on 3 March, collecting more than 12 tonnes of groceries. On 21 April, Yekaterinburg took over the “baton of kindness”, with city residents donating about 11 tonnes of food. On 29 September, a food marathon was held in Samara, where more than 7 tonnes of food were collected. On 8 December, an event timed to coincide with New Year’s and Christmas celebrations took place in Moscow and brought in about 25 tonnes of food aid. In Nizhny Novgorod, the marathon was organised online on the official website of the Basket of Kindness project, корзинадоброты.рф. As a result of the event, which ran from 15 August to 15 October, pensioners in need of assistance received 1,400 grocery packages (8.7 tonnes of food).

In autumn, the Basket of Kindness project launched a new programme to collect groceries and pet food in dedicated boxes at Karusel hypermarkets.

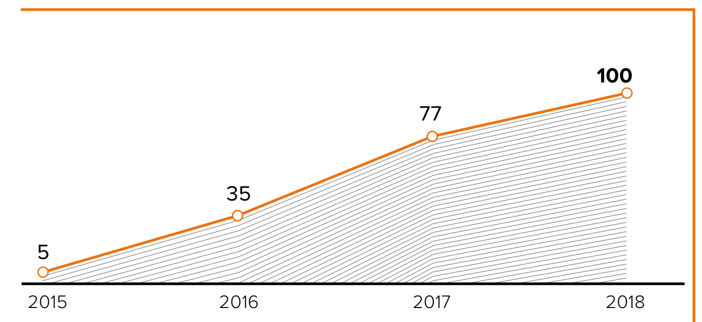
During events held in more than 900 stores in 2018, 100 tonnes of groceries were collected, which were then donated to more than 10,000 low-income families.

Basket of Kindness results

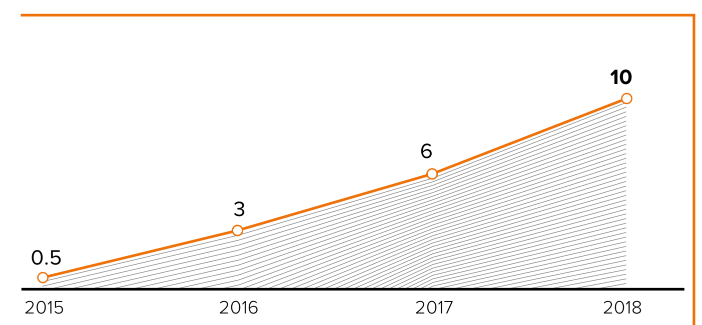
Number of participating stores



Amount of collected groceries, tonnes



Number of families who received support, ths



Support for children's causes

X5 works closely with the Life Line Foundation as part of initiatives to assist children in need throughout Russia. These projects include:

- Donation boxes placed in stores to help children with serious illnesses. In 2018, these boxes raised RUB 12.5 million compared to RUB 14 million in 2017.
- Shoppers at Pyaterochka stores can purchase so-called Candies of Kindness at checkout counters in order to donate RUB 5 to the Life Line Foundation. In 2018, this initiative collected RUB 8.5 million to help children with serious illnesses compared to RUB 7.8 million in 2017.
- Members of the Perekrestok Club loyalty programme can now help children with serious medical conditions by donating points accumulated on their bonus card to charity. Through this initiative, RUB 2.2 million was donated to the Life Line Foundation in 2018 compared to RUB 1.1 million in 2017.
- Since 2016, RUB 1 from the sale of every package of Bonte waffles at Perekrestok supermarkets has been donated to the Life Line Foundation. In 2018, this initiative raised more than RUB 1 million compared to around RUB 800,000 in 2017.
- Company employees regularly take part in the charity fairs that X5 organises together with its partners. In 2018, these fairs raised RUB 107,500 for the Life Line Foundation compared to RUB 300,000 in 2017.

X5 also works with the Connection Deaf-Blind Support Foundation, which provides assistance to people with hearing and visual impairments. In April 2017, the Company launched a new project called "Purchase a Bag, Help a Child", through which a portion of the proceeds from the sale of shopping bags at Pyaterochka, Perekrestok and Karusel stores will be used to treat and support children with vision and hearing impairments. In 2018, about RUB 50 million was collected through the project compared to RUB 28 million in 2017.

Since March 2018, X5, through its Pyaterochka store in Troitsk, has been delivering groceries to two so-called quiet homes, Russia's first specialised residential institutions for people with visual and hearing impairments.

Support for vulnerable social groups

X5 provides assistance to vulnerable groups of citizens by offering basic grocery necessities at affordable prices. For several years now, stores have been offering discounts for senior citizens, and the Company plans to continue this practice in the future. Pyaterochka stores offer pensioners a 10% discount from 9 a.m. to 1 p.m. on Mondays and a 5% discount every other day of the week, including weekends. Perekrestok supermarkets offer a 10% discount from 9 a.m. to 1 p.m. on weekdays, while Karusel hypermarkets offer a 5% discount from opening until 1 p.m. In 2018, pensioners made over 447 million purchases at X5 stores, thereby saving RUB 11 billion through pensioner discounts.

In 2018, more than 535,000 people received benefits from the electronic social card programme developed by the Moscow City Council for shopping at Pyaterochka, Perekrestok and Karusel stores (compared to 208,000 people in 2017), which provides an additional discount to shoppers who are recipients of certain social benefits.

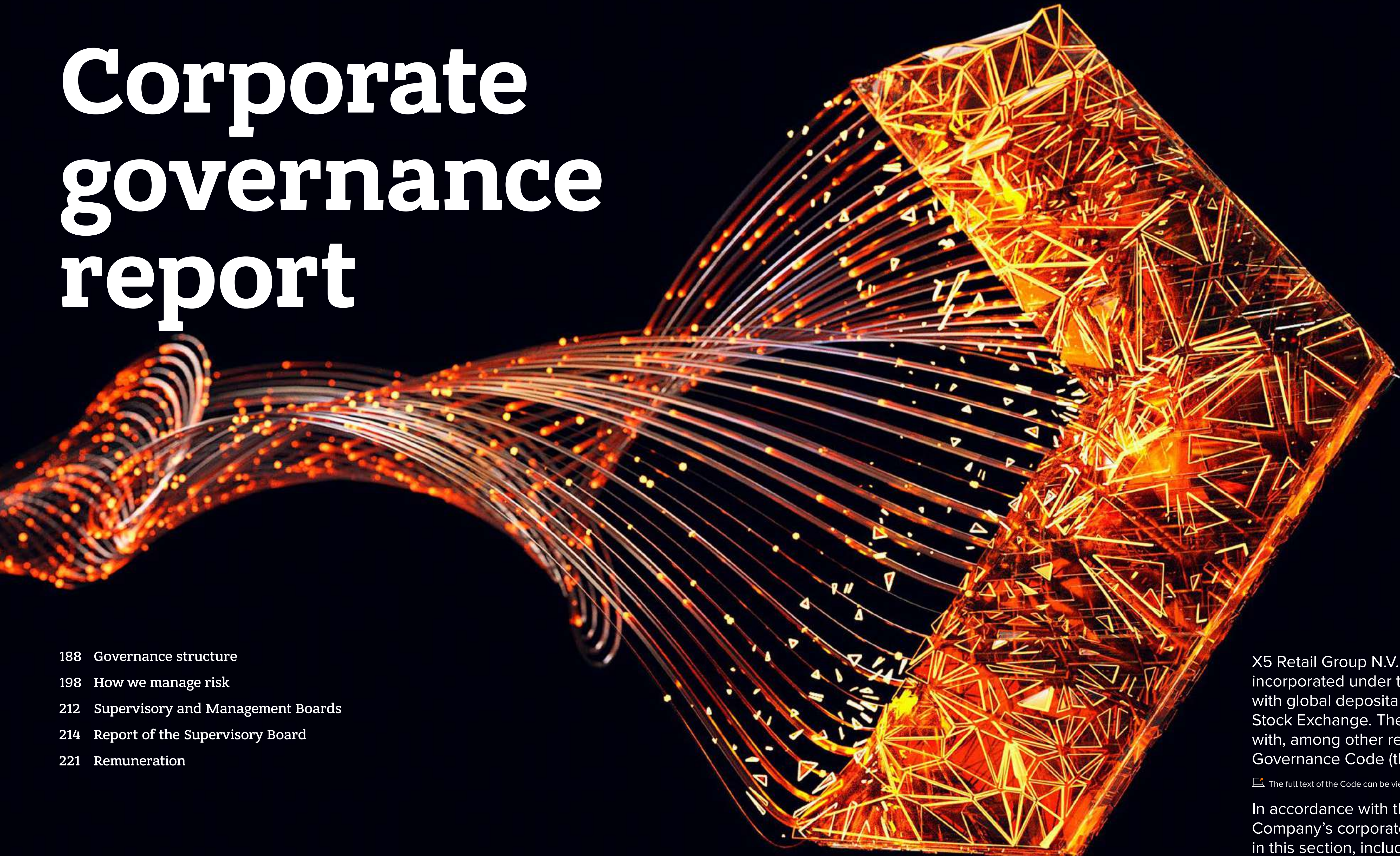
Since the end of 2017, as part of the Children's Club programme, Pyaterochka stores have been offering additional bonus points on Pyaterochka loyalty cards to families with children for children's goods. The programme has more than 1.4 million members.

In August 2018, Perekrestok supermarkets launched a club for shoppers with children and parents-to-be. Members receive discounts of up to 40% on items produced by partner brands and special benefits on purchases in all categories of children's goods. On weekends, members also receive a discount on large family purchases of any items. The club has more than 93,000 active members.

Volunteering

X5 encourages its employees to take part in socially beneficial projects. In 2018, 340 Company employees and their children took part in the Run for Life charity marathon organised by the Life Line Foundation, which raised RUB 2.8 million for charity projects. Sixty X5 employees took part in a charitable Nordic walk event organised by Life Line Foundation, which raised over RUB 475,000.

Corporate governance report



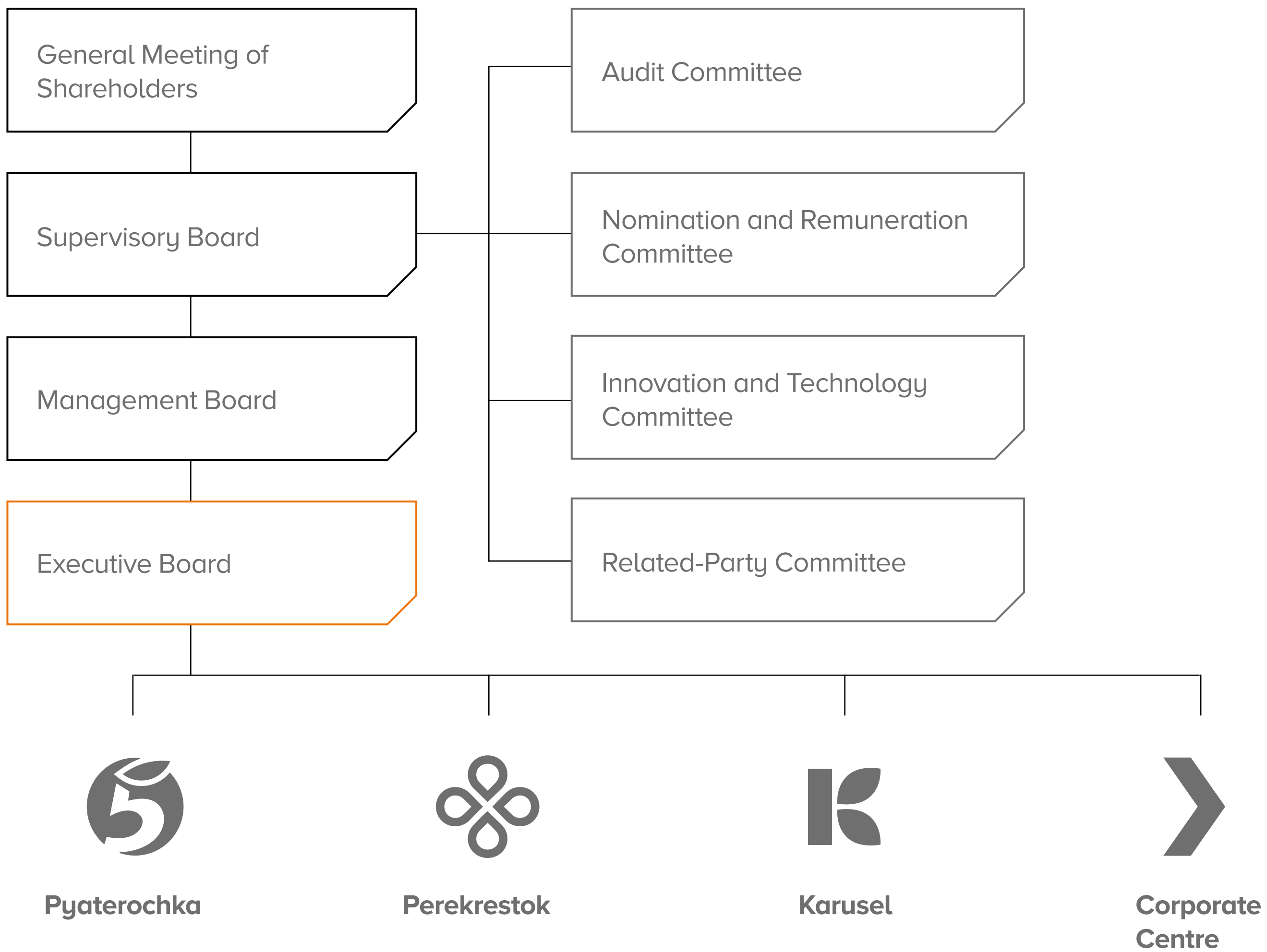
X5 Retail Group N.V. is a public limited-liability company incorporated under the laws of the Netherlands, with global depositary receipts listed on the London Stock Exchange. The Company is required to comply with, among other regulations, the Dutch Corporate Governance Code (the “Code”).

The full text of the Code can be viewed on X5's website at www.x5.ru

In accordance with the Code, a broad outline of the Company’s corporate governance structure is presented in this section, including any deviations from the Code’s principles and best practices. X5 aspires to high standards of corporate governance and is committed to a corporate governance structure that best supports its business, meets the needs of its stakeholders, and that is in compliance with applicable rules and regulations.

Governance structure

The Company has a two-tier board structure, comprising a Management Board and a Supervisory Board. The Management Board and the Supervisory Board are independent of one another and accountable to the General Meeting of Shareholders. The overview below shows the governance structure of X5.



Management Board

The Management Board has ultimate responsibility for the overall management of the Company and oversees all corporate governance activities. It is accountable for the Company's pursuit and achievement of corporate goals and objectives, its strategies and policies. The Management Board is responsible for complying with all relevant legislation and regulations, for managing the risks associated with the Company's activities and for financing and external communication.

In managing X5's general affairs and its day-to-day operations, the Management Board is supported by the Executive Board, which was established to provide for a leadership team at the level of the Company's operating subsidiaries in Russia in order to best support X5's strategy and businesses at the local operating level. The Management Board is ultimately responsible for the actions and decisions of the Executive Board.

The current members of the Management Board and the Executive Board, including their biographies, are presented on pages 54-59 and 212-213. In order to strengthen the Management Board, the Supervisory Board nominated Mr. Quinten Peer as Chief Operating Officer at the level of the Dutch holding company for appointment by the 2019 Annual General Meeting of Shareholders.

Composition and reappointment schedule of the Management Board

Name	Year of birth	Year of first appointment	End of current term of appointment[1]
Igor Shekhterman	1970	2015	2019
Frank Lhoëst	1962	2007	2019

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 X5 and its businesses. It ensures that external experience and knowledge are embedded in the Company's operations. In performing its duties, the Supervisory Board takes into account the relevant interests of the Company and all its stakeholders, and, to that end, considers all appropriate interests associated with the Company and its affiliated businesses, including corporate responsibility issues that are relevant to the Company. Major business decisions require the approval of the Supervisory Board. The Supervisory Board is responsible for monitoring and assessing its own performance.

The General Meeting of Shareholders determines the number of members of the Supervisory Board, which currently consists of eight members. The current members, including their biographies, are presented on pages 212-213.

The Supervisory Board has prepared a profile of its size and composition, taking account of the nature of the Company's business and its activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board evaluates its profile and composition annually. In line with the outcome and recommendations following from the 2017 board assessment, in particular in relation to the Supervisory Board's skill set and desire to be "fit for tomorrow", the Supervisory Board continued to develop in 2018 by strengthening its expertise in the area of technical and commercial innovation. During its meetings in December 2018 and January 2019, the Board discussed the further strengthening of its focus and expertise in technical and commercial innovation through the nomination of an additional Supervisory Board member with relevant experience in these areas. In view thereof, the Supervisory Board nominated Alexander Torbakhov as an independent Supervisory Board member for appointment by the 2019 Annual General Meeting of Shareholders. For further details, please refer to the Supervisory Board report on pages 214-220.

Supervisory Board members are appointed for a period of up to four years and may be re-elected, whereby the total term of office may not exceed 12 years. The Supervisory Board has prepared a retirement and reappointment schedule to, as far as possible, prevent simultaneous reappointments. The Supervisory Board's profile and rotation plan can be viewed on the Company's website.

[1] The Supervisory Board proposes to the 2019 Annual General Meeting of Shareholders the reappointment of Igor Shekhterman and Frank Lhoëst, whose current term as members of the Management Board comes to an end in 2019.

Composition and reappointment schedule of the Supervisory Board

Name	Year of birth	Year of first appointment	Year of possible reappointment[6]
Stephan DuCharme (Chairman)[1]	1964	2015	2019
Mikhail Fridman[2]	1964	2006	2021
Geoff King	1965	2015	2019
Peter Demchenkov	1973	2015	2019
Mikhail Kuchment	1973	2015	2019
Andrei Elinson	1979	2016	2020
Karl-Heinz Holland[3]	1967	2018	2022
Nadia Shouraboura[3]	1970	2018	2022
Christian Couvreux[4]	1950	2010	–
Pawel Musial[5]	1968	2013	–

[1] Stephan DuCharme previously served on the Supervisory Board from 2008 until 2012.
[2] A Supervisory Board member who directly or indirectly holds at least 10% of the shares in the issued share capital of the Company may hold office for more than 12 years and is eligible for reappointment after that term (see "Compliance with the Dutch Corporate Governance Code" in this report).
[3] Karl-Heinz Holland and Nadia Shouraboura were appointed on 30 August 2018.
[4] Christian Couvreux stepped down as of 10 May 2018.
[5] Pawel Musial stepped down as of 22 June 2018.
[6] Stephan DuCharme, Geoff King, Peter Demchenkov and Mikhail Kuchment are eligible for reappointment at the 2019 Annual General Meeting of Shareholders.

Committees of the Supervisory Board

The Supervisory Board currently has four permanent committees: the Audit and Risk Committee, the Nomination and Remuneration Committee, the Innovation and Technology Committee and the Related-Party Committee. The members of each committee are appointed by the Supervisory Board and from among its members. Each committee has a charter describing its role and responsibilities and the manner in which it discharges its duties and reports to the full Supervisory Board. These charters are included in the Rules of Procedure of the Supervisory Board, which can be viewed on X5's website. In 2018, the Supervisory Board resolved to rename the Audit Committee the Audit and Risk Committee in order to reflect the significant element of the Committee's risk oversight. The Innovation and Technology Committee was established in January 2019 to strengthen the focus of the Supervisory Board on technical and commercial innovation.

Audit and Risk Committee. The Audit and Risk Committee assists the Supervisory Board in overseeing the integrity of X5's financial statements, system of internal business controls and risk management, financing and finance-related strategies, tax planning, the Company's compliance with legal and regulatory requirements, as well as the qualifications, performance and independence of the external auditor and the performance of the internal audit function.

Nomination and Remuneration Committee. The Nomination and Remuneration Committee recommends the remuneration policy for the Management Board to be adopted by the General Meeting of Shareholders, prepares proposals to the Supervisory Board for remuneration of the individual members of the Management Board in line with the remuneration policy and advises the Management Board on the level and structure of compensation for other senior personnel. The Nomination and Remuneration Committee also advises in respect of the selection and appointment of members of the Supervisory Board, the Management Board and the Executive Board.

Innovation and Technology Committee. The Innovation and Technology Committee is responsible for reviewing and making recommendations to the Supervisory Board on issues relating to the Company's digital strategy, innovation and technology, which are among X5's key strategic priorities.

Related-Party Committee. The Related-Party Committee advises the Supervisory Board on handling and deciding on reported (potential) conflicts of interest and any other related-party transactions that are contemplated between X5, on the one hand, and conflicted persons or entities, including but not limited to its shareholders, members of the Supervisory Board and members of the Management Board, on the other hand.

Composition of the Supervisory Board Committees

Name	Audit and Risk Committee	Nomination and Remuneration Committee	Innovation and Technology Committee[1]	Related-Party Committee
Stephan DuCharme		Member		
Mikhail Fridman				
Geoff King	Chairman			Chairman
Peter Demchenkov		Chairman		
Mikhail Kuchment	Member		Member	
Andrei Elinson	Member	Member		
Karl-Heinz Holland	Member	Member		
Nadia Shouraboura			Member	Member

[1] The Supervisory Board proposed appointing Alexander Torbakhov as Chairman of the Innovation and Technology Committee, subject to his appointment as a Supervisory Board member by the 2019 Annual General Meeting of Shareholders.

Diversity

The Supervisory Board operates a Leadership Diversity Policy that aims for a diverse composition of both the Management Board and the Supervisory Board in particular areas of relevance for X5. This includes diversity of experience, nationality and background. Appointments to the Management Board and Supervisory Board are evaluated against the relevant profile, the existing balance of skills, knowledge and experience on the respective board and the need for the relevant board to be prepared for disruption and change. Management Board and Supervisory Board members are prompted to be mindful of diversity, inclusiveness and meritocracy considerations when examining and proposing nominations to the Management Board and Supervisory Board. In the selection and appointment of new Management Board or Supervisory Board members, the Supervisory Board will consider a diverse range of candidates. This will also include diversity of gender and age so that when the final appointment is made the Supervisory Board can be confident that the most effective candidate has been selected.

Each year, the Supervisory Board conducts an evaluation of its functioning and the functioning of the Management Board. In this context, the Supervisory Board gives careful consideration to the diversity of its own composition, as well as that of the Management Board, so as to be effective in performing its role.

While the Management and Supervisory Boards are currently not balanced with regard to gender, X5 recognises the benefits of gender diversity, and importance is attached to achieving this. Our aim is to comply with the statutory requirements within the meaning of Article 2:166 of the Dutch Civil Code whereby a balance is created; however, we feel that gender is only one part of diversity, and future members of the Management Board and Supervisory Board will continue to be selected on the basis of specific experience, backgrounds, skills, knowledge and insights. We are pleased that we were able to attract a female Supervisory Board member in 2018 in line with X5's diversity ambitions. X5 recognises the importance of diversity, including gender, at all levels of the Group and has a very strong track record of developing a critical executive layer of female business leaders. Across all of the Group's operations, specific diversity targets are taken into account in recruitment, talent development, appointments, retention of employees, mentoring and coaching programmes, succession planning, training and development.

Appointment, suspension and dismissal

The General Meeting of Shareholders appoints the members of the Management and Supervisory Board from a binding nomination made by the Supervisory Board. The recommended candidate is appointed by the General Meeting of Shareholders unless the nomination is deprived of its binding character by a qualified majority vote of at least two-thirds of the votes cast, representing more than one-half of the issued share capital of the Company.

Members of the Supervisory Board serve for a maximum term of four years from the date of their appointment or a shorter period if determined upon their appointment by the General Meeting of Shareholders or as per the Supervisory Board's rotation schedule. A Supervisory Board member can be reappointed after their first term of four years for one additional term of four years, followed by two additional terms of two years. A Supervisory Board member may not serve more than 12 years. A Supervisory Board member who directly or indirectly holds at least 10% of the shares in the issued share capital of the Company may hold office for more than 12 years and is eligible for reappointment after that term (see "Compliance with the Dutch Corporate Governance Code" in this report).

Members of the Management Board are also elected for a period of four years. Neither the Articles of Association nor the Code limits the total term of office for Management Board members.

Each member of the Supervisory Board and Management Board may, at any time, be dismissed or suspended by the General Meeting of Shareholders. A member of the Management Board may, at any time, be suspended by the Supervisory Board. Such suspension may be discontinued by the General Meeting of Shareholders at any time.

Remuneration

In line with the remuneration policy adopted by the General Meeting of Shareholders, the remuneration of the individual members of the Management Board will be decided by the Supervisory Board upon the recommendation of its Nomination and Remuneration Committee. The remuneration of the members of the Supervisory Board is determined by the General Meeting of Shareholders. The remuneration policy for members of the Management Board and Executive Board can be found in the Remuneration report on pages 221-225. The remuneration principles for the Supervisory Board are described in the Supervisory Board Report on pages 214-220.

Reporting on conflicts of interest

A member of the Management Board or Supervisory Board is required to immediately report and provide all relevant information to the Chairman of the Supervisory Board (and to the other members of the Management Board if it concerns a member of that board) on any conflict of interest, or potential conflict of interest, that they may have with the Company and that may be of material significance to them or the Company.

If a member of the Supervisory Board or a member of the Management Board has a conflict of interest with the Company, that member may not participate in the discussions or decision-making process on subjects or transactions relating to the conflict of interest. A decision taken by X5 to enter into a transaction involving a conflict of interest with a member of the Management Board or a member of the Supervisory Board that is of material significance to them or the Company requires the approval of the Supervisory Board. The Related-Party Committee advises the Supervisory Board on handling and deciding on (potential) conflicts of interest and prepares resolutions of the Supervisory Board in relation thereto. An account of related-party transactions in 2018 is included in the Supervisory Board Report on pages 214-220.

Shareholders and their rights

General Meeting of Shareholders

X5 Retail Group N.V. is required to hold a General Meeting of Shareholders within six months after the end of the financial year in order to, among other things, adopt the financial statements, decide on any proposal concerning profit allocation and discharge the members of the Management Board and Supervisory Board from their responsibility for the performance of their respective duties for the previous financial year.

Extraordinary meetings are held as often as the Management Board or the Supervisory Board deems necessary. In addition, shareholders and holders of global depositary receipts (GDRs) jointly representing 10% of the outstanding share capital may ask the Management Board and the Supervisory Board to hold a General Meeting of Shareholders, stating their proposed agenda in detail.

The powers of the General Meeting of Shareholders are specified in the Articles of Association. Apart from the decisions taken at the Annual General Meeting of Shareholders, the main powers of the General Meeting of Shareholders are to appoint (subject to the Supervisory Board's right to make binding nominations), suspend and dismiss members of the Management Board and Supervisory Board, to appoint the external auditor, to adopt amendments to the Articles of Association, to issue shares and grant subscriptions for shares, to authorise the Management Board or the Supervisory Board to issue shares and grant subscriptions for shares, to authorise the Management Board or the Supervisory Board to restrict or exclude pre-emptive rights of shareholders upon the issuance of shares, to authorise the Management Board to repurchase outstanding shares in the Company, to adopt the remuneration policy of the Management Board, to determine the remuneration of members of the Supervisory Board, and to merge, demerge or dissolve the Company.

The notice for a General Meeting of Shareholders needs to be published no later than 42 days prior to the date of the meeting. The mandatory record date, establishing which shareholders are entitled to attend and vote at the General Meeting of Shareholders, is set at least 28 days prior to the date of the meeting.

One or more shareholders or holders of GDRs representing at least 3% of X5's issued share capital are entitled to request that a matter be included on the agenda of the General Meeting of Shareholders. Such requests, if sufficiently substantiated and received by the Company at least 60 days before the date of the meeting, can only be refused on the grounds of exceptional circumstances, to be checked against the principles of reasonableness and fairness.

