

It's all about...

X5 is one of Russia's leading retail groups, operating some of the country's best-known brands across a variety of store formats. We have a clear understanding of both the challenges that we face and the opportunities that are open to us, and are very confident that we have the skills, experience and commitment to build tremendous value as we go forward into a new phase of consolidation and efficiency.

Being a market leader

by understanding our
customers

by creating
multi-format stores
for every lifestyle

by sourcing
**the highest
quality products**

by inspiring our
people

by being a responsible
corporate citizen

Overview

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Understanding our customers

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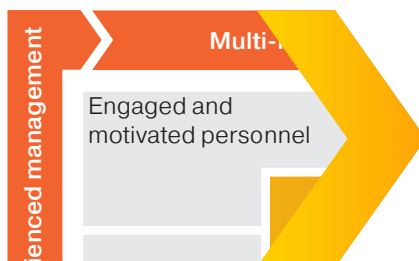
Chief Executive's review

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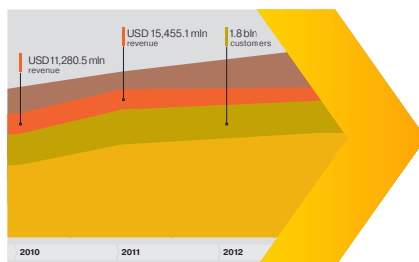
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A photograph of a woman wearing a red visor and a red and white apron, working behind a food service counter. The counter has various food items and a cash register. In the background, there are shelves with products and a price tag showing '19.99'. The image is partially obscured by a large yellow diagonal shape on the left side.

...understanding our customers

Our goal is to be the food retail shopping destination of choice across all formats. By understanding our customers we are able to offer modern services, attractive stores and a great product range – altogether an excellent shopping experience for every lifestyle.



Aiming to be the shopping destination of choice

Achieving the right mix

Fresh produce

We have introduced new buying policies to ensure that our in-store produce is absolutely fresh on our shelves.

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Wider choice

Customers are increasingly demanding in terms of the range of products available, and we conduct regular surveys to ensure these demands are met.

Better stores

A core part of our offer is the in-store experience, and we plan to invest accordingly in this area.

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Our brands

Pyaterochka Soft Discounters

Perekrestok Supermarkets

Karusel Hypermarkets

Perekrestok Express and Kopeyka
Convenience stores

We operate in a highly competitive marketplace, and understand that customers are able to choose from several alternatives. We are therefore focused on a range of initiatives designed to understand and attract customers across our formats.



Improving the shopping experience

Key to our success in retaining customers and winning new ones is our ability to deliver a positive experience in each of our formats.

Examples include improvements in product range and investments in stores to enhance customer appeal.

RUR 28 bln

(USD 902.1 mln)¹ X5's total capital expenditure for 2012, of which a majority went to increasing and improving the store base

¹ Here and further in the report the RUR/USD exchange rate is 31.093, if not stated otherwise.

+8.1%

Total RUR sales

Pursuing multi-format strategy

Our multi-format strategy is proving particularly effective, offering wide product choice and value for every consumer lifestyle and budget. Each format's value proposition is distinctive, providing customers with multiple opportunities to purchase quality products in convenient locations.

5

Unique retail formats: soft discounters, supermarkets, hypermarkets, convenience stores and E5.RU

Refining our product ranges

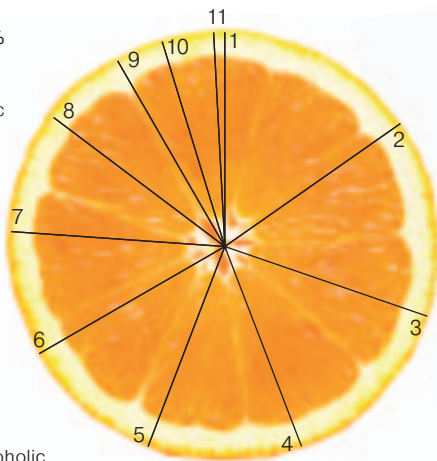
We are continuously working hard to bring our product ranges in line with customers' needs and expectations. We carry out ongoing assessment and refreshing of the product range across each of our core brands, and this involves regular customer surveys and analysis of sales to determine what our customers want to see on our shelves.

2012

Product range

Product range breakdown (% of sales)

1. Dairy products, eggs and oils **15.5%**
2. Conserve and groceries **15.0%**
3. Spirits and alcoholic beverages **13.8%**
4. Confectionery and bakery **11.8%**
5. Fresh and processed meat **10.8%**
6. Fruit and vegetables **9.3%**
7. Non-food **9.3%**
8. Fish and frozen food **6.5%**
9. Publications, tobacco and accessories **3.5%**
10. Drinks and non-alcoholic beverages **3.9%**
11. Other **0.6%**



Developing marketing strategies

In order to help sustain market leadership, each of our formats has a clearly defined brand proposition supported by targeted marketing activity designed to articulate brand values. This enables our customers to make informed choices and develop specific reasons to shop at our stores.

9.4%

Increase in traffic across our stores



New initiatives at Pyaterochka

During 2012, at Pyaterochka we rolled out several new initiatives to improve customer satisfaction and the overall shopping experience. Our 'red button' program was designed to reduce the wait at check-out lines by allowing the cashier to call for additional help if the line increased to five or more customers.

We also improved communication with customers through new leaflets and advertising campaigns to increase awareness of the stores' promotional offers.

Another initiative was to expand the number of regional supervisors to improve communication between the format's operations directors and the store directors to ensure better discipline and accountability.

See more on page 38







...creating multi-format stores for every lifestyle

We have developed a unique multi-format model over the last six years, enabling us to offer the widest range of customers the products they want at the most attractive prices. Each format's value proposition is distinctive, providing customers with multiple opportunities to purchase quality products in convenient locations.

A store for every lifestyle, budget and occasion

We have successfully developed a unique food retailing group with a particular focus on building strong brands in each of the key sectors in our market.

3,802

Total number of stores



Soft discounters

Pyaterochka is the leading national soft discounter brand in Russia and one of the first modern grocery retail chains to open in the Russian market. The stores are focused on convenient locations, the lowest prices, unique private label offerings and attractive promotional events for customers.

3,220

Number of stores

Evolving market dynamics

Adapting to change

We are very conscious of the need to provide a flexible range of formats which addresses changing customer demand.

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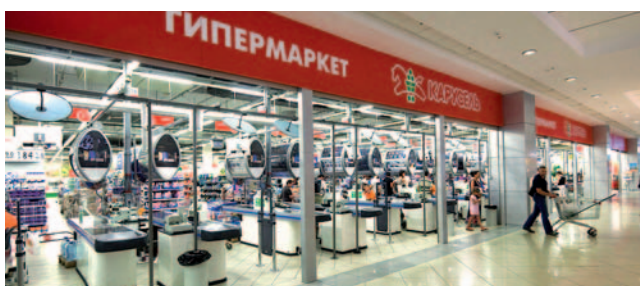


Understanding lifestyles

Our ongoing research helps us to understand and react quickly to demands across the demographic spectrum.

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Hypermarkets

Karusel is one of the largest hypermarket chains in the Russian market. Karusel hypermarkets offer customers economical one-stop shopping at city hypermarkets with a wide range of quality food and non-food products, efficient service at cash registers and engaging weekly catalogues.

78

Number of stores



E5.RU

E5.RU is our online retail brand, which has been developed to support the Company's traditional non-food sales channels and benefit from the opportunities provided by the growing Russian internet space. The brand was launched in early 2012 as an online retail store offering non-food products and the convenience and flexibility of choosing the time, location and method of receiving purchases.

1.5 mln

Number of stock-keeping units offered through E5.RU



Supermarkets

Perekrestok is the leading national supermarket brand in Russia and one of the first modern supermarkets to open in the Russian market. The stores emphasize quality, service and a wide selection of fresh goods at fair prices, supported by original promotional and advertising campaigns.

The Green Perekrestok brand is a premium version of the original supermarket brand and offers an extended assortment of high-quality products at the best prices in the premium supermarket segment.

370

Number of stores



Convenience stores

Operating under the Perekrestok Express and Kopeyka brands, these stores offer convenient shopping for people in a hurry. Perekrestok Express offers ready-to-eat meals, which account for up to 50% of the stores' product range, in high-traffic zones – near subways, airports, train stations – while Kopeyka offers convenient shopping in residential areas with a focus on fresh produce.

134

Number of stores



...sourcing the highest quality products

It is fundamentally important that we consistently source products of the highest quality across all the Group's formats. In order to ensure that we maintain these standards, we continue to invest strongly in our supply chain and have a robust program of ongoing assessment and quality control in all our supplier relationships.



Focusing on quality, value and sourcing efficiency

Customers are presented with an increasingly wide range of options in their choice of retail outlet, and we focus strongly on providing product ranges throughout our formats that reflect the quality they expect.

Maintaining standards

Training

Each store format has responsibility for ensuring its employees adhere to the Group's rigorous standards of food quality and safety.

See more on page 56

Testing

We have an ongoing testing program across our product range to ensure that quality is maintained in each individual store.

See more on page 56

Checking

In addition to our sourcing and delivery systems and processes, we carry out constant checks for quality once products have reached our shelves.

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Working closely with our suppliers

We have extensive buying operations, and have developed strong relationships with approximately 5,000 suppliers, sourcing products from both leading international and local food producers. We continue to develop these relationships in line with the growing scale of our business. As a consumer-oriented organization, we are firmly focused on customer satisfaction and our product range is therefore of key importance.

Approximately

5,000

suppliers



1,600
Private label
products

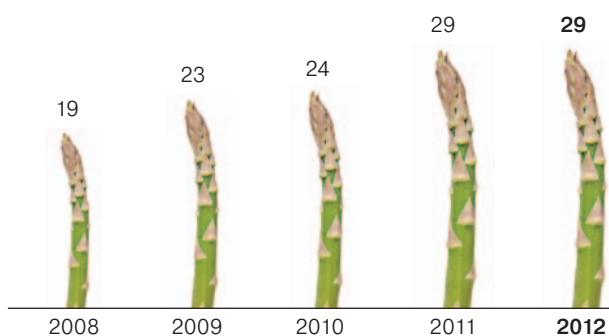
Developing private label products

Over the past five years, we have been developing our own private label program in order to offer customers a wide range of high-quality, low-priced products. This range comprises approximately 1,600 items and we are planning to increase the share of private label by developing cross-format and cross-category brands in various price segments.

10.5%

Share of private label in sales

Number of distribution centers



Investment in our supply chain

We have a program of ongoing investment in our distribution network, based on creating and developing the most efficient systems and utilizing the most up-to-date technologies. Our distribution centers operate using a single Warehouse Management System, which enables efficient control over the movement and storage of goods and supports the optimization of processes and transactions involved in shipping, receiving and picking.

29

Number of distribution centers

Sourcing the freshest produce

In 2012 we launched direct import activities to improve the quality of our products.

Each food product shipment undergoes compulsory quality control verification upon arrival at our distribution centers in order to comply with organoleptic (taste, color, odor and feel) standards.

RUR 34 mln

(USD 1.09 mln) invested in product safety





...inspiring our people

At the heart of our business are the people who make it happen. In each of our stores, across each of our brands and formats, we have teams of dedicated people without whose commitment we would not be in our market-leading position. Our confidence in building a sustainable future depends entirely on the determination and skills of all our employees across the Company.



Investing in the right people

We have a wealth of management and operations expertise and experience throughout the Group – every individual at each level has skills which contribute to the success of our brands and the Group overall.

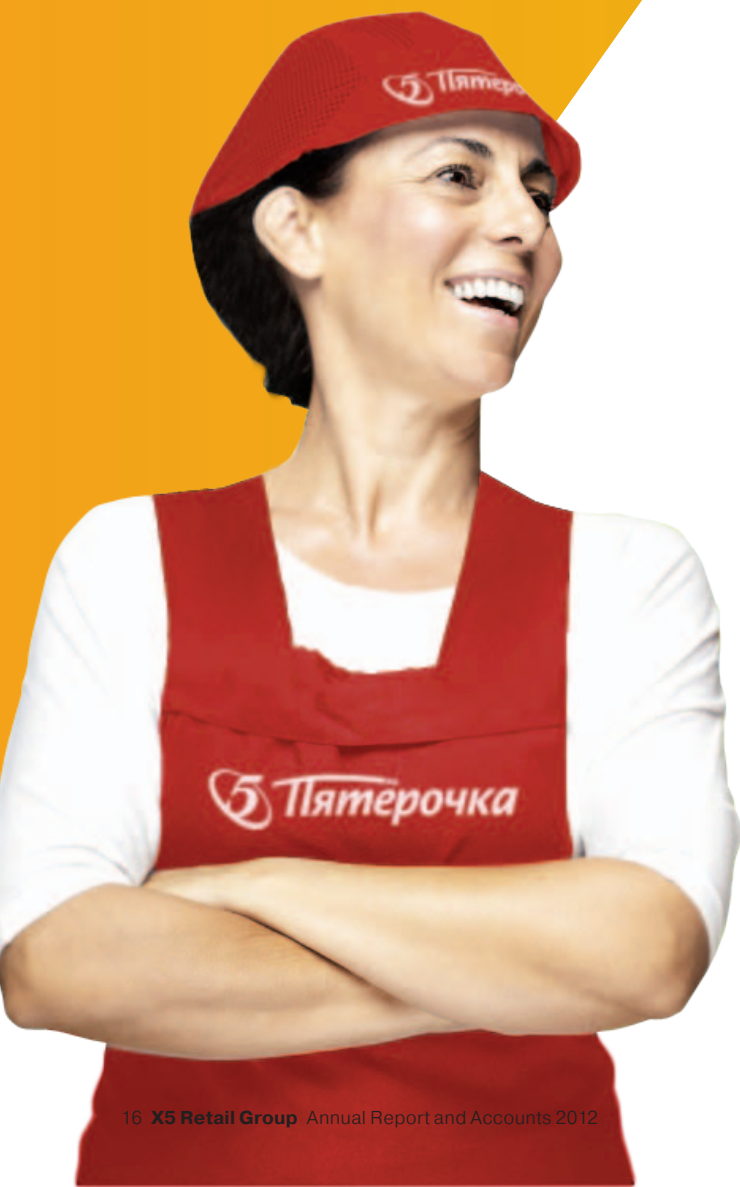


Linking with top universities to seek and foster the right skill sets for the retail industry

We have established close links with top Russian universities and technical schools, which enable us not only to develop positive perceptions of X5 as a dynamic employer of young talented people, but which also ensure that we participate in recruitment fairs and are well positioned to hire talented graduates to work in our stores and offices.

50

Educational partnerships



Training and development

Talent

Improving our skill base is crucial to our ability to continue attracting and retaining customers in our stores.

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Training

We invest heavily in training programs across each of our formats to ensure that we maintain and develop high standards in all functions, including customer service and customer relations, store management, purchasing and logistics.

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Creating the right jobs and career progression

Since its people are the Company's most valuable resource, it is critical that we have in place a strong system for attracting, motivating and retaining our employees.

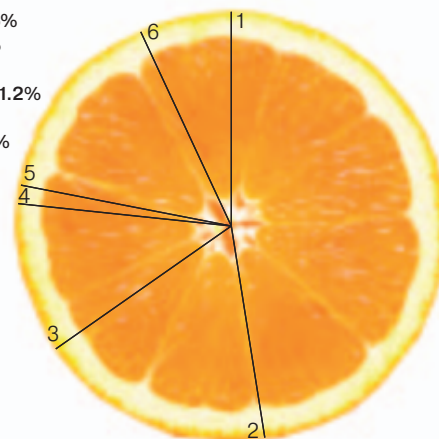
A recent initiative was the launch of our Talent Management program to identify promising employees for promotion to management positions, further develop the careers of our existing high-potential employees and address any skill gaps or succession issues.

109,000

Employees

Personnel breakdown (%)

1. Soft discounters **47.5%**
2. Supermarkets **18.0%**
3. Hypermarkets **11.4%**
4. Convenience stores **1.2%**
5. Logistics **15.1%**
6. Office and other **6.8%**



Inspiring our people to be customer-focused

Customer satisfaction is critical to our ongoing success, and this is a key focus for staff. Key developments in training and development practices at X5 in 2012 were the standardization and optimization of learning materials for different levels of employees, the development of in-store training programs with specific objectives for each format, and a focus on operational management training at all levels.

84,000

Training person-days during 2012



...being a responsible

corporate citizen

X5 is committed to complying with the highest international standards of ethical business conduct and corporate responsibility in order to improve the lives of our employees, our customers and our neighbors in the regions and communities where we operate.



Responsibility at the heart of our business



As a major employer we are very aware of our responsibilities to our staff and to the communities in which our stores are based. We also have a significant impact on the wider economy in general and in the regions where we operate.

Access to affordable products

We are sensitive to the need to make our products affordable to socially vulnerable segments of the population, and we offer special discounts and other benefits to pensioners, war veterans and disabled people at our stores through programs like our 'Care Time Hours', which offer a 5% discount to pensioners at specific times during the week.

5%

Discount during 'Care Time Hours'

A responsible approach

Employees

We have an effective and well-developed set of programs for employee support, incentivization and development which we review regularly to introduce any necessary improvements quickly and efficiently.

[See more on page 50](#)

Society

We clearly have a significant impact on the communities in which we operate, and we are extremely active in supporting and engaging with local people and organisations.

Environment

The management of environmental issues is a fundamental part of our operations, since it has a significant impact on our ability to generate sustainable growth.

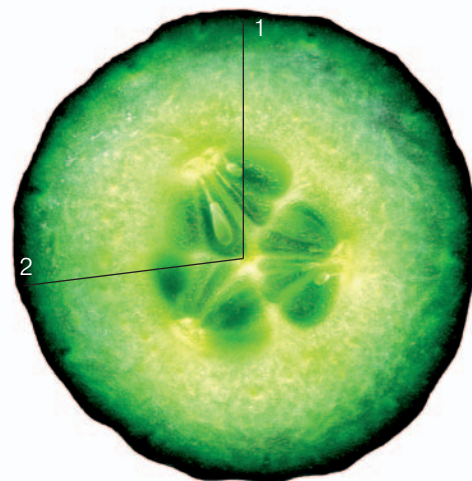
Equal opportunity employer

The Company's human resources management system is based on the principles of fairness, respect and equal opportunity, and supports an open dialogue between management and employees. Approximately 70% of our employees are women, and 24% of management positions are held by women.

24%

Percentage of women
in management positions

Gender structure of labor force



1. Women **72%**
2. Men **28%**

Charity projects

X5 is proud of the recognition that its accomplishments and initiatives have received. In 2012, our charitable program 'Crossroads of Life' was among the winners in the 'Best Program Contributing to the Development of Volunteering in Russia' category and was also recognized as the best corporate employee program benefiting children with serious illnesses. X5 was also recognized with an award in the category 'Projects supporting disadvantaged social groups' of the national program 'Russia's Best Social Projects'.

RUR 18.1 mln

(USD 0.58 mln) raised in stores for the Life Line Charitable Fund

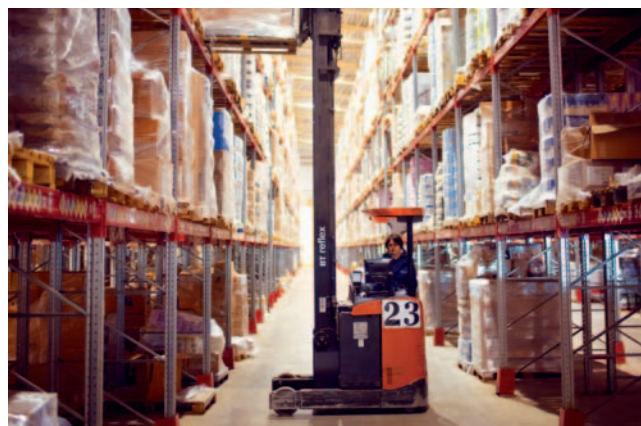


Health and safety

The health and safety of our employees is of primary importance to X5. Our priority is to ensure workplace safety for all our employees and to mitigate potential risk factors through implementation of modern safety technologies and ongoing risk analysis and monitoring.

3,500

Managers certified in Operational Health and Safety (OHS)



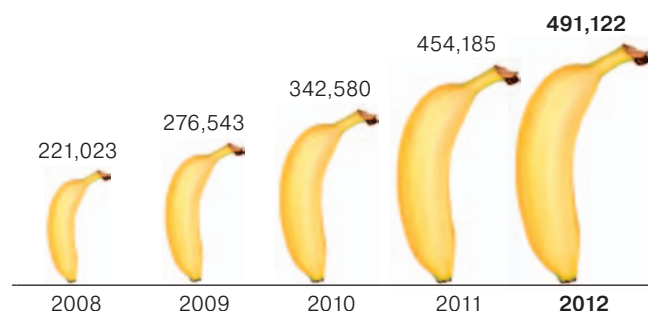
Supporting local economies

We are a major investor in the development of the Russian economy, directly employing approximately 109,000 people and providing economic opportunity for thousands of local businesses throughout our supply chain.

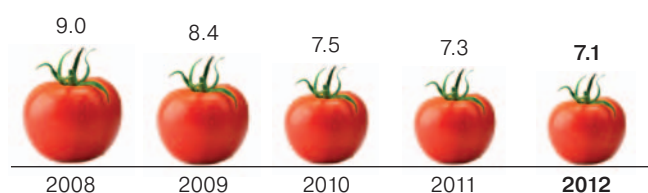
We are an active participant in the communities and economies in which we operate, and are committed to bettering the lives of our employees, customers and neighbors by contributing in a positive and responsible way. Playing a positive role in Russian society is fundamental to our success, helping us attract and cultivate talented staff and earn customer loyalty.

Financial highlights¹

Total revenue (RUR mln)

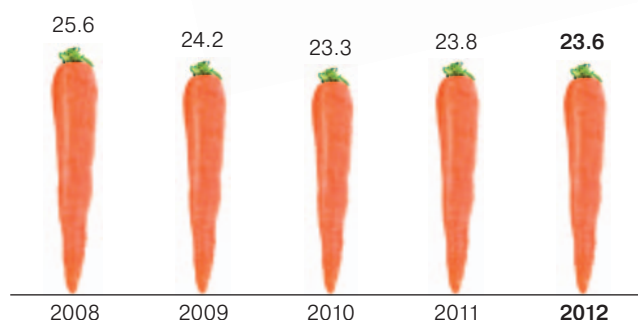


EBITDA margin (%)

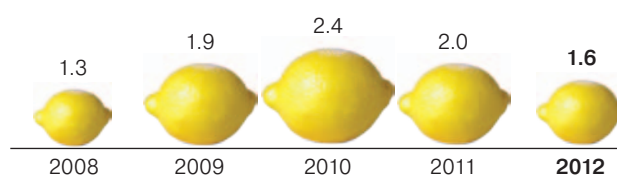


¹ Profit and loss figures for 2008 are presented on a pro-forma basis and include results of the acquired Karusel hypermarket chain from 1 January 2008. Paterson (acquired in 2009) and Kopeyka (acquired in 2010) stores' results are included only for December 2009 and December 2010 respectively.

Gross margin (%)



Adjusted net income margin (%)



8.1%

Increase in revenue

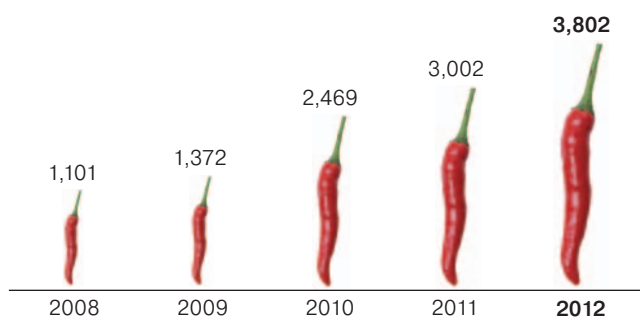
14%

Increase in selling space

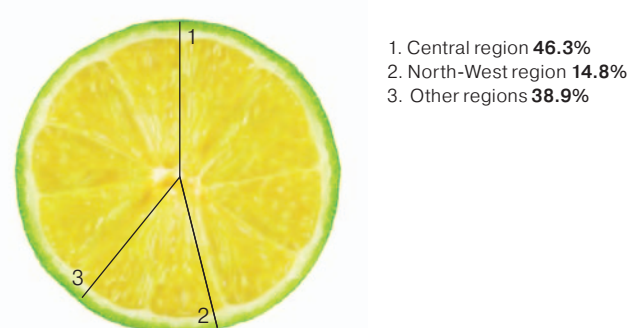
Although we have delivered some growth across several of our key performance indicators, we are fully aware that the results for 2012 do not reflect the level of performance we are capable of delivering. We are committed to generating higher growth and value as we move forward.

Non-financial highlights

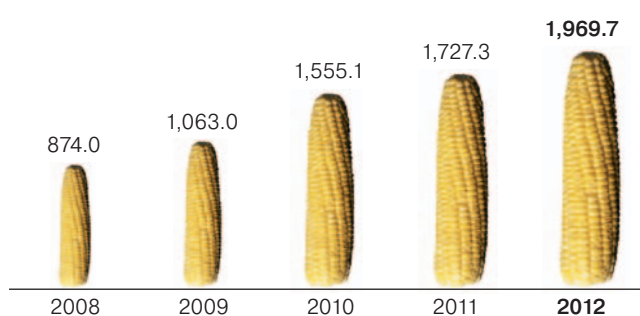
Store expansion dynamics (number of stores)



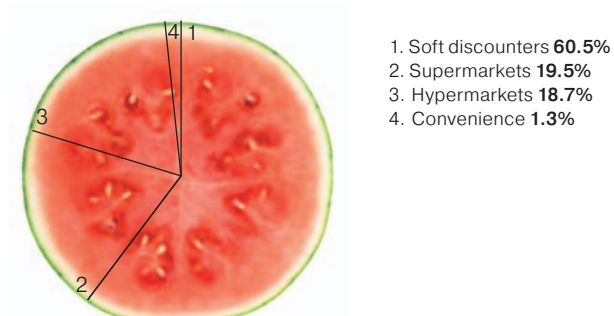
Store base breakdown by region 2012 (%)



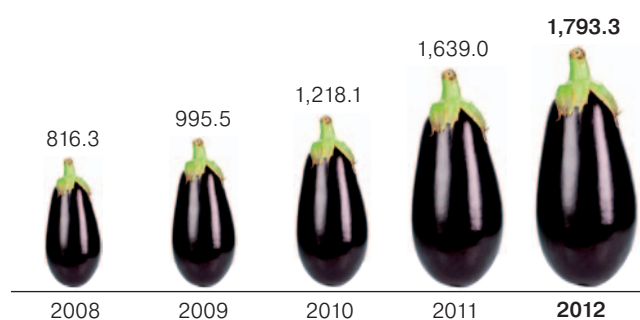
Selling space expansion dynamics (thd sqm)



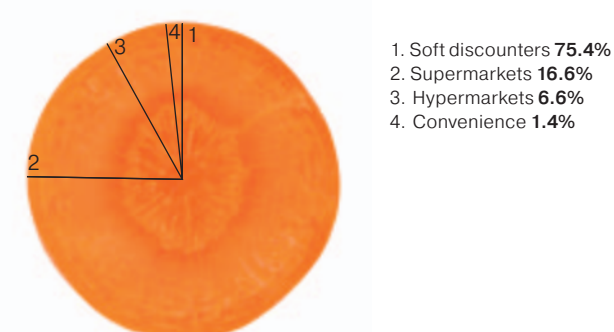
Net selling space breakdown by format 2012 (%)



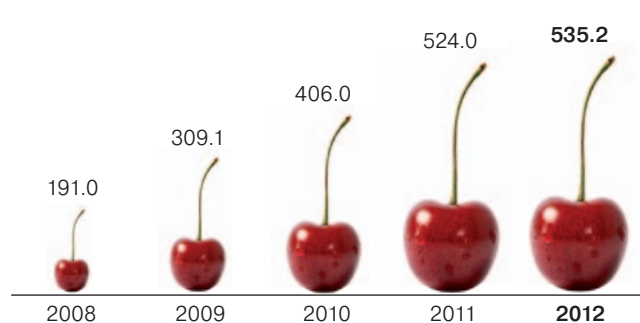
Customer visits (mln)



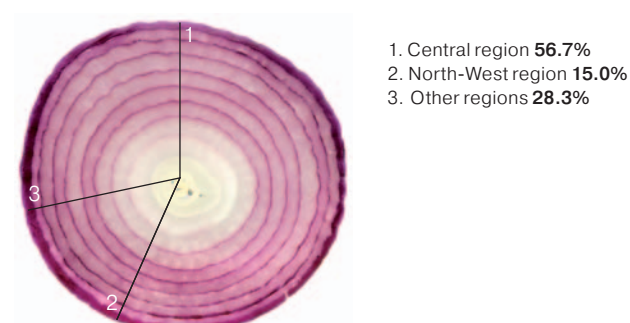
Customer visits breakdown by format 2012 (%)



Warehouse space (thd sqm)



Warehouse space breakdown 2012 (%)



Our brands

X5 Retail Group structure

Soft discounters

Pyaterochka is the leading national soft discounter brand and was one of the first modern grocery retail chains to open in the Russian market. It accounted for 65% of X5's total 2012 net retail sales. The stores are focused on convenient locations, the lowest prices, a unique private label offering and attractive promotional events for customers.



Supermarkets

Perekrestok is the leading national supermarket brand in Russia. The stores emphasize quality, service and a wide selection of fresh goods at fair prices. Green Perekrestok is a premium version of the original supermarket brand that offers an extended range of high-quality products at the best prices in the premium supermarket segment.



Hypermarkets

Karusel is X5 Retail Group's national hypermarket brand and one of the largest hypermarket chains currently operating in the Russian market. It offers its customers economical one-stop shopping at city hypermarkets with a wide range of quality food and non-food products, efficient service at cash registers and engaging weekly catalogues.



Convenience stores

Operating under the Perekrestok Express and Kopeyka brands, these stores offer convenient shopping for people in a hurry. Perekrestok Express is located in high-traffic zones – subways, airports, railway stations – and offers ready-to-eat meals, which account for up to 50% of the stores' product range. Kopeyka offers convenient shopping in residential areas with a focus on fresh produce.



3,220

Number of stores

2012 net retail sales share breakdown (%)

64.8



370

Number of stores

2012 net retail sales share breakdown (%)

21.5



78

Number of stores

2012 net retail sales share breakdown (%)

12.5

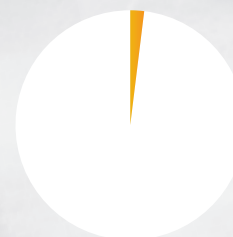


134

Number of stores

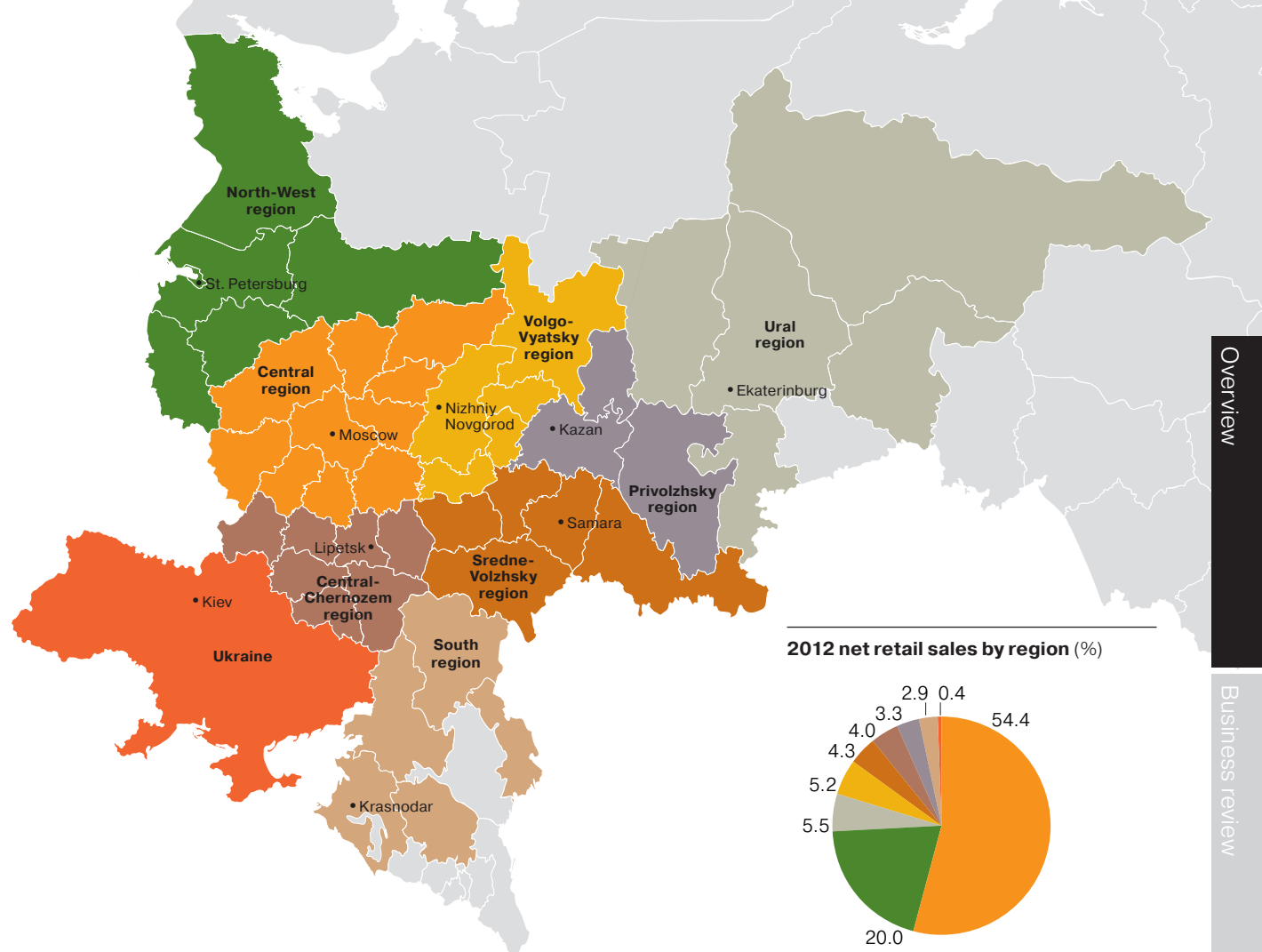
2012 net retail sales share breakdown (%)

1.0



E5.RU

E5.RU is our online retail brand developed to support the Company's traditional non-food sales channels and capitalize from the opportunities provided by the growing Russian internet space. The brand was launched in early 2012 and contributed around 0.1% of net sales.



2012 regional store and distribution center breakdown

Central

Discounters: **1,398**
 Supermarkets: **210**
 Hypermarkets: **19**
 Convenience stores: **134**
 Distribution centers: **11**

Volgo-Vyatsky

Discounters: **237**
 Supermarkets: **24**
 Hypermarkets: **9**
 Distribution centers: **2**

Privolzhsky

Discounters: **172**
 Supermarkets: **17**
 Hypermarkets: **8**
 Distribution center: **1**

North-West

Discounters: **510**
 Supermarkets: **35**
 Hypermarkets: **17**
 Distribution centers: **5**

Sredne-Volzhsky

Discounters: **180**
 Supermarkets: **31**
 Hypermarkets: **7**
 Distribution centers: **2**

South

Discounters: **180**
 Supermarkets: **18**
 Hypermarkets: **5**
 Distribution center: **1**

Ural

Discounters: **340**
 Supermarkets: **14**
 Hypermarkets: **6**
 Distribution centers: **5**

Central-Chernozem

Discounters: **203**
 Supermarkets: **9**
 Hypermarkets: **7**
 Distribution centers: **2**

Ukraine

Supermarkets: **12**

Store expansion summary by region

	2008	2009	2010	2011	2012
Central	492	598	1,265	1,438	1,761
North-West	311	356	408	489	562
Central and North-West regions	803	954	1,673	1,927	2,323
Central-Chernozem	35	37	135	167	219
Volgo-Vyatsky	54	64	150	215	270
Privolzhsky	12	46	84	142	197
Sredne-Volzhsky	29	55	141	160	218
South	21	50	87	144	203
Ural	141	160	193	237	360
Other regions	292	412	790	1,065	1,467
Ukraine	6	6	6	10	12
Total	1,101	1,372	2,469	3,002	3,802

Building a leading retail group

Growth

Since 2006, the Group has delivered significant growth in key areas: store numbers, format types, sales, customers and employees.

Consolidation

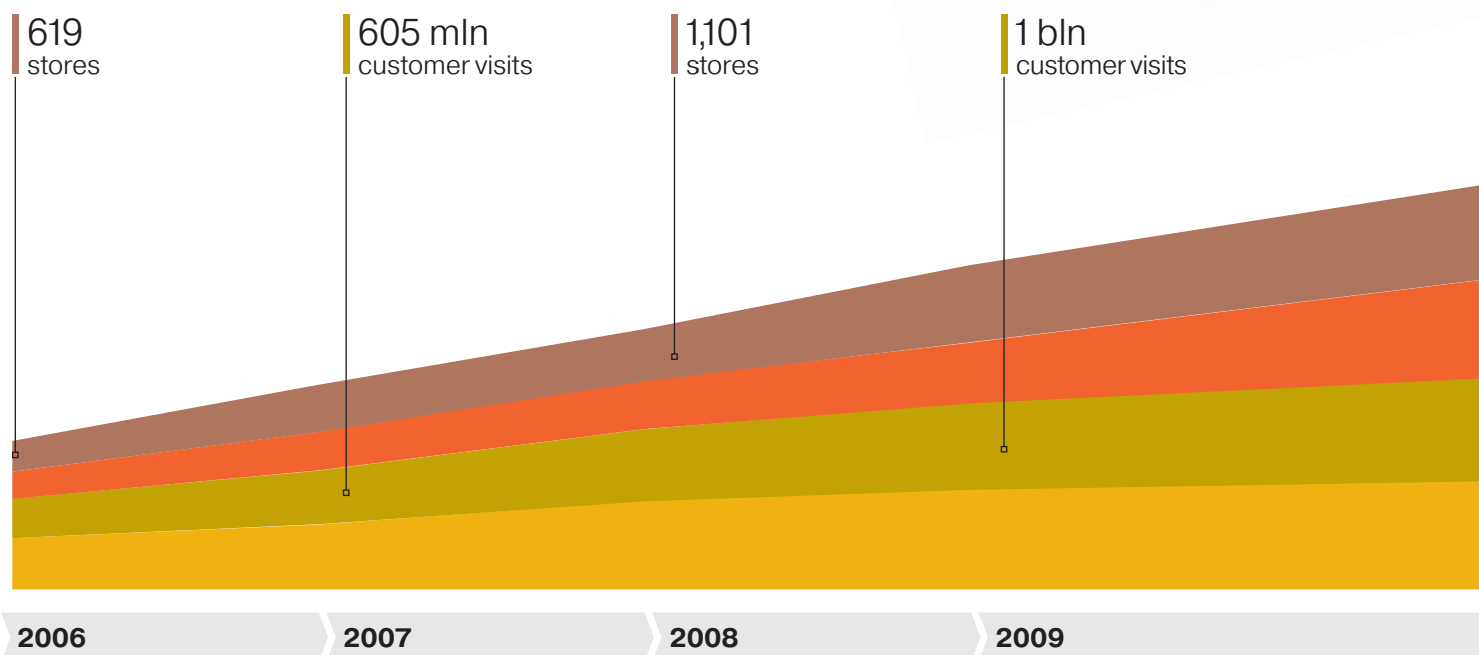
We are now entering a period of consolidation, where we will generate full value from economies of scale, better Group communications and more efficient use of common practices and systems across our brands and formats.