All shareholders and other persons who, pursuant to Dutch law or the Articles of Association, are entitled to attend and/or vote at a General Meeting of Shareholders are entitled to address the General Meeting of Shareholders. X5 uses the Bank of New York Mellon, the depositary for X5's GDR facility (the "Depositary"), to enable GDR holders to exercise their voting rights represented by the shares underlying the GDRs. As described in the "Terms and Conditions of the Global Depositary Receipts", holders of GDRs may instruct the Depositary with regard to the exercise of the voting rights connected to the shares underlying their GDRs. Alternatively, upon request of the holders of such depositary receipts, the Depositary will grant a proxy to such holders who wish to vote in person at a General Meeting of Shareholders. Persons who hold a written proxy may represent shareholders at a General Meeting of Shareholders. The written proxy must be duly executed and legalised in accordance with the applicable laws and may be submitted electronically.

Voting rights

Each share confers the right to cast one vote at the General Meeting of Shareholders. There are no restrictions, either under Dutch law or in the Articles of Association, on the right of non-residents of the Netherlands or foreign owners to hold shares or to vote, other than those also imposed on residents of the Netherlands. Resolutions of the General Meeting of Shareholders are passed by a simple majority of the votes cast in a meeting where more than 25% of the issued share capital is present or represented. If 25% or less of the issued share capital is present or represented, a second meeting should be convened no later than four weeks following the first meeting. At the second meeting, no quorum requirement will apply. However, the General Meeting of Shareholders can only resolve on (i) a merger or demerger, (ii) the authorisation to limit or exclude pre-emptive rights and (iii) cancellation of shares with a majority of at least two-thirds of the votes cast if less than 50% of the issued capital is represented in that meeting.

Dividend rights

Any distribution of profits to shareholders will be made after the adoption by the General Meeting of Shareholders of the annual accounts of the Company from which it appears that such distribution is permitted. The Company may only declare profit distributions insofar as its net assets exceed the sum of its issued share capital plus any legal reserves required to be maintained pursuant to Dutch law. A loss may only be applied against such reserves to the extent permitted by Dutch law. On a proposal of the Supervisory Board, the General Meeting of Shareholders will determine which part of the profits will be added to the reserves and the allocation of the remaining profits.

On a proposal of the Supervisory Board, the General Meeting of Shareholders may resolve to pay an interim dividend insofar as X5's net assets exceed the sum of its issued share capital and the reserves that are required to be maintained pursuant to Dutch law, as evidenced by an interim financial statement prepared and signed by all the members of the Management Board. In addition, on a proposal of the Supervisory Board, the General Meeting of Shareholders may resolve to make distributions to the shareholders out of any reserves that need not be maintained pursuant to Dutch law.

Dividends and other distributions that have not been claimed within five years after the date on which they became due and payable revert to the Company.

Significant ownership of voting shares

According to the Dutch Financial Markets Supervision Act (Wet op het financieel toezicht), any person or legal entity who, directly or indirectly, acquires or disposes of an interest in X5's capital and/or voting rights must immediately give written notice to the Netherlands Authority for Financial Markets (AFM) if the acquisition or disposal causes the percentage of outstanding capital interest and/or voting rights held by that person or legal entity to reach, exceed or fall below any of the following thresholds: 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%.

The following table lists the shareholders on record on 28 February 2019 in the AFM's public register that hold an interest of 3% or more in the share capital of the Company:

Shareholder	Date of disclosure	Capital interest[1]	Voting rights[1]
CTF Holdings Ltd.	2 August 2007	48.41%	48.41%
Axon Trust	22 December 2009	11.43%	11.43%

[1] In accordance with the filing requirements, the percentages shown include both direct and indirect capital interests and voting rights. The percentages may differ from the actual shareholders' interests due to the fact that changes within the thresholds mentioned above do not require a notification to the AFM. Further details can be obtained at www.afm.nl.

Securities owned by board members

The members of the Management Board and Supervisory Board and X5's other senior management are subject to the Company's Inside Information and Dealing Code. This Code contains rules of conduct to prevent trading in X5's GDRs of shares or other financial instruments when holding inside information or during blackout periods when trading is not permitted (for instance, prior to the publication of quarterly financial results). The Inside Information and Dealing Code can be viewed on the Company's website.

Under the Inside Information and Dealing Code, members of the Management Board and Supervisory Board must notify the AFM of X5 securities and voting rights at their disposal. These positions can be viewed in the AFM's public register.

Repurchase by the Company of its own shares

The Company may acquire fully paid shares, or GDRs thereof, in its capital for a consideration only following authorisation by the General Meeting of Shareholders and subject to certain provisions of Dutch law and the Company's Articles of Association, if:

- Shareholders' equity minus the purchase price is not less than the sum of X5's issued and fully paid-in capital plus any reserves required to be maintained by Dutch law; and
- X5 and its subsidiaries would not, as a result, hold shares or GDRs thereof with an aggregate nominal value exceeding half of the issued share capital.

In 2018, the Management Board was authorised to acquire up to 10% of the shares or GDRs thereof. This authorisation is valid through 10 November 2019. In addition, the Supervisory Board resolved that in case a purchase of shares or depositary receipts thereof by X5 would lead to X5 holding more than 5% of the shares or GDRs thereof, the Management Board would require the Supervisory Board's prior approval for such purchase.

Authorisation by the General Meeting of Shareholders is not required if X5's own shares are acquired for the purpose of transferring those shares to X5 employees pursuant to any arrangements applicable to such employees.

Shares or GDRs thereof held by X5 or a subsidiary may not be voted on and are not taken into account for determining whether quorum requirements, if any, are satisfied.

Issue of new shares and pre-emptive rights

Shares in X5 may be issued, and rights to subscribe for shares may be granted, pursuant to a resolution of the General Meeting of Shareholders or another X5 corporate body to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. In 2018, the General Meeting of Shareholders approved a delegation of this authority to the Supervisory Board, relating to the issuance and/or granting of rights to acquire up to 6,789,322 shares (10% of the issued share capital) through 10 November 2019.

Upon the issue of new shares, holders of X5's shares have a pre-emptive right to subscribe for shares in proportion to the aggregate amount of their existing holdings of X5's shares. According to the Company's Articles of Association, this pre-emptive right does not apply to any issue of shares to employees of X5 or a Group company. Pre-emptive rights may be restricted or excluded pursuant to a resolution of the General Meeting of Shareholders or another corporate body of X5 to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. The General Meeting of Shareholders has delegated the authority to restrict or exclude the pre-emptive rights of shareholders upon the issue of shares and/or the granting of rights to subscribe for shares to the Supervisory Board through 10 November 2019.

Articles of Association

X5's Articles of Association contain rules on the Company's organisation and corporate governance.

Amending the Company's Articles of Association requires a resolution of the General Meeting of Shareholders. A proposal to amend the Articles of Association, including the text of the proposed amendment, must be made available to the holders of shares and GDRs for inspection at the offices of X5 as of the date of the notice convening the meeting of the General Meeting of Shareholders until the end of the meeting of the General Meeting of Shareholders at which the proposed amendment is voted on.

The current text of the Articles of Association is available on the Company's website. An amendment of the current Articles of Association will be submitted for approval at the 2019 Annual General Meeting of Shareholders. The main purpose of the amendment is to align the Articles of Association with the Code, which entered into force as of 1 January 2017, as well as other corporate legal updates and current best practices. An overview of the amendments will be available on the Company's website at the time of the convocation for the 2019 Annual General Meeting of Shareholders.

Anti-takeover measures and change-of-control provisions

According to provision 4.2.6 of the Code, the Company is required to provide a survey of its actual or potential anti-takeover measures and to indicate in what circumstances it is expected that they may be issued.

No special rights of control, as referred to in Article 10 of the EU Directive on takeover bids, are attached to any share or GDR in X5.

There are no important agreements to which the Company is a party and that will automatically come into force or be amended or terminated under the condition of a change of control over the Company as a result of a public offer. However, the contractual conditions of most of X5's important financing agreements and notes issued (potentially) entitle the banks and noteholders, respectively, to claim early repayment of the amounts borrowed by the Company in the situation of a change of control over the Company (as specified in the respective agreement).

Auditor

The General Meeting of Shareholders appoints the Company's external auditor. The Audit and Risk Committee makes a recommendation to the Supervisory Board with respect to the external auditor to be proposed for appointment or reappointment by the General Meeting of Shareholders. In addition, the Audit and Risk Committee evaluates and, where appropriate, recommends the replacement of the external auditor. The Audit and Risk Committee also pre-approves the fees for audit and permitted non-audit services to be performed by the external auditor. The Audit and Risk Committee will not approve the engagement of an external auditor to render non-audit services prohibited by applicable laws and regulations or that would compromise the independence of the auditor. Specific rules relating to non-audit work performed by the external auditor are included in X5's "Rules on External Auditor Independence and Selection". This document is available on the Company's website.

On 10 May 2018, the General Meeting of Shareholders appointed Ernst & Young Accountants LLP as external auditor for the financial year 2018.

Compliance with the Dutch Corporate Governance Code

X5 applies the relevant principles and best practices of the Code in the manner as described in this Corporate Governance Report. Committed to a corporate governance structure that best serves the interests of all stakeholders, including shareholders, X5 continues to seek ways to improve and enhance its corporate governance standards in line with international best practices. X5 generally adheres to the Code, but does not comply with the following recommendations:

2.1.7/2.1.8: Independence of the Supervisory Board and its members

Both Mikhail Fridman and Andrei Elinson are related to companies that are owned or controlled by companies that ultimately hold 10% or more of the shares in the Company. Stephan DuCharme was a member of the Management Board immediately prior to his appointment to the Supervisory Board in November 2015. These members of the Supervisory Board are, therefore, not considered to be independent within the meaning of the Code.

In accordance with best practice provision 2.1.7, at most one Supervisory Board member may represent a shareholder who directly or indirectly holds more than 10% of the shares in the Company. Furthermore, X5 believes that the non-independent members of the Supervisory Board have in-depth knowledge of the geographic market, of business in general and of retail specifically, as well as a relevant track record in the markets in which X5 operates. This is of particular advantage to X5 and its shareholders. Meanwhile, subject to the appointment of Alexander Torbakhov as an additional independent Supervisory Board member by the 2019 Annual General Meeting of Shareholders, the Supervisory Board takes a further step in improving the ratio of independent to non-independent board members.

2.1.9: Independence of the Chairman of the Supervisory Board

In 2015, Stephan DuCharme stepped down as CEO and was appointed as Chairman of the Supervisory Board. Having carefully considered the interests of the Company and its shareholders, the Supervisory Board took the view that these interests are best served by retaining Stephan's experience and leadership for X5 in a renewed capacity as Chairman of the Supervisory Board. This offers shareholders the greatest continuity and ensures that the Chairman entrusted with X5's progress has a proven track record, as well as the confidence of critical stakeholder groups and investors.

2.2.2: Appointment and reappointment periods of Supervisory Board members

Mikhail Fridman was appointed as a member of the Supervisory Board in 2006. In 2017, he was reappointed for a fourth term, thus exceeding the maximum of 12 years prescribed by the Code.

Mikhail is the founder and chairman of the Alfa Group Consortium, currently the majority shareholder in X5 with a holding interest of 48.41%. X5 believes that long-term value creation stands to benefit from committed shareholders, and that the interests of Supervisory Board members holding more than 10% of the shares largely coincide with those of the Company. These Supervisory Board members are generally involved in the Company for a prolonged period of time, which fits in well with long-term value creation for the Company.

2.3.2: Supervisory Board Committees

"If the Supervisory Board consists of more than four members, it should designate [...] a Remuneration Committee and a Selection and Appointment Committee." As it is felt that issues related to selection, appointment and remuneration are interlinked, the Supervisory Board decided that all these activities should be dealt with by one Committee: the Nomination and Remuneration Committee.

3.3.2: Award of shares and/or rights to shares to members of the Supervisory Board

As determined by the General Meeting of Shareholders, members of the Supervisory Board may participate in the Company's restricted stock unit plan. X5 acknowledges that the award of shares to members of the Supervisory Board constitutes a deviation from the Code. However, in order to attract and reward experienced individuals with a track record that is of specific relevance to the Company, X5 believes it is necessary to allow members of the Supervisory Board to participate in the Company's equity-based remuneration plan. This structure aligns the interests of Supervisory Board members with those of shareholders and strengthens their commitment to, and confidence in, the future of the Company. Equity-based awards given to members of the Supervisory Board are not subject to performance criteria and are determined by the General Meeting of Shareholders.

How we manage risk

Risks are a normal part of doing business, but they can adversely and materially impact legal compliance, trading competitiveness, profitability and liquidity. To manage risks, the Management Board of X5, supported by the Executive Board and the Risk Management Team, is responsible for designing, implementing and operating an adequately functioning risk management system, which needs to be capable of identifying, assessing and monitoring the principal risks that may affect the Company's objectives.

Risk management and internal control

Risk management

The Management Board of X5, supported by the Executive Board, continued in 2018 to pay special attention to strengthening the design and effectiveness of the risk management and internal control system:

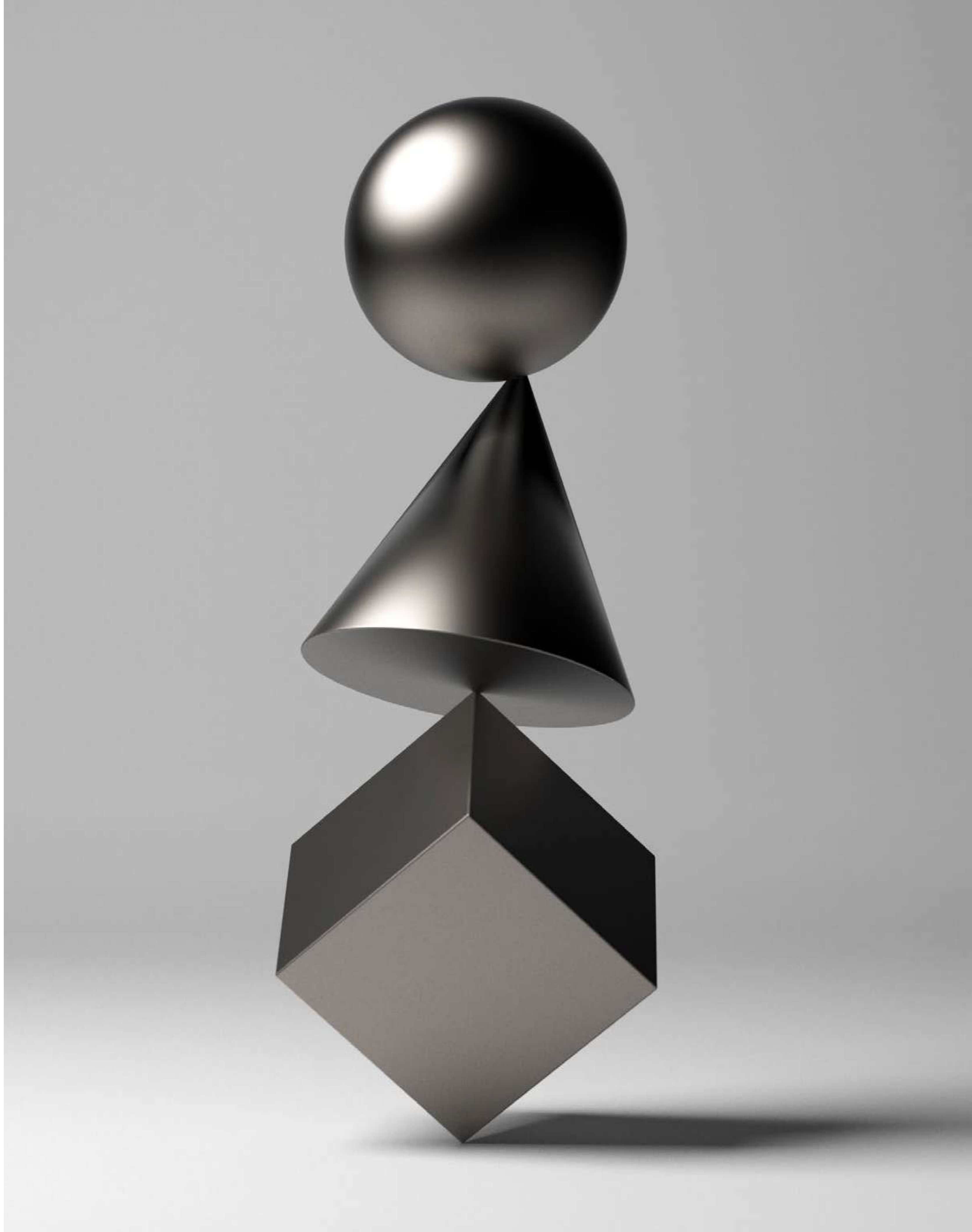
- **Strengthen the design.** Significant progress has been made in applying risk models to be able to better quantify risk. Efforts in this area will continue in 2019 to apply a cost-benefit analysis of risk mitigation activities in the financial budgeting and risk monitoring processes; and

- **Increase effectiveness.** The reporting lines of the Compliance, Internal Control and Risk Assessment Teams were changed in 2018. In the revised structure, the Risk Assessment Team and Internal Control Team now report to the Chief Financial Officer, the Compliance Team reports to the General Counsel, and the Forensic Team reports to the Head of Corporate Security.

To constantly strengthen the risk management system:
- a comprehensive review of both internal and external risks is carried out at least annually;
- risk appetite is reviewed and reconfirmed;
- annual quantitative risk impact assessments complement a qualitative risk appetite;
- risks of X5's strategic and short-term objectives are assessed;
- risk-mitigating activities are put in place.

Management teams at all levels of the organisation are continuously engaged in identifying, managing and monitoring relevant risks. The Risk Assessment Team, supported by the Internal Control Team, facilitates a company-wide view of risk-relevant issues, helps develop risk management activities in both business and functional divisions and ensures that the Management Board is continuously and promptly informed of material risk and risk management developments.

During the annual strategy review and budgeting process, Company management reassesses Company risks and develops action plans to mitigate risks and allocate appropriate resources for risk mitigation. The results of risk mitigation actions are regularly monitored and reported on a quarterly basis to the Audit Committee. X5 is committed to mitigating its risks to within acceptable levels.



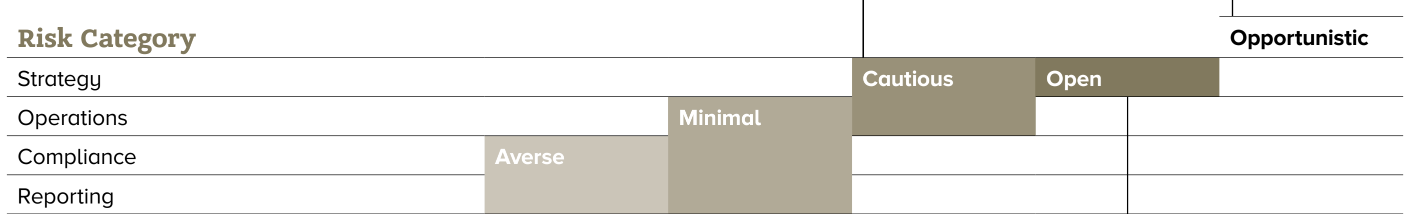
Risk appetite

The Company's risk appetite is determined by the Management Board and is integrated into the business through X5's strategy, policies, procedures, controls and budgets. For each risk, the risk appetite is determined by considering relevant business objectives, as well as potential threats to achieving those objectives.

Table shows X5's risk-appetite scale used for risk-appetite calibration.

Cautious means that only limited potential losses can be take; otherwise, managers will prefer to avoid actions leading to risks:
The maximum potential impact from these risks should be lower or equal to the minimal return. The necessary mitigation actions and controls should prevent losses.

Opportunistic – highest priority or willingness to take risk:
The risk impact is inferior to the importance placed on reaching desired targets.



Averse means total avoidance of actions leading to unacceptable risks:
Risks are unacceptable in any case despite mitigating factors and considerable potential reward.

Minimal means extremely conservative appetite to risk taking
Potential losses from these risks should be calculated and planned in advance, provisions should be created or insurance contracts should be in place, and necessary controls should be in effect.

Open – willingness to consider potential losses and taking risks only under the right conditions:
The risk impact may exceed the potential return; compensating factors may partly mitigate this impact.

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:

1. The first tier of control requires each business unit to establish, operate and monitor the necessary controls for each of their specific business processes.

2. The second tier of control oversees the development and improvement in first-tier controls as the business evolves. This work is co-ordinated by the Risk Assessment and Internal Control Teams across various central functions that design and develop changes to X5's internal control system.

3. The third tier of control is the Internal Audit function. The role of Internal Audit is to regularly assess, and recommend improvements to, the Company's first and second control tiers. Internal Audit reports directly to the Management Board and has direct access to the Audit Committee.

Ethics and compliance culture

Values and business principles are crucial elements of the internal environment for risk management. X5 is committed to practices that contribute to a culture of integrity and long-term value creation. X5 has established and internally communicated rules and policies that outline these values and principles, including X5's:
- Code of Conduct and Ethics
- Policy on Countering Misconduct, Including Fraud and Corruption
- Declaration on Human Rights

These policies are available on X5's public website at www.x5.ru

Monitoring and assurance

Internal Audit provides independent and objective assurance of the impact of X5's control processes. Systematic and disciplined evaluations of risk management, internal controls and governance activities are performed, guided by X5's Controls Heat Map, which assesses the latest recorded strength of each function or process's controls. Following a risk-based audit planning approach, Internal Audit performs evaluations of operational, financial and information system controls on key business processes that reveal control issues. Internal Audit provides recommendations to improve controls to the executives responsible. Action plans that address control issues raised by Internal Audit are prepared by business process owners and approved by the director of the business area owning that control. The timely implementation of the 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.

Internal Audit is periodically subject to independent and external evaluation to maintain and improve audit standards. In 2018, Internal Audit identified two areas for development:
- a more agile approach to audit projects (allowing for a wider scope but shorter duration of audit projects);
- enhanced auditing of controls in the area of IT, IT infrastructure and data security.

The Company's principal risks

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 less material or otherwise common to most companies.

Risk profile

Strategy

Group risk	Risk appetite	Influenced indicator	Mitigation
Market and our customer value propositions (CVP) If the customer value propositions of X5's retail formats fail to meet customer needs and preferences, this can lead to low sales densities, slower revenue growth, lower profits and returns. The risk can be caused by: • Failure to promptly respond to changes in customer preferences or behaviour patterns and lifestyle • Failure to promptly respond to new business models, services and technologies used by competitors in retail and related markets • Failure to properly understand local consumption and regional economic potential • Over-investment in unproven retail formats and new business streams	Minimal to Cautious	Net Sales, Gross Profit	• Constantly monitor retail and consumer trends in Russia and internationally to spot changes in behaviours and needs • Regularly monitor trends in operating performance indicators and Net Promoter Scores • Continually invest in improving the format CVPs while at the same time improving operating cost-efficiencies • Revise the target CVP on an annual basis and embed business improvement plans into the heart of the annual operating plan reviewed by the Supervisory Board • Explore, test and roll out new retail technologies and expand range in emerging category areas Also see "Our brands" on pages 24-25 and "Our strategy in action" on pages 44-51, as well as the section on each retail format
Economic and market conditions 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: • 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 product inflation • Unexpected decline in national or regional economic activity leading to suppressed growth, higher unemployment and lower personal incomes • Political events with a negative impact on trade practices or consumer demand	Cautious to Open	Gross Profit	• 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 Also see "Economic and consumer trends" on pages 34-35
Growth and expansion The Company is committed to a sensible expansion strategy and the upkeep of existing stores. The Company's expansion is associated with the following risks: • Lack of cost-efficient locations for new openings • Higher costs of opening and refurbishment projects can erode return on investments • Lack of logistics capacity to support expansion can cause 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 • Reaching market share caps in certain trading regions	Cautious to Open	Selling Space, Number of Stores, Net Sales	• Have a valuation methodology in place for stores of each format • Ensure that investment and post-investment valuation is carried out • Project the Company's future need for logistics capacities and open new distribution centres to keep pace with the rollout of new space in each format • Improve store opening and refurbishment processes and reduce bureaucracy and time delays • Optimise the performance of stores with negative margins Also see "Geography of operations" on pages 52-53, as well as the section on each retail format

See the risks heat map on page 210

Operations

Group risk	Risk appetite	Influenced indicator	Mitigation
Retail operations The operational efficiency of the logistics network, stores and back office units determine the operating performance of existing and new stores and the Company's overall profit margins. Operating activities are subject to the following risks: • Operational disruptions and delays in implementing the CVP • Lower productivity of the logistics network • Lower efficiency of inventory management at the DCs and stores (reduced availability of goods, increase in inventories and write-offs) • Lower productivity in stores resulting in either staff cost overspends or poor operating standards • Lower productivity in the back office resulting in higher operating costs or reduced service standards	Minimal to Cautious	Gross Profit, Operation Cost	• Ensure an optimal level of management on key business processes • Ongoing management of the product mix across the retail formats • Develop the logistics capability in line with expansion strategy and closely manage supply chains within the existing logistics network • Improve and automate processes in the back office, DCs and stores • Monitor the operating performance of stores and DCs based on defined KPIs and performance standards • Monitor the operations of national and regional competitors on an ongoing basis and ensure a prompt and appropriate response Also see "Retail infrastructure" on pages 126-145, as well as the section on each retail format
Human resources The Company's strategic goals are heavily dependent on the competencies and performance of its officers and employees. Risks related to HR management include: • Poor recruitment and vetting leading to inappropriate staff for roles • Insufficient attention to employee welfare, training and rewards • Poor morale leading to high turnover rates, high rates of morbidity and low productivity • Shortage of qualified professionals and employees in key skill areas • Competitor demand for our top talent • Inadequate succession planning	Cautious to Open	Operation Cost	• Monitor the labour market and provide employee benefits in line with market norms • Invest in a professional recruitment process, use various employee recruitment and vetting tools to ensure the right candidates are chosen • Have a system for employee onboarding, training and development in place, along with a talent pool management process • Ensure rewards are kept in line with market norms through salary benchmarking and incentive schemes • Develop and reinforce the Company culture • Monitor staff morale through employee feedback processes Also see "People review" on pages 160-167
IT performance, continuity The Company's operating model and scale of business depends on the capabilities and reliability of its IT systems. The inability to harness IT to improve productivity can limit expansion and decrease profitability. IT management is subject to the following risks: • Failure to match IT capabilities, scalability and reliability in relation to business requirements • Disruptions of business continuity due to IT failures	Minimal to Cautious	Revenue Operation Cost	• Ensure the IT development roadmap is integrated within the overall business operating plan • Employ a mix of external and internal expertise to ensure an agile response to business opportunities • Ensure IT change projects are sponsored by business owners and professionally managed to keep within scope and budget • Ensure good governance of IT architecture and the integration of IT systems • Ensure sufficiently close monitoring and speedy fault rectification of IT infrastructure • Implement policies and procedures to ensure cybersecurity protection is maximised Also see "Information technologies" on pages 138-139

Group risk	Risk appetite	Influenced indicator	Mitigation
Cybersecurity The Company understands the rising trend of external threats to information security. Cybersecurity risks include: • Cyberattacks, spread of viruses and other malicious actions to disrupt our operations • Attempts to steal or corrupt our data • Attempts to circumnavigate our control systems in order to cause fraud	Minimal to Cautious	Revenue Operation Cost	• Implement policies and procedures to protect our systems and data • Our Information Security department was set up to monitor and action issues related to cyber-risks • Use of specialised hardware and software to protect against malicious software, spam, external and internal cyberattacks, and data leaks • Use of information systems to detect atypical behaviours in the X5 network and alert trained personnel for action Also see "Information technologies" on pages 138-139
Real estate, rent and maintenance Maintaining our existing stores in a fit state of repair is an important factor in continuing to serve our customers well. Optimal service costs also affect the Company's margins. In pursuing these objectives, the following risks can arise: • High incidences of equipment failures and emergency repairs • Higher utility rates • Higher vacancy rates and a resulting decrease in revenues from subleased areas • Unplanned increases in lease rates or termination of lease agreements by the lessor in favour of another tenant	Minimal to Cautious	Operation Cost	• Have store refurbishment projects planned into our budgets • Invest in preventative maintenance programmes • Standardise and monitor the utility and technical maintenance of stores and automate store monitoring processes • Sign long-term lease agreements, specify rules for their termination, and manage rental rates and landlord relationships • Manage relations with lessors and sub-lessees
Financing risks Financing risks are driven by both internal and external factors. They can have an adverse impact on X5's liquidity, profitability and growth. The most common financing risks include: • Significant volatility of foreign exchange rates • Volatility in country and sector economic fortunes and thus increases in interest rates and banking fees • Pricing and availability of new credit	Averse to Minimal	See Financial Statements	• Raise financing in Russian roubles, avoid FX-denominated agreements in operating activities • Restrict banking activity to a pool of partner banks whose stability has been assessed and verified • Ensure continuity of funding on the best available market terms, with a diverse credit portfolio of lending arrangements • Arrange funding ahead of requirements and maintain sufficient undrawn credit limits in banks • Monitor working capital and have internal policies on credit terms, stock levels and payment terms • Closely monitor the performance against budget and introduce changes needed to achieve financial targets in a timely manner Also see "Financial review" on pages 112-121