See more on page 29



A strong record of growth in scale

The evolution of our Group



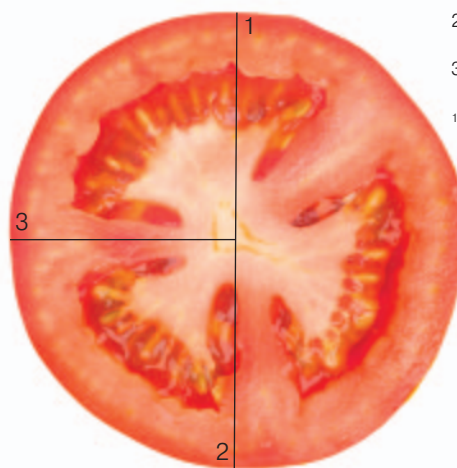
Fast growth driven by M&A

- › Merger of Pyaterochka and Perekrestok
- › Renamed X5 Retail Group N.V.
- › More than 600 stores under management
- › Presence in 21 Russian provinces
- › X5 acquires Karusel hypermarket chain
- › X5 opens 1,000th store
- › 1,000th soft discounter opened; total X5 store base exceeds 1,370 stores

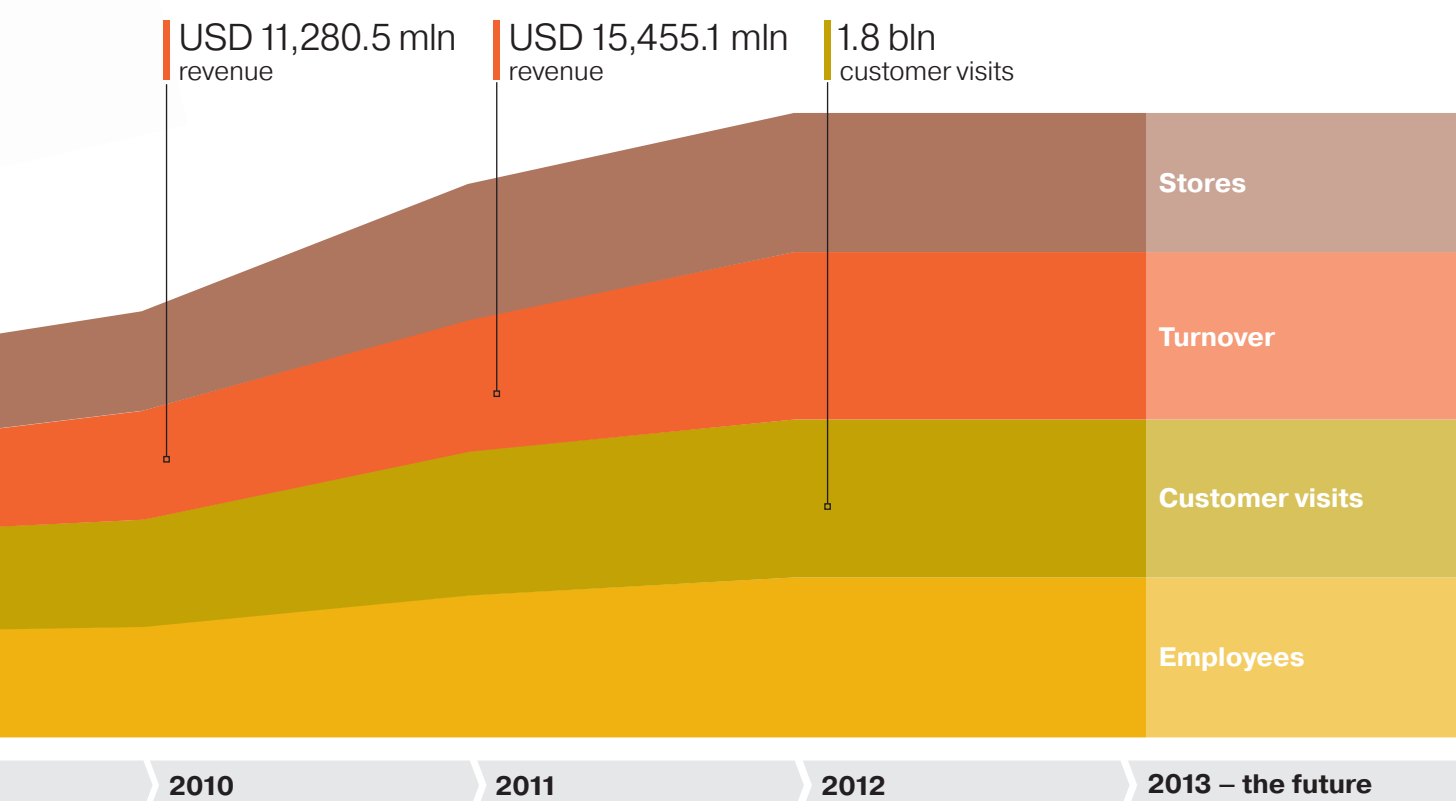
Well positioned for organic growth

Having focused strongly on building scale, presence and diversity over the last six years, we are now well positioned to use these competitive strengths to drive forward a sustained period of organic-led growth.

Store base breakdown by region¹



1. Regions with less than 250 stores **50%**
 2. Regions with 250-500 stores **25%**
 3. Regions with over 500 stores **25%**
- ¹ Excluding Ukraine



Consolidating our business for sustainable growth

➤ X5 acquires Kopeyka discounter chain

- X5 opens 3,000th store
- Over 1.6 bln customer visits
- 577 stores added organically
- Successful completion of SAP IT platform
- X5 gains full control of convenience stores

- Transformation to multi-format organizational structure
- Roll-out into 'Other' regions (presence in 47 Russian provinces)
- Launch of E5.RU internet store
- Focus on corporate values

- Invest in improving in-store experience
- Continue to strengthen local representation in our product range
- Increase direct import activities
- Expand the private label share in our product range
- Focus further on employee motivation and training
- Enhance brand recognition

Continuing our transformation



While there is much hard work ahead of us, we are confident that our strategy and leadership will deliver the value that our customers and stakeholders expect.

Hervé Defforey
Chairman

4

Independent directors

The Russian retail market offers significant opportunities for growth, supported by a strong macroeconomic environment and market development trends. X5's Supervisory Board (the 'Board') remains convinced that a decentralized, multi-format and customer-focused retail structure is the most effective means of capitalizing on the opportunities that exist in this expanding retail market.

The fact that X5 did not deliver on initial sales targets for 2012 was primarily due to an inability to respond effectively to the operational inefficiencies which arose from the Company's rapid M&A-based growth in recent years. This has not undermined X5's mid-term strategy, but we have made changes at senior management level as we continue to develop the team necessary to complete the Company's transformation and execute our strategy going forward.

In spite of the operational challenges that the Company faced during the year, it was important that we continued to take advantage of opportunities to increase selling space through organic expansion in other regions as well as strengthening X5's presence in its core regions. We will continue to push sustainable growth as a key element of our mid-term strategy and it is important to note that recently opened stores have been the main drivers of X5's sales growth.

In terms of changes at the Executive Board level, in July Andrei Gusev resigned as CEO after leading the successful decentralization and restructuring of the Company into a true multi-format retailer. Andrei also oversaw the fast-track integration of the Kopeyka acquisition and one of the largest roll-outs of SAP in the global retail industry. We would like to thank Andrei for his contribution to the transformation of X5.

The Board has nominated Stephan DuCharme to replace Andrei as X5's next CEO. Stephan has been with the Company for more than four years as a member of the Supervisory Board, and assumed control of the transformation process at X5 immediately after Andrei's departure. The Board recognizes and highly values Stephan's team-building and management abilities, which will be critical to the success of the next phase of the Company's transformation and to the development of a corporate culture and management team that can sustain future growth.

As part of the development of the new team, the Board has also nominated Sergey Piven, the Company's Deputy Commercial Director, to replace Kieran Balfe as CFO. The Board appreciates the work Kieran has done to develop X5's financial and operations reporting systems, which have provided the necessary transparency to better understand our operations.

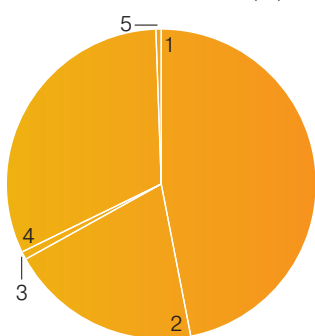
Sergey has been with X5 for over two years and has gained a unique perspective on the Company's retail operations from his position as Finance Director and Deputy Director of the Commercial Department. He will be working closely with Stephan and the divisional heads to make the necessary operational and financial decisions to put the Company back on track for growth.

At X5 we are committed to upholding the principles of good corporate governance and accountability throughout the business. This is not just for compliance purposes, but because we recognize that good stewardship of the business reduces risk and adds value.

I would like to thank all our employees for their loyalty, commitment and perseverance during a challenging year. While there is much hard work ahead of us we are determined to achieve the results that we know we are capable of, and are confident that our strategy and leadership will deliver the value that our customers and shareholders expect.

Hervé Defforey
Chairman

Shareholder structure (%)



1. Alfa Group **47.86%**
2. Founders of Pyaterochka **19.85%**
3. X5 Directors **0.13%**
4. Free float **32.05%**
5. Treasury shares **0.11%**

Our priorities

- Decentralized, multi-format and customer-focused retail structure
- Strengthening the team
- Improving communication and accountability
- Sustainable organic growth
- Upholding the principles of good corporate governance throughout the business

Putting our customers at the heart of our business



We are constantly striving to improve our procedures, systems and offering to provide the best possible customer experience within our multi-format structure and generate maximum returns for our shareholders.

Stephan DuCharme
CEO

Dear shareholders

As X5's nominated Chief Executive, I am honored to have the opportunity to lead the Company in this next phase of its development and excited to be able to share some of my thoughts about this last year and where I see us going from here.

In reviewing our results for 2012 I speak for myself as well as the Company's employees when I say that we are not satisfied with our results – we know that we are capable of far better for our customers and shareholders.

While in RUR terms total net sales increased by 8.1%, we started the year with higher expectations. However during the course of 2012 it became clear that the management team was not able to react effectively to the operational difficulties resulting from the Company's recent M&A-based growth and structural reorganization.

Before accepting the challenge of becoming the next Chief Executive I moved from my position as a Supervisory Board member to assume oversight of X5 in July 2012. In this role, my main priority was to ensure stability during the transition to a new CEO as well as to focus the senior management team on working together to deliver stronger results.

I have consequently had the opportunity to gain a better understanding of X5 not only from the perspective of the senior management team but also through visits to many of our stores and conversations with employees and customers.

This experience revealed a fragmented Executive Board that was having problems communicating both with one another and with operational management. This translated into a lack of effective execution at strategic as well as day-to-day store levels, and necessitated changes in the composition of the Executive Board.

The change in leadership at the hypermarket format has resulted in better motivated personnel and increased productivity. We have also seen improved results from refurbished stores and improvements in the product range, and this is reflected in the results for the fourth quarter.

The team remains focused on expanding the product range, with an emphasis on fresh and non-food categories, and we will continue to invest in improving the

existing store base and to expand where appropriate to offer customers the most efficient hypermarket experience.

There is still much work to do at the hypermarket format, but with the addition of several key senior managers and improved communication we are confident that we have the right team in place to execute our strategy.

In order to inject new impetus into our supermarkets' results, the new General Director has made the availability of fresh produce and improved service a priority, while at the same time increasing accountability and employee motivation. These initiatives have resulted in a year-on-year increase in net RUR retail sales of 8.4% and a 2.5% increase like-for-like sales in the fourth quarter.

Our strategy is focused on maintaining our leading position in the supermarket segment. We will continue to concentrate on improving results by increasing the quality of prepared, ready-to-eat products and maintaining our focus on providing high-quality fresh produce and customer service. Our expansion strategy will continue to balance the capital requirements of the existing store base with the prospects for new store openings.

We were encouraged by the solid results of our convenience stores in 2012 and the performance of the format's dynamic management team, which increased net RUR retail sales year-on-year by 63.0% on the back of like-for-like growth of 10.2% and a 110.6% increase in net selling space. We plan to take advantage of the format's unique value proposition and expansion opportunities to continue delivering sustainable growth.

Pyaterochka, our soft discounter brand, is the largest of X5's formats with over 3,200 stores by the end of 2012, accounting for approximately 65% of our total net sales for the year.

Due to the format's size and scale, identifying problems and effecting change throughout the network of stores will take time. Some of the issues we have identified are regional in nature and include a lack of investment in store refurbishment in our core regions, shelf availability in others and an overall lack of communication, accountability and execution.

The format's management rolled out a number of tactical initiatives during the fourth quarter to address these

problems, and by the end of the first quarter we will have defined and started implementation of priorities aimed at improving the positioning and performance of the format.

Along with the CFO and our Director of Strategy and Business Development, I am working closely with the Pyaterochka senior management team to ensure that we take the right steps to turn the format around in 2013.

I am pleased with the way in which X5's current senior management team is coming together both as a collegial body and with the other managers and employees in their respective divisions. While I believe this team is capable of accomplishing the goals we have set for 2013 it remains possible that there will be further changes. We are all accountable to the Supervisory Board and shareholders, and are answerable to them for delivering results.

We will continue to grow in 2013. The capital investment plan driving growth will be comprised primarily of investments in new store openings and store refurbishments. These investments will enable us to deliver growth in both net selling space and sales, as well as improved like-for-like results across all our formats.

2012 was all about continuing the transformation X5 embarked on in 2011, and 2013 will be the year that we aim to substantially complete this process.

On behalf of the Executive Board, I would like to sincerely thank our shareholders and bondholders for their continuing support. I would also like to take this opportunity to thank our customers for their continued loyalty and our employees for their dedication and commitment to the Company.

Looking to 2013 and beyond, we are well positioned with our unique asset base and multi-format structure to take advantage of the growth prospects in the Russian retail market. We remain committed to sustainable growth, the principles and practices of corporate governance of both the Dutch and UK financial regulators, and to creating lasting stakeholder value.

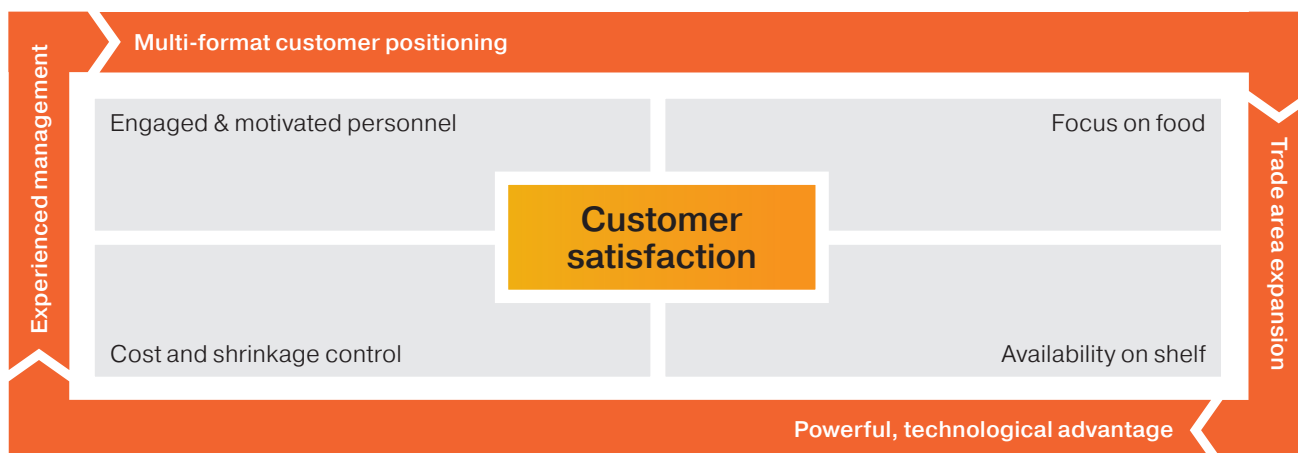
Stephan DuCharme
CEO

Strategy for sustainable growth

A clear strategy for generating growing value from strong, customer-focused brands

Our strategy is to leverage our multi-format retail structure, scale and human capital to take advantage of the opportunities in the Russian retail market. We seek to expand our operations and capture greater wallet share by providing customers with the products and quality they demand.





Objectives

Maintaining market leadership through popular, differentiated brands and motivated employees

2012 results

- › Store additions across all formats; launch of E5.RU online retail channel
- › Improved employee appraisal and review system and motivation scheme
- › New format advertising campaigns
- › Industry recognition: Pyaterochka soft discounter chain received the Golden Brand Award for Franchiser of the Year 2012

2013 plans

- › Increase investments to improve instore experience
- › Selective, intelligent expansion
- › Continue with employee appraisal and motivation reviews and improvements
- › Support brand recognition through advertising and promotional events

Organic expansion in core and developing regions while supporting local producers and economies

- › 800 stores or 242.5 thd sqm added; increase of 14.0% in total selling space
- › Approximately 50% of total selling space added came from 'Other' regions¹
- › Established and strengthened relations with local producers in new and existing regions of operation
- › Continued our support for local charities, humanitarian organizations and corporate volunteerism
- › Expansion of stores and regions participating in the E5.RU project

- › Focus on responsible, organic growth
- › Continue to strengthen the local representation in our product range
- › Continue our ongoing relationships with charities and other non-profit organizations

Increasing store traffic by improving value proposition to customers while maintaining cost discipline to grow margins

- › Improved customer service and feedback channels in our formats
- › Improved product range across our formats
- › Completed negotiations with suppliers based on customer-driven assortment
- › Launched direct import of select categories
- › Improved and enhanced our private label offering
- › Optimization of supply chain
- › Selling, general and administrative expenses (SG&A) as a percentage of sales was unchanged year-on-year despite decline in sales densities
- › Introduced voice-picking and pallet-weighing technologies

- › Ramp up direct import activities, especially in fruit and vegetables
- › Continue to expand the private label share in our product range
- › Continue with supply chain optimization
- › Invest to improve customer experience

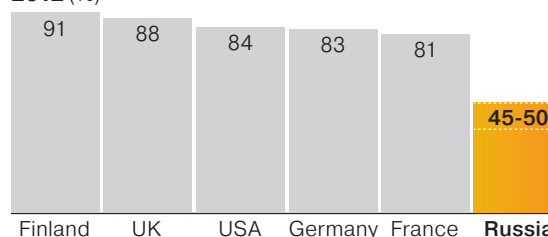
¹ In order to manage our priority activities efficiently we divide our store base into three geographical zones: Central, North-West and 'Other' regions.

The Russian retail market

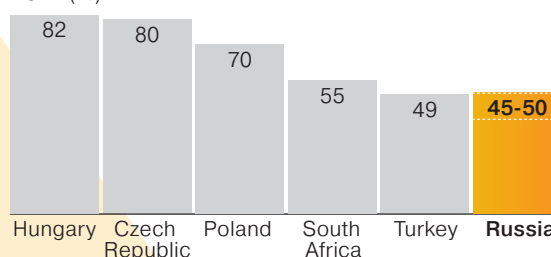
A robust and dynamic market

Russian retail market highlights

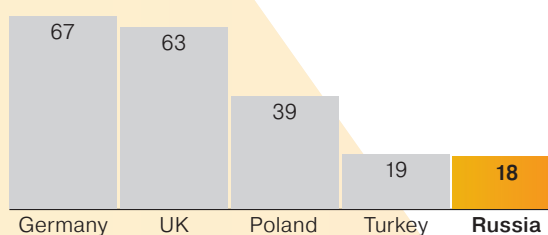
Modern retail penetration in developed markets 2012 (%)



Modern retail penetration in emerging markets 2012 (%)



Market share of top five largest players 2012 (%)



Russia's leading food retailers

	Company name	Net retail sales 2012, USD mln ¹	% in top 10	% in total market ²
1	X5 Retail Group	15,762	25.3%	5.6%
2	Magnit	14,240	22.8%	5.1%
3	Auchan	8,383	13.4%	3.0%
4	Metro	6,185	9.9%	2.2%
5	Dixy	4,729	7.6%	1.7%
6	O'key	3,728	6.0%	1.3%
7	Lenta	3,254	5.2%	1.2%
8	SPAR	2,750	4.4%	1.0%
9	Seventh Continent	2,006	3.2%	0.7%
10	Monetka	1,346	2.2%	0.5%
	Total	62,382	100.0%	22.3%

Source: Companies' press releases for public companies, X5 estimates for private companies; X5 estimates are based on RUR forecasts translated to USD at the rate 31.093 RUR/USD.

¹ Magnit sales exclude cosmetics stores' sales.

² Market share data according to Rosstat.

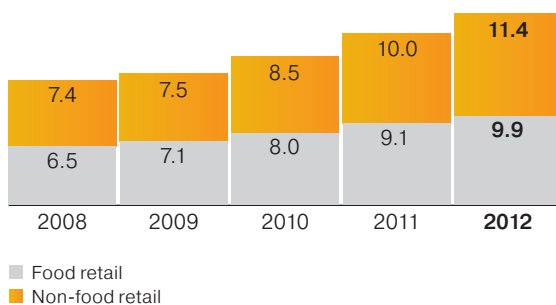
The Russian food retail market is one of the world's most attractive markets to invest in:

- 5th largest food retail market in Europe
- Modern retail penetration of 45-50%; well below average of CEEMEA and developed markets
- The top five players account for only about 18% of the market compared to, for example, 39% in Poland and 63% in UK.

Source: Euromonitor, X5 estimates.