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
Reputation and social responsibility As X5's success depends to a significant extent on brand recognition, the brand names Pyaterochka, Perekrestok, Karusel and X5 and their associated reputations are key long-term assets of X5's business. 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: • 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 Minimal	N/A	• 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 Also see "Community investment review" on pages 180-185
Environment X5 is committed to preserving and protecting the environment and making sustainable use of natural resources. Risks regarding environmental management include: • Reputational damage for being perceived as an environmentally uncaring organisation • Financial penalties imposed for non-compliance with environmental regulations	Averse to Minimal	N/A	• Implement energy-efficient technologies and equipment • Make wider use of paperless document flows • Set environmental expectations for contractors in their work for X5 • Ensure our vehicles meet emission standards • Collect and dispose of waste appropriately, and promote recycling wherever possible Also see "Environmental review" on pages 174-177

Group risk	Risk appetite	Influenced indicator	Mitigation
Human rights While most human rights laws concern relationships between the state and individuals, non-state organisations also impact individuals' human rights, and they have a responsibility to respect them. In its operations, X5 addresses the following human rights violations: • 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. • Unethical employee behaviour in violation of human rights (e.g., forced or unpaid labour, workplace bullying, harassment, use of offensive language or humiliation) • X5's involvement in human rights violations by third parties	Averse to Minimal	N/A	• X5's Declaration on Human Rights (available on the Company's website) • Use the X5 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 • Receive complaints from the Company's employees via the hotline and investigate and take necessary disciplinary actions • Improve the Company's business processes to eliminate the root causes of complaints received through the hotline • Use the Customer Service Standards and the hotline for customers, and investigate and remedy complaints • Ensure accessibility for special-needs customers and employees Also see "People review" section on pages 160-167
Health and safety The health and safety of our employees and customers is our primary responsibility. Injuries or fatalities would have a negative impact on the trust and loyalty of our customers and X5's business reputation. The Company addresses the following risks: • 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 the necessary first aid on a timely basis	Averse to Minimal	N/A	• Provide a safe working environment (premises, equipment, uniforms) at the Company's offices, DCs and stores, and carry out regular 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 Also see "Occupational health and safety" on pages 168-173
Product safety and quality Product safety and quality are important criteria for our customers. Products of poor quality and with little shelf life remaining can lead to high wastage and potentially damaged customer relationships. This risk may be triggered by: • 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, representations about quality or that have insufficient shelf life	Averse to Minimal	N/A	• Audit suppliers by carrying out laboratory tests of product samples before adding the products to the assortment. Remove suppliers from our assortment who fail to meet our standards • Ensure inspection of incoming products at DCs and stores • Comply with all rules for product transportation, storage and sale • Comply with sanitation and personal-hygiene rules • Provide training for employees on quality assurance • Handle complaints and requests from customers and investigate root causes Also see "Product safety and production quality" on pages 150-155

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
Legislation and litigation 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: • 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	Averse to Minimal	N/A	• 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

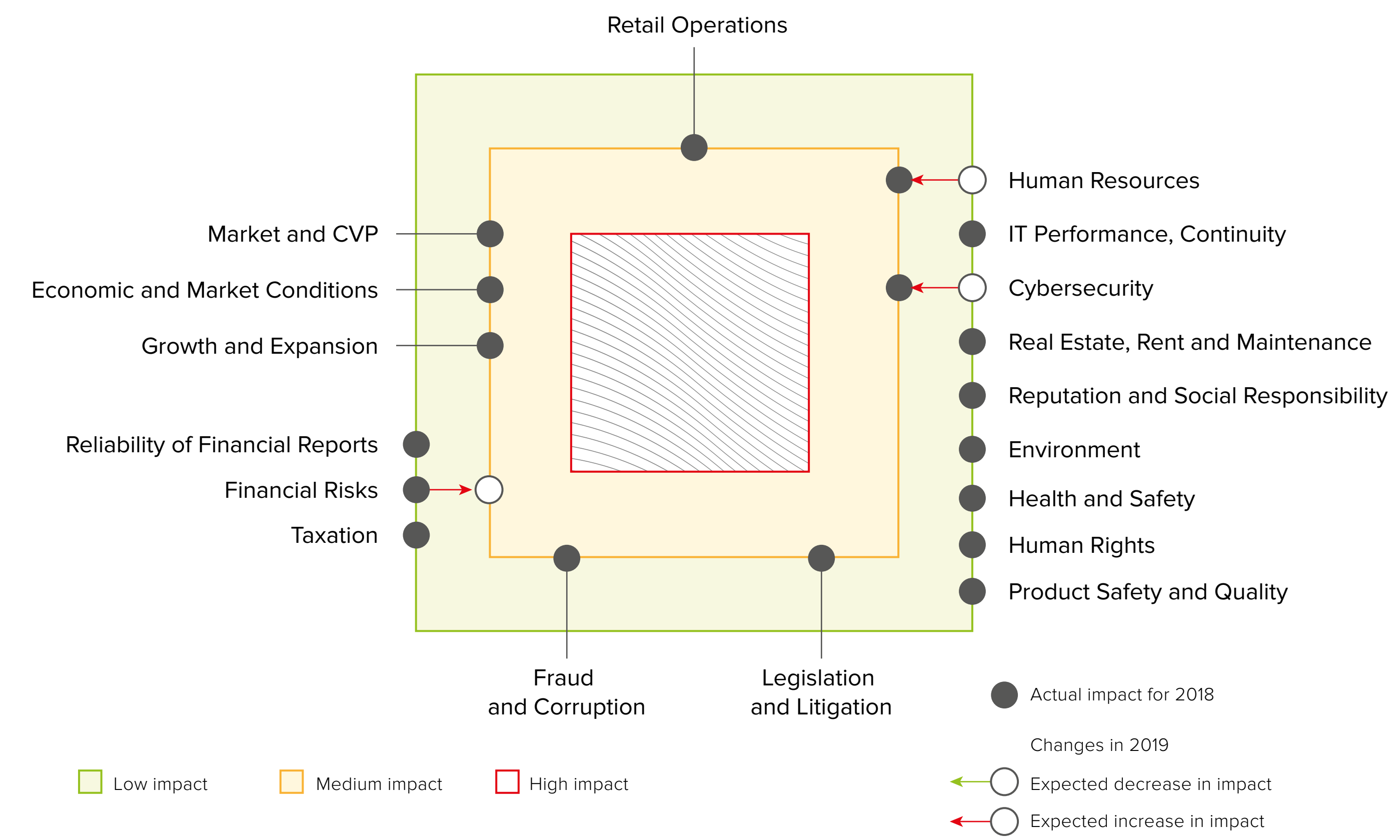
Group risk	Risk appetite	Influenced indicator	Mitigation
Fraud and corruption Like many other industries, the retail sector is exposed to risks of fraud and corruption. The scale of X5's activities and the diversity of its business operations can result in fraud risks and potential for corruption. These risks include: • 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 Minimal	Operation Cost	• 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 and information about our codes and policies • Implement segregation of duties of sensitive roles to reduce risk, and closely manage access rights to our systems • Conduct background checks on counterparties and employees • Identify abuses, fraud and theft by internal departments (Security, Audit, Finance and IT). 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 • Require declaration of conflicts of interest for all employees
Taxation 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: • 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 Minimal	See Financial Statements	• 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
Reliability of financial reports The reliability and completeness of financial reports is a critical element when it comes to maintaining the trust of shareholders and other stakeholders. The integrity of financial reporting is exposed to the following risks: • Non-compliance with statutory requirements on financial reporting • Misrepresentation of management accounts and financial statements • Ambiguity of management accounts and financial statements • Disclosure levels not in line with shareholder, lender or market expectations	Averse to Minimal	N/A	• Annual audit by professional external auditors • Monitoring and prompt adoption of legislative initiatives regarding financial statements and changes in reporting methodologies • Management controls over the methodologies adopted and consistent application in preparing management reporting • 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 2018 and made predictions about the expected future impact, taking external conditions and trends into consideration.



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 2018. 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 an 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, and the management letter from the external auditor with observations and remarks regarding internal controls.

For more information on X5's risk management activities, internal control, risk management systems and key risks, see the section "How we manage risk" above. 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;
- based on the current state of affairs, it is appropriate that the financial reporting is prepared on a going concern basis (notes 30(c) and 32 to the consolidated financial statements).

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
19 March 2019

Supervisory and Management Boards

1 2 3 4 5 6 7 8 9 10

Supervisory Board

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, an 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 Lviv, 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, he 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, a Russian citizen, is the Managing Partner at A1, the key investment subdivision of Alfa Group, where he has worked since March 2018. Currently, Mr Elinson is also a member of the Supervisory Board of Alfa Group. Between December 2015 and March 2018, Mr Elinson was the Director of Asset Management at CTF Consultancy Limited. 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 and 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).

5 Geoff King

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

Geoff King is a British national and currently the CEO of The Food Purveyor, a supermarket retailer in Malaysia. Between 2010 and 2014, he was the Group CFO of Maxis, a major Malaysian telecoms operator, and more recently acted as an advisor to a number of South-east Asian food retailers. Prior to moving to South-east Asia, Geoff held many senior international leadership roles in Tesco PLC in a career spanning over two decades. Geoff graduated from the University of Exeter with a degree in Pure Mathematics and is a prize-winning CIMA qualified accountant.

6 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 he holds an Executive MBA from the Skolkovo Moscow School of Management.

7 Karl-Heinz Holland

Member of the Supervisory Board

Karl-Heinz Holland, a German national, joined X5 in 2018. He served at Lidl Group for over 20 years in various leadership capacities, including six years as CEO, during which time he drove the expansion of Lidl across Europe. He has wide-ranging expertise in the international retail arena, and currently serves as Chairman of the Board of the DSD – Duales System Holding GmbH & Co. KG, member of the Supervisory Board of Zooplus AG, and Chairman of the Advisory Board of Takko Fashion. Karl-Heinz has a degree in Business Administration from Augsburg University of Applied Sciences.

8 Nadia Shouraboura

Member of the Supervisory Board

Nadia Shouraboura, a US citizen, joined X5 in 2018. She has extensive experience in development of innovative concepts for modern retail, as well as technology and data-driven solutions for consumers. In 2004-2012, Nadia served as Technology Vice President for Amazon's global supply chain and fulfilment platforms. Subsequently, she launched her own technology consultancy for the retail industry globally, aimed at combining the best of the online and offline worlds. Nadia holds a degree in Mathematics and Computer Science from Moscow State University and a PhD in Mathematics from Princeton University.

Management Board

9 Igor Shekhterman

X5 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 Enterprises (France, 1994) and the Danish Management School (1995).

10 Frank Lhoëst

Company Secretary, Member of the Management Board

Frank Lhoëst, a Dutch national, joined X5 in 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 Company's general course of affairs, strategy and operational performance. 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 Supervisory Board currently 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 profile is published on X5's corporate website.

The composition of the Supervisory Board changed substantially in 2018. Christian Couvreux stepped down from the Supervisory Board at the 2018 Annual General Meeting of Shareholders, having served two terms in office since 2010. In June, Pawel Musial resigned as a member of the Supervisory Board, having served in this capacity for nearly five years. The Supervisory Board expresses its profound gratitude for the significant contribution of both Christian and Pawel to the development of X5 during an important time of transformation, when the Company regained market leadership by making customers, stores and growth its key priorities.

In order to fill these vacancies, and mindful of the profile of the Supervisory Board, the Supervisory Board nominated Karl-Heinz Holland and Nadia Shouraboura as independent members of the Supervisory Board. Both of the new members were nominated based on their extensive experience as leading retail industry professionals. As former CEO of Lidl Group, Karl Heinz Holland has wide-ranging expertise in European retail and a track record of establishing Lidl as a powerhouse in European food retail, while Nadia Shouraboura's nine years at Amazon provided her with extensive experience in the development of innovative concepts for modern retail as well as technology- and data-driven solutions for consumers. Both nominees were appointed by the General Meeting of Shareholders on 30 August 2018.

Upon the appointment of Karl-Heinz Holland and Nadia Shouraboura, the Supervisory Board continued to reflect on the need to strengthen its expertise in the area of technical and commercial innovation. This resulted in the nomination of Alexander Torbakhov on 25 January 2019 in view of his extensive experience in digital transformation processes, most recently as Deputy Chairman of the Executive Board of Sberbank. Subject to his appointment by the 2019 Annual General Meeting of Shareholders, X5's Supervisory Board will consist of nine members, with a majority of six independent members.

In accordance with the retirement and reappointment schedule of the Supervisory Board, the terms of Stephan DuCharme, Geoff King, Petr Demchenkov and Michael Kuchment will expire in 2019. All four Board members are eligible for reappointment.

Finally, in line with governance best practice, the Supervisory Board approved the appointment of Peter Demchenkov as Vice-Chairman of the Supervisory Board as of March 2019.

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 212-213.

Composition of the committees

While retaining overall responsibility, the Supervisory Board assigns certain tasks to four committees: the Audit and Risk Committee, the Nomination and Remuneration Committee, a newly created Innovation and Technology Committee and the Related-Party Committee.

Upon the appointment of Nadia Shouraboura and Karl-Heinz Holland in August, the latter became a member of the Audit and Risk Committee and the Nomination and Remuneration Committee, while the former took over Michael Kuchment's position as a member of the Related-Party Committee.

In 2018, the Supervisory Board resolved to rename the Audit Committee the Audit and Risk Committee in order to reflect the significant element of the Committee's risk oversight.

The Innovation and Technology Committee was established in January 2019 to strengthen the focus of the Supervisory Board on technical and commercial innovation and to address the disruption that increasingly characterises retail across many geographies. The members of the committee are Nadia Shouraboura, Michael Kuchment and, subject to his appointment by the 2019 Annual General Meeting of Shareholders, Alexander Torbakhov, who was nominated by the Supervisory Board in January 2019.

An overview of the current composition of the committees is presented in the Corporate Governance Report.

Induction and ongoing education

Induction and ongoing 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 Company executives. In addition, prior to their appointment, they are invited to 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 expand their knowledge of local operations, opportunities and challenges.

As part of the follow-up measures to the 2017 Supervisory Board assessment, the Board critically reviewed and improved the induction process for its new members, also in view of the changes made to the composition of the Supervisory Board in 2018. In addition, the Supervisory Board launched a tailored peer group networking programme for its Chairman and committee Chairs to create a targeted network of experienced non-executive directors as a source of best practice and informal learning. As an additional source of informal learning, guest speakers with expert knowledge of topics that are of particular relevance to the Company and the Board were invited to plenary Board meetings as a matter of standard practice going forward. The Supervisory Board remains committed to the ongoing education of its members in order to comply with the highest standards of excellence and governance.

Meetings of the Supervisory Board

In 2018, the Supervisory Board held four regular meetings and one meeting by conference call. In addition, resolutions in writing were taken when necessary during the year. For each of the four meetings in 2018, the Supervisory Board meeting was preceded by meetings of the Audit and Risk Committee and the Nomination and Remuneration Committee. The Related-Party Committee convened throughout the year if and when necessary.

The plenary Supervisory Board meetings in June, September and December included a half-day strategy session, thus ensuring sufficient time for meetings and discussions on specific topics, such as operational performance, strategy and management development. The CEO attended all meetings, and the CFO and other members of senior management were regularly invited to present. In 2018, 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 2017 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 remains 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 2018, the attendance rate was 100% for both the Supervisory Board and the committee meetings.

Activities in 2018

In 2018, the Supervisory Board reviewed various matters related to all significant aspects of the Company, its activities and operational results, 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 long-term value creation through operational excellence and X5's capacity to adjust to changing customer needs. Against the background of an increasingly competitive environment and challenging macroeconomic conditions as well as technological disruption, the Supervisory Board particularly focused on measures to strengthen X5's current businesses, with specific attention paid to operational efficiencies and improving customer experience through the use of technology and innovation.

As part of its strategic cycle, the Supervisory Board reviewed a progress update of X5's "Strategic Vision 2020" and X5's current and future capability and requirements in terms of organisation, leadership and corporate culture to ensure sustainable growth in the rapidly transforming global retail landscape driven by innovative business concepts and omnichannel retailing.

The Supervisory Board paid specific attention to succession planning and management development in the context of a number of senior executives leaving the Company during the first half of the year. In response, the Supervisory Board, assisted by its Nomination and Remuneration Committee, ensured continuity in X5's leadership team, while simultaneously strengthening the group's executive retention programme. The Supervisory Board is pleased with the important weight of internal promotions as part of the Company's systematic succession planning. The Supervisory Board also reviewed human resource policy at store level, alongside measures to improve staff engagement, recognising that the quality and commitment of staff, supported by simple and efficient end-to-end processes, are key factors in a customer-centric business approach.

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 leadership strategy for the Pyaterochka retail format, with renewed focus on the assortment and value proposition, human resources, quality of service, operational efficiencies and cost discipline, as well as organisational structure in view of the format's size and geographic span;
- the leadership strategy for the Perekrestok retail format, with ongoing focus on the value proposition and performance of regional stores versus cosmopolitan stores, as well as the growth strategy for the format's online business;
- the growth strategy for the hypermarket format Karusel, driven by innovative pilot projects to strengthen the format as a distinct brand within X5's multi-format strategy;
- the private-label strategy and implementation programme for each of the formats.

In addition, throughout the year, the Supervisory Board discussed and/or approved the following (regular) topics:

- the financial reporting process and in particular the approval of the 2017 Annual Report and review of the 2018 half-yearly and quarterly financial reports;
- the agenda and explanatory notes for the Annual General Meeting of Shareholders to be held in May 2018, including the dividend proposal;
- reports by the internal and external auditors;
- impact of the new IFRS 16 accounting standards for lease accounting to be implemented as of 2019;
- the assessment of cooperation with the external auditor, based on a report from the Audit and Risk Committee;
- 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 autumn of 2017 and the changing composition of the Board in 2018;
- X5's Group Leadership Diversity Policy, codifying the Company's commitment to supporting and valuing inclusiveness and diversity, and setting diversity targets in terms of age, skills, background and gender;
- the amendment of the Supervisory Board's rules of procedure, in line with new Board practices and the revised Dutch Corporate Governance Code that entered into force on 1 January 2017;
- the corporate social responsibility strategy and initiatives;
- updates to X5's risk landscape and risk appetite, as well as risk mitigation measures and internal controls;
- The annual budget for 2019.

Board evaluation

X5 undertakes an annual review of its 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.

Throughout the year, the Supervisory Board reflected on the recommendations from the Board assessment performed by an external party in 2017, with, as key points of attention, 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. With the appointment and nomination of new Supervisory Board members in 2018 and January 2019, and enhanced Board induction and development initiatives as described in this report, the Supervisory Board ensured that it made good progress in its continuous development as a team, that it has a balanced composition that suits the Company in its current life stage, and that it works well together in an open and constructive atmosphere.

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 its relationship with the Executive Board.

Meetings of the committees

Audit and Risk Committee

The role of the Audit and Risk Committee is described in its charter, which is available on the Company's website. On 31 December 2018, the Audit and Risk Committee consisted of Geoff King (Chairman), Andrei Elinson and Karl-Heinz Holland. In 2018, the 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, while the Chairman and CEO were invited to attend all meetings. Other members of the Supervisory Board and senior management were invited when necessary or appropriate. The Committee met once with the external auditor without the presence of management.

In 2018, the Committee focused on, among other things, overseeing the integrity and quality of X5's financial reporting and the effectiveness of the internal risk and control systems. The 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 Committee discussed relevant and new accounting standards, with increased focus on the impact of lease accounting under IFRS 16. Throughout the year, the Committee reviewed the level of financial provisions, key movements in the balance sheet and any contingent liability movements. As part of this review, the Committee paid specific attention to controls and initiatives in the area of working capital management.

Furthermore, the Committee reviewed and approved the audit plans of the internal and external auditors, with a focus on scoping, materiality and key risks. The 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 Committee oversaw follow-up by management to the recommendations made in internal and external management letters.

In 2018, the Audit and Risk Committee, together with management, conducted its periodic assessment of the functioning and independence of the external auditor, in line with the Company's Rules on External Auditor Independence and Selection. The results were shared with the current auditors, and actions to further improve optimising the auditor relationship were agreed. The main conclusions of this assessment, including the proposed external audit fees for the next three-year period, were shared with the Supervisory Board for the purpose of submitting the reappointment of the external auditor to the General Meeting of Shareholders.

Throughout the year, the 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. In the context of periodic ethics and compliance updates, the Committee reviewed whistle-blower reports, and dedicated specific attention to economic and political sanctions and their impact on X5's operations. Furthermore, the Committee reviewed activities and initiatives related to detection and prevention of misconduct and irregularities, and risk-mitigating measures to protect the Company in these areas.

The Committee extensively discussed the effectiveness of the internal control framework. Each quarter, the agenda includes a discussion of 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, to mitigate any significant risks or weaknesses and to build a relevant internal audit plan for 2019.

Throughout the year, the 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 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 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 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 2017 consolidated financial statements;
- quarterly interim financial reports and trading updates;
- X5's financing strategy;
- X5's dividend policy;
- tax matters;
- IT infrastructure and data security;
- material legal cases;
- regulatory compliance and changes in legislation, with ongoing attention to Russian trade law and its proposed amendments on the return of unsold goods to suppliers, effective as of 1 January 2019;
- the effectiveness of the internal audit function and its plans to develop in the coming years;
- non-audit fee payments to the incumbent external auditor, ensuring that the level of expenditure does not exceed the internal Company guideline of 70% of the annual audit fee in any given year.

With respect to the external auditor's management letter about the 2018 financial year, the Audit and Risk 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 2018, the Nomination and Remuneration Committee consisted of Peter Demchenkov (Chairman), Stephan DuCharme, Andrei Elinson and Karl-Heinz Holland. The Nomination and Remuneration Committee held six meetings in 2018, including two meetings 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 2018, the Committee's main areas of focus were succession planning for the Supervisory Board and overall succession and management development processes, with specific attention paid to new executive succession planning following changes in the management team during the first half of the year. Also, as part of an in-depth analysis of corporate culture, the Committee reviewed measures to increase employee engagement, recognising that the quality and commitment of staff, supported by simple and efficient end-to-end processes, are key factors in a customer-centric business approach. In this context, the Committee also discussed the Company's approach to the level and structure of compensation for personnel other than members of the Executive Board, with a focus on operational and store personnel.

The Committee was also involved in organisational and governance matters in relation to the Company's multi-format operating model and strategic objectives. In this context, the Committee reflected on headcount and cost discipline at the central level, aiming to strike the right balance between the Group's decentralised operating model and the role and size of the Group's Corporate Centre as a platform for performing unique functions in support of the three formats. The Committee also reviewed and made recommendations in respect of the Group's central leadership and direct reports structure.

In terms of remuneration, the Committee reviewed adjustments within the total remuneration package of the members of the Executive Board based on a base salary benchmarking analysis, in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation.

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;
- performance measures, targets and remuneration of individual members of the Executive Board;
- changes in the composition of the Executive Board, including the appointment of Sergey Goncharov as General Director of Pyaterochka and Vladislav Kurbatov as General Director of Perekrestok;
- the profile and composition of the Supervisory Board, including the nominations of Karl-Heinz Holland and Nadia Shouraboura, who were appointed as new Board members by the General Meeting of Shareholders in August;
- the new long-term incentive programme 2018-2020 as approved by the 2018 Annual General Meeting of Shareholders.

For information on the remuneration policy, see "Remuneration" on pages 221-225. Details of actual remuneration in 2018 can be found in notes 27 and 28 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 2018, the Related-Party Committee consisted of Geoff King (Chairman) and Nadia Shouraboura. In 2018, the Related-Party Committee convened once in person to discuss, in particular, safeguards to make sure that pre-approved related-party transactions are periodically tested to ensure ongoing competitiveness. Resolutions in writing were taken 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 reviewed the following transactions in 2018:

- service agreements with Alfa Services Limited;
- the supply agreement with Alidi following its acquisition of Central Distribution Company;
- a joint venture agreement with Sovcom Bank for distribution of online orders through a network of parcel lockers in Pyaterochka and Perekrestok stores;
- an agreement with Sovcombank on the use of the Halva instalments card in stores;
- agreements with Vimpelcom related to the supply of hardware for stores and mobile application support for store personnel;
- the sublease of storage space in Tyumen to Hoff;
- an agreement with Alfabank on Perekrestok "Mobile Wallet" loyalty cards.

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 judgement of these Supervisory Board members while performing their duties for X5.

Remuneration

The General Meeting of Shareholders determines the remuneration of the members of the Supervisory Board. The detailed amounts are stated in notes 27 and 28 to the consolidated financial statements.

Financial Statements

This Annual Report and the 2018 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 293-301.

The Supervisory Board recommends that shareholders adopt these financial statements and, as proposed by the Management Board, appropriate RUB 25,000 million for dividend payments. The underlying principle of the dividend policy is that at least 25% of the consolidated net profit for the full year has to be placed at the disposal of holders of global depositary receipts for distribution as dividends. The proposed dividend amounts to RUB 92.06 per GDR with a nominal value of EUR 0.25.

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 2018.

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 2018.

The Supervisory Board
19 March 2019

Remuneration

This report outlines the remuneration policy of the Company's Management Board as well as the actual remuneration of the Management Board for the 2018 financial year. Further details of actual remuneration of the Management Board and Supervisory Board in 2018 can be found in notes 27 and 28 to the consolidated financial statements.

Remuneration policy

The remuneration policy for members of the Management Board was adopted at the General Meeting of Shareholders on 7 May 2015. It is aligns with the Company's strategy and supports the long-term development of the Company, while aiming to be effective, transparent and simple.

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

The objective of X5's remuneration policy is twofold:

- to create a remuneration structure that will support a healthy corporate culture and allow the Company to attract, reward and retain the best-qualified talent to lead the Company towards its strategic objectives;
- to balance short-term operational performance with the long-term objectives of the Company and sustainable value creation for its shareholders and stakeholders.

The Supervisory Board's Nomination and Remuneration Committee closely monitors developments in regional and local labour markets and takes these developments into account when making recommendations on Executive Board compensation to the Supervisory Board for consideration and approval. While developing the remuneration policy, the Nomination and Remuneration Committee carries out scenario analyses to determine the risks to which variable remuneration may expose the Company.

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

Benchmarking with industry peers

The basic components of the total direct compensation provided to Executive Board members is benchmarked against the labour market peer group. As a company with operations mainly in Russia, the peer group created for the benchmarking is composed of Russian companies equivalent in terms of size of business, complexity of operations and corporate governance.

The composition (risk profile) of the levels of total direct compensation is also taken into account when benchmarking salary levels. The target total direct compensation level is typically around the median or 75th percentile, depending on the position of the relevant executive.

Total direct compensation

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

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

Base salary

The level of each Executive Board member’s base salary is derived from the benchmarking of total direct compensation. Adjustment of the base salary is at the discretion of the Supervisory Board.

Short-term incentive (STI)

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

At the beginning of each financial year, the Supervisory Board sets the performance measures and their relative weight, the targets to be achieved for each performance measure, as well as performance ranges, i.e., the value below which no payout will be made (the threshold), the on-target value and the maximum payout level. Financial performance measures comprise components related to the Company’s operational performance, particularly sales growth, operating margin and return on investment, with a profitability threshold as a condition for STI payout. Individual performance measures include divisional performance or key project-related targets.

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

Long-term incentive (LTI)

In 2018, the General Meeting of Shareholders approved a new LTI programme that was developed by the Supervisory Board since targets under the previous programme were achieved in 2017. Whereas the 2015-2018 LTI programme was specifically designed to support the Company’s ambitious transition to accelerated growth and expansion in line with long-term strategic targets, the Supervisory Board recognised that the Company is entering a new stage with enhanced focus on sustainability and strategic objectives that contribute to long-term value creation for the Company. The new LTI is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred, conditional payouts in order to maintain the focus on long-term goals and to provide for an effective retention mechanism. In comparison to the 2015-2018 LTI programme, it is designed for a wider group of participants within the Company and aims to create greater balance between short- and long-term compensation of the programme participants.

Targets under the LTI are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and enterprise value multiple relative to competition. Additionally, the LTI includes thresholds related to (i) the EBITDA margin to ensure that profitability is not sacrificed and (ii) the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management. Under the programme, 50% of the total award is paid in 2021 subject to maintaining achieved targets until the end of 2020, while the other 50% is deferred to 2022 subject to maintaining achieved targets in 2021 with a profitability threshold as a condition for deferred payout. This creates a focus on long-term goals throughout the programme and provides an effective mechanism for motivating and retaining executives who are critical to the Company’s continued success.

The size of each individual cash award is based on the participant’s annual base salary and LTI scale, reflecting his/her role and contribution to meeting the LTI targets at both individual and team levels, with a maximum of 133% per year of the participant’s base salary during the three-year programme. The total available fund for all payouts under the LTI programme is capped at 5% of average EBITDA during the three-year period of the programme.

Other remuneration components

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

Contractual arrangements

Members of the Management Board are engaged on the basis of a management services agreement with a four-year term, to be extended upon reappointment by the Annual General Meeting of Shareholders. The CEO, as a Russia-based member of the Management Board, also has an employment contract with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract reflect the relevant responsibilities of each member of the Management Board in the Netherlands and in Russia.

Severance arrangement

The severance payment is limited to a maximum of six months’ base salary for Management Board members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances. No severance pay is awarded if the agreement is terminated at the initiative of the Executive Board member or in the event of seriously culpable or negligent behaviour on his/her part.

Clawback

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

Insurance and indemnity arrangements

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

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

2018 Management Board Remuneration

The Management Board remuneration for 2018 is in accordance with the remuneration policy for members of the Management and Executive Board adopted at the General Meeting of shareholders on 7 May 2015.

The following table provides an overview of the Management Board's actual remuneration that became unconditional in 2018 or at year end (in millions of Russian roubles). For disclosures in line with IFRS reporting requirements, which are accrual-based over earning/performance periods and partly depend on estimations/assumptions, see note 8 "Related-party transactions" on page 254.

Name	Year	Base salary	Short-term incentive	Long-term incentive	Share based compen-sation	Social security cost	Total
I. Shekhterman	2018	60	59	183	1	44	**347**
	2017	46	36	211	8	43	**344**
F. Lhoëst	2018	20	13	–	–	–	**33**
	2017	18	10	–	–	–	**28**
TOTAL	**2018**	**80**	**72**	**183**	**1**	**44**	**380**
	2017	**64**	**46**	**211**	**8**	**43**	**372**

Ad (1) – Base salary

In 2018, the Supervisory Board reviewed and approved an adjustment within the total remuneration package for the members of the Executive Board, based on a base salary benchmarking analysis in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation. Accordingly, in line with compensation levels in peer group companies, Mr. Shekhterman's annual base salary was increased to RUB 70,000,000 (2017: RUB 42,000,000). The table reflects actual base salary amounts, including adjustments based on the number of days spent on vacation and business trips in 2018, in accordance with Russian labour law.

For Mr Shekhterman, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr DuCharme when in office as CEO specifically for hiring and retention purposes and to safeguard continuity in the interest of the Company and its shareholders, as Mr Shekhterman's leadership and skills are considered to be crucial for the continuity of the Company's growth and success. As disclosed when Mr Shekhterman took office in 2015, his reward package does not include a severance entitlement; instead, he will be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration based on fixed and variable components, Mr Shekhterman will be entitled to the difference upon completion of his full term as CEO.

Ad (2) – Short-term incentive

Short-term incentives are based on results achieved in 2018 and payable in 2019. For 2018, the Supervisory Board determined that 50% of the total on-target bonus opportunity for the CEO depends on achieving quantitative financial performance measures, and 50% on individual performance measures. Financial performance measures consist of elements related to the Company's operational performance, including EBITDA and return on investment, with a profitability threshold as a condition for STI payout. For the Company Secretary, the STI is based on achievement of individual performance measures, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO and 60% for the Company Secretary. The achievement of all performance targets was assessed and determined by the Supervisory Board for each Management Board member individually. As of 31 December 2018, all financial targets set for the CEO by the Supervisory Board, in particular operating margin and return on investment, were achieved above target within a 110% outperformance range. Taking into account achievement levels of individual performance measures, this resulted in payouts of 103% of base salary for Mr Shekhterman and 58% of base salary for Mr Lhoëst.

Ad (3) – Long-term incentive

The 2015-2018 LTI programme came to an end when targets under the second stage of the programme were achieved in 2017. Under the programme's deferred payout mechanism, 50% of the total award under the second stage of the programme was paid to Mr Shekhterman in 2018, with a final 50% deferred payout in 2019.

Internal pay ratio

The ratio of the total salary expense of the Management Board vs. total average salary expense per employee (excluding LTI) is presented in the table below:

Pay ratio between	Year	Ratio
X5 CEO vs. X5 employees	2018	209:1
	2017	174:1
Company Secretary vs. X5 employees	2018	58:1
	2017	61:1

The pay ratio is calculated by dividing the total remuneration of the respective Management Board members by the average remuneration of all X5 employees over 2017 and 2018 to convey the year-on-year changes. The average remuneration per employee is calculated as the total labour costs derived from note 27 on page 268 divided by the number of employees on an FTE basis. Given the irregular nature of awards under the LTI programme and the fact that not every member of the Management Board participates in the LTI programme, LTI awards are not included in the pay ratio for fair and consistent presentation purposes.

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

Remuneration policy in 2019 and beyond

In 2018, the remuneration policy as described in this report was applied. It is the intention that the current policy will in principle be continued in the next financial year and beyond.

The Supervisory Board
19 March 2019

Financial statements

X5 Retail Group N.V.

International Financial Reporting Standards
Consolidated Financial Statements
31 December 2018

Contents

CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

COMPANY FINANCIAL STATEMENTS

X5 Retail Group N.V.

Consolidated Statement of Financial Position

at 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2018	31 December 2017 Restated*
Assets			
Non-current assets			
Property, plant and equipment	10	303,802	278,928
Investment property	11	6,173	5,488
Goodwill	12	94,627	90,276
Other intangible assets	13	22,126	18,442
Investments in associates and joint ventures		203	–
Other non-current assets	16	8,015	7,708
Deferred tax assets	29	5,013	5,143
		439,959	**405,985**
Current assets			
Inventories	14	115,990	99,300
Indemnification asset		–	106
Trade, other accounts receivable and prepayments	16	14,172	15,531
Current income tax receivable		6,167	2,384
VAT and other taxes receivable	17	10,143	14,347
Cash and cash equivalents	9	24,368	27,605
		170,840	**159,273**
TOTAL ASSETS		**610,799**	**565,258**
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	21	2,458	2,458
Share premium		46,192	46,212
Retained earnings		116,707	109,655
Share-based payment reserve	28	118	117
		165,475	**158,442**
Total equity		**165,475**	**158,442**
Non-current liabilities			
Long-term borrowings	20	147,329	135,622
Deferred tax liabilities	29	6,166	5,670
Long-term contract liabilities		–	5
Other non-current liabilities		626	1,344
		154,121	**142,641**
Current liabilities			
Trade accounts payable		154,873	130,766
Short-term borrowings	20	60,435	58,674
Interest accrued		1,770	1,642
Short-term contract liabilities	19	1,664	1,815
Current income tax payable		725	635
Provisions and other liabilities	18	71,736	70,643
		291,203	**264,175**
Total liabilities		**445,324**	**406,816**
TOTAL EQUITY AND LIABILITIES		**610,799**	**565,258**

* Certain amounts shown here do not correspond to the consolidated financial statements for the year ended 31 December 2017 and reflect adjustments described in Note 4.

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

X5 Retail Group N.V.

Consolidated Statement of Profit or Loss

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2018	2017 Restated*
Revenue	23	1,532,537	1,295,008
Cost of sales	24	(1,162,817)	(986,070)
Gross profit		**369,720**	**308,938**
Selling, general and administrative expenses	24	(323,358)	(259,146)
Net impairment losses on financial assets	16	(501)	(230)
Lease/sublease and other income	25	12,293	8,196
Operating profit		**58,154**	**57,758**
Finance costs	26	(18,846)	(16,138)
Finance income	26	179	121
Net foreign exchange (loss)/gain		(447)	75
Profit before tax		**39,040**	**41,816**
Income tax expense	29	(10,398)	(10,422)
Profit for the year		**28,642**	**31,394**
Profit for the year attributable to:			
Equity holders of the parent		28,642	31,394
Basic earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	22	421.90	462.45
Diluted earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	22	421.87	462.36

* Certain amounts shown here do not correspond to the consolidated financial statements for the year ended 31 December 2017 and reflect adjustments described in Note 4.

X5 Retail Group N.V.

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	2018	2017
Profit for the year	28,642	31,394
Total comprehensive income for the year, net of tax	**28,642**	**31,394**
Total comprehensive income for the year attributable to:		
Equity holders of the parent	28,642	31,394

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

X5 Retail Group N.V.

Consolidated Statement of Cash Flows

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2018	2017 Restated*
Profit before tax		**39,040**	**41,816**
Adjustments for:			
Depreciation, amortisation and impairment of property, plant and equipment, investment property and intangible assets	24	49,474	38,435
Gain on disposal of property, plant and equipment, investment property and intangible assets		(213)	(61)
Finance costs, net	26	18,667	16,017
Net impairment losses on financial assets	16	501	230
Impairment of prepayments	16	216	292
Share-based compensation expense	28	72	71
Net foreign exchange loss/(gain)		447	(75)
Other non-cash items		(377)	105
Net cash from operating activities before changes in working capital		**107,827**	**96,830**
Decrease in trade, other accounts receivable and prepayments		4,360	4,290
Increase in inventories		(16,690)	(25,498)
Increase in trade payable		24,183	448
Increase in other accounts payable and contract liabilities		7,756	9,374
Net cash flows generated from operations		**127,436**	**85,444**
Interest paid		(16,893)	(15,069)
Interest received		75	59
Income tax paid		(12,584)	(11,776)
Net cash flows from operating activities		**98,034**	**58,658**
Cash flows from investing activities			
Purchase of property, plant and equipment		(73,494)	(78,355)
Acquisition of businesses, net of cash acquired	7	(14,524)	(6,467)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		735	776
Purchase of other intangible assets		(5,274)	(3,438)
Acquisition of interest in associates and joint ventures		(203)	–
Proceeds from disposal of available-for-sale investments		–	210
Net cash flows used in investing activities		**(92,760)**	**(87,274)**
Cash flows from financing activities			
Proceeds from loans	20	108,054	100,780
Repayment of loans	20	(94,810)	(62,700)
Purchase of treasury shares		(90)	(63)
Dividends paid to equity holders of the parent	21	(21,590)	–
Net cash flows (used in)/from financing activities		**(8,436)**	**38,017**
Effect of exchange rate changes on cash and cash equivalents		(75)	14
Net (decrease)/increase in cash and cash equivalents		**(3,237)**	**9,415**
Movements in cash and cash equivalents			
Cash and cash equivalents at the beginning of the year	9	27,605	18,190
Net (decrease)/increase in cash and cash equivalents		(3,237)	9,415
Cash and cash equivalents at the end of the year	9	**24,368**	**27,605**

* Certain amounts shown here do not correspond to the consolidated financial statements for the year ended 31 December 2017 and reflect adjustments described in Note 4.

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

X5 Retail Group N.V.

Consolidated Statement of Changes In Equity

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	Attributable to equity holders of the parent						Total
	Number of shares	Share capital	Share premium	Share-based payment reserve	Retained earnings	Total shareholders' equity	
BALANCE AS AT 1 JANUARY 2017	**67,884,340**	**2,458**	**46,251**	**70**	**78,261**	**127,040**	**127,040**
Profit for the period	–	–	–	–	31,394	31,394	31,394
Total comprehensive income for the period	–	–	–	–	**31,394**	**31,394**	**31,394**
Share-based payment compensation (Note 28)	–	–	–	71	–	71	71
Transfer and waiving of vested equity rights	2,408	–	(39)	(24)	–	(63)	(63)
BALANCE AS AT 31 DECEMBER 2017	**67,886,748**	**2,458**	**46,212**	**117**	**109,655**	**158,442**	**158,442**
BALANCE AS AT 1 JANUARY 2018	**67,886,748**	**2,458**	**46,212**	**117**	**109,655**	**158,442**	**158,442**
Profit for the period	–	–	–	–	28,642	28,642	28,642
Total comprehensive income for the period	–	–	–	–	**28,642**	**28,642**	**28,642**
Dividends (Note 21)	–	–	–	–	(21,590)	(21,590)	(21,590)
Share-based payment compensation (Note 28)	–	–	–	72	–	72	72
Transfer and waiving of vested equity rights	3,351	–	(20)	(71)	–	(91)	(91)
BALANCE AS AT 31 DECEMBER 2018	**67,890,099**	**2,458**	**46,192**	**118**	**116,707**	**165,475**	**165,475**

X5 Retail Group N.V.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

01 PRINCIPAL ACTIVITIES AND THE GROUP STRUCTURE

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

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

The main activity of the Group is the development and operation of grocery retail stores. As at 31 December 2018 the Group operated a retail chain of 14,431 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express" (each representing separate format) in major population centres in Russia, including but not limited to Moscow, St. Petersburg, Nizhniy Novgorod, Rostov-on-Don, Kazan, Samara, Lipetsk, Chelyabinsk, Perm, Ekaterinburg (31 December 2017: 12,121 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express"), with the following number of stores:

	31 December 2018	31 December 2017
"Perekrestok" – Supermarket		
Central FD	449	389
Volga FD	119	107
North-western FD	98	65
Ural FD	42	40
Southern FD	43	28
Northern Caucasus	9	9
TOTAL	**760**	**638**
"Pyaterochka" – Proximity stores		
Central FD	5,279	4,607
Volga FD	3,676	3,038
North-western FD	1,552	1,333
Ural FD	1,120	951
Southern FD	1,174	841
Siberian FD	479	277
Northern Caucasus	242	178
TOTAL	**13,522**	**11,225**
"Karusel" – Hypermarket		
Central FD	39	37
Volga FD	25	24
North-western FD	18	18
Ural FD	6	8
Southern FD	5	5
Northern Caucasus	1	1
TOTAL	**94**	**93**
"Perekrestok Express" – Express	**55**	**165**
TOTAL STORES	**14,431**	**12,121**

As at 31 December 2018 the principal shareholder exerting significant influence over the Company is CTF Holdings S.A. ("CTF"). CTF owns 47.86% of total issued shares in the Company, indirectly through Luxaro Retail Holding S.a.r.l. As at 31 December 2018 the Company's shares were listed on the London and Moscow Stock Exchanges in the form of Global Depositary Receipts (GDRs) with each GDR representing an interest of 0.25 in an ordinary share (Note 21).

In 2018 X5 Retail Group N.V. has issued a liability statement as mentioned in article 403 sub 2 of Book 2 of the Dutch Civil Code regarding its subsidiary X5 Finance B.V. In compliance with these and other conditions as included in article 403, the financial statements of the X5 Finance B.V. for the year ended 31 December 2018 will be prepared on a condensed basis and will not be audited.

02 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of preparation

These consolidated financial statements for the year ended 31 December 2018 have been prepared in accordance with and comply with International Financial Reporting Standards as adopted by the European Union and with Part 9 Book 2 of the Dutch Civil Code.

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

On 19 March 2019, the Management Board authorised the consolidated financial statements for issue. Publication is on 20 March 2019.

2.2 Basis of consolidation

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

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

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

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

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

02

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

2.3 Foreign currency translation and transactions

(a) Functional and presentation currency

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

(b) Transactions and balances

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

2.4 Segment reporting

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

2.5 Property, plant and equipment

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

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

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

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

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

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

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

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

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

2.6 Investment property

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

Investment properties are stated at cost less accumulated depreciation and provision for impairment, where required. If any indication exists that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs of disposal. Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred.

Transfers are made to (or from) investment property only when there is a change in use. Transfers between investment property and owner-occupied property do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are 40-50 years.

Investment properties are derecognised either when they have been disposed of (i.e., at the date the recipient obtains control) or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in profit or loss in the period of derecognition. The amount of consideration to be included in the gain or loss arising from the derecognition of investment property is determined in accordance with the requirements for determining the transaction price in IFRS 15.

Fair value determined for the disclosure purposes (Note 11) represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The measurement is classified in level 3 of the fair value hierarchy.

2.7 Intangible assets

(a) Goodwill

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

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

02

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(b) Lease rights

Lease rights represent:

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

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

(c) Brand and private labels

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

	Useful lives
Private labels	1-8 years

(d) Software and other intangible assets

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

(e) Impairment of intangible assets

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

2.8 Operating leases

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

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

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

2.9 Inventories

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

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

2.10 Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(a) Financial assets

Initial recognition and measurement

The Group classifies its financial assets as those to be measured subsequently at amortised cost, fair value through other comprehensive income or fair value through profit and loss. The classification depends on the financial asset's contractual cash flow characteristics and the business model for managing the financial assets.

With the exception of trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient, the Group initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs. Trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient are measured at the transaction price determined under IFRS 15. Refer to the accounting policies in section 2.24 (a) Revenue from contracts with customers.

Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date, if required under IFRS. In order for a financial asset to be classified and measured at amortised cost or fair value through OCI, it needs to give rise to cash flows that are 'solely payments of principal and interest (SPPI)' on the principal amount outstanding. This assessment is referred to as the SPPI test and is performed at an instrument level.

The Group's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

Subsequent measurement

For purposes of subsequent measurement, financial assets are classified in four categories:

- Financial assets at amortised cost (debt instruments);
- Financial assets at fair value through OCI with recycling of cumulative gains and losses (debt instruments);
- Financial assets designated at fair value through OCI with no recycling of cumulative gains and losses upon derecognition (equity instruments);
- Financial assets at fair value through profit or loss.

Financial assets at amortised cost (debt instruments) is the most relevant to the Group. The Group measures financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows, and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at amortised cost are subsequently measured using the effective interest (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

Derecognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Group's consolidated statement of financial position) when:

- The rights to receive cash flows from the asset have expired, or
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of its continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Impairment of financial assets
The Group recognises an allowance for expected credit losses (ECLs) for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Group expects to receive, discounted at an approximation of the original effective interest rate. The expected cash flows will include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

For trade and other receivables the Group applies a simplified approach in calculating ECLs. Therefore, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

(b) Financial liabilities
Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, loans and borrowings. For more information refer to Note 2.11 and Note 2.12.

Derecognition
A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the statement of profit or loss.

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

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

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

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

After initial recognition, interest-bearing borrowings are subsequently measured at amortised cost using the effective interest ("EIR") method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the consolidated statement of profit or loss.

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

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

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

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

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

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

2.17 Share-based payments

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

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

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

Service and non-market performance conditions are not taken into account when determining the grant date fair value of awards, but the likelihood of the conditions being met is assessed as part of the Group's best estimate of the number of equity instruments that will ultimately vest. Market performance conditions are reflected within the grant date fair value. Any other conditions attached to an award, but without an associated service requirement, are considered to be non-vesting conditions. Non-vesting conditions are reflected in the fair value of an award and lead to an immediate expensing of an award unless there are also service and/or performance conditions. No expense is recognised for awards that do not ultimately vest because non-market performance and/or service conditions have not been met. Where awards include a market or non-vesting condition, the transactions are treated as vested irrespective of whether the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

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

02

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.18 Share capital

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

2.19 Dividends

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

2.20 Treasury shares

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

2.21 Earnings per share

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

2.22 Taxes

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

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

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

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted within the consolidated group of taxpayers (CGT) and within individual companies of the Group for the entities that are not members of the CGT.

The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period. Adjustments for uncertain income tax positions are recorded within the income tax charge. Interest incurred in relation to taxation is included in finance costs in the consolidated statement of profit or loss. Provisions are maintained, and updated if necessary, for the period over which the respective tax positions remain subject to review by the tax and customs authorities, being 3 years from the year of filing.

2.23 Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 33.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

2.24 Income and expense recognition

Income and expenses are recognised on an accrual basis as earned or incurred. Recognition of the principal types of income and expenses is as follows:

(a) Revenue from contracts with customers

The Group is in the retail business and sells its goods both through stores operated by the Group and through franchisees (agents) acting as a principal. The revenue recognised by the Group meets the definition of revenue from contracts with customers as per IFRS 15. The Group recognises revenue when control of goods and services is transferred to the customer, generally for the retail customers it is occurred in the stores at the point of sale. Payment of the transaction price is due immediately when the customer purchases goods.

The Group has loyalty points programmes, which allow customers to accumulate points that can be redeemed for free products. The loyalty points give rise to a separate performance obligation as they provide a material right to the customer. A portion of the transaction price is allocated to the loyalty points awarded to customers based on relative stand-alone selling price and recognised as a contract liability until the points are redeemed. Revenue is recognised upon redemption of products by the customer.

When estimating the stand-alone selling price of the loyalty points, the Group considers the likelihood that the customer will redeem the points. The Group updates its estimates of the points that will be redeemed on a monthly basis and any adjustments to the contract liability balance are charged against revenue.

(b) Cost of sales

Cost of sales includes the purchase price of the products sold and other costs incurred in bringing the inventories to the location and condition ready for sale, i.e. retail outlets. These costs include costs of purchasing, storing, rent, salaries and transporting the products to the extent it relates to bringing the inventories to the location and condition ready for sale.

02 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Group receives various types of allowances from suppliers in the form of volume discounts and other forms of payment. In accounting for supplier bonuses received by the Group, the Group determined that these bonuses are a reduction in prices paid for the product and are reported as part of the cost of sales as the related inventory is sold. Bonuses receivable from suppliers in cash are presented as trade receivables.

(c) Interest income and expense

Interest income and expense are recognised on an effective yield basis.

(d) Selling, general and administrative expenses

Selling expenses consist of salaries and wages of stores employees, store expenses, rent or depreciation of stores, utilities, advertising costs and other selling expenses. General and administrative expenses include costs of salaries and wages of support office employees, rent and depreciation of support offices, impairment and amortisation charges of non-current assets and other general and administrative expenses. Selling, general and administrative expenses are recognised on an accrual basis as incurred.

2.25 Contract liability

A contract liability is the obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer. If a customer pays consideration before the Group transfers goods or services to the customer, a contract liability is recognised when the payment is made or the payment is due (whichever is earlier). Contract liabilities are recognised as revenue when the Group performs under the contract.

2.26 Impairment of non-current assets other than goodwill

The Group periodically assesses whether there is any indication that non-current assets may be impaired. If any such indicators exist, the Group estimates the recoverable amount of the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash generating unit to which it belongs. Individual stores are considered separate cash-generating units for impairment testing purposes. Impairment loss is recognised whenever the carrying amount of an asset or the related cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the consolidated statement of profit or loss. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.27 Fair value of assets and liabilities at the acquisition date

A primary valuation of assets and liabilities of acquired companies was performed on a provisional basis. Once the valuation is finalised, any adjustments arising are recognised retrospectively.

2.28 Indemnification asset

The indemnification asset equivalent to the fair value of the indemnified liabilities is included in net assets acquired in the business combination if the selling shareholders of the acquiree agreed to compensate possible claims or contingencies. Subsequent measurement of the indemnification asset and contingent liability does not have any impact on future earnings, unless the indemnification asset becomes impaired.

2.29 Offsetting of financial assets and financial liabilities

Accounts receivable and accounts payable are offset and the net amount is presented in the consolidated statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and intends to settle on a net basis.

03 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities include:

Impairment of goodwill

The Group tests goodwill for impairment at least annually. The recoverable amount of a cash-generating unit has been determined based on the higher of fair value less costs to sell or value-in-use calculations. These calculations require the use of estimates as further detailed in Note 12.

Identifying a business combination

The Group enters into transactions to acquire integrated set of assets and operations of retail stores. The Group determines whether such transactions represent a business combination or assets acquisitions. The Group treats such transactions as business combinations when the integrated set of activities and assets acquired is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to the Group. In making this judgment the Group considers whether it acquired inputs and processes applied to the inputs that have ability to create output. All acquisitions of assets and operations of retail stores occurred in 2018 and 2017 were treated by the Group as business combinations.

Litigations

The Group exercises considerable judgment in measuring and recognising provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations (Note 34).

Deferred tax assets and liabilities

Group's management judgment is required for the calculation of current and deferred income taxes. Deferred tax assets are recognised to the extent that their utilisation is probable. The utilisation of deferred tax assets will depend on whether it is possible to generate sufficient taxable income in respective tax type and jurisdiction. Various factors are used to assess the probability of the future utilisation of deferred tax assets, including past operating results, the operational plan, expiration of tax losses carried forward, and tax planning strategies. In the event that an assessment of future utilisation indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in profit or loss.

IAS 12 requires a deferred tax liability to be recognised for all taxable temporary differences associated with investments in subsidiaries unless: (a) the parent, investor joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and (b) it is probable that the temporary difference will not reverse in the foreseeable future. The Group exercises significant judgment in assessing the amount of taxable temporary differences associated with investments in subsidiaries (unremitted earnings) that will not reverse in the foreseeable future.

If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected.

Property, plant and equipment

The Group's management determines the estimated useful lives and related depreciation charges for its plant and equipment (Note 10). The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets. Management increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that property, plant and equipment may be impaired. The Group performs assets impairment testing (Note 10). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2018 the Group recognised an impairment loss in the amount of RUB 4,117 (year ended 31 December 2017: a net impairment loss in the amount of RUB 5,311).

03 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

Investment property

The Group's management determines the estimated useful lives and related depreciation charges for its investment properties (Note 11). Management increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that investment property may be impaired. The Group performs assets impairment testing (Note 11). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2018 the Group recognised a net impairment gain in the amount of RUB 72 (year ended 31 December 2017: a net impairment gain in the amount of RUB 1,007).

Lease rights

The Group's management determines the fair value of lease rights acquired in business combinations. The assessment of the fair value of such lease rights is based on the estimate of the market rates of the lease (Note 13). The Group periodically assesses whether there is any indication that lease rights may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2018 the Group recognised a net impairment gain in the amount of RUB 36 (year ended 31 December 2017: a net impairment gain in the amount of RUB 178).

Inventories of goods for resale provisions

The Group provides for estimated inventory shrinkage on the basis of historical shrinkage as a percentage of cost of sales. This provision is adjusted at the end of each reporting period to reflect the historical trend of the actual physical inventory count results. The Group also provides for aged stock where the expected selling price is below cost (Note 14).

Revenue recognition – Loyalty programmes

The Group estimates the amount of obligations related to customer loyalty programmes by allocating transaction price to loyalty points based on the standalone selling price of the points. The standalone selling price of the points is reduced for the expected amount of the points that will expire unredeemed.