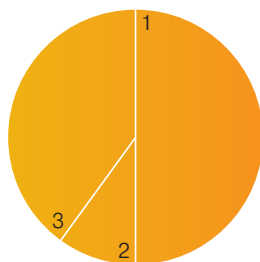
Russian retail market

Russian retail market (RUR tln)



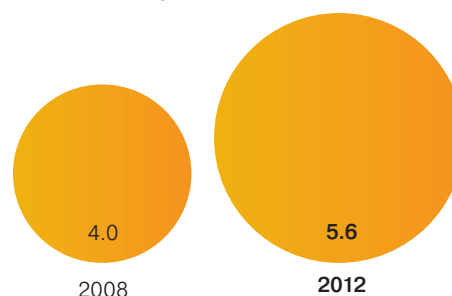
Russian retail market structure 2012 (%)

1. Modern retail **45-50%**
2. Open markets **11%**
3. Other **39-44%**



Russian trade market dynamics

X5's market share growth 2008-2012 (%)



› The retail trade sector is one of the key contributors to the Russian economy in terms of GDP, employment and investments.

Food retail market vs top 10 retailers RUR growth (%)



Note: X5 2008 growth is based on pro-forma net retail sales, including Karusel results from 1 January 2007 and 2008. 2009 and 2010 growth is based on consolidated results that include December Paterson and Kopeyka sales in 2009 and 2010 respectively.

Strength in depth

X5 is the number one food retailer, in terms of sales, in Russia, one of the most exciting consumer markets in the world. We operate five formats that provide specific offerings for the range of customers and budgets. In 2011, X5 embarked on a multi-year transformation strategy to position the business for long-term market leadership and financial success.



+9.4%

Increase in customer visits in 2012



X5 Retail Group N.V. ('X5' or the 'Company') is Russia's largest retailer in terms of sales, which increased by 8.1% in Russian Rouble terms to RUR 491.1 billion (USD 15.8 billion) in 2012, compared to 2011. This was mainly due to a 9.5% increase in 2012 sales from new stores, which was offset by a 1.4% decrease in like-for-like sales.

The Company operates the following retail formats, primarily in the Russian Federation: a soft discounter chain under the Pyaterochka brand, a supermarket chain under the Perekrestok brand, a hypermarket chain under the Karusel brand, an online retail channel under E5.RU brand and convenience stores under the Perekrestok Express and Kopeyka brands.

X5 was established on 18 May 2006, as the result of the merger between the Pyaterochka and Perekrestok retail chains. In June 2008, X5 acquired Karusel, which enabled the Company to substantially strengthen its position in the hypermarket category and become a true multi-format retail chain. X5 continued to consolidate the Russian retail market by completing two milestone transactions in 2009 and 2010 with the acquisition of the Paterson supermarket and Kopeyka discounter retail chains, respectively.

In 2011, the Company was reorganized to decentralize its retail operations and provide more autonomy for the formats. As part of this reorganization the formats now have responsibility for the following functions: profit and loss, human resources, product range and pricing. In 2013, the development function is also being cascaded down to format level.

X5's multi-format organizational structure provides the Company with a unique opportunity to capitalize on the growing food retail market in Russia. In 2012, this market grew by 9.0%,¹ and the penetration of modern retail formats in the Russian retail food market currently still stands at just 45-50%,² well below that of Central and Eastern Europe.

Our unique formats enable us to offer customers the products they want at the most attractive prices. Each format's value proposition is distinctive, which provides customers with multiple opportunities to purchase quality products in convenient locations, and allows X5 to capture a greater share of the consumer's wallet.

X5 is a true national retailer and as at 31 December 2012 had 3,802 Company-operated stores, 800 of which were added during the year. This increased net selling space by 243 thousand square meters to 1,970 thousand square meters. We have the leading market position in Moscow and St. Petersburg and a significant presence in European Russia.³ The Company's store base includes 3,220 soft discounter stores, 370 supermarkets, 78 hypermarkets and 134 Perekrestok Express and Kopeyka convenience stores. X5 also operates 422 direct franchisee stores across Russia.

The Company's growth in 2012 was primarily the result of organic expansion, which resulted in a 14.0% increase in total net selling space at the end of the year. X5's total capital expenditures for 2012 amounted to RUR 28 billion (USD 902 million) of which a majority went to increasing and improving the store base while the remainder was divided more or less equally between logistics, IT and strategic projects.

In order to support the Company's national scale and rapid expansion, X5 has developed a robust supply chain to source and deliver products to the stores. As the largest retail chain in Russia in terms of sales, X5 is one of the major buyers for many domestic and international food producers. This scale and wide geographic presence enables the Company to negotiate favorable terms from suppliers so that the consumer pays less in our stores.

To ensure that products are efficiently transported to our shelves, X5 has developed a logistics infrastructure comprised of 29 distribution centers, or 535 thousand square meters, which utilize modern technologies to provide timely delivery of products to store shelves. In 2012, the Company maintained a centralization level of approximately 75%, in line with 2011.

X5's employees are the Company's most valuable resource. In parallel with the Company's rapid growth X5 has also invested in improving the quality of its workforce at both management and store levels. During 2012, there have been a number of changes to the Executive Board as well as at store management level, to improve communication and execution.

X5 offers its employees at all levels a competitive social benefits package, as well as continuous, comprehensive training and professional development opportunities.

¹ Rosstat, the Russian Federal State Statistics Service.

² Euromonitor.

³ That portion of Russia west of and including the Ural region.

Russia's leading brand in the soft discounter market

Pyaterochka Soft discounters



3,000th

Pyaterochka opened in 2012



Pyaterochka, X5 Retail Group's soft discounter brand, is the leading national soft discounter chain in Russia and one of the first modern grocery retail chains to open in the Russian market. The brand was launched in St. Petersburg in February 1999 and as of 31 December 2012 the chain included 3,220 stores located in European Russia.

Pyaterochka stores are focused on convenient locations, the lowest prices, a unique private label offering and attractive promotional events for customers. The stores offer a range of approximately 3,500 active stock-keeping units and target an average net selling space of approximately 350 square meters.

In 2012, Pyaterochka stores reported net retail sales of RUR 317,751.3 million (USD 10,219.4 million) representing a year-on-year increase of 12.3% in Russian Rouble terms, and accounted for 64.8% of X5's total 2012 net retail sales. The increase was primarily due to the performance of new stores opened in the last two years. In 2012, Pyaterochka stores in the Central and North-West regions generated 53.1% and 22.3% of soft discounter sales, respectively, while the share of the 'Other' regions amounted to 24.6%.

We added 695 Pyaterochka stores or 195 thousand square meters of net selling space in 2012, including 239 stores in the Central region, 72 stores in the North-West region and 384 stores in the remaining 'Other' regions. In 2012, we also remodeled 49 Pyaterochka stores, primarily in the Central and North-West regions, targeting the mature stores in the format's core regions. We plan to continue our store roll-out in our current regions of presence and increase the number of mature stores undergoing capital remodels as well as implementing cosmetic changes to improve lighting, layout and overall store appearance.

During 2012, we rolled out several new initiatives to improve customer satisfaction and the overall shopping experience. Our 'red button' program was designed to reduce the wait at check-out lines by allowing the cashier to call for additional help if the line increased to five or more customers. We also improved communication with customers through new leaflets and advertising campaigns to increase awareness of the stores' promotional offers. We are also expanding the number of regional supervisors to improve communication between the format's operations directors and the store directors to ensure better discipline and accountability.

In the fourth quarter of 2012 we launched three priority initiatives:

1. To maintain 100% availability level for the format's 500 best-selling products from the standardized product range.
2. To focus on fresh by increasing the selling space allocated to fruit and vegetables by one square meter, on average, and improving the overall quality of fresh products.
3. To ensure that our stores offer an inviting and pleasant experience for the consumer.

To help manage these initiatives, we have divided the store base into three geographical zones, Central, North-West and 'Other' regions. These have separate Operations Directors to enable more effective management of the large store base and provide a closer working relationship with the regional supervisors.

Key figures

65%

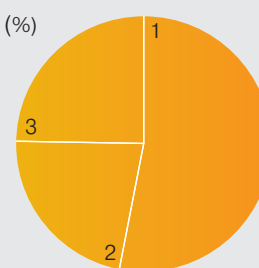
Share of soft
discounters in Group
net retail sales

3,500

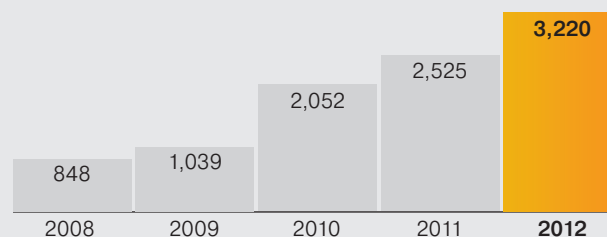
Stock-keeping units
available

2012 net retail sales breakdown (%)

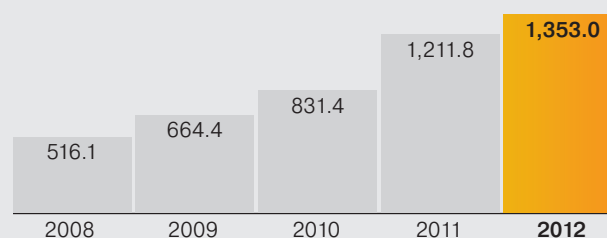
1. Central region **53.1%**
2. North-West region **22.3%**
3. Other regions **24.6%**



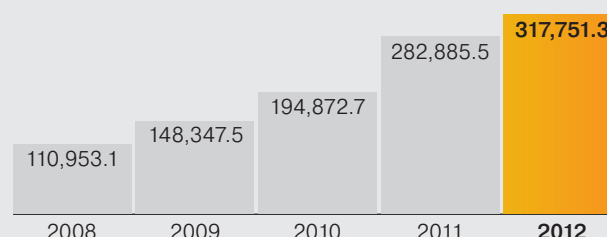
Store expansion (number of stores)



Customer visits (mln)



Net retail sales dynamics (RUR mln)



Overview

Business review

Governance

Financial statements

The country's most popular supermarket chain

Perekrestok Supermarkets



1st

**Green Perekrestok
premium supermarket
opened in St. Petersburg**

Perekrestok, X5 Retail Group's supermarket brand, is the leading national supermarket chain in Russia and one of the first modern supermarkets to open in the Russian market. The brand was launched in Moscow in September 1995 and as of 31 December 2012 the chain included 358 supermarkets located in European Russia and 12 supermarkets in Ukraine.

Perekrestok supermarket stores emphasize quality, service and a wide selection of fresh goods at fair prices supported by original promotional and advertising campaigns. The stores offer a range of approximately 11,000 stock-keeping units and target an average net selling space of approximately 1,000 square meters.

In April 2008, Perekrestok launched the Green Perekrestok brand, which is a premium version of the original supermarket brand and offers an extended range of high-quality products at the best prices in the premium supermarket segment. As of 31 December 2012, the Perekrestok chain operated 14 Green Perekrestok supermarkets, of which 12 are located in Moscow and the Moscow region and one store each in the Russian cities of Rostov-on-Don and St. Petersburg. The financial and operational results of both original Perekrestok and Green Perekrestok supermarkets are reported together.

Perekrestok stores reported net retail sales of RUR 105,472.1 million (USD 3,392.1 million) in 2012 representing a year-on-year increase of 5.7%, in Russian Rouble terms, and accounting for 21.5% of X5's total 2012 net retail sales. The increase was primarily due to the performance of stores opened in the last two years. In 2012, Perekrestok stores in Central and North-West regions generated 69.0% and 10.2% of supermarket sales respectively. The share of the 'Other' regions amounted to 20.8%.

In 2012, the chain added 40 stores or 36 thousand square meters, including 18 stores in the Central region, one store in the North-West region and 21 stores in 'Other' regions. We also remodeled 15 supermarkets during the year in Central and 'Other' regions. We plan to continue investing to expand the network and to carry out full and partial store remodels, to improve the customer experience.

During 2012, Perekrestok stores implemented a number of initiatives to improve service and quality in the stores. These included the 'red button' program that the cashier can use to summon additional personnel to open check-out registers if lines reach five or more customers. We also improved customer feedback channels by establishing terminals in the stores for customers' suggestions and our 'Siren' hotline that customers can use to communicate directly with store managers. Another initiative involves store directors allocating time on a weekly basis to be present in the trade area to talk with customers directly and better understand their needs. We also optimized the format's product range to focus on fresh and prepared foods, two of the most important categories for our customers.

We plan to continue these efforts, with support from attractive and consistent marketing campaigns and format positioning. To help manage this process and improve communication and accountability, we are strengthening our operational management team and creating supermarket clusters to enable better supervision and accountability.

Key figures

22%

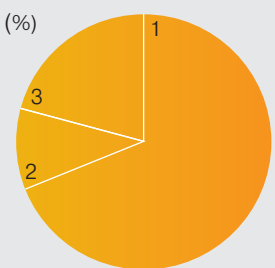
Share of supermarkets
in Group net retail sales

11,000

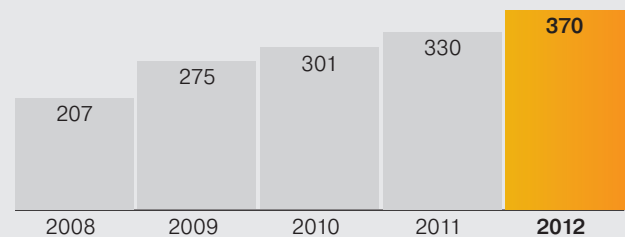
Stock-keeping units
available

2012 net retail sales breakdown (%)

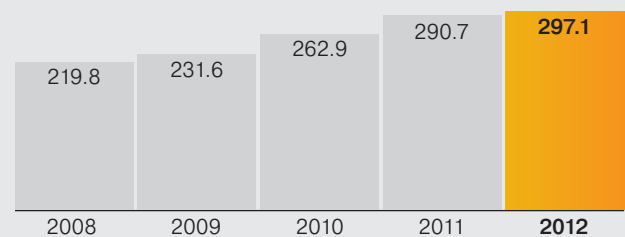
1. Central region **69.0%**
2. North-West region **10.2%**
3. Other regions **20.8%**



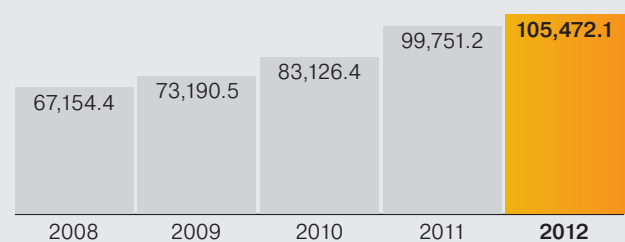
Store expansion (number of stores)



Customer visits (mln)



Net retail sales dynamics (RUR mln)



Economical one-stop shopping

Karusel Hypermarkets



22,000

Stock-keeping units on average



Karusel is X5 Retail Group's national hypermarket brand and one of the largest hypermarket chains currently operating in the Russian market.

X5 had been developing hypermarkets under the Perekrestok brand until the acquisition of Karusel in 2008, significantly strengthening the Company's position in this segment. As of 31 December 2012, the chain included 78 hypermarkets located in European Russia. In 2011, as part of the Company's reorganization into a true multi-format retailer, we separated hypermarkets from supermarkets and established a stand-alone hypermarket format.

Karusel hypermarkets offer customers economical one-stop shopping at city locations with a wide range of quality food and non-food products, efficient service at cash registers and engaging weekly catalogues. The stores carry on average 22,000 stock-keeping units comprising groceries, pre-prepared ready-to-eat meals, baked goods and an extended range of non-food items and basic consumer products. The stores target an average net selling space of approximately 5,000 square meters.

Karusel stores reported net retail sales of RUR 61,484.9 million (USD 1,977.5 million) in 2012 representing a year-on-year decrease of 7.7% in Russian Rouble terms, and accounting for 12.5% of X5's total 2012 net retail sales. Hypermarkets in the Central region accounted for 31.6% of the format's total net retail sales, while the North-West and 'Other' regions accounted for 26.7% and 41.7% respectively.

In 2012, we added one net hypermarket. During the year we opened two hypermarkets in the Central region and one in 'Other' regions where we also closed two stores that did not meet the format's efficiency or size criteria. Additionally, we expanded the food range, with a particular focus on fresh produce, and our non-food stock continues to transition to higher quality, well-known brands.

We also improved feedback channels by providing customers direct, online access to regional directors, which accelerated the response time to customer requests. Flexible employee scheduling was also introduced to increase the number of cashiers in peak hours and reduce check-out lines.

Further plans to strengthen Karusel's value proposition include the roll-out of a new loyalty card program, improved product availability on the shelves and continued investment in store upgrades and remodeling. We are also targeting a number of stores for further capital remodels, primarily in the Central and North-West regions where our store base is the oldest.

Key figures

13%

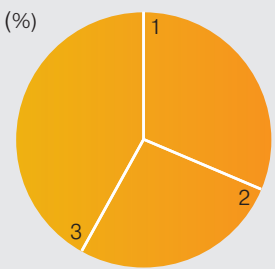
Share of hypermarkets in Group net retail sales

22,000

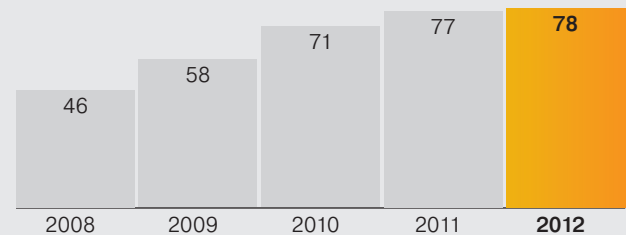
Stock-keeping units available

2012 net retail sales breakdown (%)

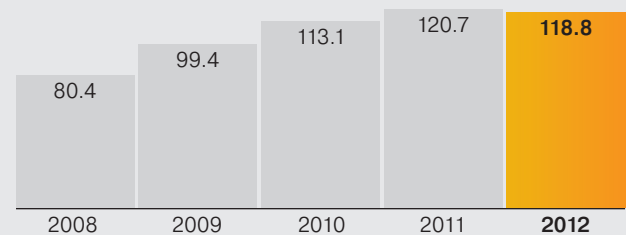
1. Central region **31.6%**
2. North-West region **26.7%**
3. Other regions **41.7%**



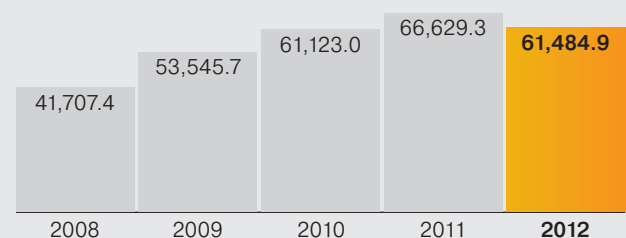
Store expansion (number of stores)



Customer visits (mln)



Net retail sales dynamics (RUR mln)



Note: In 2008 net retail sales include Karusel on a pro-forma basis.

Our fastest-growing format

Perekrestok Express and Kopeyka Convenience stores



63%

Growth in net retail sales of convenience stores



Convenience stores are operated by X5 under the Perekrestok Express and Kopeyka brands. The format was introduced in 2007 as a part of a joint venture between the Company and local retail entrepreneurs. X5 gained operational control in 2010 and, as of 31 December 2012, the chain included 134 stores located in Moscow and the Moscow region with 64 stores opened during the year.

Our convenience stores offer convenient shopping for people in a hurry. The Perekrestok Express brand offers ready-to-eat meals, which account for up to 50% of the stores' product range, in high-traffic zones – near subways, airports and train stations – while the Kopeyka brand offers convenient shopping in residential areas with a focus on fresh produce. The stores target an average net selling space of approximately 150 square meters and approximately 2,000 stock-keeping units.

In 2012, convenience stores reported net retail sales of RUR 4,877.8 million (USD 156.9 million) representing a year-on-year increase of 63.0%, in Russian Rouble terms, and accounting for 1.0% of X5's total 2012 net retail sales. The increase was primarily due to the continued performance of stores opened over the last several years as well as new stores added in 2012.

Convenience stores target the profitable and less competitive market niche of small, close-to-customer stores with a focus on ready-to-eat food and fresh produce. The format is being developed in Moscow and its suburbs, the wealthiest segment of the Russian food retail market. We plan to continue our expansion of this format, primarily in the Central region.

E5.RU

E5.RU is the Group's online retail channel that aims to support the Company's traditional non-food sales channels and benefit from the potential opportunities of the growing Russian internet space. The E5.RU project was launched in early 2012 as an online retail store offering more than 1,500,000 non-food products and the convenience and flexibility of choosing the time, location and method of receiving online purchases.