The Group estimates the stand-alone selling price of the loyalty points awarded under loyalty programmes. The stand-alone selling price of the loyalty points issued is calculated by multiplying to the estimated redemption rate and to the monetary value assigned to the loyalty points. In estimating the redemption rate, the Group considers breakage which represents the portion of the points issued that will never be redeemed. The Group applies statistical projection methods in its estimation using customers' historical redemption patterns as the main input. The redemption rate is updated monthly and the liability for the unredeemed points is adjusted accordingly. The Group ensures that the value assigned to the loyalty points is commensurate to the stand-alone selling price of the products eligible for redemption (i.e., the value of each point is equivalent to the stand-alone selling price of any product eligible for redemption divided by number of points required).

Points issued under the loyalty programmes normally expires in twelve months from their recognition. However due to periodic changes in customer redemption patterns estimates of the stand-alone selling price are subject to significant uncertainty.

Any significant changes in customers' redemption patterns will impact the estimated redemption rate. As at 31 December 2018, the estimated liability for unredeemed points was 1,489 (31 December 2017: RUB 1,665).

Provision for expected credit losses of trade and other receivables

The Group uses a provision matrix to calculate ECLs for trade and other receivables. The provision rates are based on days past due for groupings of various customer segments that have similar loss patterns (by customer type). The calculation reflects the probability-weighted outcome, the time value of money and reasonable and supportable information that is available at the reporting date about past events, current conditions and forecasts of future economic conditions. Generally, trade and other receivables are written-off if past due for more than 3 years and are no subject to enforcement activity. The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets.

The provision matrix is initially based on the Group's historical observed default rates. The Group calibrates the matrix to adjust the historical credit loss experience with forward-looking information. For instance, if forecast economic conditions (i.e., gross domestic product) are expected to deteriorate over the next year which can lead to an increased number of defaults, the historical default rates are adjusted. At every reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analysed.

The assessment of the correlation between historical observed default rates, forecast economic conditions and ECLs is a significant estimate. The amount of ECLs is sensitive to changes in circumstances and of forecast economic conditions. The Group's historical credit loss experience and forecast of economic conditions may also not be representative of customer's actual default in the future. The information about the ECLs on the Group's trade and other receivables is disclosed in Note 16.

Brand and private labels

The Group periodically assesses whether there is any indication that brand and private labels may be impaired. The Group performs assets impairment testing of brands with indefinite useful lives at least annually (Note 13). The Group estimates the recoverable amount of the asset and if it is less than the carrying amount an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2018 the Group recognised impairment in the amount of RUB Nil (year ended 31 December 2017: RUB Nil).

04 ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS AND NEW ACCOUNTING PRONOUNCEMENTS

In the preparation of these consolidated financial statements, the Group followed the same accounting policies and methods of computation as compared with those applied in the previous year, except for the adoption of new standards and interpretations and revision of the existing standards as of 1 January 2018. Standards, Interpretations and amendments other than those described below effective 1 January 2018 did not have a material impact on the financial position or performance of the Group.

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting. The Group currently does not apply hedge accounting due to the absence of hedging relationships.

For the periods starting 1 January 2018, the Group changed its accounting policy relating to classification and measurement of financial assets and liabilities in accordance with the core principles of the standard. As a result of the change in accounting policy financial assets were classified as those to be measured subsequently at amortised cost and with no need for retrospective adjustments due to absence of changes in classification of assets measured at amortised cost. The Group has applied IFRS 9 retrospectively (full retrospective approach), with the initial application date of 1 January 2018 and adjusting the comparative information for the period beginning 1 January 2017.

The adoption of IFRS 9 has fundamentally changed the Group's accounting for impairment losses for financial assets by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach.

The Group has chosen to apply the simplified approach to providing for expected credit losses prescribed by IFRS 9, which permits the use of the lifetime expected loss provision for all trade and other receivables. The provision under IFRS 9 did not differ significantly from the provision assessed under previous accounting policy and the Group did not make retrospective adjustments.

For other financial assets the ECL is based on the 12-month ECL. The 12-month ECL is the portion of lifetime ECLs that results from default events on a financial instrument that are possible within 12 months after the reporting date. However, when there has been a significant increase in credit risk since origination, the allowance will be based on the lifetime ECL.

While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

As a result of IFRS 9 adoption the Group changed presentation of its consolidated statement of profit or loss by reclassification of net impairment losses on financial assets of RUB 501 out of selling, general and administrative expenses, where these losses were included in previous periods (2017: RUB 230). The Group also amended comparative information in the consolidated statement of profit or loss to reflect this change.

04 ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS AND NEW ACCOUNTING PRONOUNCEMENTS

IFRS 15 Revenue from Contracts with Customers

IFRS 15 supersedes IAS 11 Construction Contracts, IAS 18 Revenue and related Interpretations and it is applied to all revenue arising from contracts with customers, unless those contracts are in the scope of other standards. The new standard establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgement, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

In accordance with the transition provisions of IFRS 15 the Group has elected full retrospective method of adoption. There are no significant changes from application of IFRS 15 except for the following reclassifications of deferred revenue and advances received from customers to contract liabilities described below.

The following table shows the reclassification adjustments recognised for each individual line item as a result of IFRS 15 adoption.

	31 December 2017 as originally presented	IFRS 15 Reclassification adjustments	31 December 2017 as restated
Consolidated statement of financial position			
Long-term deferred revenue	5	(5)	–
Short-term deferred revenue	1,701	(1,701)	–
Provisions and other liabilities	70,757	(114)	70,643
Long-term contract liabilities	–	5	5
Short-term contract liabilities	–	1,815	1,815

	2017 as originally presented	IFRS 15 Reclassification adjustments	2017 as restated
Consolidated statement of cash flows			
Increase in other accounts payable	9,374	(9,374)	–
Increase in other accounts payable and contract liabilities	–	9,374	9,374

	1 January 2017 as originally presented	IFRS 15 Reclassification adjustments	1 January 2017 as restated
Consolidated statement of financial position			
Long-term deferred revenue	8	(8)	–
Short-term deferred revenue	282	(282)	–
Provisions and other liabilities	48,742	(107)	48,635
Long-term contract liabilities	–	8	8
Short-term contract liabilities	–	389	389

The Group operates loyalty points programmes, which allow customers to accumulate points when they purchase products in the Group's retail stores. The points can be redeemed for free products, subject to a minimum number of points obtained. Prior to adoption of IFRS 15, loyalty programmes offered by the Group resulted in the allocation of a portion of the transaction price to the loyalty programme using the fair value of points issued and recognition of the deferred revenue in relation to points issued but not yet redeemed or expired. The Group concluded that under IFRS 15 the loyalty points give rise to a separate performance obligation because they provide a material right to the customer and allocated a portion of the transaction price to the loyalty points awarded to customers based on the relative standalone selling price. The Group determined that, considering the relative stand-alone selling prices, the amount allocated to the loyalty programmes were insignificantly different from the previous accounting policy. The deferred revenue related to these loyalty points programmes was reclassified to Contract liabilities.

The Group has not early adopted any standard, interpretation or amendment that has been issued but is not yet effective.

Standards issued but not yet effective in the European Union	Effective for annual periods beginning on or after
Amendments to IAS 28 – *Long-term Interests in Associates and Joint Ventures*	1 January 2019*
Annual Improvements to IFRS Standards 2015-2017 Cycle	1 January 2019*
Amendments to IAS 19 – *Plan Amendment, Curtailment or Settlement*	1 January 2019*
Amendments to References to the Conceptual Framework in IFRS Standards	1 January 2020*
Amendment to IFRS 3 *Business Combinations*	1 January 2020*
Amendments to IAS 1 and IAS 8 – *Definition of Material*	1 January 2020*
IFRIC 23 *Uncertainty over Income Tax Treatments*	1 January 2019
Amendments to IFRS 9 – *Prepayment Features with Negative Compensation*	1 January 2019
IFRS 16 *Leases*	1 January 2019
IFRS 17 *Insurance Contracts*	1 January 2021*

* Subject to EU endorsement.

The Group expects that the adoption of the pronouncements listed above will not have a significant impact on the Group's results of operations and financial position in the period of initial application except for IFRS 16.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. At the commencement date of a lease, the Group will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). The Group will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. The lease term will correspond to the duration of the contracts signed except in cases where the Group is reasonably certain that it will exercise contractual extension options.

The Group will make a transition to IFRS 16 using the modified retrospective approach. Under this approach the prior year figures will not be adjusted and both lease liabilities and right-of-use assets will be recognised at the date of transition to IFRS 16.

For leases previously classified as an operating lease applying IAS 17 at the date of transition to IFRS 16 the Group will measure these lease liabilities at the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application. For leases previously classified as an operating lease applying IAS 17 the Group at the date of transition to IFRS 16 will on a lease-by-lease basis measure right-of-use assets at either:

(i) Its carrying amount as if IFRS 16 had been applied since the commencement date, but discounted using the Group's applicable incremental borrowing rate at the date of transition to IFRS 16; or

(ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the consolidated statement of financial position immediately before the date of transition to IFRS 16.

The Group has elected to use the following practical expedients proposed by the standard:

- On initial application initial direct costs will be excluded from the measurement of the right-of-use asset;
- On initial application IFRS 16 will only be applied to contracts that were previously classified as leases;
- For all classes of underlying assets each lease component and any associated non-lease components will be accounted as a single lease component;
- Lease payments for contracts with a duration of 12 months or less for the classes of underlying assets other than land and buildings will continue to be expensed to the statement of profit or loss on a straight-line basis over the lease term.

IFRS 16 will have a material effect on components of the consolidated financial statements and the presentation of the net assets, financial position and results of operations of the Group. The analysis performed on the initial application of

04 ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS AND NEW ACCOUNTING PRONOUNCEMENTS

the standard indicates that the amount of lease liabilities and right-of-use assets that will be probably recognised as a result of the transition falls in the range of 410 - 460 bln RUB. The difference between the amount of lease liability and right-of-use assets will be reflected as a decrease in equity. Annual operating lease expenses and associated non-lease charges, which would have been recognised under existing accounting standards, will be replaced by depreciation and interest expense, which is higher on an initial stage of a lease decreasing over its term, so that a material impact on profit before tax is expected in the year of transition.

As disclosed in Note 34 at 31 December 2018 the Group's outstanding short and long-term lease agreements were cancellable. IAS 17 requires disclosing operating lease commitments only for non-cancellable leases, while under IFRS 16 the Group is also required to include in lease term periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

05 SEGMENT REPORTING

The Group identifies retail chains of each format (see Note 1) as separate operating segments in accordance with the criteria set forth in IFRS 8.

The following significant operating functions are decentralised by formats:

- Category management, including purchasing, pricing, assortment management, promotion management;
- Distribution centres logistics;
- Development function.

The formats' general managers are determined as segment managers in accordance with IFRS 8. The chief operating decision-maker has been determined as the Management Board. The Management Board reviews each format's internal reporting in order to assess performance and allocate resources.

The Management Board assesses the performance of the operating segments based on a measure of sales and adjusted earnings before interest, tax, depreciation, amortisation and impairment (EBITDA). Other information provided to the Management Board is measured in a manner consistent with that in the consolidated financial statements. Capital expenditures include additions of property, plant and equipment, investment properties and intangible assets, acquisitions of property, plant and equipment, investment properties and intangible assets through business combinations as well as goodwill acquired through such business combinations.

The accounting policies used for segments are the same as accounting policies applied for these consolidated financial statements.

The segment information for the year ended 31 December 2018, comparative figures for earlier periods and reconciliation of EBITDA to profit for the year is provided as follows:

Year ended 31 December 2018	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	**1,200,457**	**232,490**	**92,458**	**7,132**	–	**1,532,537**
EBITDA	**92,910**	**15,550**	**4,423**	**(235)**	**(5,020)**	**107,628**
Depreciation, amortisation and impairment						**(49,474)**
Operating profit						**58,154**
Finance cost, net						**(18,667)**
Net foreign exchange result						**(447)**
Profit before income tax						**39,040**
Income tax expense						**(10,398)**
Profit for the year						**28,642**
Capital expenditure	60,863	16,869	3,914	5	2,017	**83,668**
31 December 2018						
Inventories	88,923	16,609	10,063	395	–	**115,990**

Year ended 31 December 2017	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	**1,004,406**	**188,501**	**90,608**	**11,493**	–	**1,295,008**
EBITDA	**82,891**	**13,012**	**4,618**	**(68)**	**(4,260)**	**96,193**
Depreciation, amortisation and impairment						**(38,435)**
Operating profit						**57,758**
Finance cost, net						**(16,017)**
Net foreign exchange result						**75**
Profit before income tax						**41,816**
Income tax expense						**(10,422)**
Profit for the year						**31,394**
Capital expenditure	70,401	23,734	4,047	103	356	**98,641**
31 December 2017						
Inventories	75,304	14,627	8,472	897	–	**99,300**

06 SUBSIDIARIES

Details of the Company's significant subsidiaries at 31 December 2018 and 31 December 2017 are as follows:

Company	Country	Nature of operations	Ownership (%) 31 December 2018	Ownership (%) 31 December 2017
Agrotorg LLC	Russia	Retailing	100	100
Trade House PEREKRIOSTOK JSC	Russia	Retailing	100	100
Agroaspect LLC	Russia	Retailing	100	100
X5 Nedvizhimost CJSC	Russia	Assets holding company	100	100
KOPEYKA-MOSCOW Ltd.	Russia	Retailing	100	100
Krasnoborskoe LLC	Russia	Assets holding company	100	100
PEREKRESTOK HOLDINGS Ltd.	Gibraltar	Holding company	100	100
PEREKRIOSTOK-2000 LLC	Russia	Assets holding company	100	100
ALPEGRU RETAIL PROPERTIES Ltd.	Cyprus	Assets holding company	100	100
Beta Estate LLC	Russia	Assets holding company	100	100
SPEAK GLOBAL Ltd.	Cyprus	Assets holding company	100	100
X5 FINANSE LLC	Russia	Bond issuer	100	100
X5 Finance B.V.	The Netherlands	Bond issuer	100	100
Agro-Avto LLC	Russia	Assets holding company	100	100

07

ACQUISITION OF BUSINESSES

Acquisitions in 2018

In 2018 the Group acquired 100% of several businesses of other retail chains in Russian regions. The acquisitions were individually immaterial.

In the year ended 31 December 2018 the acquired businesses contributed revenue of RUB 8,320 from the date of acquisition. As the businesses were not acquired as separate legal entities, it is impracticable to disclose net profit from the date of acquisition. The businesses did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2018 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities of acquired businesses and the related goodwill are as follows:

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	805
Other intangible assets (Note 13)	88
Deferred tax assets (Note 29)	896
Trade, other accounts receivable and prepayments	63
VAT and other taxes receivable	71
Cash and cash equivalents	28
Deferred tax liabilities (Note 29)	(47)
Provisions and other liabilities	(72)
Net assets acquired	**1,832**
Goodwill (Note 12)	4,351
Purchase consideration	**6,183**
Net cash outflow arising from the acquisition	**4,982**

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within a 12-month period from the acquisition date which is not yet finished at the date of approval of these consolidated financial statements.

The purchase consideration comprised the transfer of cash and cash equivalents of RUB 5,010 and RUB 1,173 as deferred consideration. During 12 months ended 31 December 2018 the Group transferred RUB 9,542 as deferred payments for prior period's acquisitions.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers. The goodwill related to these acquisitions was allocated to Pyaterochka and Perekrestok segments.

Acquisitions in 2017

In 2017 the Group acquired 100% of several businesses of other retail chains in Russian regions.

In the year ended 31 December 2017 the acquired businesses contributed revenue of RUB 8,742 from the date of acquisition. The businesses did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2017 as though the acquisition date had been the beginning of that period.

At 31 December 2017 the Group assigned provisional fair values to net assets acquired, in estimating provisional fair values of acquired assets. In 2018 the Group completed the purchase price allocation, which resulted in the following changes in fair values at the acquisition date:

	Finalised fair values at the acquisition date
Property, plant and equipment (Note 10)	3,246
Other intangible assets (Note 13)	161
Other non-current assets	895
Deferred tax assets (Note 29)	879
Trade, other accounts receivable and prepayments	51
VAT and other taxes receivable	165
Cash and cash equivalents	5
Provisions and other liabilities	(23)
Net assets acquired	**5,379**
Goodwill (Note 12)	10,193
Purchase consideration	**15,572**
Net cash outflow arising from the acquisition	**6,467**

The purchase consideration for the prior period comprised the transfer of cash and cash equivalents of RUB 6,472 and RUB 9,100 as deferred consideration.

The goodwill recognised was attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers.

08

RELATED PARTY TRANSACTIONS

In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the relationships for those related parties with which the Group entered into significant transactions or had significant balances outstanding at 31 December 2018 are provided below. The ownership structure is disclosed in Note 1.

The following transactions were carried out with related parties:

	Relationship	2018	2017
CTF Holdings S.A.	Entity with significant influence over the Company		
Management services received		128	93
Other	Under control by the entity with significant influence over the Company		
Purchases from related parties		2,482	1,831
Insurance expenses		417	339
Other operating expenses		3	2
Bonuses from related parties		117	66
Other	Other		
Other operating expenses		16	1

The consolidated financial statements include the following balances with the related parties:

	Relationship	31 December 2018	31 December 2017
CTF Holdings S.A.	Entity with significant influence over the Company		
Other accounts payable		83	–
Other	Under control by the entity with significant influence over the Company		
Trade accounts payable		394	298
Other accounts payable		1	1
Trade accounts receivable		23	19
Other receivables and prepayments from related parties		50	2

Key management personnel compensation

Key management personnel compensation is disclosed in Note 27.

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the year-end are unsecured and interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. For the years ended 31 December 2018 and 2017, the Group did not record any impairment of receivables relating to amounts owed by related parties.

09

CASH AND CASH EQUIVALENTS

	31 December 2018	31 December 2017
Bank current account – Roubles	2,518	12,120
Cash in transit – Roubles	16,523	11,750
Cash in hand – Roubles	5,327	3,063
Deposits – Euros	–	653
Deposits – US dollars	–	19
TOTAL	**24,368**	**27,605**

The bank accounts represent current accounts. Interest income on overnights/term deposits was immaterial. Cash in transit is cash transferred from retail outlets to bank accounts and bank card payments being processed.

The Group assessed credit quality of outstanding cash and cash equivalents balances as high and considered that there was no significant individual exposure. The maximum exposure to credit risk at the reporting date was the carrying value of cash and bank balances.

Credit quality of cash and cash equivalents balances are summarised as follows (current ratings):

Bank	Moody's	Fitch	S&P	31 December 2018	31 December 2017
Alfa-Bank	Ba2	BB+	BB+	945	1,123
Sberbank	Ba1	BBB-	–	1,533	10,978
Russian Regional Development Bank	Ba1/NP	–	–	–	374
Russian Agricultural Bank	Ba2	BB+	–	–	279
Gazprombank	Ba2	BB+	BB+	28	24
Vneshtorgbank	Ba1	–	BBB-	10	–
Other banks				2	14
Cash in transit and in hand				21,850	14,813
TOTAL				**24,368**	**27,605**

10 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Machinery and equipment	Refrigerating equipment	Vehicles	Other	Construction in progress*	Total
Cost							
At 1 January 2017	**207,961**	**31,242**	**38,237**	**11,930**	**25,989**	**10,955**	**326,314**
Additions	–	–	–	–	–	80,783	80,783
Transfers	41,288	11,854	11,745	5,774	10,520	(81,181)	–
Transfers to investment property (Note 11)	(267)	–	–	–	–	–	(267)
Assets from acquisitions (Note 7)	–	27	37	–	91	3,091	3,246
Disposals	(10,016)	(2,790)	(2,446)	(1,046)	(1,942)	(48)	(18,288)
At 31 December 2017	**238,966**	**40,333**	**47,573**	**16,658**	**34,658**	**13,600**	**391,788**
Additions	–	–	–	–	–	72,089	72,089
Transfers	38,185	10,144	11,797	6,372	11,531	(78,029)	–
Transfers to investment property (Note 11)	(986)	–	–	–	–	–	(986)
Assets from acquisitions (Note 7)	452	78	57	–	6	212	805
Disposals	(2,035)	(3,037)	(2,391)	(1,457)	(1,953)	(299)	(11,172)
At 31 December 2018	**274,582**	**47,518**	**57,036**	**21,573**	**44,242**	**7,573**	**452,524**
Accumulated depreciation and impairment							
At 1 January 2017	**(52,623)**	**(11,847)**	**(11,671)**	**(4,441)**	**(12,608)**	**(808)**	**(93,998)**
Depreciation charge	(12,655)	(5,091)	(5,215)	(1,983)	(6,292)	–	(31,236)
Impairment charge	(6,908)	(787)	(747)	(34)	(266)	(130)	(8,872)
Reversal of impairment	3,611	–	–	–	–	(50)	3,561
Transfers	(580)	(12)	3	–	33	556	–
Transfers to investment property (Note 11)	122	–	–	–	–	–	122
Disposals	9,871	2,736	2,413	615	1,922	6	17,563
At 31 December 2017	**(59,162)**	**(15,001)**	**(15,217)**	**(5,843)**	**(17,211)**	**(426)**	**(112,860)**
Depreciation charge	(18,840)	(6,332)	(6,527)	(2,468)	(8,309)	–	(42,476)
Impairment charge	(5,795)	(597)	(489)	–	(131)	(576)	(7,588)
Reversal of impairment	3,303	–	–	49	–	119	3,471
Transfers to investment property (Note 11)	20	–	–	–	–	–	20
Disposals	1,982	2,884	2,332	1,374	1,928	211	10,711
At 31 December 2018	**(78,492)**	**(19,046)**	**(19,901)**	**(6,888)**	**(23,723)**	**(672)**	**(148,722)**
Net book value at 31 December 2018	**196,090**	**28,472**	**37,135**	**14,685**	**20,519**	**6,901**	**303,802**
Net book value at 31 December 2017	**179,804**	**25,332**	**32,356**	**10,815**	**17,447**	**13,174**	**278,928**
Net book value at 1 January 2017	**155,338**	**19,395**	**26,566**	**7,489**	**13,381**	**10,147**	**232,316**

* This category also includes machinery and equipment, refrigerating equipment, vehicles and other items of property, plant and equipment not yet put into use.

Depreciation charge, impairment charge and reversal of impairment were included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2018 and 31 December 2017.

Construction in progress predominantly related to the development of stores through the use of sub-contractors.

The buildings are mostly located on leased land. Land leases with periodic lease payments are disclosed as part of commitments under operating leases (Note 34). No loans were collateralised by land and buildings including investment property as of 31 December 2018.

Impairment test

At the end of 2018 management performed an impairment test of property, plant and equipment, lease rights and investment property. The approach for determination of the recoverable amount of an asset was different for each class of property, plant and equipment, lease rights and investment property.

The evaluation for long-lived assets is performed at the lowest level of identifiable cash flows, which is generally at the individual store/unit level (cash generating unit – CGU). The variability of these factors depends on a number of conditions, including uncertainty about future events and changes in demand.

The impairment review has been carried out by comparing recoverable amount of the individual store/unit with their carrying values. The recoverable amount of store/unit is determined as the higher of fair value less cost of disposal or value in use.

The resulting impairment charge arose primarily from underperforming stores. At the same time the Group recognised the reversal of previously recorded impairment charges due to improved performance of certain stores. Due to the great number of CGUs being tested for impairment it is considered impracticable to disclose detailed information for each individual CGU.

Fair value less costs of disposal

Fair value of land and buildings and construction in progress is determined by management internal specialists by reference to current observable prices on an active market subsequently adjusted for specific characteristics of respective assets. The fair value measurement of these assets is classified at level 3 of the fair value hierarchy.

Value in use

For property, plant and equipment, lease rights and investment property the discounted future cash flow approach is applied and covers a 10-year period from 2019 onwards. The Group believes that use of 10 year forecast better reflects expected future cash flows of its cash generating units due to cyclical nature of their renovation expenditures. The future cash flows are based on the current budgets and forecasts approved by the management. For the forecast period, the data of the strategic business plan is extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. One of the main assumptions used for the forecast period is revenue growth being in the range from 4% to 6.38% in accordance with the internal forecasts based on budget and consumer price index projections (31 December 2017: 4% to 7.9%). For the years beyond the forecast period the long term consumer price index forecast of 4% at 31 December 2018 is used (31 December 2017: 4%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 14.46% (31 December 2017: 13.9%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions. If the revised estimated discount rate consistently applied to the discounted cash flows had been 200 b.p. higher than management's estimates, the Group would need to reduce the carrying value of property, plant and equipment, investment property and intangible assets by RUB 1,738 (31 December 2017: RUB 1,449), if 200 b.p. lower – increase by RUB 1,620 (31 December 2017: RUB 1,589). If the annual revenue growth rate used in calculations of value in use had been 200 b.p. higher, the Group would need to increase the carrying value of property, plant and equipment, investment property and intangible assets by RUB 2,879 (31 December 2017: RUB 2,765), lower – decrease by RUB 3,904 (31 December 2017: RUB 3,261).

11

INVESTMENT PROPERTY

The Group held the following investment properties at 31 December 2018 and 31 December 2017:

	2018	2017
Cost		
Cost at 1 January	**8,916**	**8,684**
Transfer from fixed assets	986	267
Disposals	(510)	(35)
Cost at 31 December	**9,392**	**8,916**
Accumulated depreciation and impairment		
Accumulated depreciation and impairment at 1 January	**(3,428)**	**(4,094)**
Depreciation charge	(219)	(254)
Impairment charge	(64)	(292)
Reversal of impairment	136	1,299
Transfer from fixed assets	(20)	(122)
Disposals	376	35
Accumulated depreciation and impairment at 31 December	**(3,219)**	**(3,428)**
Net book value at 31 December	**6,173**	**5,488**
Net book value at 1 January	**5,488**	**4,590**

Depreciation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2018 and 31 December 2017.

Rental income from investment property amounted to RUB 1,591 (2017: RUB 1,365). Direct operating expenses incurred by the Group in relation to investment property amounted to RUB 686 (2017: RUB 604). There were no significant direct operating expenses incurred by the Group in relation to investment property that did not generate rental income.

Management estimates that the fair value of investment property at 31 December 2018 amounted to RUB 9,760 (31 December 2017: RUB 9,701). The fair value was estimated using market approach with key inputs being rent income rates and market value of comparable assets.

Impairment test

At the end of 2018 management performed an impairment test of investment property. The evaluation performed and reasons for it are consistent with the approach for impairment testing of Property, Plant and Equipment (Note 10).

12

GOODWILL

Movements in goodwill arising on the acquisition of businesses at 31 December 2018 and 31 December 2017 are:

	2018	2017
Cost		
Gross book value at 1 January	**156,874**	**146,681**
Acquisition of businesses (Note 7)	4,351	10,193
Gross book value at 31 December	**161,225**	**156,874**
Accumulated impairment losses		
Accumulated impairment losses at 1 January	**(66,598)**	**(66,312)**
Impairment charge	–	(286)
Accumulated impairment losses at 31 December	**(66,598)**	**(66,598)**
Carrying amount at 1 January	**90,276**	**80,369**
Carrying amount at 31 December	**94,627**	**90,276**

Goodwill impairment test

For the purposes of impairment testing, goodwill is allocated to groups of cash-generating units (groups of CGUs) being store chains of each format. This represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

The group of CGUs to which goodwill has been allocated is tested for impairment annually or more frequently if there are indications that the particular group of CGUs might be impaired. Goodwill is tested for impairment at the group of CGUs level by comparing carrying values of particular group of CGU assets including allocated goodwill to their value in use.

The allocation of carrying amounts of goodwill to each group of CGUs is as follows:

Year ended 31 December 2018	Pyaterochka	Perekrestok	Karusel	Other	Total
Goodwill	74,122	15,955	4,550	–	94,627

Year ended 31 December 2017	Pyaterochka	Perekrestok	Karusel	Other	Total
Goodwill	70,426	15,300	4,550	–	90,276

Value in use

For items of land, buildings and construction in progress the discounted future cash flow approach is applied and covers a 10-year period from 2019 onwards. The Group believes that use of 10 year forecast better reflects expected future cash flows of its cash generating units due to cyclical nature of their renovation expenditures. The future cash flows are based on the current budgets and forecasts approved by the management. For the forecast period, the data of the strategic business plan are extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. One of the main assumptions used for the forecast period is revenue growth being in the range from 4% to 6.38% in accordance with the internal forecasts based on budget and consumer price index projections (31 December 2017: 4% to 7.9%). For the years beyond the forecast period the long term consumer price index forecast of 4% at 31 December 2018 is used (31 December 2017: 4%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 14.46% (31 December 2017: 13.9%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

The changes in assumptions applied in the model used for impairment testing do not indicate any trigger for impairment because the fair value less cost of disposal and the value in use are significantly higher than the carrying values of the cash generating unit assets.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions.

Impairment test

The recoverable amount of the groups of CGUs calculated exceeds their carrying amounts and therefore no impairment was recognised for them during the year ended 31 December 2018 (year ended 31 December 2017: impairment loss of RUB 286).

13 OTHER INTANGIBLE ASSETS

Other intangible assets comprise the following:

	Brand and private labels	Software and other	Lease rights	Total
Cost				
At 1 January 2017	**17,136**	**10,775**	**12,765**	**40,676**
Additions	–	3,821	437	4,258
Acquisition of businesses (Note 7)	–	–	161	161
Disposals	–	(15)	(82)	(97)
At 31 December 2017	**17,136**	**14,581**	**13,281**	**44,998**
Additions	–	6,178	157	6,335
Acquisition of businesses (Note 7)	–	–	88	88
Disposals	(293)	(70)	(370)	(733)
At 31 December 2018	**16,843**	**20,689**	**13,156**	**50,688**
Accumulated amortisation and impairment				
At 1 January 2017	**(11,790)**	**(4,286)**	**(8,220)**	**(24,296)**
Amortisation charge	(26)	(1,596)	(737)	(2,359)
Impairment charge	–	(174)	(358)	(532)
Reversal of impairment	–	–	536	536
Disposals	–	15	80	95
At 31 December 2017	**(11,816)**	**(6,041)**	**(8,699)**	**(26,556)**
Amortisation charge	(19)	(2,068)	(672)	(2,759)
Impairment charge	–	(11)	(274)	(285)
Reversal of impairment	–	–	310	310
Disposals	293	70	365	728
At 31 December 2018	**(11,542)**	**(8,050)**	**(8,970)**	**(28,562)**
Net book value at 31 December 2018	**5,301**	**12,639**	**4,186**	**22,126**
Net book value at 31 December 2017	**5,320**	**8,540**	**4,582**	**18,442**
Net book value at 1 January 2017	**5,346**	**6,489**	**4,545**	**16,380**

Brand and private labels includes brand "Pyaterochka" with the carrying amount of RUB 4,029 (31 December 2017: RUB 4,029) and brand "Karusel" with the carrying amount of RUB 1,258 (31 December 2017: RUB 1,258).

Amortisation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2018 and 31 December 2017.

Impairment test

At the end of 2018 management performed an impairment test of lease rights and brands.

For private labels and lease rights the evaluation performed and reasons for it are consistent with the approach for impairment testing of property, plant and equipment (Note 10). For brands, which are tested annually for impairment evaluation performed, is consistent with the approach for goodwill (Note 12).

Also the Group recognised an impairment of software which was no longer used.

14 INVENTORIES

At 31 December 2018 inventories in the amount of RUB 115,990 were accounted at the lower of cost and net realisable value (31 December 2017: RUB 99,300). Write-off of inventory to net realisable value at 31 December 2018 amounted to RUB 2,274 (31 December 2017: RUB 1,986).

15 FINANCIAL INSTRUMENTS BY CATEGORY

	Financial assets at amortised cost
31 December 2018	
Assets as per consolidated statement of financial position	
Trade and other receivables excluding prepayments	10,900
Cash and cash equivalents	24,368
TOTAL	**35,268**

	Financial liabilities at amortised cost
31 December 2018	
Liabilities as per consolidated statement of financial position	
Borrowings	207,764
Interest accrued	1,770
Trade, other current and non-current payables excluding statutory liabilities and advances	208,758
TOTAL	**418,292**

	Financial assets at amortised cost
31 December 2017	
Assets as per consolidated statement of financial position	
Trade and other receivables excluding prepayments	12,214
Cash and cash equivalents	27,605
TOTAL	**39,819**

	Financial liabilities at amortised cost
31 December 2017	
Liabilities as per consolidated statement of financial position	
Borrowings	194,296
Interest accrued	1,642
Trade and other payables excluding statutory liabilities and advances	188,639
TOTAL	**384,577**

16 TRADE, OTHER ACCOUNTS RECEIVABLE AND PREPAYMENTS

	31 December 2018	31 December 2017
Trade accounts receivable	10,218	11,770
Other receivables	1,780	1,912
Allowance for expected credit losses of trade and other receivables	(1,098)	(1,468)
Total trade and other accounts receivable	**10,900**	**12,214**
Prepayments	3,310	3,567
Advances made to trade suppliers	589	445
Allowance for impairment of prepayments and advances	(627)	(695)
Total prepayments	**3,272**	**3,317**
TOTAL	**14,172**	**15,531**

16 TRADE, OTHER ACCOUNTS RECEIVABLE AND PREPAYMENTS

The carrying amounts of the Group's trade and other receivables were primarily denominated in Russian Roubles. Trade receivables and other receivables are non-interest bearing and are generally on terms of 30 to 90 days.

Other non-current assets were mainly represented by long-term prepayments for rent in the amount of RUB 7,661 (31 December 2017: RUB 7,375).

Trade receivables

Trade receivables are mainly bonuses from suppliers of goods for resale with a low historic default rate. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable. The Group did not hold any collateral as security.

Set out below is the information about the credit risk exposure on the Group's trade receivables using a provision matrix:

	Expected credit loss rate at 31 December 2018	Estimated total gross carrying amount at default 31 December 2018	Expected credit loss 31 December 2018	Expected credit loss rate at 31 December 2017	Estimated total gross carrying amount at default 31 December 2017	Expected credit loss 31 December 2017
Not overdue – 1 month	1.27%	9,422	120	1.21%	10,009	121
1-6 months	25.28%	269	68	4.08%	857	35
6-12 months	67.13%	216	145	35.56%	180	64
Over 1 year	69.13%	311	215	64.64%	724	468
TOTAL		**10,218**	**548**		**11,770**	**688**

Movements on the allowance for expected credit losses of trade receivables were as follows:

	2018	2017
At 1 January	**(688)**	**(912)**
Addition of allowance for expected credit losses	(417)	(235)
Release of allowance for expected credit losses	41	92
Trade receivables written off as uncollectable	516	367
At 31 December	**(548)**	**(688)**

The creation and release of the allowance for expected credit losses have been included in net impairment losses on financial assets in the consolidated statement of profit or loss.

Other receivables

The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable. The Group did not hold any collateral as security.

Set out below is the information about the credit risk exposure on the Group's trade receivables using a provision matrix:

	Expected credit loss rate at 31 December 2018	Estimated total gross carrying amount at default 31 December 2018	Expected credit loss 31 December 2018	Expected credit loss rate at 31 December 2017	Estimated total gross carrying amount at default 31 December 2017	Expected credit loss 31 December 2017
Not overdue – 1 month	7.91%	860	68	7.64%	785	60
1-6 months	10.19%	265	27	21.20%	368	78
6-12 months	45.05%	182	82	85.21%	142	121
Over 1 year	78.86%	473	373	84.44%	617	521
TOTAL		**1,780**	**550**		**1,912**	**780**

Movements on the allowance for expected credit losses of other receivables were as follows:

	2018	2017
At 1 January	**(780)**	**(894)**
Addition of allowance for expected credit losses	(437)	(329)
Release of allowance for expected credit losses	312	199
Other receivables written off as uncollectable	355	244
At 31 December	**(550)**	**(780)**

The creation and release of the allowance for expected credit losses have been included in net impairment losses on financial assets in the consolidated statement of profit or loss.

Prepayments and advances made to trade suppliers

Movements on the allowance for impairment of prepayments and advances made to trade suppliers were as follows:

	2018	2017
At 1 January	**(695)**	**(683)**
Addition of allowance for prepayments and advances to trade suppliers impairment	(438)	(453)
Release of allowance for prepayments and advances to trade suppliers impairment	222	161
Prepayments and advances to trade suppliers written off as uncollectable	284	280
At 31 December	**(627)**	**(695)**

The creation and release of the allowance for impaired prepayments have been included in general and administrative costs in the consolidated statement of profit or loss.

The individually impaired prepayments mainly related to debtors that expected financial difficulties or there was likelihood of the debtor's insolvency. It was assessed that a portion of the prepayments was expected to be recovered.

17 VAT AND OTHER TAXES RECEIVABLE

	31 December 2018	31 December 2017
VAT receivable	9,856	13,924
Other taxes receivable	287	423
TOTAL	**10,143**	**14,347**

18 PROVISIONS AND OTHER LIABILITIES

	31 December 2018	31 December 2017 Restated
Other accounts payable and accruals	18,545	24,725
Accrued salaries and bonuses	19,194	15,386
Accounts payable for property, plant and equipment	13,823	15,228
Taxes other than income tax	16,488	11,804
Advances received	1,773	1,638
Payables to landlords	1,780	1,368
Provisions and liabilities for tax uncertainties (Note 34)	133	494
TOTAL	**71,736**	**70,643**

There were no significant amounts of other payables to foreign counterparties as at 31 December 2018 and 31 December 2017.

19 CONTRACT LIABILITIES

	31 December 2018	31 December 2017
Short-term contract liabilities		
Short-term contract liabilities related to loyalty programmes	1,489	1,665
Advances received from wholesales customers	54	41
Advances received from other customers	121	109
TOTAL SHORT-TERM CONTRACT LIABILITIES	**1,664**	**1,815**

Movements in short-term contract liabilities related to loyalty programmes comprise the following:

	2018	2017
At 1 January	**1,665**	**236**
Deferred during the year	1,489	1,665
Recognised as revenue during the year	(1,665)	(236)
At 31 December	**1,489**	**1,665**

20 BORROWINGS

The Group had the following borrowings at 31 December 2018 and 31 December 2017:

Current	Final maturity year*	Fair value 2018	Fair value 2017	Carrying value 2018	Carrying value 2017
RUB Bonds X5 Finance series BO-04	2019	5,250	–	4,999	–
RUB Bonds X5 Finance series BO-05		–	5,100	–	4,998
RUB Bonds X5 Finance series BO-06	2019	5,025	–	4,999	–
RUB Bonds X5 Finance series BO-07	2019	5,004	–	5,000	–
RUB Bonds X5 Finance series 001P-01	2019	15,072	–	14,994	–
RUB Bilateral Loans	2019	30,443	53,676	30,443	53,676
Total current borrowings		**60,794**	**58,776**	**60,435**	**58,674**

Non-current	Final maturity year*	Fair value 2018	Fair value 2017	Carrying value 2018	Carrying value 2017
RUB Bonds X5 Finance series BO-04		–	5,243	–	4,996
RUB Bonds X5 Finance series BO-05	2021	410	–	390	–
RUB Bonds X5 Finance series BO-06		–	5,002	–	4,996
RUB Bonds X5 Finance series BO-07		–	5,095	–	4,995
RUB Bonds X5 Finance series 001P-01		–	15,480	–	14,987
RUB Bonds X5 Finance series 001P-02	2020	10,000	10,135	9,990	9,985
RUB Bonds X5 Finance series 001P-03	2020	9,908	–	9,988	–
RUB Eurobond X5 Finance B.V.	2020	20,092	20,490	19,937	19,872
RUB Bilateral Loans	2021	103,254	76,571	107,024	75,791
Total non-current borrowings		**143,664**	**138,016**	**147,329**	**135,622**
TOTAL BORROWINGS		**204,458**	**196,792**	**207,764**	**194,296**

* In case of the Group's Bonds – the next oferta (put option) date.

In March 2018 the Group issued RUB 10,000 exchange–registered corporate bonds series 001P-03 with 6.95% coupon rate and 2-years oferta (put-option).

In September 2018 the Group successfully passed the oferta on the exchange-registered corporate bonds series BO-05 in the amount of RUB 5.0 bln and bought back RUB 4.6 bln from the issue. For the remaining RUB 0.4 bln the new annual rate for the next 6 semi-annual coupons was fixed at 6.95%.

The weighted average effective interest rate on X5's total borrowings for the year ended 31 December 2018 comprised 8.39% per annum (year ended 31 December 2017: 9.51%).

All borrowings at 31 December 2018 are shown net of related transaction costs of RUB 166 which are amortised over the term of the loans using the effective interest method (31 December 2017: RUB 303). Borrowing costs capitalised for the year ended 31 December 2018 amounted to RUB 314 (for year ended 31 December 2017: RUB 338). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation was approximate to weighted average effective interest rate for the period.

Change in total borrowings in amount of RUB 13,468 in 2018 equals to the proceeds from borrowings in amount of RUB 108,054, repayment of borrowings in amount of RUB 94,810 (the Condensed Consolidated Statement of Cash Flows) plus amortisation of transaction costs in amount of RUB 210 and other non-cash changes of RUB 14. Change in total borrowings in amount of RUB 38,263 in 2017 equals to the proceeds from borrowings in amount of RUB 100,780, repayment of borrowings in amount of RUB 62,700 (the Consolidated Statement of Cash Flows) plus amortisation of transaction costs in amount of RUB 183.

In accordance with loan agreements the Group maintains an optimal capital structure by tracking certain covenants, such as the maximum level of Net Debt / EBITDA (4.00/4.25 during 2 quarters after acquisition). The Group's Eurobond documentation implies 3.75 leverage ratio threshold but with additional permitted indebtedness baskets and exclusions. At 31 December 2018 the Group complied with this covenant and Net Debt / EBITDA was equal to 1.70 (31 December 2017: 1.73).

21 SHARE CAPITAL

As at 31 December 2018 the Group had 190,000,000 authorised ordinary shares (31 December 2017: 190,000,000) of which 67,890,099 ordinary shares were outstanding (31 December 2017: 67,886,748) and 3,119 ordinary shares were held as treasury stock (31 December 2017: 6,470). The nominal par value of each ordinary share is EUR 1.

Dividends approved for distribution at the General Meeting in May 2018 have been paid in the amount of RUB 21,590 during the year ended 31 December 2018 (RUB 318.00 per share).

The Supervisory Board proposed to the General Meeting to distribute in 2019 current year profit in the amount of RUB 25,000 (368.23 RUB per ordinary share) to shareholders.

22 EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding treasury shares.

Earnings per share were calculated as follows:

	2018	2017
Profit attributable to equity holders of the parent	28,642	31,394
Weighted average number of ordinary shares in issue	67,888,863	67,885,831
Effect of share options granted to employees, number of shares	4,533	12,944
Weighted average number of ordinary shares for the purposes of diluted earnings per share	67,893,396	67,898,775
Basic earnings per share for profit (expressed in RUB per share)	**421.90**	**462.45**
Diluted earnings per share for profit (expressed in RUB per share)	**421.87**	**462.36**

23 REVENUE

2018	Pyaterochka	Perekrestok	Karusel	Other segments	Total
Revenue from sale of goods through own stores (at a point of time)	1,188,207	229,689	90,818	5,577	1,514,291
Revenue from sale of goods through franchisees (at a point of time)	9,565	1,159	–	–	10,724
Revenue from wholesale of goods (at a point of time)	2,256	1,435	1,442	1,549	6,682
Revenue from other services (over time)	429	207	198	6	840
TOTAL	**1,200,457**	**232,490**	**92,458**	**7,132**	**1,532,537**

2017	Pyaterochka	Perekrestok	Karusel	Other segments	Total
Revenue from sale of goods (at a point of time)	991,733	182,759	89,302	9,769	1,273,563
Revenue from sale of goods through franchisees (at a point of time)	9,209	4,177	–	–	13,386
Revenue from wholesale of goods (at a point of time)	3,234	1,430	1,161	1,707	7,532
Revenue from other services (over time)	230	135	145	17	527
TOTAL	**1,004,406**	**188,501**	**90,608**	**11,493**	**1,295,008**

24 EXPENSES BY NATURE

	2018	2017
Cost of goods sold	1,116,264	946,044
Staff costs (Note 27)	139,456	114,808
Operating lease expenses	80,745	64,472
Depreciation, amortisation	45,454	33,849
Impairment of non-current assets	4,020	4,586
Other store costs	23,996	20,201
Utilities	33,401	24,976
Net impairment losses on financial assets	501	230
Other	42,839	36,280
TOTAL	**1,486,676**	**1,245,446**

Operating lease expenses included RUB 76,956 (2017: RUB 61,967) of minimum lease payments and contingent rent of RUB 3,789 (2017: 2,505 RUB).

Impairment of prepayments amounted to RUB 216 for the year ended 31 December 2018 (2017: RUB 292).

The fees listed below related to the procedures applied to the Group by Ernst & Young Accountants LLP and Other EY Network as referred to in article 1(1) of the Dutch Accounting Firms Oversight Act (Dutch acronym: Wta):

	2018	2017
Statutory audit of financial statements performed by Ernst & Young Accountants LLP	16	12
Other assurance services performed by Ernst & Young Accountants LLP	–	11
Statutory audit of financial statements performed by Other EY Network	47	49
Other assurance services performed by Other EY Network	–	1
Non-audit services by Other EY Network	32	35
TOTAL	**95**	**108**

In addition to the statutory audit of the financial statements the EY member firm in Russia provided non-audit services in the areas of supply chain network design, retail pricing proof, business trainings and tax advisory. The external auditor of the Group is Ernst & Young Accountants LLP.

25 LEASE/SUBLEASE AND OTHER INCOME

Lease/sublease and other income consists mainly of the income the Group receives from leasing part of its store space to companies selling supplementary goods and services to customers. The remaining part of other income comprises various kinds of individually insignificant income (for example income from sale of waste, net gain from disposal of property plant and equipment, insurance reimbursements, etc.).

The lease arrangements are operating leases, the majority of which are short-term. The future minimum lease and sublease payments receivable under non-cancellable operating leases were as follows:

	31 December 2018	31 December 2017
Not later than 1 year	2,966	2,769
Later than 1 year and no later than 5 years	2,832	2,161
Later than 5 years	1,691	1,649
TOTAL	**7,489**	**6,579**

The rental income from operating leases recognised in the consolidated statement of profit or loss for the year ended 31 December 2018 amounted to RUB 7,262 (2017: RUB 6,584). The contingent rents recognised in the consolidated statement of profit or loss in the year ended 31 December 2018 amounted to RUB 123 (2017: 113).

26 FINANCE INCOME AND COSTS

	2018	2017
Interest expense	17,021	15,533
Interest income	(73)	(59)
Other finance costs, net	1,719	543
TOTAL	**18,667**	**16,017**

27

STAFF COSTS

	2018	2017
Wages and salaries	108,753	89,385
Social security costs	30,631	25,352
Share-based payments expense	72	71
TOTAL	**139,456**	**114,808**

Wages and salaries in 2018 included expenses of RUB 2,128 related to the long-term incentive programme (LTI) for key employees, including members of the Management Board, other key management and other key employees (2017: RUB 2,470). In addition to the accrued amount the Group currently assesses the possible additional expenses attributable to the new LTI programme, that are more than remote, but for which no liability is required to be recognised under IFRS, as RUB 619.

Social security costs in 2018 included pension contributions amounted to RUB 20,422 (2017: RUB 16,555).

The number of employees as at 31 December 2018 amounted to 278,399 (31 December 2017: 250,874).

Key management personnel

The Group 'key management personnel' consists of members of the Supervisory Board and Management Board as well as 'other key personnel', i.e. all members of the Executive Board excluding the CEO. The total direct compensation for Executive Board members consists of a base salary, a performance related annual cash incentive (STI) and a performance related long-term cash incentive (LTI); members of the Supervisory Board receive an annual base compensation in cash and share-based payments.

Management Board

The remuneration of the members of the Management Board, which comprises the CEO and the Company Secretary, is determined by the Supervisory Board within the framework of the remuneration policy as approved by the General Meeting of Shareholders. More details about the remuneration policy are included in the "Remuneration" section on pages 221-225.

Base salaries in 2018

In 2018 the Supervisory Board reviewed and approved an adjustment within the total remuneration package of the members of the Executive Board, based on a base salary benchmarking analysis in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation. Accordingly, in line with compensation levels in peer group companies, Mr. Shekhterman's annual base salary was increased to RUB 70,000,000 (2017: RUB 42,000,000).

As disclosed when Mr. Shekhterman took office in 2015, his reward package does not include a severance entitlement and instead, he shall be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman shall be entitled to the difference upon completion of his full term as CEO.

Short-term incentive (STI) for 2018

For 2018 the Supervisory Board determined that 50% of the total on-target bonus opportunity for the CEO depends on achieving quantitative financial targets, and 50% on individual performance targets. Financial targets consist of elements related to the Company's operational performance, including EBITDA and return on investment (ROI), with a profitability threshold as a condition for STI payout. For the Company Secretary the STI is based on achievement of individual targets, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO, and 60% for the Company Secretary. As per 31 December 2018 all financial targets set for the CEO by the Supervisory Board were achieved above target within a 110% outperformance range. The achievement of all performance targets was assessed and determined by the Supervisory Board for each Management Board member individually, as reflected in the table below.

Long-term incentive (LTI)

The 2015-2018 LTI programme came to an end when targets under the second stage of the programme were achieved in 2017. Under the programme's deferred payout mechanism, 50% of the total award under the second stage was paid to participants in 2018, with final deferred payouts in 2019.

The Supervisory Board developed a next generation LTI programme that was approved by the General Meeting of Shareholders in 2018. The new LTI is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred, conditional payouts in order to maintain focus on long-term goals and to provide for an effective retention mechanism. Targets under the new LTI are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and enterprise value multiple relative to competition. The total available fund for all payouts under the new LTI programme is capped at 5% of average EBITDA during the three-year period of the programme. More details on the new LTI can be found in the "Remuneration" section on pages 221-225.

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

Name	Year	Base salary[1]	Short-term incentive[2]	Long-term incentive[3]	Share based compen-sation[4]	Social security cost[5]	Total
I. Shekhterman	2018	60	59	183	1	44	**347**
	2017	46	36	211	8	43	**344**
F. Lhoëst	2018	20	13	–	–	–	**33**
	2017	18	10	–	–	–	**28**
TOTAL	**2018**	**80**	**72**	**183**	**1**	**44**	**380**
	2017	**64**	**46**	**211**	**8**	**43**	**372**

[1] In 2018 Mr. Shekhterman's annual base salary was increased from RUB 42 million to RUB 70 million. The table reflects actual base salary amounts, including adjustments based on number of days spent on vacation, in accordance with Russian labour law.

[2] Short-term incentives are based on results achieved in 2018 and payable in 2019. The short-term incentive levels are based on full achievement of individual and group targets, resulting in payouts of 103% of base salary for Mr. Shekhterman (31 December 2017: 85%), and 58% of base salary for Mr. Lhoëst (31 December 2017: 55%).

[3] Targets under the second stage of the 2015-2018 LTI programme were achieved by Mr. Shekhterman in 2017. Under the programme's deferred payout mechanism, 50% of the total award under the second stage is payable in 2019.
For Mr. Shekhterman the expense recognised for the long-term incentive reward is composed of three elements: (i) accrual for the period 2018 with respect to the first payout under the second stage of the LTI programme, (ii) accrual for the period 2018 with respect to the second payout under the second stage of the LTI programme and (iii) an accrual based on the probability of achieving the targets under the new long-term incentive programme.

[4] Since 2013 members of the Management Board no longer participate in the Company's Restricted Stock Unit Plan. The share based compensation reflects the accrued amounts related to previous awards under the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

[5] For the year ended 31 December 2018 statutory pension contributions amounted to RUB 29 (2017: RUB 28).

27

STAFF COSTS

Restricted Stock Units (RSU) awarded and outstanding to members of the Management Board:

Name	Tranche	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016	Year of vesting	RSUs vested	Value on vesting date[1]	GDRs locked-up as per 31 December 2018[2]	End of lock-up period	RSUs outstanding as per 31 December 2018	RSUs outstanding as per 31 December 2017
I. Shekhterman	4	7,384	–	–	2016	7,384	9	–	2018	–	–
	5	–	15,793	–	2017	15,793	33	15,793	2019	–	–
	6	–	–	11,396	2018	11,396	21	11,396	2020	–	11,396

[1] Vesting date is 19 May of each respective year of vesting. If 19 May falls in a weekend, vesting date is the immediately following business day (in 2018: 21 May).

[2] Number of GDRs held during lock-up period equal the number of vested RSUs minus GDRs sold to cover taxes, if any.

Supervisory Board

The Annual General Meeting of Shareholders adopted the following remuneration principles for members of the Supervisory Board:

The chairman receives a fee of EUR 250,000, members chairing a committee receive a fee of EUR 200,000 with other members drawing a fee of EUR 100,000. Any member of the Supervisory Board who represents a legal entity or person holding at least thirty per cent of the voting rights in the Company, shall waive his/her entitlement to remuneration for acting as a member of the Supervisory Board.

In addition, all remunerated board members are entitled to:

- Additional compensation for time and expertise dedicated to specific strategic projects for X5, provided that such compensation (i) relates to work of a temporary, one-off nature, performed as an extension of the statutory non-executive duties of the relevant Board member and (ii) is approved in advance by the Supervisory Board -upon recommendation of the Nomination and Remuneration Committee- which will ensure, on a case-by-case basis, that any such engagement shall under no circumstance compromise the independence of the relevant Board member or the Board collectively.
- Equity in the form of Restricted Stock Units (RSUs). The number of RSUs awarded in each given year is based on 100% of the board member's fixed annual remuneration, divided by the average market value[1] of a GDR on the relevant award date. RSU awards are subject to a three-year vesting period and a further twoyear lock-in period. RSU awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

In accordance with these remuneration principles, Mikhail Fridman and Andrey Elinson are not remunerated by the Group. In 2018 the remaining Supervisory Board members received remuneration in cash and an annual award of Restricted Stock Units (RSUs).

[1] The Average Market Value is defined as "on any particular day the volume weighted average price of a GDR over the thirty immediately preceding calendar days. The volume weighted average price is calculated using the closing price of a GDR taken from the Official List of the London Stock Exchange".

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

	Base remuneration[1]		Additional remuneration[2]		Share-based compensation[3]	
	2018	2017	2018	2017	2018	2017
S. DuCharme	20	20	–	–	19	14
A. Elinson	–	–	–	–	–	–
M. Fridman	–	–	–	–	–	–
C. Couvreux	41	13	–	–	4	16
P. Musial	12	7	–	–	2	8
G. King	19	17	–	–	16	17
P. Demchenkov	15	12	–	–	9	8
M. Kuchment	7	7	–	13	6	4
K.-H. Holland	4	–	–	–	–	–
N. Shouraboura	4	–	–	–	–	–
TOTAL	**122**	**76**	**–**	**13**	**56**	**67**

[1] The annual membership allowance for independent Supervisory Board members is determined and paid in Euro, as follows: chairman EUR 250,000; members chairing a committee EUR 200,000; members chairing more than 1 committee EUR 250,000 and other members EUR 100,000. In accordance with the remuneration principles for the Supervisory Board, Messrs. Fridman and Elinson were not remunerated. The 2018 allowance for Messrs. Couvreux and Musial include social security payments assessed and paid for the years 2015-2018 in resp. France (RUB 34 million) for Mr. Couvreux and in Poland (RUB 8 million) for Mr. Musial.

[2] Additional cash remuneration for time and expertise dedicated to key strategic projects in 2017.