In 2012, E5.RU reported net retail sales of RUR 502.1 million (USD 16.1 million) representing a year-on-year increase of 123.7%, in Russian Rouble terms, and accounted for 0.1% of X5's total 2012 net retail sales.

As of 31 December 2012, E5.RU has established point-of-sale locations in the following X5 stores: 786 Pyaterochka soft discount stores, 260 Perekrestok supermarkets and 37 Karusel hypermarkets in addition to seven E5.RU customer service centers.

E5.RU purchases were delivered to customers via stores and courier delivery in nine Russian provinces, including Moscow and the Moscow region, St. Petersburg and the Leningrad region, Ekaterinburg, Kazan, Nizhniy Novgorod and the Nizhniy Novgorod province, Samara, Rostov-on-Don and the Rostov province. Courier delivery is available in other provinces.

Key figures

1%

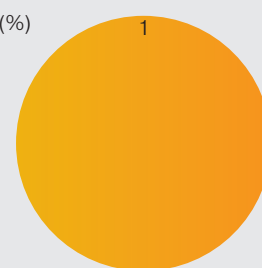
Share of convenience stores in Group net retail sales

2,000

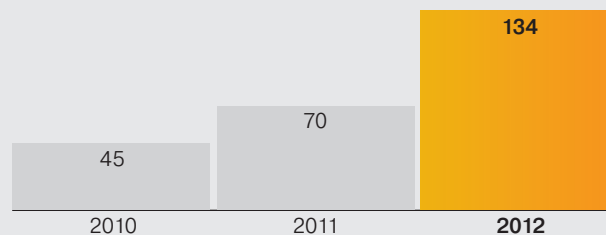
Stock-keeping units available

2012 net retail sales breakdown (%)

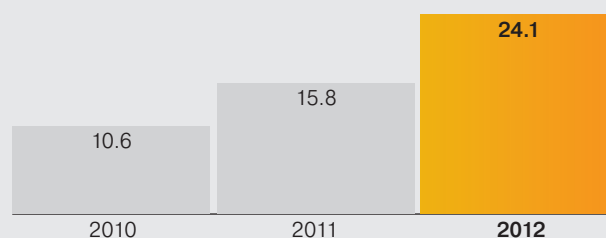
1. Central region 100%



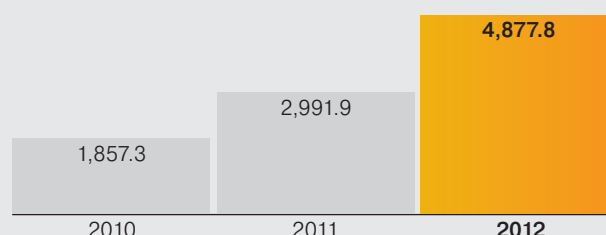
Store expansion (number of stores)



Customer visits (mln)



Net retail sales dynamics (RUR mln)



Supply chain: commercial activities and logistics

Commercial activities

X5's commercial department has established relations with approximately 5,000 domestic and international fast-moving consumer goods (FMCG) companies and continues to enhance and develop these relations in line with the Company's growing business scale. As the number one retail chain in Russia in terms of sales, X5 is the largest buyer for many domestic and international food producers, while the Company's wide geographical presence provides suppliers with increased penetration of the Russian market.

In 2012, X5 initiated annual supplier negotiations based on a customer-oriented product range that includes products from both leading international food producers and local producers as well. The product range matrix of within the Company's formats is supplemented by local items varying from region to region and based on consumer preferences.

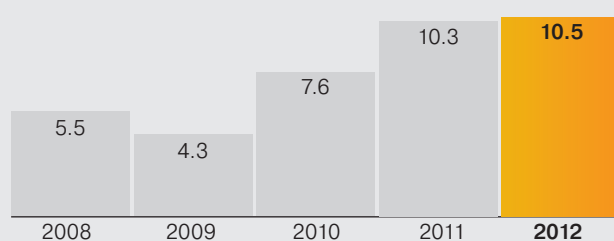
X5 sourced products from approximately 5,000 suppliers from Russia and abroad during the year, with the top 10 suppliers' products accounting for approximately 12% of the Company's net sales. The approximate breakdown of X5's product range structure is as follows: 70% – nationally sourced products, 15% – local and 15% – private label and first price goods.

Throughout 2012, X5 has been working to bring the Company's product range further in line with our customers' needs and wants. This has involved a comprehensive analysis of the product range matrix across each of X5's core brands: Pyaterochka, Perekrestok and Karusel. We conducted numerous customer surveys and complex analyses of sales across all categories to determine what our customers want to see on the shelves of our stores. That was accompanied by product range standardization aiming to reduce the number of products in the matrix and the associated management costs. While this first important milestone of our product range rationalization has been completed, we still see significant potential to refine the product range through further standardization via category reviews with the individual formats.

In August 2012, X5 introduced cutting-edge technology to support the exchange of electronic sales invoices with suppliers, through the launch of a pilot project that connected select suppliers to this new network. Based on the success of this pilot project, X5 is expanding the number of connected suppliers to the network. Implementing the automated exchange of electronic sales invoices will simplify and speed up the invoicing process and is another step towards improving X5's working practices with suppliers.

Our commercial department continued to optimize supply channels during 2012 through the implementation of direct imports of certain categories, such as fruit and vegetables and non-food items. Besides enabling better purchasing terms, the direct imports will also provide for better control of the products' quality and availability on the shelves. We plan to significantly increase the Company's level of direct imports in 2013.

Share of private label in net retail sales (%)



Private label

X5's Perekrestok supermarket was a pioneer in the private label market among Russian food retailers, offering customers bottled water under its own brand in 2001. Over the past five years, X5 has been actively developing its private label program in order to offer Russian customers a wide range of high-quality low-priced products. We have succeeded in doubling the share of private label both on a corporate level and across the formats. In 2012, the share of private label in soft discounters, supermarkets and hypermarkets' net sales amounted to 12.6%, 6.8% and 5.6%, respectively, while the average aggregated share for X5 reached 10.5%.

X5's private label program is comprised of approximately 1,600 items and we are planning to increase market share by developing cross-format and cross-category brands in various price segments.

An integral part of our private label program is locating reliable manufacturers that can provide high volumes at the desired quality. We have established relations with Russian and foreign companies that supply private label products to our stores. More than 100 private label products are, for instance, dairy products under the Bio Plus, Dessert Plus and Bonte brands, which are produced in France, and a number of wines under various brands are produced in Italy, France and Spain.

X5 has a strict monitoring and quality control system within the entire private label product development and production chain. We conduct annual external audits of manufacturers and have established relations with testing centers to ensure the quality of private label goods. In 2012, we conducted audits of 163 private label producers and tested over 5,500 items.

We will continue to improve and enhance our private label offering and have plans for a number of new brands including, but not limited to, farm-fresh products, prepared foods and fresh salads.

Logistics

A well-developed logistics infrastructure is vital to maintain efficient retail operations and ensure sustainable growth. During 2012, X5 made substantial progress in upgrading its supply chain management system, enhancing the efficiency of its operations and strengthening the Company's competitive advantages.

At the end of 2012, X5 owned and/or leased 29 distribution centers (DCs) with 535 thousand square meters of floor space, which covered eight regions of the Company's operations. Five DCs are owned and operated by the Company, four are operated by third-party logistics providers and the rest are leased and operated by X5. Depending on the region, our DCs may have a specific profile – for example in the Central region where X5 has a significant presence, we run mostly mono-format DCs. In 'Other' regions our DCs are generally multi-format. We are currently evaluating the effectiveness of each form of DC operation to determine our optimal warehouse management structure.

In 2012, our transportation fleet was expanded by 564 vehicles and reached 1,956 trucks by year-end. We are currently in the process of determining the optimal balance between owned resources and third-party transportation services, to increase reliability of deliveries and optimize the logistics cost structure.

X5 continues to make investments to develop an optimized distribution network by utilizing the most up-to-date technologies. Our DCs operate using a single Warehouse Management System (WMS) which enables efficient control over the movement and storage of goods within our warehouses and supports the optimization of processes and transactions involved in shipping, receiving and picking. By the end of 2012, the WMS in every DC had been complemented by voice-picking technology to improve order picking accuracy and productivity of warehouse personnel.

We are also implementing weighing technology to optimize the delivery-acceptance process between stores and DCs. The system works by checking the weight of the pallet of goods to be delivered to the store at the tailgate of the warehouse to ensure that it has been loaded correctly and corresponds to the store's order.

In 2012, X5 embarked on a multi-year project to roll out the JDA supply-chain management solution. JDA is a state-of-the-art demand planning and store replenishment system aimed at providing higher inventory turnover and product availability on store shelves. The overall goal of the JDA implementation is to create a smoother, streamlined demand and replenishment process that enables us to increase sales levels at X5 stores. JDA will be integrated with our existing WMS and SAP backbone to extract correct data on inventories at the DC level and communicate with our in-store software.



01 Inside one of our distribution centers.

02 Part of our 1,956-strong transport fleet.

Another important initiative introduced in 2012 was the implementation of a pilot program for the SAP ERP auto ordering system in the soft discounter format. The pilot program was successful in improving availability and decreasing inventories at participating stores, so we have begun a more widespread roll-out of the technology.

Over the past three years, X5 has substantially increased its supply centralization level. During 2012, supply centralization reached 75%, which was in line with 76% in 2011 and much improved compared to 70% for 2010. This provides important support for our store roll-out plan in the coming years.

Social, corporate and environmental responsibility

X5 and society

X5 is an active participant in the communities and economies where it operates and is committed to bettering the lives of its employees, customers and neighbors by contributing in a positive and responsible way.

Life Line Charitable Fund partnership

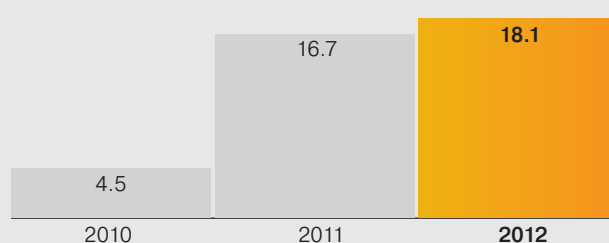
Our charitable activities are focused on a strategic partnership with the Life Line Charitable Fund (the 'Fund') to help children with severe health problems. X5 has worked with the Fund since 2006 and is represented on the Fund's Board of Trustees.

Currently, we support the Fund via the 'Crossroads of Life' and 'Karusel for Children' programs, which consolidate financial support from X5's customers. We have installed special collection boxes for cash donations at our Perekrestok and Karusel stores, which are directly transferred to the Life Line Fund. The aim of these programs is to attract customers' attention to an important social problem and to provide a convenient way for them to provide assistance.

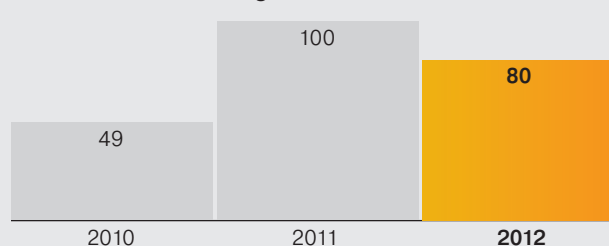
In addition to the ongoing activities mentioned above, X5 also organized a series of special events in 2012 in cooperation with the Life Line Fund:

- Charity Marathon 5275. The marathon, of which X5 was a corporate sponsor, took place in September at Moscow's Gorky Park and participants donated RUR 1,000 (USD 32.1) to enter the race. More than 200 X5 employees participated, making our corporate team the largest among those taking part in the event. In total the marathon raised RUR 2.9 million (USD 93.3 thd) for the Fund.
- 'Nobody's life is too small to change'. This charitable program established special stands at our Perekrestok and Karusel supermarkets and hypermarkets, respectively, on selected dates and in selected regions in June and October to collect spare change in any amount from the stores' customers. The aggregate amount collected totaled RUR 1 million (USD 32.2 thd), which was used by the Fund to finance specialized medical treatment for severely ill children. X5 intends to continue with the program in 2013.

Money raised for children surgeries (RUR mln)



Number of children surgeries



Red Cross aid program

In early 2012, our Karusel hypermarket chain signed a partnership agreement with the Russian Red Cross to donate more than 700 containers filled with clothes, personal hygiene items, household products, toys and other goods. The donated goods were distributed by the Red Cross to senior citizens, orphans and the disabled.

Supporting vulnerable segments of the population

As Russia's largest food retailer in terms of sales, X5 has the ability and considers it a responsibility to ensure that the more vulnerable sections of society have access to basic food products at affordable prices. In the past, we have consistently supported Russia's senior citizens by offering them discounts at our stores and we plan to continue this practice going forward.

In 2012, this support was extended both in terms of time and the discount size across our formats and regions. At our soft discounter format, senior citizens enjoy a 5% discount, on average, throughout the week from 9 a.m. to 1 p.m., with some regional and store format exceptions. In our supermarket and hypermarket formats, the 5% discount is available Monday to Friday from 8 a.m. to 1 p.m.

In addition to these discounts, we also support veterans of the Great Patriotic War (World War II) via additional promotional campaigns. In 2012, special campaigns were held in our supermarket and hypermarket stores on select days during the May holidays. On these days, all veterans received a 10% discount in supermarkets and a 9% discount in hypermarkets across Russia. We consider our store discount to be a modest, but sincere expression of our appreciation for our veterans.

Multi-child families

In 2011, X5's Perekrestok chain of supermarkets participated in the 'Product Basket' social program organized by Moscow City Council's department of social and youth policy. As part of the program, Perekrestok issued special bonus cards to families with three or more children, with an opening bonus points balance equivalent to RUR 500 (USD 16.1). The cards can be used to shop in Moscow Perekrestok supermarkets for any products at their discretion (with the exception of alcoholic beverages and cigarettes). In 2012, Perekrestok issued 85,000 cards that were distributed by the city council to eligible families.

Other 2012 activities

X5 is committed to helping and supporting the communities where we operate, especially in times of need. After the July 2012 flood in the Krasnodar region that took many lives and left thousands of people homeless, we arranged to supply basic food products and water to the city of Krymsk and adjacent areas of the region. Our central office and regional branches, as well as individual X5 employees, were also involved in collecting money and organizing supplies for the stricken areas. In total, X5 arranged three trucks with 40 tons of food supplies per truck and sent more than 4.5 tons of water.

Collection boxes were also installed in the Moscow central office and some other regional branches, including the South region where the tragedy took place, to allow employees to provide additional financial aid.

In 2012, X5 launched a special program to support animal shelters. During the year, select Moscow Perekrestok supermarkets began donating damaged products as well as scraps from the Company's in-store meat departments to local animal shelters. The products are put into containers in low-temperature freezers and after thorough inspection and approval by veterinarians, volunteers take them to the shelters.

Charity awards

X5 is proud of the recognition that its accomplishments and initiatives have received. In 2012, our charitable program 'Crossroads of Life' was among the winners in the 'Best Program Contributing to the Development of Volunteering in Russia' category and was also recognized as the best corporate employee program benefiting children with serious illnesses. X5 was also recognized with an award in the category 'Projects supporting disadvantaged social groups' of the national program 'Russia's Best Social Projects'.

01



02



01 Collecting money for the Life Line Charitable Fund.

02 Sponsorship for the Marathon 5275 charity.

Social, corporate and environmental responsibility continued

Human resources

X5 considers its employees as the Company's most valuable resource in running its current activities and delivering its future development plans. The Company's human resource (HR) management system is based on the principles of fairness, respect and equal opportunity and supports an open dialogue between management and employees. X5 also provides continuous, comprehensive training and professional development opportunities for the Company's employees at all levels.

X5 is one of the largest employers in the Russian labor market, with a workforce of 109,000 as of 31 December 2012. The majority of employees work in our retail operation divisions (78%) and logistics (15%), while 7% work in our central and regional offices and other divisions. The number of people working in our stores is even higher if outsource employees are taken into account. The average number of outsource employees for the retail operation division and logistics amounted to approximately 28% of their total personnel, as of 31 December 2012.

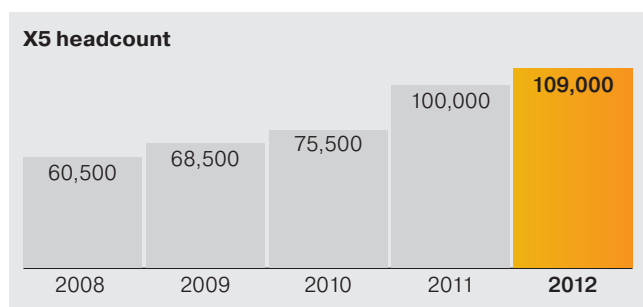
X5 employee benefits

In 2012, the Company offered the following social benefits for its employees:

- › medical insurance;
- › life insurance (for employees who frequently travel for work);
- › corporate rates for mobile telephones;
- › short-term disability payments;
- › additional payments to employees (financial support);
- › additional vacation days;
- › purchase discounts in our stores; and
- › transportation and corporate buses.

We provide our senior store and office employees with insurance programs immediately upon joining the Company. Those employees and their family members who do not qualify for insurance programs may buy insurance coverage at X5's corporate rates.

In November 2012, X5 took out life insurance policies on drivers from our logistics division. As a result, the number of insured employees increased by 5,300.



Employee annual review system

In 2012, X5 continued to develop its 'Compass X5' annual performance appraisal system. This is a critical tool for efficient HR management and performance measurement that:

- › facilitates employee feedback from team leaders on results and achievements, key strengths and areas for further professional development and growth;
- › supports managers in making decisions on promotions and personnel development and in establishing transparent links between employees' performance and remuneration; and
- › enables the Company to improve professional standards and increase business efficiency.

Following their annual performance appraisal each employee is assigned an individual score which is used as a basis for annual bonus calculations, making the process transparent and understandable. The performance appraisal results are also used for planning employee training and are taken into account in HR decisions with regard to career development and promotions.

The annual review conducted in 2012 covered all office employees, or more than 6,000 people, and a number of retail division employees.

Employee awards

X5 uses employee awards as a tool to motivate, recognize and reward employee contributions to the Company. Our inter-corporate award program selects up to 3,000 employees for various awards in our branch offices and retail and logistics operations.

In 2012, awards were given to approximately 1,700 employees of the soft discounter format, the largest business division of X5. More than 1,200 employees received medals and other awards and 500 employees received certificates of merit.

Internal communication

As a result of X5's transformation from a functional to a multi-format organizational structure, our internal communications were also reorganized to support each of our business divisions' needs: Corporate Center, logistics and soft discounter, supermarket and hypermarket formats.

X5 has weekly electronic digests and corporate newspapers for each of its formats, logistics personnel and Corporate Center employees. As an additional means of internal communication, we use press walls and corporate meetings. In May 2012, for the first time in the Company's history, we held a corporate conference for top and middle management to discuss the Company's strategy and recent developments. Senior managers and more than 300 corporate participants were joined by change management experts to help develop the Company's corporate culture.

To improve internal communication efficiency and the understanding of business processes, X5 implements a rotation system for office employees. As part of this program, office employees are assigned to work in the Company's stores to gain practical experience in X5's operations.

In the regional branches, we organize meetings to inform local managers on recent developments in strategy and policies, alongside team-building events and other corporate events to increase the level of interaction between the Company's divisions and branches.

Partners in education

The Company has established close links with top Russian universities and various technical schools, including: Moscow State University, the Plekhanov Russian University of Economics, the Russian University of Economy and Trade and various technical schools such as the Presidential Academy of National Economy and Public Administration, among others. These close ties allow us to project a positive image of X5 as a dynamic employer of young talented people, to participate in career fairs and to hire talented graduates for entry-level positions in stores and offices.

In 2012, approximately 30 students completed internship programs at our Corporate Center and the best performing candidates joined the Company as full-time employees.

X5 has cooperation agreements with more than 50 technical schools and institutions in the regions in which it operates. Students studying in retail operations and culinary programs are invited for internships year-round. In 2012:

- 114 students completed internships in Pyaterochka soft discounters, after which 53 of them received job offers and joined X5;
- 116 students completed internships in Perekrestok supermarkets, after which 21 of them received job offers and joined X5; and
- 59 students completed internships in Karusel hypermarkets, after which 5 of them received job offers and joined X5.

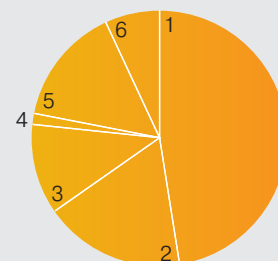
In the Central region, we created positions for 66 student internships – 46 in our stores and 20 in the regional office. We offer internship programs in many Russian regions; the most active participants are in Ekaterinburg, Perm, Tyumen, Magnitogorsk and Chelyabinsk. We plan to introduce internships for students in St. Petersburg early next year.