[3] The share-based compensation reflects the accrued amounts related to the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

Restricted Stock Units

In 2018 the Annual General Meeting of Shareholders approved that the Supervisory Board members Stephan DuCharme, Pawel Musial, Geoff King, Peter Demchenkov and Michael Kuchment be awarded a number of RSUs with award date 21 May 2018, equal to 100% of the fixed remuneration in 2018 of the relevant Board member, divided by USD 30.00, the average market value of one GDR as of 21 May 2018. The RSUs awarded under tranche 9 will vest on 19 May 2021, followed by a lock-in period ending on 19 May 2023.

When Christian Couvreux and Pawel Musial stepped down from the Supervisory Board on 10 May and 22 June 2018 respectively, the RSU Plan rules on accelerated vesting and release were applied as described in Notes 4 and 5 to the table below.

The number of RSUs awarded and outstanding to the members of the Supervisory Board is shown below. For the calculation of the intrinsic value and further details refer to Note 28.

27 STAFF COSTS

Restricted Stock Units awarded and outstanding to members of the Supervisory Board:

Name	Tranche	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016[1]	RSUs awarded in 2017	RSUs awarded in 2018	Year of vesting	RSUs vested	Value on vesting date[2]	Vested GDRs after tax	GDRs locked-up as per 31 December 2018[3]	End of lock-up period	RSUs outstanding as per 31 December 2018	RSUs outstanding as per 31 December 2017
S. DuCharme	7	–	–	25,703	–	–	2019	–	–	–	–	2021	25,703	25,703
	8	–	–	–	9,631	–	2020	–	–	–	–	2022	9,631	9,631
	9	–	–	–	–	9,977	2021	–	–	–	–	2023	9,977	–
C. Couvreux[4]	4	14,768	–	–	–	–	2016	14,768	19	9,747	–	2018	–	–
	5	–	15,793	–	–	–	2017	15,793	33	7,996	–	2018	–	–
	6	–	–	11,396	–	–	2018	11,396	21	5,476	–	2018	–	11,396
	7	–	–	11,424	–	–	2019	7,616	14	3,659	–	2018	–	11,424
	8	–	–	–	6,421	–	2020	2,140	4	1,028	–	2018	–	6,421
P. Musial[5]	4	2,461	–	–	–	–	2016	2,461	3	2,461	–	2018	–	–
	5	–	7,897	–	–	–	2017	7,897	17	5,212	–	2019	–	–
	6	–	–	5,698	–	–	2018	5,698	11	3,762	–	2020	–	5,698
	7	–	–	5,712	–	–	2019	3,808	7	2,714	–	2021	–	5,712
	8	–	–	–	3,210	–	2020	1,070	2	763	–	2022	–	3,210
	9	–	–	–	–	3,991	2021	–	–	–	–	2023	–	–
G. King	6	–	–	13,250	–	–	2018	13,250	25	8,749	8,749	2020	–	13,250
	7	–	–	14,280	–	–	2019	–	–	–	–	2021	14,280	14,280
	8	–	–	–	8,026	–	2020	–	–	–	–	2022	8,026	8,026
	9	–	–	–	–	9,977	2021	–	–	–	–	2023	9,977	–
P. Demchenkov	6	–	–	5,698	–	–	2018	5,698	11	3,762	3,762	2020	–	5,698
	7	–	–	5,712	–	–	2019	–	–	–	–	2021	5,712	5,712
	8	–	–	–	5,618	–	2020	–	–	–	–	2022	5,618	5,618
	9	–	–	–	–	7,982	2021	–	–	–	–	2023	7,982	–
M. Kuchment	7	–	–	5,712	–	–	2019	–	–	–	–	2021	5,712	5,712
	8	–	–	–	3,210	–	2020	–	–	–	–	2022	3,210	3,210
	9	–	–	–	–	3,991	2021	–	–	–	–	2023	3,991	–

[1] In 2016 the RSUs awarded under tranche 7 were awarded in accordance with the amended award schedule, observing the 3 year vesting period prescribed by the RSU Plan.

[2] Vesting date is 19 May of each respective year of vesting. If 19 May falls in a weekend, vesting date is the immediately following business day (in 2018: 21 May).

[3] Number of GDRs held during lock-up period equal the number of vested RSUs minus GDRs sold to cover taxes, if any.

[4] Christian Couvreux stepped down from the Supervisory Board per the AGM on 10 May 2018. As per the RSU Plan rules 8,089 RSUs awarded under tranches 7-8 forfeited as per 21 May 2018, and consequently a total of 21,152 RSUs awarded under tranches 6-8 vested in 2018. After tax, Mr. Couvreux was entitled to immediate release of 27,906 GDRs relating to awards under tranches 4-8.

[5] Pawel Musial stepped down from the Supervisory Board on 22 June 2018. As per the RSU Plan rules 8,035 RSUs awarded under tranches 7-9 forfeited as per 22 June 2018, and consequently a total of 4,878 RSUs awarded under tranches 7-8 vested in 2018. After tax, Mr. Musial was entitled to immediate release of 12,451 GDRs relating to awards under tranches 5-8.

Other key management personnel

Other key management personnel comprises all members of the Executive Board excluding the CEO. In comparison to the previous year two executives were added to the group of 'Other key management personnel', i.e. the Director Strategy and Director Big Data. In accordance with the Remuneration Policy, the total direct compensation of other key management personnel consists of a base salary, a performance-related annual cash incentive (STI) and a performance-related long-term cash incentive (LTI).

Base salaries in 2018

In 2018 the Supervisory Board reviewed and approved an adjustment within the total remuneration package of members of the Executive Board, based on a base salary benchmarking analysis in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation. Accordingly, in line with compensation levels in peer group companies, and taking into account the adjusted composition of 'Other key management personnel' as referred to above, the aggregate base salary amount of members of the Executive Board (excluding the CEO) increased as reflected in the table below.

Short-term Incentive

For 2018, the Supervisory Board determined that 100% of the total on-target bonus opportunity for leaders of the formats would be based on both financial quantitative and individual performance measures at format level, with thresholds at group level (EBITDA) and at format level (net sales) as a condition for STI payout. Financial performance measures include EBITDA, like-for-like sales and/or return on investment (ROI). For functional leaders the total on-target bonus opportunity depends on financial quantitative and individual performance measures at group level, also with a profitability threshold at group level as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100%. As per 31 December 2018 group financial targets were achieved, whereas financial targets at format level were achieved or partially achieved. The achievement of performance targets was assessed and determined by the Supervisory Board for each executive individually.

Long-term incentive

See footnote no. 3 to the table below.

Expenses recognised for remuneration of other key management personnel:

	Year	Base salary[1]	Short-term incentive[2]	Long-term incentive[3]	Exit payment	Social security cost[4]	Total
Other key management personnel	2018	228	167	235	42	69	**741**
	2017	165	134	414	14	88	**815**

[1] Base salary remuneration reflects the increase in salary for some key management personnel, as well as fluctuation in base salary due to the number of days spent on vacation, in accordance with Russian labor law.

[2] Short-term incentive for performance in the year 2018 (2017) paid in cash in 2019 (2018).

[3] Targets under the second stage of the 2015-2018 LTI programme were achieved by members of the Executive Board in 2017. Under the programme's deferred payout mechanism 50% of the total award under the second stage was paid in 2018, with final deferred payouts in 2019. The expense recognised for the long-term incentive rewards is composed of three elements: (i) accrual for the period 2018 with respect to the first payout under the second stage of the LTI programme, (ii) accrual for the period 2018 with respect to the second payout under the second stage of the LTI programme and (iii) an accrual based on the probability of achieving the targets under the new long-term incentive programme.

[4] For the year ended 31 December 2018 statutory pension contributions amounted to RUB 45 (2017: RUB 65).

28

SHARE-BASED PAYMENTS

Restricted Stock Unit plan

Members of the Supervisory Board are entitled to annual awards of restricted stock units (RSUs) under the Company's Restricted Stock Unit Plan (RSU Plan) approved at the AGM in 2010. RSU awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

During the year ended 31 December 2018, a total number of 35,918 RSUs were awarded under tranche 9 of the RSU Plan and will vest in 2021. In 2018 62,072 RSUs vested. Upon vesting these RSUs were converted into GDRs registered in the participant's name. The GDRs are kept in custody during a two-year lock-in period during which the GDRs cannot be traded. In accordance with the RSU Plan rules the lock-in restrictions do not apply in case of accelerated release of GDRs, if and when a Supervisory Board member ceases to be a member of the Supervisory Board.

During the year ended 31 December 2017, a total number of 36,116 RSUs were awarded under tranche 8 of the RSU Plan and will vest in 2020. In 2017 39,483 RSUs awarded in 2015 under tranche 5 vested. Upon vesting these RSUs were converted into GDRs registered in the participant's name, and kept in custody during a two-year lock-in period during which the GDRs cannot be traded.

In total, during the year ended 31 December 2018 the Group recognised expense related to the RSU Plan in the amount of RUB 72 (expense during the year ended 31 December 2017: RUB 71). At 31 December 2018 the equity component was RUB 118 (31 December 2017: RUB 117). The fair value of services received in return for the conditional RSUs granted to employees is measured by reference to the market price of the GDRs which is determined at grant date.

Details of the conditional rights outstanding were as follows:

	2018		2017	
	Number of conditional rights	Weighted average fair value, RUB	Number of conditional rights	Weighted average fair value, RUB
Outstanding at the beginning of the period	152,097	1,397.63	155,464	1,030.77
Awarded during the period	35,918	1,858.22	36,116	2,114.26
Vested during the period	(62,072)	1,133.34	(39,483)	608.64
Forfeited during the period	(16,124)	1,752.51	–	–
Outstanding at the end of the period	**109,819**	**1,645.55**	**152,097**	**1,397.63**

29

INCOME TAX

	2018	2017
Current income tax charge	8,923	10,215
Deferred income tax charge	1,475	207
Income tax charge for the year	**10,398**	**10,422**

The theoretical and effective tax rates are reconciled as follows:

	2018	2017
Profit before taxation	39,040	41,816
Theoretical tax at the effective statutory rate*	**7,808**	**8,363**
Tax effect of items which are not deductible or assessable for taxation purposes		
Effect of income taxable at rates different from standard statutory rates	4	(2,716)
Expenses on inventory shortage	200	2,386
Unrecognised tax loss carry forwards for the year	650	557
Deferred tax income arising from the recovery of the deferred tax assets written down in previous periods	–	(85)
Change in deferred tax liability associated with investments in subsidiaries	1,294	1,158
Other non-deductible expense	442	759
Income tax charge for the year	**10,398**	**10,422**

* Profit before taxation on Russian operations is assessed based on the statutory rate of 20%.

As at 31 December 2018 37 Russian subsidiaries of the Group were the members of the CGT (consolidated group of taxpayers) with Agroaspect LLC acting as a responsible CGT member.

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2018:

	31 December 2017	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	31 December 2018
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	4,980	(87)	–	4,893
Property, plant and equipment and Investment property	585	(143)	25	467
Other intangible assets	808	(1,078)	871	601
Inventories	1,026	675	–	1,701
Accounts receivable	103	(62)	–	41
Accounts payable	5,092	508	–	5,600
Other	750	(145)	–	605
Gross deferred tax assets	**13,344**	**(332)**	**896**	**13,908**
Less offsetting with deferred tax liabilities	(8,201)	(694)	–	(8,895)
Recognised deferred tax assets	**5,143**	**(1,026)**	**896**	**5,013**
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(10,971)	(371)	(47)	(11,389)
Other intangible assets	(451)	233	–	(218)
Investments into subsidiary	(1,158)	(1,294)	–	(2,452)
Accounts receivable	(837)	132	–	(705)
Accounts payable	(10)	3	–	(7)
Other	(444)	154	–	(290)
Gross deferred tax liabilities	**(13,871)**	**(1,143)**	**(47)**	**(15,061)**
Less offsetting with deferred tax assets	8,201	694	–	8,895
Recognised deferred tax liabilities	**(5,670)**	**(449)**	**(47)**	**(6,166)**

29 INCOME TAX

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2017:

	31 December 2016	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	31 December 2017
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	4,844	136	–	4,980
Property, plant and equipment and Investment property	622	(118)	81	585
Other intangible assets	21	310	477	808
Inventories	1,604	(578)	–	1,026
Accounts receivable	243	(140)	–	103
Accounts payable	5,106	(14)	–	5,092
Other	173	256	321	750
Gross deferred tax assets	**12,613**	**(148)**	**879**	**13,344**
Less offsetting with deferred tax liabilities	(7,307)	(894)	–	(8,201)
Recognised deferred tax assets	**5,306**	**(1,042)**	**879**	**5,143**
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(8,933)	(2,038)	–	(10,971)
Other intangible assets	(1,521)	1,070	–	(451)
Investments into subsidiary	–	(1,158)	–	(1,158)
Accounts receivable	(2,911)	2,074	–	(837)
Accounts payable	(2)	(8)	–	(10)
Other	(445)	1	–	(444)
Gross deferred tax liabilities	**(13,812)**	**(59)**	**–**	**(13,871)**
Less offsetting with deferred tax assets	7,307	894	–	8,201
Recognised deferred tax liabilities	**(6,505)**	**835**	**–**	**(5,670)**

Unrecognised deferred tax liability on unremitted earnings of certain subsidiaries amounted to RUB 4,968 (2017: RUB 4,541) for which the deferred tax liability was not recognised as such amounts are being reinvested for the foreseeable future.

Management believes that the future taxable profits in tax jurisdictions that suffered a loss in the current or preceding years will be available to utilise the deferred tax asset of RUB 4,893 recognised at 31 December 2018 for the carry forward of unused tax losses (31 December 2017: RUB 4,980).

The Group estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards at 31 December 2018 of RUB 3,966 (31 December 2017: RUB 3,316).

At 31 December 2018 these unused tax losses in the amount of 1,720 were available for carry forward for a period not less than four years, unused tax losses in the amount of 2,246 have no time restrictions for carry forward.

30 FINANCIAL RISK MANAGEMENT

Financial risk management is a part of integrated risk management and internal control framework described in "Corporate Governance" section of this Annual Report. The primary objectives of the financial risk management are to establish risk limits, and then ensure that exposure to risks stays within these limits.

Financial risk management is carried out by Corporate Finance Department. Corporate Finance Department monitors and measures financial risks and undertakes steps to limit their influence on the Group's performance.

(a) Market risk

Currency risk

The Group is exposed to foreign exchange risk arising from foreign currency denominated assets and liabilities with respect to import purchases. As at 31 December 2018 the Group had trade accounts payable denominated in foreign currency in the amount of RUB 3,071 (31 December 2017: RUB 2,504). As at 31 December 2018 the Group did not have any other significant assets and liabilities denominated in foreign currency and the exposure for the Group was estimated as not significant.

Interest rates risk

As at 31 December 2018 the Group had no floating interest-bearing assets and liabilities, the Group's income, expenses and operating cash inflows and outflows were substantially independent of changes in market interest rates.

(b) Credit risk

Financial assets, which are potentially subject to credit risk, consisted principally of cash and cash equivalents held in banks, trade and other receivables (Note 9 and Note 16). Due to the nature of its main activities (retail sales to individual customers) the Group had no significant concentration of credit risk. Cash was placed in financial institutions which were considered at the time of deposit to have low risk of default (Note 9).

The Group has policies in place to ensure that in case of credit sales of products and services to wholesale customers and reverse franchise schemes only those counteragents with an appropriate credit history are selected. Although collection of receivables could be influenced by economic factors, management believes that there was no significant risk of loss to the Group beyond the allowance already recorded. In accordance with the Group treasury policies and exposure management practices, counterparty credit exposure limits were continually monitored and no individual exposure was considered significant.

(c) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Liquidity risk is managed by the Group Treasury.

The Group finances its operations by a combination of cash flows from operating activities and long-term and short-term debt. The objective is to ensure continuity of funding on the best available market terms. The policy is to keep the Group's credit portfolio diversified structure, continue to improve the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn available bank facilities/limits, and a strong credit rating so that maturing debt may be refinanced as it falls due.

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities as at the reporting date at spot foreign exchange rates:

Year ended 31 December 2018	During 1 year	In 1 to 3 years
Borrowings	76,196	158,865
Trade payables	154,873	–
Other financial liabilities	53,342	543
TOTAL	**284,411**	**159,408**

Year ended 31 December 2017	During 1 year	In 1 to 4 years
Borrowings	74,928	146,331
Trade payables	130,766	–
Other financial liabilities	56,707	1,166
TOTAL	**262,401**	**147,497**

At 31 December 2018 the Group had net current liabilities of RUB 120,363 (31 December 2017: RUB 104,902) including short-term borrowings of RUB 60,435 (31 December 2017: RUB 58,674). At 31 December 2018 the Group had available bank credit lines of RUB 341,502 (31 December 2017: RUB 314,838). At 31 December 2018 the Group had RUB registered bonds programme available for issue on MICEX of RUB 15,000 (31 December 2017: RUB 25,000).

Management regularly monitors the Group's operating cash flows and available credit lines to ensure that these are adequate to meet the Group's ongoing obligations and its expansion programmes. Part of the short term liquidity needs is seasonal, with the highest peak in 1st quarter and strong cash generation in 4th quarter, therefore the Group negotiates the maturity of credit lines for those quarters, when the future cash flow allows for the repayment of debts. Part of the existing lines is provided on rolling basis which is closely monitored by detailed cash flow forecasts and are managed by the Group Treasury.

The Group's capital expenditure programme is highly discretionary. The Group optimises its cash outflows by managing the speed of execution of current capex projects and by delaying future capital extensive programmes, if required.

The Group is carefully monitoring its liquidity profile by optimizing the cost of funding and the drawdown periods within revolving credit facilities as well as extending existing credit facilities or obtaining new credit lines. The Group manages liquidity requirements by the use of both short-term and long-term projections and maintaining the availability of funding. Based on the review of the current liquidity position of the Group management considers that the available credit lines and expected cash flows are more than sufficient to finance the Group's current operations.

31 OPERATING ENVIRONMENT OF THE GROUP

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy has been negatively impacted by highly volatile in oil prices and sanctions imposed on Russia by a number of countries. The Rouble interest rates remained high. The combination of the above resulted in reduced access to capital, a higher cost of capital and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

32 CAPITAL RISK MANAGEMENT

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages total equity attributable to equity holders recognised under IFRS requirements. The Group is in compliance with externally imposed capital requirements.

In accordance with loan facilities the Group maintains an optimal capital structure by tracking certain requirements: the maximum level of Net Debt/EBITDA (4.00/4.25 after acquisition). The Group's Eurobond documentation implies 3.75 leverage ratio threshold but with additional permitted indebtedness baskets and exclusions. Net debt is calculated as the sum of short-term and long-term borrowings less cash and cash equivalents. Reconciliation of EBITDA to operating profit is performed in Note 5. This ratio is included as covenants into some of Group's loan agreements (Note 20). At 31 December 2018 the Group complied with the requirements under the loan facilities.

33 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value.

Financial assets carried at amortised cost

The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty.

The carrying amount of cash and cash equivalents and trade and other financial receivables approximates their fair value.

Liabilities carried at amortised cost

The fair value of bonds is based on quoted market prices. Fair values of other liabilities are determined using valuation techniques.

The fair value of bonds traded on the MICEX and the ISE is determined based on active market quotations and amounted to RUB 70,761 at 31 December 2018 (31 December 2017: RUB 66,545). The measurement is classified in level 1 of the fair value hierarchy. The carrying value of these bonds amounted to RUB 70,297 at 31 December 2018 (31 December 2017: RUB 64,829) (Note 20). The fair value of long-term borrowings amounted to RUB 103,254 at 31 December 2018 (31 December 2017: RUB 76,571). The measurement is classified in level 3 of the fair value hierarchy and is determined based on expected cash flows discounted using interest rate of similar instruments available on the market. The sensitivity analysis shows that the increase/decrease of the market interest rate by 10% leads to the decrease/increase of fair value of long-term borrowings by RUB 1,852 at 31 December 2018. The fair value of short-term borrowings was not materially different from their carrying amounts.

34 COMMITMENTS AND CONTINGENCIES

Commitments under operating leases

At 31 December 2018, the Group operated 12,553 stores through rented premises (31 December 2017: 10,303 stores). There are two types of fees in respect of operating leases payable by the Group: fixed and variable (contingent rent). For each store fixed rent payments are defined in the lease contracts. The variable part of rent payments is predominantly denominated in RUB and normally calculated as a percentage of turnover. Fixed rent payments constitute the main part of operating lease expenses of the Group as compared to the variable rent payments.

The Group entered into a number of cancellable short-term and long-term lease agreements. The expected annual lease payments under these agreements amount to RUB 38,303 (net of VAT) (31 December 2017: RUB 36,860).

Capital expenditure commitments

At 31 December 2018 the Group contracted for capital expenditure for the acquisition of property, plant and equipment and intangible assets of RUB 10,801 (net of VAT) (31 December 2017: RUB 9,830).

34 COMMITMENTS AND CONTINGENCIES

Legal contingencies

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time. Management believes that there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued at 31 December 2018.

Taxation environment

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of these legislative areas as applied to the transactions and activities of the Group may be challenged by the relevant regional and federal authorities. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian authorities decide to issue a claim and prove successful in court, they would be entitled to recover the tax amount claimed, together with fines amounting to 20% of such amount and late payment interest at the rate of 1/300 of the rate of the Central Bank of the Russian Federation (CBRF rate) for each day of the delay during the first 30 days, 1/150 of CBRF rate for each day of the delay if the latter is for more than 30 days to be calculated from the amount of underpaid tax. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Russia has transfer pricing rules generally aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD). The transfer pricing legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of controlled transactions (transactions with related parties and some types of transactions with unrelated parties), provided that the transaction price is not arm's length. Management believes that its pricing policy is arm's length and it has implemented internal controls to be in compliance with the transfer pricing legislation. Therefore the impact of any potential challenge of the Group's transfer prices is not expected to be significant to the financial conditions and/or the overall operations of the Group.

The concept of beneficial ownership

The possibility to apply the reduced tax rates to the income paid to foreign companies of the Group allowed under double tax treaties (DTTs) will depend on whether the company receiving such income is its beneficial owner. When determining the beneficial owner status of a foreign company the functions it performs and the risks it undertakes should be tested. It will be also considered whether such income was transferred (fully or in part) to another company. Given that relevant court practice on this issue is still developing, the impact of any potential challenge may be significant and have an effect on the financial conditions and/or the overall operations of the Group.

Management believes that the Group's foreign companies receiving income from Russia are beneficial owners of that income and the reduced tax rates are correctly applied in accordance with the relevant DTTs.

Tax residency of legal entities

Few years ago, more specific and detailed rules were put in place establishing when foreign entities can be viewed as managed from Russia and consequently can be deemed Russian tax residents. Russian tax residency means that such legal entities' worldwide income will be taxed in Russia. The Group comprises companies incorporated outside of Russia. The tax liabilities of the Group were determined on the assumption that these companies were not subject to Russian profits tax, because they did not have a permanent establishment in Russia and were not Russian tax residents by way of application of the new tax residency rules. This interpretation of relevant legislation in regard to the Group companies incorporated outside of Russia may be challenged. Given that the concept of the Russian broader rules for determining the tax residency of legal entities is rather new and the practice is not yet developed, the impact of any such challenge cannot be reliably estimated currently; however, it may be significant to the financial position and/or the overall operations of the Group.

Tax contingencies, commitments and risks

Russian tax legislation does not provide definitive guidance in many areas and continue to evolve. Various legislative acts and regulations are not always clearly written, and their interpretation is subject to discussion by taxpayers, tax authorities, Courts and other regulating bodies.

The tax authorities may take a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in past may be challenged as not having been in compliance with Russian tax laws applicable at the relevant time. In particular, the Supreme Court issued guidance to lower courts on reviewing tax cases providing a systematic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed.

From time to time, the Group adopts interpretations of such uncertain areas that reduce the overall tax rate of the Group. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices; the impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial condition and operations of the entity.

In Russia, tax returns remain open and subject to tax audit for a period of up to three years. If an understatement of a tax liability is detected as a result of a tax audit, penalties and fines should be paid. Under a certain conditions a repeated tax audit can be open for the periods already closed, however such cases are not very often.

Management regularly reviews the Group's taxation compliance with applicable legislation, laws and decrees and current interpretations published by the authorities in the jurisdictions in which the Group has operations. Furthermore, management regularly assesses the potential financial exposure relating to tax contingencies not only for the periods open for tax audit but also for which the three years tax inspection right has expired but which, under certain circumstances, may be challenged by the regulatory bodies. From time to time potential exposures and contingencies are identified and at any point in time a number of open matters may exist.

Management estimates that possible exposure in relation to the aforementioned risks, as well as other profits tax and non-profits tax risks (e.g. imposition of additional VAT liabilities), that are more than remote, but for which no liability is required to be recognised under IFRS, could be several times more than accrued liabilities and provisions reflected on the statement of financial position at that date. This estimation is provided for the IFRS requirement for disclosure of possible taxes and should not be considered as an estimate of the Group's future tax liability.

In 2018 the Group made net release of provisions and liabilities for tax uncertainties attributable to income tax and non-income tax risks in amount of RUB 626 including net release of non-income tax provision of RUB 463, income tax provision of RUB 67 with simultaneous release of indemnification asset of RUB 96 .

In 2017 the Group made net accrual of provisions and liabilities for tax uncertainties attributable to income tax and non-income tax risks in amount of RUB 542 including net accrual of non-income tax provision of RUB 231, income tax provision of RUB 387 with simultaneous release of respective indemnification asset of RUB 76.

At the same time management has recorded liabilities for income taxes in the amount of RUB 384 (31 December 2017: RUB 389) and provisions for taxes other than income taxes in the amount of RUB 133 at 31 December 2018 (31 December 2017: RUB 494) in these consolidated financial statements as their best estimate of the Group's liability related to tax uncertainties as follows:

Balance at 31 December 2016	**898**
Release of provision	(604)
Accrual of provision	1,146
Offset of provision	(557)
Balance at 31 December 2017	**883**
Release of provision	(1,113)
Accrual of provision	487
Offset of provision	260
Balance at 31 December 2018	**517**

35 SUBSEQUENT EVENTS FOR THE GROUP

In February 2019 the Group issued RUB 5 bln exchange-registered corporate bonds series 001P-04 with 8.5% coupon rate and 2.5 years oferta (put-option).

In February 2019 the Group successfully passed the oferta on the RUB 5 bln exchange-registered corporate bonds series BO-07. The new annual interest rate for the next 3 years was fixed at 8.55%.

X5 Retail Group N.V.

Company Financial Statements

31 December 2018

X5 Retail Group N.V.

Company Statement of Financial Position

at 31 December 2018 Before appropriation of profit
(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2018	31 December 2017
Assets			
Non-current assets			
Financial fixed assets	37	210,867	178,614
		210,867	**178,614**
Current assets			
Financial assets	37	–	19
Amounts due from subsidiaries		7,977	7,128
Prepaid expenses		5	1
VAT receivable		–	10
Other receivables		244	81
		8,226	**7,239**
TOTAL ASSETS		**219,093**	**185,853**
Equity and liabilities			
Paid up and called up share capital	38	5,395	4,675
Share premium account	38	46,192	46,212
Share-based payment reserve	41	118	117
Other reserves		85,128	76,044
Profit for the period		28,642	31,394
Total equity		**165,475**	**158,442**
Provisions			
Deferred tax liabilities	43	2,452	1,158
		2,452	**1,158**
Non-current liabilities			
Loan from group company	39	18,873	17,175
Bank loan	40	21,572	–
		40,445	**17,175**
Current liabilities			
Amounts due to group companies		10,611	9,021
Accrued expenses and other liabilities		93	37
VAT and other taxes payable		17	20
		10,721	**9,078**
Total liabilities		**53,618**	**27,411**
TOTAL EQUITY AND LIABILITIES		**219,093**	**185,853**

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

X5 Retail Group N.V.

Company Statement of Profit or Loss

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	2018	2017
General and administrative expenses	42	(431)	(268)
Other income		359	97
Operating loss		**(72)**	**(171)**
Finance costs		(2,705)	(1,709)
Finance income		817	852
Net foreign exchange (loss)/gain		(210)	54
Loss before tax		**(2,170)**	**(974)**
Income tax expense	43	(1,294)	(1,158)
Income on participating interest after tax		32,106	33,526
Profit for the period		**28,642**	**31,394**

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

X5 Retail Group N.V.

Notes to the Company Financial Statements

for the year ended 31 December 2018
(expressed in millions of Russian Roubles, unless otherwise stated)

36 ACCOUNTING PRINCIPLES

General

The Company was incorporated as a limited liability Company under the laws of The Netherlands on 13 August 1975 and has its statutory seat in Amsterdam. The Company is publicly owned. The principal activity of the Company is to act as the listed holding company for retail chains operating mainly in Russia. The number at Chamber of Commerce is 33143036.

Basis of presentation

The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the Netherlands, in accordance with Part 9 of Book 2 of the Dutch Civil Code (art 362.8).

Accounting principles

Unless stated otherwise below, the accounting principles applied for the Company accounts are similar to those used in the IFRS *Consolidated Financial Statements* (refer to Note 2.1 to the *Consolidated Financial Statements*). The consolidated accounts of companies publicly listed in the European Union must be prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and adopted by the European Commission.

As the Company mainly exploits Russian grocery stores in four formats (proximity stores, supermarket, hypermarket and convenience stores), the functional currency of the Company is the Russian Rouble as this is the currency of its primarily business environment and reflects the economic reality. Unless stated otherwise all amounts are in millions of Russian Rouble ("RUB").

Investments in group companies

Investments in group companies are entities (including intermediate subsidiaries and special purpose entities) over which the Company has control, because the Company (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. Group companies are recognised from the date on which control is transferred to the Company or its intermediate holding entities. They are derecognised from the date that control ceases.

The Company applies the acquisition method to account for acquiring group companies, consistent with the approach identified in the consolidated financial statements. Investments in group companies are presented in accordance with the net asset value method. When an acquisition of an investment in a group company is achieved in stages, any previously held equity interest is remeasured to fair value on the date of acquisition. The measurement against the book value is accounted for in the statement of profit and loss.

When the Company ceases to have control over a group company, any retained interest is remeasured to its fair value, with the change in carrying amount to be accounted for in the statement of profit or loss. When parts of investments in group companies are bought or sold, and such transaction does not result in the loss of control, the difference between the consideration paid or received and the carrying amount of the net assets acquired or sold, is directly recognised in equity.

When the Company's share of losses in an investment in a group company equals or exceeds its interest in the investment (including separately presented goodwill or any other unsecured non-current receivables being part of the net investment), the Company does not recognise any further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the investment. In such case the Company will recognise a provision.

Amounts due from group companies

Amounts due from group companies are stated initially at fair value and subsequently at amortised cost. Amortised cost is determined using the effective interest rate.

To avoid the difference between equity in the Consolidated and the Company's Financial Statements any expected credit losses on intercompany receivables recognised in the Company's statement of Profit and Loss are eliminated (reversed) through the respective intercompany receivable account.

36 ACCOUNTING PRINCIPLES

Financial guarantee

For financial guarantee contracts, IFRS 9 retains the same definition and initial recognition requirements as IAS 39 but introduces different subsequent measurement requirements. On subsequent measurement financial guarantees contacts are measured at the 'higher of': The expected credit losses allowance as defined above, and the amount initially recognised (i.e. fair value) less any cumulative amount of income amortisation recognised.

For intercompany financial guarantees issued by the Company, the expected default is not significant and therefore the financial guarantees are not recognised.

Shareholders' Equity

Issued and paid up share capital, which is denominated in Euro, is restated into Russian Rouble ("RUB") at the official exchange rate of the Central Bank of the Russian Federation as at reporting date in accordance with section 373 sub 5 of book 2 of the Dutch Civil Code. The difference is settled in the other reserves.

37 FINANCIAL FIXED ASSETS

	31 December 2018	31 December 2017
a. Movements in the interests in group companies have been as follows		
Opening balance	171,312	138,150
Acquisitions/capital contribution	16	9,228
Divestment of group companies / capital repayments	–	(9,592)
Profit from group companies for the year	32,106	33,526
Closing balance	**203,434**	**171,312**

A complete list of group companies has been disclosed in the consolidated financial statements (refer to Note 6 of the consolidated financial statements).

	31 December 2018	31 December 2017
b. Movements in the loans to group companies have been as follows		
Opening balance	7,321	7,313
Additions	77	14
Foreign exchange differences	35	(6)
Closing balance	**7,433**	**7,321**
Non-current financial assets	210,867	178,614
Current financial assets	–	19
TOTAL FINANCIAL FIXED ASSETS	**210,867**	**178,633**

31 December 2018	Loan currency	Carrying value	Interest rate, % p.a.	Maturity date
Borrowing group company				
GSWL Finance Ltd	RUB	4,601	11%	December 2022
GSWL Finance Ltd.	RUB	2,612	Mosprime 1m + 3.6%	December 2021
Perekrestok Holdings Ltd.	USD	190	11%	December 2022
X5 Capital S.A.R.L	EUR	29	4.5%	December 2023
X5 Capital S.A.R.L	EUR	1	4%	December 2022
TOTAL LOANS TO GROUP COMPANIES		**7,433**		

31 December 2017	Loan currency	Carrying value	Interest rate, % p.a.	Maturity date
Borrowing group company				
GSWL Finance Ltd	RUB	4,598	11%	December 2022
GSWL Finance Ltd.	RUB	2,570	Mosprime 1m + 3.6%	December 2021
Perekrestok Holdings Ltd.	USD	133	11%	December 2022
X5 Capital S.A.R.L	EUR	19	4.5%	December 2022
X5 Capital S.A.R.L	EUR	1	4%	December 2018
TOTAL LOANS TO GROUP COMPANIES		**7,321**		

The total amount of the loans provided to group companies was RUB 7,433 (2017: RUB 7,321) and it approximated the fair value. The loans have not been secured.

38 SHAREHOLDERS' EQUITY

	Share capital[1]	Share premium	Other reserves	Profit/ (loss)	Share-based payment (equity)	Total
Balance as at 1 January 2017	**4,332**	**46,251**	**54,096**	**22,291**	**70**	**127,040**
Share-based payment compensation (Note 28)	–	–	–	–	71	71
Transfer	–	–	22,291	(22,291)	–	–
Currency translation	343	–	(343)	–	–	–
Transfer of vested equity rights	–	(39)		–	(24)	(63)
Result for the period	–	–	–	31,394	–	31,394
Balance as at 1 January 2017	**4,675**	**46,212**	**76,044**	**31,394**	**117**	**158,442**
Share-based payment compensation (Note 28)	–	–			72	72
Transfer	–	–	31,394	(31,394)	–	–
Currency translation	720	–	(720)	–	–	–
Transfer of vested equity rights	–	(20)	–	–	(71)	(91)
Result for the period	–	–	–	28,642	–	28,642
Dividends	–	–	(21,590)	–	–	(21,590)
Balance as at 31 December 2018	**5,395**	**46,192**	**85,128**	**28,642**	**118**	**165,475**

[1] Share capital translated at the year-end exchange rate EUR/RUB of 79.4605 (2017: 68.8668).

Share capital issued

As at 31 December 2018 the Group had 190,000,000 authorised ordinary shares (31 December 2017: 190,000,000) of which 67,890,099 ordinary shares were outstanding (31 December 2017: 67,886,748) and 3,119 ordinary shares held as treasury stock (31 December 2017: 6,470). The nominal par value of each ordinary share is EUR 1.

The acquisition price of the shares purchased was charged against other reserves. Other reserves as at 31 December 2018 included translation reserve of RUB 2,937 (2017: RUB 2,217) and legal reserves of RUB 1,344 (2017: RUB 517).

Statutory profit appropriation

Dividends approved for distribution at the General Meeting in May 2018 have been paid in the amount of RUB 21,590 during the year ended 31 December 2018 (RUB 318.00 per share).

38

SHAREHOLDERS' EQUITY

The Supervisory Board proposed to the General Meeting to distribute in 2019 current year profit in the amount of RUB 25,000 (368.23 RUB per ordinary share) to shareholders.

39

LOAN FROM GROUP COMPANY

	Loan currency	31 December 2018	Interest rate, % p.a.	Final maturity date
Trade House PEREKRIOSTOK JSC	RUB	16,570	10%	December 2020
Trade House PEREKRIOSTOK JSC	USD	1,515	10%	December 2020
Trade House PEREKRIOSTOK JSC	EUR	788	10%	December 2020
TOTAL		**18,873**		

	Loan currency	31 December 2017	Interest rate, % p.a.	Final maturity date
Trade House PEREKRIOSTOK JSC	RUB	15,628	10%	December 2020
Trade House PEREKRIOSTOK JSC	USD	1,235	10%	December 2020
Trade House PEREKRIOSTOK JSC	EUR	312	10%	December 2020
TOTAL		**17,175**		

The loan payable to Trade House PEREKRIOSTOK JSC denominated in RUB/USD/EUR. RUB facility amounted to 16,570 (2017: RUB 15,628), USD 21.8 million (2017: USD 21.4 million) and EUR 9.9 million (2017: EUR 4.5 million).

40

BANK LOAN

	31 December 2018	31 December 2017
Balance as at 1 January		
Opening balance	–	–
Proceeds from the bank loan	21,568	–
Amortisation of transaction costs	4	–
Closing balance	**21,572**	–

In May 2018, X5 Retail Group NV closed a refinancing of its financial indebtedness with the credit facility from Sberbank. The size of the facility is RUB 21,900 of debt, non – revolving, that bears a fixed interest with the maturity of June 2021.

41

SHARE-BASED PAYMENTS

X5 Retail Group N.V. operates equity settled share based compensation plan in the form of its Restricted Stock Unit Plan.

The Restricted Stock Unit Plan consists of performance based awards and awards subject to the employment condition only. For employees of the Company an expense is recorded in the profit and loss account.

The receivable or expense is accounted for at the fair value determined in accordance with the policy on share-based payments as included in the consolidated financial statements, including the related liability for cash settled plans or as equity increase for equity settled plans (Note 28).

The following is included in the entity's accounts for the Restricted Stock Unit Plan:

	2018	2017
Equity share-based payment reserve as at 31 December	118	117
Expenses for the year ended 31 December	72	71

42

GENERAL AND ADMINISTRATIVE EXPENSES

	2018	2017
Other expenses	343	194
Audit expenses	16	12
RSU	72	62
TOTAL	**431**	**268**

In accordance with the Dutch legislation article 2:382a the total audit fees related to the accounting organisation Ernst & Young Accountants LLP amounted to RUB 16 (2017: RUB 12).

43

INCOME TAX EXPENSE

	2018	2017
Current income tax charge	–	–
Deferred income tax charge	1,294	1,158
Income tax charge for the year	1,294	1,158

The theoretical and effective tax rates are reconciled as follows:

	2018	2017
Loss before taxation	**(2,170)**	**(974)**
Theoretical tax at the effective statutory rate*	**(543)**	**(244)**
Tax effect of items which are not deductible or assessable for taxation purposes		
Unrecognised tax loss carry forwards for the year	526	119
Change in deferred tax liability associated with investments in subsidiaries	1,294	1,158
Other non-deductible expense	17	125
INCOME TAX CHARGE FOR THE YEAR	**1,294**	**1,158**

* Profit before taxation on operations in Netherlands is assessed based on the statutory rate of 25%.

No deferred tax asset has been recognised due to uncertainty of future taxable income to offset the current tax losses.

43 INCOME TAX EXPENSE

Deferred income tax

Deferred tax liabilities and the deferred tax charge in the company statement of profit or loss were attributable to the following items for the year ended 31 December 2018:

	31 December 2017	Credited/ (debited) to profit and loss	31 December 2018
Tax effects of taxable temporary differences			
Investments into subsidiary	(1,158)	(1,294)	(2,452)
Gross deferred tax liabilities	**(1,158)**	**(1,294)**	**(2,452)**
Recognised deferred tax liabilities	**(1,158)**	**(1,294)**	**(2,452)**

Deferred tax liabilities and the deferred tax charge in the company statement of profit or loss were attributable to the following items for the year ended 31 December 2017:

	31 December 2016	Credited/ (debited) to profit and loss	31 December 2017
Tax effects of taxable temporary differences			
Investments into subsidiary	–	(1,158)	(1,158)
Gross deferred tax liabilities	–	**(1,158)**	**(1,158)**
Recognised deferred tax liabilities	–	**(1,158)**	**(1,158)**

The Company estimates that part of temporary difference related to investments in subsidiaries will be reversed in the foreseeable future and therefore accrued related deferred tax liability.

The Company estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of RUB 1,320 (2017: RUB 794). Unused tax losses are available for carry forward for a period not less than four years (for 2017 – five years).

44 STAFF NUMBERS AND EMPLOYEE EXPENSES

The number of persons having a contract with the Company is five: one of them has a services contract, and four of them have a contract of employment. One of them was posted outside of the Netherlands. For the remuneration of past and present members of the Management Board, please refer to Note 27 Staff Cost in the consolidated financial statements, which is deemed incorporated and repeated herein by reference. Incurred wages, salaries and related social security charges in relation to the other three employees comprise RUB 12 (2017: RUB 9).

45 CONTINGENT RIGHTS AND LIABILITIES

Guarantees are irrevocable assurances that the Company will make payments in the event that another party cannot meet its obligations. The Company had the following guarantees issued under obligations of its group companies:

	31 December 2018	31 December 2017
Irrevocable offer to holders of X5 Finance LLC bonds	51,424	45,000
Irrevocable offer to holders of X5 Finance B.V. Eurobonds	20,375	20,000
Suretyship for Trade House PEREKRIOSTOK JSC	22,458	62,400
Suretyship for Agrotorg LLC	25,054	–
TOTAL	**119,311**	**127,400**

The guarantees issued matures as follows:

	31 December 2018	31 December 2017
Not later than 1 year	44,690	20,000
Later than 1 year and no later than 5 years	74,621	107,400
TOTAL	**119,311**	**127,400**

46 RELATED PARTY TRANSACTIONS

Refer to Note 8 of the consolidated financial statements; all group companies are also considered related parties.

Statutory director's compensation

The Company has a Management Board and a Supervisory Board. The total remuneration of all board members as well as key management is disclosed in Note 27 and Note 28 of the Consolidated Financial Statements.

Loans to group companies

For loans issued to and interest income from the group companies refer to Note 37.

Loan from group company

For loan received from and interest expenses to the group company refer to Note 39.

47 SUBSEQUENT EVENTS FOR THE COMPANY

There were no significant events after the reporting date.

Amsterdam, 19 March 2019	
Management Board:	**Supervisory Board:**
Frank Lhoëst	Stephan DuCharme
Igor Shekhterman	Mikhail Fridman
	Andrei Elinson
	Geoff King
	Peter Demchenkov
	Michael Kuchment
	Karl-Heinz Holland
	Nadia Shouraboura

OTHER INFORMATION

Auditor’s report

The auditor’s report is included on pages 293-301.

Statutory profit appropriation

In Article 28 of the Company’s statutory regulations the following has been stated concerning the appropriation of result:

On proposal of the Supervisory Board, the General Meeting shall determine which part of the profits earned in a financial year shall be added to the reserves and the allocation of the remaining profits.

The Supervisory Board proposed to the General Meeting to distribute in 2019 current year profit in the amount of RUB 25,000 (368.23 RUB per ordinary share) to shareholders.

Subsequent events

For subsequent events, please refer to Notes 35 and 47 of the financial statements.

Independent auditor’s report

To: The Supervisory Board and Shareholders of X5 Retail Group N.V.

EY

Building a better working world

Report on the audit of the financial statements 2018 included in the annual report

Our opinion

We have audited the financial statements 2018 of X5 Retail Group N.V., based in Amsterdam, the Netherlands. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

- The accompanying consolidated financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2018, and of its result and its cash flows for 2018 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- The accompanying company financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2018, and of its result for 2018 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

- The consolidated statement of financial position as at 31 December 2018;
- The following statements for 2018: the consolidated statement of profit or loss, the consolidated statements of comprehensive income, cash flows and changes in equity;
- The notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

- The company statement of financial position as at 31 December 2018;
- The company statement of profit or loss for 2018;
- The notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of X5 Retail Group N.V. in accordance with the EU Regulation on specific requirements regarding statutory audit of public-interest entities, the "Wet toezicht accountantsorganisaties" (Wta, Audit firms supervision act), the "Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten" (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore we have complied with the "Verordening gedrags- en beroepsregels accountants" (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Materiality

Materiality	RUB 2.7 billion (2017: RUB 2.4 billion)
Benchmark	2.5% of EBITDA
Explanation	Based on our professional judgment, we consider an earnings-based measure as the most appropriate basis to determine materiality. On the basis of our analysis of stakeholders' needs and main KPIs set for the Management Board, we believe that EBITDA is an important benchmark for the financial performance of the Group. The materiality and applied benchmark are in line with the 2017 audit.

We have also taken misstatements into account and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of RUB 135 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

X5 Retail Group N.V. is established in the Netherlands and is head of a group of subsidiaries operating food retail stores in Russia ("the Group"). The financial information of all these entities is included in the consolidated financial statements of the Group.

We are responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out. The Group accounting function is centralized in Moscow and Nizhny Novgorod and the Group is primarily managed as a single operating unit with multiple operating segments. We have used the work of EY Moscow to perform full-scope audit procedures to obtain sufficient coverage for financial statement line items from a consolidated financial statement perspective. We executed a program of regular communication that has been designed to ensure that the audit progress and findings were discussed between us and the audit team of EY Moscow. We have visited EY Moscow during planning and execution phases, as well as held meetings with the Group's Management Board, finance and reporting, risk management, internal audit and legal representatives.

By performing the procedures mentioned above, we have been able to obtain sufficient and appropriate audit evidence of the group's financial information to provide an opinion on the consolidated financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of goodwill

(see note 12 to the financial statements)

Risk	As a result of past acquisitions, the Group carries capitalized goodwill with a value of RUB 95 billion as at 31 December 2018. In accordance with the requirements of IAS 36 Impairment of Assets, management performs an impairment assessment of the capitalized goodwill on an annual basis. The Group identified the cashflow generating units to be the operating segments for each of its retail formats. The goodwill impairment assessment is performed at the level of these cashflow generating units. The impairment assessment includes the assessment of the recoverable amount based on expected cash flows. These cash flows are based on current budgets and forecasts approved by the Supervisory Board and are extrapolated for subsequent years based on consumer price index. Key assumptions used are revenue growth, projected EBITDA margin and the discount rate. We consider this to be a key audit matter as the goodwill amount is significant, the assessment requires significant judgment and there is complexity in the valuation methodologies used to determine whether the carrying value of goodwill is appropriate, which includes the assumptions used within models to support the recoverable amount of goodwill.
Audit approach	We obtained an in-depth understanding of the Group's methodology used for performing the goodwill impairment test and ensured it is in accordance with EU-IFRS. We challenged management's key assumptions used in the goodwill impairment test and compared the assumptions used with industry trends and forecasts developed by independent analysts. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias. Regarding the key assumptions used and methodology applied, we involved internal valuation experts, who compared assumptions used in the model with observable market data and verified the methodology applied is compliant with EU-IFRS. We tested mathematical accuracy of the impairment testing model, reconciled internal inputs in the model with audited accounting records and ensured consistency of data used for goodwill impairment testing with other information obtained during the audit. We considered the adequacy of the disclosures to the financial statements.
Key observations	We consider Management Board's key assumptions to be within a reasonable range of our own expectations and goodwill to be fairly stated. Additionally we consider the related disclosures in note 12 to the financial statements to be adequate.

Impairment of stores and other non-current assets

(notes 10,11 and 13 to the financial statements)

Risk

The Group operates more than 14,000 retail stores in Russia. The associated value of stores and other non-current assets, such as property, equipment and intangible assets excluding goodwill, approximated RUB 332 billion as at 31 December 2018 and is considered a key audit matter due to the magnitude of the carrying value as well as the judgment involved in assessing the recoverability of the invested amounts.

Management assesses annually the existence of triggering events for potential impairment of assets, or reversals thereof. With respect to underperforming stores management assesses the impairment and impairment reversal on an annual basis using an internal calculation model. For the impairment, management first determines the value in use for each store and compares this to the carrying value. Where the carrying value is higher than the value in use, the fair value less cost of disposal is determined.

The judgment involved focuses predominantly on the discount rate and future store performance, which is, among others, dependent on the expected revenue and the local competition. The expected revenue is determined based on the strategic growth plan prepared with reference to macroeconomic forecasts.

Judgment is also involved in determination of the fair value of property undertaken on the basis of internal and external property valuation reports.

Audit approach

Among other audit procedures, we assessed appropriateness of the Group's policies and procedures to identify triggering events for potential (reversal of) impairment of stores and other non-current assets.

For underperforming stores, we challenged management's key assumptions used in the cash flow forecast such as revenue growth and corroborated these assumptions through comparison to management's internal forecasts, external data and historical performance. We assessed accuracy of management's forecasts used in prior year to identify potential bias.

We involved our internal valuation experts to evaluate the methodology, inputs and assumptions used in the model for consistency with general practice and market observable data.

The audit of the model also included verification that the impairment methodology is consistently applied and that the model is mathematically accurate.

We involved our internal real estate valuation experts to assess the (market) property valuations performed by the Group. We also assessed objectivity and competency of external appraisers engaged by the Group.

We considered the adequacy of the disclosures to the financial statements.

Key observations

We consider Management Board's key assumptions to be within a reasonable range of our own expectations and stores and other non-current assets to be fairly stated. Additionally we find the related disclosures in notes 10, 11 and 13 to the financial statements to be adequate.

Recognition of vendor allowances

(see note 2.24 to the financial statements)

Risk

The Group receives various types of vendor allowances such as rebates and service fees. Rebates largely depend on volumes of products purchased and service fees are received for promotional activities that the Group undertakes with respect to certain products. These allowances represent a significant component of cost of sales and are recognized as a reduction of the inventory cost value. While the majority of the allowances are settled during the financial year, a substantial amount remains outstanding at each year-end and is recognized as part of trade receivables.

We consider this to be a key audit matter because allowance arrangements are individually different, can be complex and recognition of vendor allowances and related receivables require a certain level of judgment by management, for example, timing of delivery of the service and evidence thereof. Moreover, the allocation of the allowances to inventory cost value also has an element of judgment.

The Group evaluates all required disclosures for vendor allowances and determines that these are appropriately included in the financial statements.

Audit approach

Our procedures included testing of internal controls related to occurrence, completeness and measurement of the allowances recognized in the accounting system and covered both, IT application and manual controls, including controls related to periodic reconciliations with vendors.

We verified that the Group is in compliance with relevant laws and regulations in relation to these vendor allowances, including the new trade law implemented in 2017.

We selected a sample of vendors and obtained direct confirmations from vendors of their settlements with the Group.

We tested on a sample basis documents supporting journal entries regarding the recognition of vendor rebates and service fees.

In addition, we performed margin analysis and we reviewed subsequent collections on prior period vendor allowance receivables and subsequent collections of the vendor allowances receivable in the current year.

We verified that the policy for the reduction of inventory cost related to vendor allowances is appropriate and has been applied correctly.

We considered the adequacy of the disclosures to the financial statements.

Key observations

We did not identify material exceptions and we found the Management Board's recognition of vendor allowances to be reasonable. Additionally we found the related disclosures in note 2.24 to the financial statements to be adequate.

Long-term incentive programme (LTI)

(see note 27 to the financial statements)

Risk	The Group has two long-term incentive programmes in place. The first one was introduced in 2015 and runs until 31 December 2019. The second one was approved in December 2017 and runs until 31 December 2020. Targets under the LTI programmes are structured to align the long-term interests of shareholders and management, with a focus on maintaining market leadership in terms of revenue and, as additional long-term objective set in the second LTI programme, market leadership in terms of enterprise value multiple relative to competitors, without sacrificing EBITDA margin. The total available fund for all pay-outs under the first LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. The total available fund for all pay-outs under the second LTI programme is capped at 5% of average EBITDA during the three-year period of the program. Each stage of the LTI programmes includes a deferred component of conditional pay-outs in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI pay-out may be adjusted downwards based on individual performance during the period of the programme. We consider this to be a key audit matter due to significant judgment involved in determination of appropriate accounting policies and estimates used in LTI calculations.
Audit approach	We obtained an in-depth understanding of the Group's new LTI programme and methodology used for recognition of LTI expenses. We challenged management's key assumptions used in the LTI expense calculation for both new and existing LTI programmes. This includes the period over which the expenses should be accrued in relation to both the LTI phases and targets achieved in 2018 as well as those expected to be achieved in future years. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias. We tested mathematical accuracy of LTI expense calculations, reconciled internal inputs in the calculations with audited accounting records and ensured consistency of data used for LTI calculations with other information obtained during the audit. We considered the adequacy of the disclosures to the financial statements.
Key observations	We did not identify material exceptions in the LTI expenses and we consider the Management Board's key assumptions to be within a reasonable range of our own expectations and the related disclosures in note 27 to the financial statements to be adequate.

Effect of IFRS 16 transition disclosure

(see note 4 to the financial statements)

Risk	IFRS 16 Leases, becomes effective for annual reporting periods beginning on or after 1 January 2019. The application of this new standard as disclosed in note 4 will have a material effect on components of the financial statements and the presentation of the net assets, financial position and results of operations of the Group. The analysis performed on the initial application of the standard indicates that the amount of lease liabilities and right-of-use assets that will be recognised as a result of the transition falls in the range of RUB 410 – 460 billion. The difference between the amount of lease liabilities and right-of-use assets will be reflected as a decrease in equity. We believe that this is a key audit matter because of the magnitude of the effect and complexity of the implementation process, which required to identify all lease contracts and process significant volumes of data associated with lease contracts. Also such matters as discount rates and lease terms involves significant management judgments.
Audit approach	We obtained an in-depth understanding of the Group's methodology used for assessment of the IFRS 16 transition adjustment. We challenged management's key assumptions and judgments including those used in determination of the lease term and discount rates. We also considered completeness of the lease contracts population identified by the Group. Our procedures included testing of internal controls related to measurement of IFRS 16 transition adjustment and covered both IT application and manual controls. We selected a sample of lease contracts and manually recalculated for their right-of-use assets and lease liabilities at 1 January 2019. We tested on a sample basis documents supporting lease contracts master data used for IFRS 16 right-of-use assets and lease liabilities calculation at 1 January 2019. We considered the adequacy of the IFRS 16 transition disclosures to the financial statements.
Key observations	We did not identify material exceptions and we found the Group's IFRS 16 transition disclosure in note 4 to the financial statements to be adequate.

In prior year we included a key audit matter in relation to the Depreciation of buildings. We consider this no longer a key audit matter because it was resolved in prior year.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- The Chairman's statement;
- The Management Report;
- The Supervisory Board Report;
- The Remuneration Report;
- Other information as required by Part 9 of Book 2 of the Dutch Civil Code.

Based on the following procedures performed, we conclude that the other information:

- Is consistent with the financial statements and does not contain material misstatements;
- Contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is substantially less than the scope of those performed in our audit of the financial statements.

The Management Board is responsible for the preparation of the other information, including the Management Report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information as required by Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

Following the appointment by the extraordinary general meeting of shareholders on 12 November 2015, we were engaged by the Supervisory Board on 15 December 2015 as auditor of X5 Retail Group N.V. as of the audit for the year 2016 and have operated as statutory auditor since that date.

No prohibited non-audit services

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

Description of responsibilities for the financial statements

Responsibilities of the Management Board and the Supervisory Board for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Management Board is responsible for such internal control as the Management Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Management Board is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Management Board should prepare the financial statements using the going concern basis of accounting unless the Management Board either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Management Board should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit engagement in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not detect all material errors and fraud during our audit.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included among others:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Concluding on the appropriateness of the Management Board's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit. In this respect we also submit an additional report to the Audit Committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine the key audit matters: those matters that were of most significance in the audit of the financial statements. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, 19 March 2019

Ernst & Young Accountants LLP
Signed by G.A. Arnold