To hire employees for our developing logistics division, X5 has actively participated in career fairs, which were hosted in cities located in the Moscow region.

To facilitate the recruitment of store personnel (shop assistants, cashiers and laborers) in 2013, we plan to introduce flexible and interchangeable positions. We expect this will attract students and other potential employees who prefer part-time jobs and thus alleviate the problem of personnel shortage during rush hours, holidays and weekends.

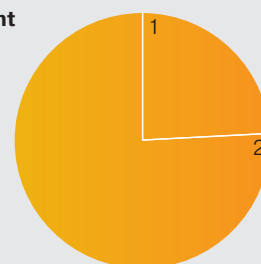
Distribution of personnel (%)

1. Soft discounters **47.5%**
2. Supermarkets **18.0%**
3. Hypermarkets **11.4%**
4. Convenience stores **1.2%**
5. Logistics **15.1%**
6. Office and other **6.8%**



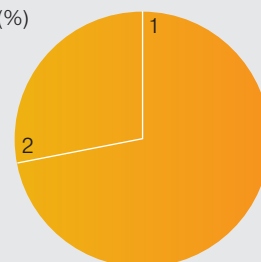
Gender structure of management (departmental director and above) (%)

1. Women **24.2%**
2. Men **75.8%**



Gender structure of labor force (%)

1. Women **72.0%**
2. Men **28.0%**



01 An employee training course in progress.

02 A member of the logistics and distribution network in action.

Social, corporate and environmental responsibility continued

Recruitment process

In 2012, we focused on strengthening our local HR divisions whose responsibilities are cascaded down from corporate HR in our central office. We succeeded in increasing the efficiency and standardization of their recruitment processes by customizing all procedures of the newly formed divisions to format specifics and granting more independence in the decision-making.

In line with general HR policy, the corporate HR function is responsible for developing, implementing and maintaining recruitment procedure standards within all store formats. The corporate HR function also provides advice and guidance on organizing corporate training for Company staff at all levels and supervises other HR activities.

The regional HR offices are responsible for recruiting store personnel and controlling advertising activities, as well as conducting marketing campaigns to attract new employees to stores and distribution centers and developing a candidate pool for positions that are difficult to fill.

In 2012, the corporate and format HR officers modified corporate assessment procedures and organized training seminars to help our recruiters adopt modern recruitment and assessment approaches and techniques in their work. Regional HR managers gained control over assessment and review activities. Corporate HR and the individual formats implemented standardized templates for media advertising to help us maintain our corporate brand identity.

Personnel training and development

X5 pays special attention to the training and professional development of managers and employees who work in our stores and distribution centers.

The talent of our top managers and the expertise of our in-store employees are fundamental to the Company's operating success, as well as the achievement of X5's strategic objectives. Educated and well-trained employees are best equipped to provide quality customer service and support sales growth in our stores.

As of 31 December 2012, X5 had 138 lecture halls used for training sessions, approximately half of which were located in the Central and North-West regions. As a result of last year's increased focus on logistics, we have opened 16 new education classrooms in distribution centers.

Key trends in training and development practices at X5 in 2012 were the standardization and optimization of curricula for different levels of employees, the development of in-store training programs with specific objectives for each store format and a focus on operational management training at all levels including distance learning.

Our training programs encompass all staff from senior managers to store personnel. In 2012, the number of employees using our training centers amounted to approximately 18,000 people or 84,000 person-days compared to 56,000 person-days in 2011.

We were very active with our mentoring program in hypermarkets, where we selected and trained 800 mentors using specially developed training programs for this format. Mentors are involved in training new employees, including store managers, as well as making decisions on operating issues related to training programs.

Last year, we launched our training software platform for distance learning and have developed numerous courses, including: 'Information Security' for all X5 employees and training courses for each of the formats on 'Cashier Desk Discipline', 'Client Dealing Based on Consumer Protection Law' and 'Fruit and Vegetables'. The total number of courses in the Company's training bank is 42.

More than 5,200 employees completed training courses last year.

In 2012, the Company implemented the 'Smart Retail' development program for strategic managers. The program is designed to strengthen the competitive advantages and leadership position of X5 as well as foster management team-building. The program targets the following areas of development: human resource management, retail trade and finance, and personal efficiency. In 2012, 45 strategic managers from the soft discounter, supermarket and hypermarket formats, logistics division, commercial division and development division took part in the program.

Attracting and developing talented employees

Our 'Talent Pool' program assists the Company in planning for the expected increase in demand for new employees. The program identifies potential candidates for management and administrative positions in retail operations and includes employee reviews and training programs for new positions.

In 2012, we enhanced the program for retail by refreshing review techniques and the selection process of employees for the reserve. All corporate and regional HR officers completed a course on refreshing their methodology and assessment procedures.

In 2012, the number of participants passing through our assessment centers exceeded 1,200 people. Of these 55% were added to the 'Talent Pool' and 48% of them secured positions, mostly in our stores.

In 2012, we launched a 'Talent Management' program to identify promising employees for promotion to management positions, to further develop the careers of our existing high-potential employees and to analyze certain HR risks. We organized 13 strategic sessions and selected 105 program participants. For each participant selected, an HR specialist, together with the participant's direct supervisor, worked out a development plan for the candidate.

All participants were divided into two groups based on their position within the Company:

- Talent League 1 included 27 participants and focused on individual development, coaching and exclusive programs (Skolkovo University and 'Smart Retail' educational programs);
- Talent League 2 included 78 participants and focused on key management qualities – leadership, strategic vision, personnel management and internal communication.

Between April and November 2012, 22% of program participants were promoted.

Women in our workforce

X5 is committed to supporting women in the workforce and offers equal support to female employees regardless of the position they hold within the Company. Approximately 70% of our employees are women, 24% of management positions (department heads or higher) are held by women – and two women were part of our Executive Board at the end of 2012. The Company provides additional financial support for women on maternity leave by maintaining salaries at their base levels, which is above the Russian statutory norms.

Health and safety

Overview

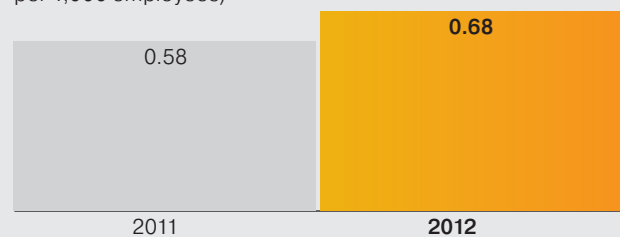
The health and safety of our employees is of primary importance to X5. The Company's industrial safety and labor protection activities are based on a health and safety policy that sets out the Company's approach, and underscores our commitment to effective management of health and safety issues related to our operations.

Our priority is to ensure workplace safety for all our employees and mitigate potential risk factors, in compliance with Russian legislation, through implementation of modern safety technologies and ongoing risk analysis and monitoring. In order to effectively manage and oversee compliance with the Company's health and safety policy we have established an Occupational Health and Safety (OHS) Department with the following functions and responsibilities:

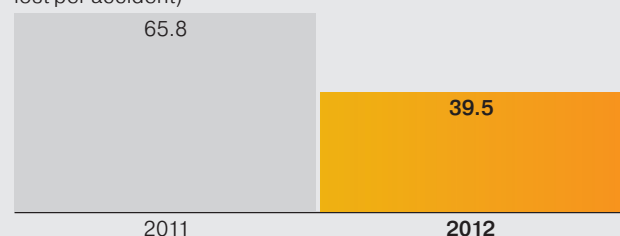
- development and implementation of a unified health and safety policy across all of the Company's divisions and formats;
- coordination of X5's health and safety specialists' activities;
- analysis of accident frequency rates and assessment of employee working conditions to provide recommendations for improvements in safety levels; and
- regular internal audits to identify possible violations of applicable Russian laws and inform relevant supervisors of the necessary steps to avoid violations.

Based on the Company's health and safety policy the OHS Department has developed a number of specific regulatory documents that cover all of X5's business operations and major professions from retail and logistics to office functions. All applicable documents are available on our internal website.

Accident frequency rate (number of accidents per 1,000 employees)



Severe accident rate (total number of employee work days lost per accident)



Social, corporate and environmental responsibility continued

X5 has implemented a centralized approach to managing health and safety activities. Every regional division has its own OHS service that is responsible for the stores located in that region, and reports directly to the OHS department in the Corporate Center.

The logistics division has its own health and safety department with specially trained employees that also reports to the OHS department in the Corporate Center. X5 pays particular attention to health and safety at the logistics division due to the higher level of hazardous working conditions there compared to the Company's other divisions.

Control and monitoring

In order to ensure the health and safety of our employees and improve OHS activities, X5 carries out regular monitoring and internal audits to confirm compliance with the health and safety policy and make recommendations for improvements.

In 2012, OHS specialists conducted internal audits of select stores in five regional divisions to assess compliance with Company standards and policies. In each regional division two stores were randomly selected from each format to audit for compliance with Russian regulations and internal policies. Recommendations were recorded in the inspection acts and relevant measures were taken to eradicate the identified violations. Over 60% of detected violations were fixed within 10 days and we developed specific schedules and deadlines to address those remaining.

Employee training

To ensure that our employees have the relevant qualifications and expertise we have developed special training programs both for OHS specialists and for all the Company's employees irrespective of their position or the hazard level of their work.

Our newly hired managers (store directors, distribution center directors, transportation unit directors, store department heads, security managers, etc.) are obliged to complete a safety education program in a specialized training center and then participate in a refresher course every three years. In 2012, the number of managers certified in OHS totaled 3,500 employees.

Store, distribution center and transportation division employees are briefed on the Company's labor protection policy at their workplaces upon joining the Company and every six months thereafter. In 2012, all our employees received either induction or ongoing training in health and safety.

Injury statistics

In spite of the measures we have taken to minimize risks and prevent accidents, it is difficult to completely avoid occupational injuries for a business of our scale. In 2012, there were a number of accidents that resulted in injuries of varying severity. The accident frequency rate that indicates the number of accidents per 1,000 employees slightly increased to 0.68, while the severity of the accidents measured in employee work days lost per accident significantly decreased to 39.5 days. We have analyzed the causes of all the accidents and all necessary steps are being taken to further reduce the risk of accidents and minimize their consequences.

Environmental safety

X5 is committed to conducting its operations in full compliance with Russian legislation and international standards for environmental protection and safety. The Company promotes the responsible use of natural resources, energy saving initiatives and the reduction of adverse environmental effects throughout its operations to increase operating efficiencies and reduce costs.

In 2011, as part of X5's decentralization, the responsibilities of our environmental safety department were also cascaded down to the Company's retail formats and the development and coordination of environmental documentation was transferred from external organizations to internal environmental safety department specialists.

Apart from the practical advantages of an individualized approach towards environmental policy for each format, this initiative has also yielded cost savings in 2012.

Waste reduction program

During 2012, the Company conducted full-scale inventories of all waste generated and found that the majority consisted of materials which can be recycled and/or resold.

Under this program, recyclable waste, as well as the legal ownership of the waste, is transferred to other companies for subsequent recycling. As a result, X5 does not have to pay statutory fees which are levied on companies for the negative environmental impact of transferring waste to landfills. In some cases we can even sell the recyclable waste for income.

In 2012, X5 adopted an internal policy stipulating that all stores must recycle packaging waste including cardboard, polyethylene and plastic boxes. As a result, the Company was able to reduce expenses for waste disposal due to the sale of cardboard and polyethylene and the reduction in statutory fees.

We have also initiated a vegetable oil recycling program, which utilizes leftover oil in grills and roasters as feedstock that can be processed into bio-fuel. Overall, thanks to separate sorting and collection of waste, the Company has managed to decrease the amount of waste sent to landfills.

Eco-bags and Eco-boxes

As part of the implementation of environmental initiatives to promote the responsible use of raw materials, we announced in April 2012 the introduction of Eco-bags into X5's product range. The Eco-bags are made from recycled paper, can carry up to three kilograms and do not pollute the environment. Our customers have the option to choose Eco-bags instead of plastic bags at a cost of RUR 10 (USD 0.32) and the organic bags can be recycled after usage.

In June 2012, we further announced the introduction of Eco-boxes into our product range. The Eco-boxes are made from spun-bond, a non-woven fabric material, which decomposes easily and conforms to the European Ecology Standard Directive 94/62EC. The new environmentally safe

boxes can be purchased at Perekrestok supermarkets in Moscow, as well as at Karusel hypermarkets in Moscow and St. Petersburg. The Eco-box can carry up to 31 liters and, due to its durability, one Eco-box can replace eight to ten plastic bags. After usage, it can be recycled without damaging the environment.

In 2012, X5 sold approximately 430,000 Eco-bags and Eco-boxes across the Company's supermarket and hypermarket network.

Environmental cooperation

In 2012, X5 partnered with the environmental organization Greenpeace, within the framework of special projects such as 'Green Weekend'. This event was organized to collect recyclable waste in various Russian cities. Volunteers collected trash from the cities' streets, offices and stores and sorted the recyclable waste for deposit in collection stations organized by Greenpeace at our Perekrestok and Karusel stores. As a result, approximately seven tons of recyclable waste was collected over the two and a half weeks of the project.

Our Perekrestok supermarkets also participated in the 'Give Up the Bags' environmental project, which was organized in partnership with Volkswagen and Tetra Pak. As part of the project mobile waste collection points comprised of Volkswagen commercial vehicles were established in Perekrestok supermarket parking lots to collect packaging used for products such as milk, juice and wine for further recycling.

In 2012, our environmental initiatives were recognized and in May X5 took first place in a ranking of the environmental friendliness of Russian supermarkets, which was published by Greenpeace. Russia's ten largest chains were evaluated against 20 different criteria developed by Greenpeace.

We realize that we are only at the beginning of developing an environmentally responsible business in line with global best practices. However, during the past year, we have made measurable progress and received valuable support from our employees, customers and the public. Inspired by this, we will continue to set ambitious goals for our environmental policies.

01



02



01 Mobile collection vehicle used in the Eco campaign.

02 A 'Bag for Life' part of our environmental investment program.

Product safety and production quality

Ensuring the safety and quality of X5's products

Among X5's core objectives is the quality and safety of the products on our stores' shelves. In order to ensure this, the Company has developed and introduced a set of rules that covers the entire food product chain – from production to end consumption – and at each stage, specific measures for regulation and control are taken.

To make certain that X5's products meet the health and safety standards that the retail industry and consumers demand, the Company employs the Hazard Analysis and Critical Control Points (HACCP) principles throughout the food production chain.

Each of the Company's store formats has its own dedicated quality control department comprising the following specialists: quality system managers, product engineers for merchandise groups, merchandisers and specialists for standardization and certification.

The quality control departments cover all stages of the production cycle from labor protection to customer safety. X5 has made food product safety for our customers a priority and in 2012 the Company invested RUR 34 million (USD 1.09 million) in this process. Laboratory studies are conducted on a regular basis at accredited testing facilities and federal health protection institutions, as well as at research and development facilities.

Each store format is responsible for training employees according to the Company's food safety and quality program, as well as for informing consumers on production quality and product ingredients. Consumers' expectations of receiving fresh, healthy and nutritious products with great taste and quality underpins X5's food safety and quality program. The safety of the Company's products is ensured through purchasing controls, modern packaging and processes and through the use of good manufacturing and hygiene practices.

Quality control at all stages of the production cycle:

Introducing goods to the product range

Before entering into a supply contract, the supplier provides samples of goods to the format's quality control department, where specialists confirm compliance with Company and industry regulations.

Acceptance at distribution centers

Each food product shipment undergoes compulsory quality control verification upon arrival at our distribution centers with a view to confirming compliance with organoleptic (taste, color, odor and feel) standards. Quality control for fruit, vegetables and exotic fruit is performed in accordance with Russian national standards, United Nations Economic Commission for Europe standards (UNECE) and the quality catalog of X5, as well as individual criteria for caliber/size/ ripeness level, etc. specified under the acceptance procedure.

Controlling quality in stores

At the beginning of 2008, X5 introduced the 'quality hour' throughout stores in all formats. Every morning, from 9 a.m. to 10 a.m., store employees sort fruit and vegetables and check for external defects on all goods on the shop floor.

Working with consumers

The Company's department for consumer rights protection thoroughly studies any complaint received through the numerous channels available to the consumer and, in certain cases, control purchases are performed for complaint verification. In the case of valid complaints, the item in question is returned to the supplier and if necessary measures for increasing quality control are undertaken.

2012 results

During 2012, X5's quality department audited 163 food product producers resulting in 10 producers being denied certification.

In the course of the year, 6,967 items were sent for analysis at independent accredited testing facilities and approximately 11%, or 762 items, did not meet the applicable requirements, compared to 14% or 979 items in 2011. The analysis was performed to confirm the organoleptic, physic-chemical and microbiological quality parameters of the product. In addition, a number of specific analyses were performed to identify intentional changes in composition, the replacement of main ingredients with cheaper alternatives, the addition of supplements and the use of elements such as artificial colorants, sweeteners and preserving agents.

In July 2012, X5's 'Green Perekrestok' supermarkets underwent certification audits in accordance with HACCP principles and the Codex Alimentarius Commission, (an organization founded jointly by the World Health Organization and the UN Food and Agriculture Organization to develop policy in the field of nutrition and food safety), to confirm that the supermarket's safety management system conforms to international standards. X5 plans to continue to enhance the safety assurance system at the 'Green Perekrestok' supermarkets by developing and introducing the Food Safety System Certification Standard 2200, which was approved by the retail trade organization Global Food Safety Initiative (GFSI). GFSI is an organization created by leading global retailers and producers for harmonizing standards in the area of food quality and safety.

In order to supply customers with food that is safe and appropriate for consumption, X5 provides clear information about the goods on our stores' shelves, such as their ingredients and nutritional value, as required by the applicable Russian regulations concerning food products. The Company has created an internal assessment system that monitors legislative and regulatory acts in order to identify any that require proactive steps by the Company to introduce

amendments or to ensure compliance. Employees of X5's quality department are current members of Technical Committees (TCs) under the governmental agency for technical regulation and metrology, which is under the jurisdiction of the Russian Ministry of Industry and Trade. The TCs include the following:

- TC 226 'Meat and meat products';
- TC 300 'Fish products – food, feed grade, technical and packaging';
- TC 178 'Fresh vegetables, vegetables and mushrooms, production of ethereal-oil medicine, nut-bearing cultures and flower-growing'; and
- TC 347 'Trade services and food service industry'

Since the beginning of 2012, X5's quality department has prepared 32 proposals for legislative acts as part of its cooperation with trade groups from the Association of Retailing Companies, the Union of Consumer Market Participants, the Russian Union of Industrialists and Entrepreneurs and the Russian Chamber of Commerce and Industry. The quality department has also participated in the development of industry-wide positions including suggestions for the development (amendment) of current legislation regarding technical regulations, veterinary controls and supervision, sanitary and phyto-sanitary measures, the protection of consumer rights and systems of accreditation and standardization.

Russia's entrance into the World Trade Organization (WTO) in 2012 also requires addressing a broad range of issues connected with harmonizing Russian legislation with international rules, norms and standards. The quality department of X5 will actively participate in work aimed at preparing proposals for food standards, introducing practical suggestions to protect consumer health and promote conscientious food trade. Within the framework of the Codex Alimentarius Commission, committees are actively developing standards, which include various food requirements, and our quality department plans to actively participate in this work.

Financial review

Net sales in full year (FY) 2012 reported in US Dollars increased by 2.2%, which differs from the reported increase in Russian Rouble terms due to exchange rate differences between the Russian Rouble, X5's operational currency, and the US Dollar, the Company's presentation currency.

Income statement highlights¹

USD mln	FY 2012	FY 2011	% change, y-o-y
Net sales	15,795.2	15,455.1	2.2%
incl. retail	15,762.0	15,397.3	2.4%
Soft discounters	10,219.4	9,626.1	6.2%
Supermarkets	3,392.1	3,394.3	(0.1%)
Hypermarkets	1,977.5	2,267.3	(12.8%)
Convenience stores	156.9	101.8	54.1%
Online ²	16.1	7.8	107.2%
Gross profit	3,724.2	3,679.0	1.2%
Gross profit margin, %	23.6%	23.8%	
Operating profit	191.4	702.0	(72.7%)
Operating profit margin, %	1.2%	4.5%	
Net (loss)/profit	(126.5)	302.2	n/a
Net profit margin, %	n/a	2.0%	
EBITDA	1,123.8	1,130.2	(0.6%)
EBITDA margin, %	7.1%	7.3%	
Impairment of assets	(467.3)	–	n/a
Deferred tax income from impairment	91.3	–	n/a
Adjusted net profit	249.5	302.2	(17.4%)
Adjusted net profit margin, %	1.6%	2.0%	

¹ Please note that in this and other tables of the Annual Report, immaterial deviations in the calculation of % changes, subtotals and totals are explained by rounding.

² We disposed of the online retail brands, 'bolero.ru' and '003.ru' on 29 April 2011. In mid-February 2012, X5 launched E5.RU brand, the Company's revised online retail business model.

In FY 2012, X5's net sales in Russian Roubles terms increased year-on-year (y-o-y) by 8.1%. The increase was primarily driven by sales growth at soft discounters and to a lesser extent at supermarkets and convenience stores, resulting from organic store additions, the positive performance of maturing stores added over the past two years and ongoing promotional activities. These increases were partially offset by a decrease in net retail sales at hypermarkets.

In 2012, net RUR retail sales attributable to hypermarket operations decreased by 7.7% y-o-y primarily due to the closures of a 10,000 and 3,000 square meter hypermarket in July and December of 2012, respectively, the sell-off of a portion of the format's non-food range in the fourth quarter (Q4) of 2011 as well as other operational issues related to the ongoing transformation of the format's business model in 2012.

The gross margin in FY 2012 amounted to 23.6%, which was 20 basis points (bp) below the gross margin in FY 2011. The decline in 2012 was primarily due to inventory clean up at distribution centers throughout the year, which was partially offset by improved commercial terms from suppliers.

Selling, general and administrative (SG&A) expenses

USD mln	FY 2012	FY 2011	% change, y-o-y
Staff costs	(1,298.5)	(1,294.3)	0.3%
% of net sales	8.2%	8.4%	
Lease expenses	(598.5)	(565.4)	5.9%
% of net sales	3.8%	3.7%	
Other store costs	(264.4)	(211.7)	24.9%
% of net sales	1.7%	1.4%	
D&A, including	(932.4)	(428.3)	117.7%
% of net sales	5.9%	2.8%	
Impairment of assets	(467.3)	–	n/a
% of net sales	3.0%	–	
Utilities	(326.7)	(326.8)	0.0%
% of net sales	2.1%	2.1%	
Third party services	(126.4)	(110.7)	14.1%
% of net sales	0.8%	0.7%	
Other expenses	(160.1)	(234.1)	(31.6%)
% of net sales	1.0%	1.5%	
Total SG&A	(3,706.9)	(3,171.2)	16.9%
% of net sales	23.5%	20.5%	

In FY 2012, SG&A expenses, as a percentage of net sales, increased y-o-y by 3.0% to 23.5%. Excluding the impairment of assets effect, total SG&A costs as a percentage of net sales in FY 2012 amounted to 20.5% and were in line with the corresponding period in 2011.

Staff costs, as a percentage of net sales, decreased y-o-y by 16 bp in FY 2012 to 8.2% primarily due to the following: reclassification of security and maintenance staff expenses from staff costs to other store costs (39 bp), a y-o-y reduction in bonus accruals (20 bp) and a decrease in the social tax rate from 34% to 30%, effective from 1 January 2012 (20 bp). These decreases were partially offset by a y-o-y increase in our 2012 employee salaries and wages (24 bp) and out-staffing expense (10 bp) and a decrease in income recognized on the re-measurement of the Company's long-term incentive plans (29 bp) at 31 December 2012, compared to the corresponding period of 2011.

The Company's FY 2012 lease expenses, as a percentage of net sales, increased y-o-y by 13 bp to 3.8% primarily due to an increase in store openings and the greater percentage of leased space in our total real estate portfolio. As a percentage of X5's total real estate portfolio, leased space accounted for 54.4% at 31 December 2012 compared to 53.6% in the corresponding period of 2011.

In FY 2012, other store costs increased, as a percentage of net sales, by 30 bp y-o-y to 1.7% mainly due to the reclassification of security and maintenance staff expenses from staff costs to other store costs.

Third party services expense in FY 2012 increased, as a percentage of net sales, by 8 bp y-o-y due to an increase in advertising and marketing activity.

Other expenses decreased by 50 bp in FY 2012, as a percentage of net sales, primarily due to a decrease in bad debt provision in 2012 (17 bp), while the remainder related to other immaterial expense items.

As a result of the factors discussed above, EBITDA in FY 2012 totaled USD 1,124 million, or 7.1% of net sales.

Financial review continued

Impairment of assets

In Q4 2012, the Company recorded an impairment charge to property, plant and equipment, intangible assets, investment property and prepaid leases in the amount of USD 343 million, USD 78 million, USD 26 million and USD 20 million, respectively. The impairment test was carried out in accordance with IAS 36 'Impairment of assets' and comprises impairments to certain non-performing assets, equipment and the Kopeyka brand. The aggregate amount of the impairment charge is RUR 14,530 million or USD 467 million. The impairment charge is a non-cash item, which did not affect the Company's key credit metrics or covenants, bank credit arrangements and bonds.

Non-operating gains and losses

USD mln	FY 2012	FY 2011	% change, y-o-y
Operating profit	191.4	702.0	(72.7%)
Finance costs (net)	(325.9)	(297.7)	9.5%
Net FX result	(2.5)	0.8	n/a
Share of loss of associates	(0.1)	–	n/a
(Loss)/profit before tax	(137.0)	405.1	n/a
Income tax benefit/(expense)	10.5	(102.9)	n/a
Net (loss)/profit	(126.5)	302.2	n/a
Net profit margin, %	n/a	2.0%	

Net finance costs in FY 2012 increased by 9.5% y-o-y in USD terms, and 15.8% in RUR. The weighted average effective interest rate on X5's total debt for FY 2012 increased to 8.6% from 7.7% for FY 2011. The increase was primarily due to the conversion of the Company's USD-denominated debt into RUR by year-end 2011, and the generally higher interest rates charged on RUR-based borrowings.

In FY 2012, X5 recorded an income tax benefit in the amount of USD 11 million resulting from the Q4 2012 impairment charge. The Company's FY 2012 income tax expense, excluding the effect of the deferred tax income from impairment, was USD 80 million, which implies an effective tax rate of 24.5% for the year.

Consolidated cash flow

USD mln	FY 2012	FY 2011	% change, y-o-y
Net cash from operating activities	609.2	926.1	(34.2%)
Net cash from operating activities before changes in working capital	1,135.2	1,189.4	(4.6%)
Change in working capital	7.8	174.1	(95.5%)
Net interest and income tax paid	(533.8)	(437.4)	22.0%
Net cash used in investing activities	(796.3)	(893.9)	(10.9%)
Net cash generated from financing activities	187.6	111.1	68.9%
Effect of exchange rate changes on cash and cash equivalents	22.4	(29.0)	n/a
Net increase in cash and cash equivalents	22.9	114.2	(80.0%)

Net cash from operating activities in FY 2012 amounted to USD 609 million compared to USD 926 million in FY 2011. The decrease was primarily due to changes in working capital and increases in interest expense and taxes paid in FY 2012.

Working capital changes in 2012 were driven by an increase in trade payables, due to an increase in purchases related to the growth in sales and the seasonal buildup in inventory prior to the New Year holidays. The increase in purchases also resulted in a higher inventory balance at 31 December 2012 compared to the corresponding period in 2011, which was also affected by the sell-off of a portion of our assortment.

Net cash used in investing activities totaled USD 796 million in FY 2012, compared to USD 894 million for the corresponding period in 2011, and generally consisted of payments for property, plant and equipment.

Net cash generated from financing activities in FY 2012 totaled USD 188 million and was related to short-term credit facilities drawn to finance working capital requirements.

Liquidity update

USD mln	31 December 2012	% in total	31 December 2011	% in total
Total debt	4,027.3		3,610.0	
Short-term debt	1,680.9	41.7%	913.2	25.3%
Long-term debt	2,346.4	58.3%	2,696.9	74.7%
Net debt	3,619.4		3,225.0	
Denominated in USD	0.0	0.0%	(9.5)	(0.3%)
Denominated in RUR	3,619.4	100.0%	3,234.5	100.3%
FX, EoP	30.37		32.20	
Net debt/EBITDA (RUR)¹	3.15x²		3.13x ³	

¹ In Russian Rouble terms, as the Company's debt covenants are set in Russian Rouble terms in accordance with X5's loan facilities.

² Based on consolidated EBITDA of RUR 34,944 mln.

³ Based on consolidated EBITDA of RUR 33,215 mln.

At 31 December 2012, the Company's total debt amounted to USD 4,027 million (at RUR exchange rate of 30.37), of which 41.7% was short-term debt (USD 1,681 million) and 58.3% long-term debt (USD 2,346 million). At 31 December 2012, the Company had access to RUR 81,600 million (USD 2,687 million) in undrawn credit lines with major Russian and international banks.

Business review

Executive Board

01 Stephan DuCharme

Nominated Chief Executive Officer¹

Year of birth: 1964

Expertise: Stephan has served on X5's Supervisory Board since 2008. Previously he held positions with SUN Group, Alfa Group, European Bank for Reconstruction and Development (EBRD) and Salomon Brothers Inc. Stephan has served on the Boards of Directors of CSA Czech Airlines, Alfa Bank, SUN-Interbrew Ltd. and JSC SUEK.

Education: Stephan graduated with distinction from the University of California at Berkeley and received his MBA from INSEAD.

02 Kieran Balfe

Chief Financial Officer

Year of birth: 1969

Expertise: Kieran joined X5 in February 2011. He has almost two decades of management experience in the Russian market, most recently at Mars Inc. From 2001 to 2009, Kieran was Wrigley's Deputy General Manager and CFO for Emerging Markets. From 1996 to 2001, he held positions at Glencore, American Home Products and Japan Tobacco.

Education: Kieran graduated from University College Dublin with a Master's degree in Accounting. He qualified as a Chartered Accountant in 1993 and was awarded a Fellowship at the Institute of Chartered Accountants in Ireland in 2005.

03 Luc Koenot

Chief Information Officer

Year of birth: 1962

Expertise: Luc joined X5 in August 2012. Luc has over 30 years' experience in food retail and IT, mostly with Delhaize Group, an international multi-format food retailer where he held various management positions, including most recently Senior Vice President & CIO and Senior Vice President Supply Chain & Logistics, Delhaize Belgium.

Education: Luc graduated from the Institut Catholique des Hautes Etudes Commerciales in Brussels.

04 Anton Mironenkov

Mergers, Acquisitions and Business Development Director

Year of birth: 1976

Expertise: Anton joined X5 as a Deputy Director in September 2006. From 2005 to 2006, Anton managed various projects in Alfa Group including the merger of Pyaterochka and Perekrestok. Anton began his business career in 2000 as an auditor at PricewaterhouseCoopers, and subsequently spent four years as an investment banker at Troika Dialog before his transfer to the Vice President position at Troika Dialog Asset Management in 2005.

Education: Anton graduated with honors from Moscow State University in 1998 with a degree in Economics.

05 Paul Martins

Commercial Director

Year of birth: 1963

Expertise: Paul joined X5 in August 2011. He has more than 25 years of experience in multinational retail companies. He worked for Casino Group for 23 years, starting as a store manager and holding various positions including Commercial Director, Marketing Director and General Director of Géant hypermarkets (division of Casino Group in Poland). He headed the discount chain Leader Price in Poland for seven years (another division of Casino Group). In 2007, Paul joined Tesco Group as Operations Director for small formats in Poland.

Education: Paul studied at the University of Lyon, Economics Faculty.

06 Igor Sotnikov

Logistics Director

Year of birth: 1968

Expertise: Igor has extensive managerial experience with X5. In 2005, Igor was named Perekrestok Trade Director and in 2007 he was named Director of Logistics for Pyaterochka and later X5. In 2008, Igor served as CEO of X5 in Ukraine and was named General Director of the Supermarket Format in September 2011 and was appointed Logistics Director in August 2012.

¹ The Supervisory Board nominated Mr. DuCharme as member of the Management Board and CEO, to be appointed by the upcoming 2013 Annual General Meeting of Shareholders.



Education: Igor graduated from Bauman Moscow State Technical University in 1992. In 1997 he was awarded his second degree from Moscow State University, Mathematics Faculty.

07 Igor Pletnev
Director for Regional Branch Management and Organic Development

Year of birth: 1971

Expertise: Igor joined X5 in March 2011. Prior to his appointment as X5's Director for Regional Branch Management and Organic Development, Igor was Director for Regional Development in Kopeyka, a position he had held since April 2007. Before joining Kopeyka he held positions in various companies including Evolution Asset Management, Russian Land Asset Management, Evdakovsky Butter and Oil, the Agricultural Sector Development Fund and ZAO Industry Investment.

Education: Igor was accepted to Moscow State University and transferred to the Belarusian State Pedagogical University where he graduated in 1998.

08 Frank Michael Mros
General Director of Soft Discount Format
Year of birth: 1963

Expertise: Frank joined X5 in June 2012. He has over 18 years of retail industry experience in Europe with the leading German discounter chain Lidl. He began

his career at Lidl as a retail clerk and worked his way up through management positions in sales and logistics to the senior executive level. He served as a Managing Director of Lidl Germany, Lidl Poland and Lidl London, UK.

Education: Frank graduated from the German Naval Academy.

09 Svetlana Volikova
General Director of Hypermarket Format
Year of birth: 1972

Expertise: Svetlana joined X5 in 2007. Since then she has held various positions within X5's finance department. In July 2011 she was appointed as CFO of the hypermarket format and in August 2012 promoted to General Director of Hypermarket Format. From 1996 to 2007, she held positions at Auchan and Danone and was responsible for finance and operational control.

Education: Svetlana graduated from the Higher Institute of Management in Paris, France. She qualified as an ACCA accountant in 2009.

10 Valeriy Tarakanov
General Director of Supermarket Format
Year of birth: 1958

Expertise: Valeriy joined X5 in 2008. Since 1989, he had been engaged in entrepreneurial activities in Russia including the establishment of a

convenience store chain in Moscow. From 1995-1997 he was President of the Russian Association of Fruit Importers. Prior to that he held various positions at the USSR's Ministry of Foreign Trade. Valeriy has led X5's convenience store format since January 2008 and was appointed General Director of the Supermarket Format in August 2012.

Education: Valeriy graduated from Plekhanov Russian University of Economics and Academy of National Economy.

11 Tatiana Kozhevnikova
HR Director
Year of birth: 1967

Expertise: Tatiana joined X5 in May 2011. From 1993 to 2011, she held positions at Coca-Cola, Mars, Ernst & Young, Metro Cash&Carry and Rosatom.

Education: Tatiana graduated with honors from Moscow State University, Economics Faculty, where she also received a Ph.D. in Economics for her work on labor factors in economic development. In 2007, Tatiana completed the London Business School's Executive Program on Strategic Talent Management.



Corporate Governance report

As a public company established under the laws of the Netherlands, with global depositary receipts of shares listed on the London Stock Exchange, X5 Retail Group N.V. is subject to the Dutch Corporate Governance Code adopted in 2003 and amended in 2008 (the 'Code'). The full text of the Code can be viewed on X5's website.

In accordance with the Code, a broad outline of the corporate governance structure of the Company is presented in this section, including any deviations from the Code's principles and best practice provisions. The Company adheres to the principles and best practice provisions of the Code as far as may be reasonably expected, while complying with local legislation and applying market practices in the countries in which the Company operates.

The Management and Supervisory Boards

X5's management and supervision structure is organized as a two-tier system, comprising a Management Board and a Supervisory Board. Both the Management Board and the Supervisory Board are accountable to the General Meeting of Shareholders for the performance of their functions.

Duties of the Management Board

The Management Board is responsible for X5's overall management. 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, for financing and external communication. The Management Board is required to report related developments to, and discuss internal risk management and control systems with the Supervisory Board and its Audit Committee.

Composition of the Management Board

The Management Board consists of three members: the Chief Executive Officer, the Chief Financial Officer and the Company Secretary. In 2012 the composition of the Management Board changed: in July Mr. Gusev left his position as Chief Executive Officer of the Company.

Subject to the approval of the General Meeting of Shareholders he will be succeeded by Mr. DuCharme who was nominated by the Supervisory Board in January 2013, following a six-month period during which he assumed the CEO's responsibilities in a delegated capacity. Also in January 2013, the Supervisory Board nominated Mr. Piven as Chief Financial Officer, to succeed Mr. Balfe who steps down in March 2013.

Duties of the Supervisory Board

The Supervisory Board is responsible for advising and supervising the Management Board and overseeing the general course of affairs of X5 and its businesses. In performing its duties, the Supervisory Board takes into account the relevant interests of the Company's stakeholders, and, to that end, considers all appropriate interests associated with the Company. Major business decisions require the approval of the Supervisory Board. The Supervisory Board also supervises the structure and management of systems of internal controls as well as the financial reporting process. The Supervisory Board meets at least four times per year.

Composition of the Supervisory Board

The General Meeting of Shareholders determines the number of members of the Supervisory Board. The Supervisory Board currently consists of six members.

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 annually.

According to the Rules governing the Principles and Practices of the Supervisory Board, a person may be appointed to the Supervisory Board for a maximum of three terms of four years. The Supervisory Board has prepared a retirement and reappointment schedule to prevent, to the greatest extent possible, reappointments occurring simultaneously. Both the Supervisory Board profile and rotation plan can be viewed on the Company's website.

The table below shows the (nominated) members of X5's Management Board and their respective terms of appointment:

Name	Year of birth	Position	Year of initial appointment	End of current term of appointment
Stephan DuCharme	1964	Chief Executive Officer, Chairman of Management Board ¹	2013	2017
Sergey Piven	1974	Chief Financial Officer ²	2013	2017
Frank Lhoëst	1962	Company Secretary	2007	2015

¹ The Supervisory Board nominated Mr. DuCharme as member of the Management Board and CEO, to be appointed by the upcoming 2013 Annual General Meeting of Shareholders.

² The Supervisory Board nominated Mr. Piven as member of the Management Board and CFO, to be appointed by the upcoming 2013 Annual General Meeting of Shareholders.

The table below shows the current members of the Supervisory Board and their respective terms of appointment. The term of Mr. Fridman will expire in 2013; he is eligible for reappointment.

Name	Year of birth	Position	Year of initial appointment	End of current term of appointment
Hervé Defforey	1950	Chairman	2006	2014
Mikhail Fridman	1964	Member	2006	2013
David Gould	1969	Member	2006	2014
Alexander Tynkovan	1967	Member	2008	2016
Christian Couvreur	1950	Member	2010	2014
Dmitry Dorofeev	1977	Member	2012	2016

Committees of the Supervisory Board

While retaining overall responsibility, the Supervisory Board assigns certain tasks to its four permanent committees: the Audit Committee, the Nomination and Remuneration Committee, the Related Party Committee and the Strategy Committee. Each committee is composed of at least two members, at least one of whom must be independent within the meaning of the Dutch Corporate Governance Code. The members of each committee are appointed by and from the Supervisory Board. 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 governing the Principles and Practices of the Supervisory Board, which can be viewed on X5's website.

Audit Committee

The Audit Committee assists the Supervisory Board in fulfilling its supervision and monitoring responsibilities in respect of the integrity of X5's financial statements, system of internal business control and risk management, financing and finance-related strategies and tax planning. It furthermore advises in respect of the appointment of the external auditor by the General Meeting of Shareholders and the auditor's remuneration.

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 and the Management Board. At least annually the Nomination and Remuneration Committee evaluates the size and composition of the Supervisory Board and the Management Board, as well as the functioning of the individual members, and reports the results of such evaluations to the Supervisory Board.

Related Party Committee

The Related Party Committee advises the Supervisory Board on handling and deciding on reported (potential) conflicts of interests and any other related party transactions which 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.

Strategy Committee

The Strategy Committee advises on the general strategy of X5, including, but not limited to, the future direction to be taken by X5 as a whole and each of its affiliated businesses, overall growth and development strategy, mergers and acquisitions and financing strategy.

Composition of the Supervisory Board Committees

Name	Audit Committee	Nomination and Remuneration Committee	Related Party Committee	Strategy Committee
Hervé Defforey	Member	Member	Member	Member
Mikhail Fridman				
David Gould	Chairman			
Alexander Tynkovan		Member	Chairman	Member
Christian Couvreur				Chairman
Dmitry Dorofeev	Member	Chairman		Member

Diversity

Pursuant to new legislation in the Netherlands (the Management and Supervision Act, which took effect on 1 January 2013), at least 30% of the positions on the Management Board and the Supervisory Board are to be held by women. Currently, in terms of gender diversity, the composition of X5's Management and Supervisory Boards is not balanced in accordance with the Act. X5 aims for a diverse composition and embraces diversity, be it through culture, nationality, race, religion, gender or age. Whilst diversity is an important consideration for X5, it is not a decisive factor when finding the most suitable candidate for any of the Company's boards.

Appointment, suspension and dismissal

The General Meeting of Shareholders shall appoint the members of the Management and Supervisory Board from a binding nomination, to be drawn up by the Supervisory Board. The nomination by the Supervisory Board of the candidate is binding, and therefore the recommended candidate will be 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.

Supervisory Board members are appointed for a period of up to four years and may be re-elected twice. Members of the Management Board are also elected for a period of four years. The Articles of Association do not limit 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 on 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, as well as the remuneration of members of the Supervisory Board, is incorporated in the Remuneration Report on page 76, and is available on the website of the Company.

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 he may have with the Company and that may be of material significance to him 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, such member may not participate in the discussions and decision-making process on subjects or transactions relating to the conflict of interest. A decision of 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 him or the Company requires the approval of the Supervisory Board. The Related Party Committee advises the Supervisory Board on the 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 2012 is included in the Report of the Supervisory Board on page 72.

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, among other things to adopt the financial statements, to decide on any proposal concerning profit allocation and to 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 will be 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 request the Management Board and the Supervisory Board that a General Meeting of Shareholders be held, stating their proposed agenda in detail.

The powers of the General Meeting of Shareholders are defined in the Articles of Association. Apart from the decisions taken at the Annual General Meeting of Shareholders, the main powers of the shareholders are to appoint (subject to the Supervisory Board's right of making 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 issuance of shares, to authorise the Management Board to repurchase outstanding shares of 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 not later than the 42nd day prior to the day of the meeting. The mandatory record date, establishing which shareholders are entitled to attend and vote at the General Meeting of Shareholders, is fixed at the 28th day prior to the date of the meeting.

One or more shareholders or holders of GDRs representing at least 1% of X5's issued share capital or representing a value of EUR 50 million are entitled to request a matter to 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, 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, 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, on the right of non-residents of the Netherlands or foreign owners to hold or vote the shares, other than those also imposed on residents of the Netherlands. Resolutions of the General Meeting of Shareholders will be 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 and held no later than four weeks following the first meeting. At such second meeting, no quorum requirement will apply. However, the General Meeting of Shareholders can only resolve on a merger or demerger 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 and the Articles. 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 to 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 the 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: 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%.

The following table lists the shareholders on record on 28 February 2013 in the AFM's public register that hold an interest of 5% or more in the share capital of the Company:

Shareholder	Date of disclosure	Capital interest and voting rights ¹
CTF Holdings Ltd.	2 August 2007	47.86%
Axon Trust	22 December 2009	11.43%
The Baker Trust	11 December 2009	8.42%
Genesis Asset Managers, LLP	16 July 2012	5.23%

¹ In accordance with the filing requirements the percentages shown include both direct and indirect capital interests and voting rights. 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 Code of Conduct with regard to Insider trading, which contains rules of conduct to prevent trading in X5's Global Depositary Receipts of shares or other financial instruments when holding inside information. The Code of Conduct with regard to insider trading can be viewed on the Company's website.

The Code of Conduct includes a specific section on obligations of members of the Management Board to report to the Compliance Officer in case of changes in their holding of securities in any Dutch listed company, not being X5 securities, in accordance with the Dutch Corporate Governance Code.

Furthermore, under the Dutch Financial Markets Supervision Act, members of the Management Board and Supervisory Board shall notify the AFM of X5 securities and voting rights at their disposal. These positions can be viewed on the AFM's public register.

In addition, under the Disclosure and Transparency Rules in the United Kingdom, X5 must notify a Regulatory Information Service (RIS) of the occurrence of all transactions in X5 conducted – on their own account – and notified by members of the Management Board and Supervisory Board.

Repurchase by the Company of its own shares

The Company may acquire fully paid shares, or depositary receipts thereof, in its capital for a consideration only following authorization of 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-up capital plus any reserves required to be maintained by Dutch law or X5's Articles of Association; and
- X5 and its subsidiaries would not, as a result, hold shares or depositary receipts thereof with an aggregate nominal value exceeding half of the issued share capital.

In 2012 the Management Board has been authorized to acquire up to 10% of the shares or depositary receipts thereof. This authorization is valid through 14 December 2013. In addition, the Supervisory Board has 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 depositary receipts thereof, the Management Board requires the Supervisory Board's prior approval for such purchase.

Corporate Governance report continued

Authorization 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 depositary receipts 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 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 approved a delegation of this authority to the Supervisory Board, relating to the issuance and/or granting of rights to acquire up to 13,578,643 shares (20% of the issued share capital) through 14 December 2013.

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 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 14 December 2013.

Articles of Association

X5's Articles of Association contain rules on the organization and corporate governance of the Company. The current text of the Articles of Association is available at the Trade Register of the Chamber of Commerce and Industry for Amsterdam and on X5's website.

The amendment of the Articles of Association of the Company requires a resolution of the General Meeting of Shareholders. The proposal to amend the Articles including the text of the proposed amendment must be made available to holders of shares and GDR holders 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.

In 2012 the Company's Articles of Association were amended in order to, inter alia, bring them in accordance with certain provisions of the new Dutch Act on Management and Supervision which came into force in the Netherlands on 1 January 2013. The current text of the Articles of Association is available on X5's website.

Anti-takeover measures and change-of-control provisions

According to provision IV.3.11 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. X5 and X5 subsidiaries may have customary change of control arrangements included in agreements, such as credit facilities, ISDA-agreements and debt instruments. Following a change of control of X5 (as the result of a public bid or otherwise), such agreements may be amended or terminated, leading, for example, to an early repayment of amounts due under existing credit facilities.

Auditor

The General Meeting of Shareholders appoints the external auditor upon nomination of the Supervisory Board. Both the Audit Committee and the Management Board make a recommendation to the Supervisory Board with respect to the external auditor to be proposed for (re)appointment by the General Meeting of Shareholders. In addition, the Audit Committee evaluates and, where appropriate, recommends the replacement of the external auditor. The Audit Committee also pre-approves the fees for audit and permitted non-audit services to be performed by the external auditor as negotiated by the Management Board. The Audit Committee shall not approve the engagement of the external auditor to render non-audit services prohibited by applicable laws and regulations or that would compromise their independence.

At least every four years, the Management Board shall together with the Audit Committee thoroughly assess the functioning of the external auditor in the various entities and capacities in which the external auditor operates. The main conclusions of the assessment shall be notified to the General Meeting of Shareholders for the purpose of considering the nomination for the appointment of external auditor of the Company.

Compliance with Dutch Corporate Governance Code

X5 applies the relevant principles and best practices of the Code in the manner described in this Corporate Governance Report. X5's policy with respect to the implementation of the Code was last discussed with its shareholders at the 2010 Annual General Meeting of Shareholders. Since then, there have been no substantial changes in the corporate governance structure of the Company. Committed to a corporate governance structure that best serves the interests of all stakeholders, 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:

II.3.4, III.6.3 and III.6.4: Disclosure of transactions with related parties in the Annual Report

In accordance with the Code, transactions with members of the Management Board, Supervisory Board, or persons holding at least 10% of shares or depositary receipts thereof in which there are significant conflicting interests will be published in X5's Annual Report. However, in deviation from the Code, a detailed statement of the relevant conflict of interest is not published if (i) this conflicts with the law, (ii) the confidential, share-price sensitive or competition-sensitive nature of the transaction prevents publication or could damage X5's competitive position.

III.2.1: Independence of members of the Supervisory Board

Three out of six members of the Supervisory Board are related to companies that are owned or controlled by companies that ultimately hold 10% or more of the shares or GDRs in X5. These members of the Supervisory Board are, therefore, not considered to be independent within the meaning of the Code. Mr. Defforey, Mr. Tynkovan and Mr. Couvreur are independent within the meaning of the Code.

X5 believes that the non-independent members of the Supervisory Board have an in-depth knowledge of the geographic market, of business in general and of retail specifically in the markets in which X5 operates, which is of particular advantage to X5 and its stakeholders.

III.5: Committees of the Supervisory Board and deviation from the maximum of one non-independent member of the Audit Committee

In 2009, the Supervisory Board resolved to merge the Supervisory Board's Remuneration Committee and Selection and Appointment Committee to one 'Nomination and Remuneration Committee' and accordingly X5 currently deviates from the Code, which requires these two committees to be separate committees. However, in light of the respective duties, responsibilities and composition of each of the Remuneration Committee and the Selection and Appointment Committee, and for reasons of practicality, X5 believes that it was in X5's best interest to merge these Committees.

In addition, X5 acknowledges that Mr. Gould and Mr. Dorofeev are non-independent members of the Audit Committee within the meaning of the Code whereas, pursuant to the Code, the terms of reference of each committee of the Supervisory Board may provide that a maximum of one member of each committee may not be independent. Considering Mr. Gould's and Mr. Dorofeev's financial expertise, and for reasons of continuity, X5 believes that it is in X5's best interest that Mr. Gould's and Mr. Dorofeev's membership of the Audit Committee be continued.

III.7.1: No grant of shares and options to members of the Supervisory Board

As determined by the General Meeting of Shareholders, Mr. Defforey, Mr. Tynkovan, Mr. DuCharme and Mr. Couvreur participate in the Company's stock option plan and/or restricted stock unit plan. X5 acknowledges that the award of options or shares to members of the Supervisory Board under these plans 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 incentive plans. In addition, 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.

Supervisory and Management Boards

Supervisory Board

01 Hervé Defforey

**Chairman
Independent Director**

Mr. Defforey, a French citizen, was an operating partner in GRP Partners, Los Angeles until 2012. Prior to joining GRP in 2001, Mr. Defforey was CFO and Managing Director of Carrefour S.A., from 1993 to 2001, where he remained on the board until 2004. Previously, Mr. Defforey was Treasurer at BMW Group and General Manager of various BMW AG group subsidiaries, and also held senior positions at Chase Manhattan Bank, EBRO Agrícolas, S.A. and Nestlé S.A. Mr. Defforey graduated from the University of St. Gallen, Switzerland with a degree in Business Administration.

02 Stephan DuCharme

Nominated Chief Executive Officer¹

See biography on page 62.

03 Mikhail Fridman

Director

Mr. Fridman, a Russian citizen, serves as Chairman of the Supervisory Board of Alfa Group and is one of Alfa Group's

principal founders. He also serves as the Chairman of the Board of Directors of Alfa Finance Holdings S.A. and of TNK-BP and is a member of the Board of Directors of ABH Holdings S.A. (holding company for Alfa-Banking Group) and of VimpelCom. He is also a member of the International Advisory Board of the Council of Foreign Relations (USA). Mr. Fridman graduated from the Moscow Institute of Steel and Alloys.

04 David Gould

**Director
Chairman of the Audit Committee**

Mr. Gould, a U.S. citizen, has been serving as Deputy Director for Corporate Development, Finance and Control at Alfa Group Consortium since 2000. He also serves as a member of the Board of Directors of Alfa Finance Holdings S.A. and of ABH Holdings S.A. (holding company for Alfa-Banking Group). From 1992 to 2000, Mr. Gould held various positions at PricewaterhouseCoopers in Boston and in Moscow. He received his BA with honours from Colgate University in 1991 (concentration in Liberal Arts and minor concentration in Economics) and received his MBA-MS (Accounting) from Northeastern University in 1992.

He qualified as a Certified Public Accountant in 1993 and as a Chartered Financial Analyst in 1999.

05 Dmitry Dorofeev

**Director
Chairman of the Nomination
and Remuneration Committees**

Mr. Dorofeev, a Russian citizen, joined Alfa Group in May 2012 as Director of Group Portfolio Management and Control. His responsibilities include analysis and coordination of investment and strategic planning of Alfa Group's companies. Mr. Dorofeev also serves as a member at the Supervisory Board of Alfa Group. Prior to joining Alfa Group, Mr. Dorofeev worked in McKinsey & Company in Moscow from 2004. From 2000 to 2004, he also held various positions at Ernst & Young in St. Petersburg and in Moscow. Mr. Dorofeev received his Master of Science at the Baltic State Technical University 'Voenmeh' D. Ustinov, Faculty of International Industrial Management. He also graduated from the Bodø Graduate School of Business in Norway, Faculty of International Business. Mr. Dorofeev qualified as a Chartered Certified Accountant (ACCA) in 2004.

¹ The Supervisory Board nominated Mr. DuCharme as member of the Management Board and CEO, to be appointed by the upcoming 2013 Annual General Meeting of Shareholders.



06 Alexander Tynkovan
Independent Director
Chairman of the Related Party Committee

Mr. Tynkovan, a Russian citizen, is the founder and CEO of 'M.Video', a leading consumer electronics and home appliance retailer in the Russian Federation. Mr. Tynkovan graduated summa cum laude from the Moscow Energy Institute, majoring in Aircraft Electric Equipment.

07 Christian Couvreur
Independent Director
Chairman of the Strategy Committee

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

Management Board

08 Kieran Balfe
Chief Financial Officer

Mr. Balfe, an Irish citizen, joined X5 in February 2011. He has almost two decades of management experience in the Russian market, most recently at Mars Inc. From 2001 to 2009, he was Wrigley's Deputy General Manager and CFO for Emerging Markets. From 1996 to 2001, he held positions at Glencore, American Home Products and Japan Tobacco. Mr. Balfe graduated from University College Dublin with Master's degree in Accounting. He qualified as a Chartered Accountant in 1993 and was awarded a fellowship with the Institute of Chartered Accountants in Ireland in 2005.

09 Frank Lhoëst
Company Secretary

Mr. Lhoëst, a Dutch citizen, was appointed as Statutory Director and Company Secretary of X5 on 5 November 2007. Since 1991 Mr. Lhoëst has held several positions at Intertrust Group, from account manager in the Netherlands Antilles to founder and Director of the Intertrust office in Vienna, Austria. In 2002, Mr. Lhoëst established the Intellectual Property Group of Intertrust in the Netherlands. Mr. Lhoëst graduated from Leiden University with a degree in Law.



Report of the Supervisory Board

The Supervisory Board is charged with supervising the policies of the Management Board and the general affairs of the Company and the business connected with it, as well as assisting the Management Board by providing advice. In performing its duties the Supervisory Board is charged with acting in accordance with the interests of the Company and its affiliated businesses. It shall take into account the relevant interest of the Company's stakeholders and, to that end, consider all appropriate interests associated with the Company.

Composition and profile of the Supervisory Board

X5's General Meeting of Shareholders determines the number of members of the Supervisory Board. Currently X5's Supervisory Board consists of six members. The Supervisory Board reviews, on an annual basis, the profile of its size and composition, taking into account the evolving nature of X5's business and activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board's profile is published on X5's corporate website.

At the Annual General Meeting of Shareholders on 14 June 2012 Dmitry Dorofeev was appointed a new member of the Supervisory Board, succeeding Mr. Ashurkov who stepped down on the same date. Mr. DuCharme stepped down from the Supervisory Board on 11 January 2013, following his nomination to become CEO of the Company. In accordance with the retirement and reappointment schedule of the Supervisory Board, Mr. Fridman's term will expire in 2013. Mr. Fridman is eligible for reappointment.

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

Composition of the Committees

While retaining overall responsibility, the Supervisory Board assigns certain tasks to its four permanent committees: the Audit Committee, the Nomination and Remuneration Committee, the Related Party Committee and the Strategy Committee. When Mr. Dorofeev succeeded Mr. Ashurkov in June 2012, he took over his position as member of the Audit Committee, Nomination and Remuneration Committee and Strategy Committee. In July 2012 the Supervisory Board delegated Mr. DuCharme to assume the CEO's responsibilities on a temporary basis. In connection herewith, Mr. Dorofeev took over Mr. DuCharme's position as chairman of the Nomination and Remuneration Committee, while Mr. Defforey took over his position as member of the Related Party Committee. In January 2013, in connection with his nomination as CEO, Mr. DuCharme stepped down from the Supervisory Board and its committees altogether.

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

Induction

Induction and ongoing education are key elements of good governance. New members of the Board follow an induction program covering the strategic, financial, legal and reporting affairs of the Company and meetings with senior executives. On an ongoing basis, members of the Supervisory Board visit operating companies and other parts of the business, including stores and warehouses, to gain greater familiarity with senior management, and to develop deeper knowledge of local operations, opportunities and challenges.

Meetings of the Supervisory Board

In 2012 the Supervisory Board held five meetings in person and one meeting by conference call. Further resolutions in writing were taken when necessary during the year. On five occasions in 2012 the Supervisory Board meeting was preceded by meetings of the Audit Committee, the Nomination and Remuneration Committee, the Strategy Committee and, when necessary, the Related Party Committee. The meeting in April was followed by a half-day feedback session with the members of the Executive Board, dedicated to the Company's organizational structure, culture and talent development. The meeting in July was preceded by a two-day meeting fully dedicated to the Company's strategy.

All meetings were attended by the full Supervisory Board, apart from the meeting in February which was not attended by Mr. Fridman. The members of the Management Board attended the meetings, and other members of senior management were regularly invited to present to the Supervisory Board. In 2012 the Supervisory Board held regular private sessions with no members of the Management Board present, to independently discuss matters related to the performance, functioning and development of the Management Board and members of senior management. The external auditor attended the meeting in April at which the 2011 Annual Report and financial statements were recommended for adoption by the Annual General Meeting of Shareholders. In April the Supervisory Board conducted a self-assessment and appraised its functioning, profile, competence and composition, as well as its relationship with the Management Board. The assessment covered a number of essential topics related to Supervisory Board activity, including succession issues related to the management transition in 2011 and 2012, and areas of improvement as identified in previous years. This evaluation was conducted on the basis of a questionnaire and interviews with the Chairman of the Nomination and Remuneration Committee. The members of the Supervisory Board had frequent (telephone) meetings with members of the Management Board and other Company management in between the Supervisory Board meetings.

During 2012 the Supervisory Board reviewed various matters related to the Company's activities, operational results, strategies and management, but devoted considerable time to the following topics in particular:

- › the medium- to long-term strategy for the Company with emphasis on specific strategic growth opportunities for each of the formats;
- › the Company's organization structure, including the decentralization process initiated in 2011;
- › human resource issues connected to the decentralization and management transition process, leading to, inter alia, the nomination of Mr. DuCharme and Mr. Piven as, respectively, new CEO and CFO in January 2013; and
- › an in-depth review of challenges faced by the logistics and supply chain division.

Other topics included:

- › the financial reporting process and in particular the approval of the 2011 Annual Report and review of the 2012 half-yearly and quarterly financial statements and management accounts;
- › the reports by the internal and the external auditor;
- › the regular assessment of the members of the Management Board and the Executive Board, including talent management and succession planning;
- › the appointment and remuneration of senior managers of the Company;
- › the Remuneration Policy for members of the Management Board and Executive Board, in particular the new incentive plan for senior managers of the Company, to be launched in 2013;
- › detailed performance and strategy review of the various business divisions of the Company;
- › the financing and investment strategy;
- › development and expansion plan as part of the annual strategic planning cycle;
- › the progress of post-merger integration efforts and synergy effects throughout the various operational and staff divisions of the Company;
- › risk management; and
- › the review and approval of the annual budget.

Committees meetings

Audit Committee

The role of the Audit Committee is described in its charter which is available on the Company's website. On 31 December 2012 the Audit Committee consisted of Mr. Gould (Chairman), Mr. Defforey and Mr. Dorofeev. In 2012 the Audit Committee held five meetings in person. Additional meetings were held by conference call when necessary, for instance to review the publication of the quarterly financial reports and trading updates. As a rule, all meetings were attended by the CFO, the external auditor and the head of the corporate audit department (CAD). Other members of the Supervisory Board and senior management were invited when necessary or appropriate. The Audit Committee met once with the auditors without the presence of management.

Throughout 2012 discussions regularly focused on internal and external control procedures, risk management, the Company's financing structure, financial reporting and tax. Internal audit reports were provided during all Audit Committee meetings. In 2012 the Audit Committee devoted considerable time to supply chain and logistics, with a continued focus on progress in aged inventory and loss prevention plans.

The Audit Committee discussed further topics including:

- › the 2011 Annual Report and financial statements;
- › the external auditor's report with respect to accounting and audit issues in respect of their audit of the 2011 consolidated financial statements;
- › quarterly interim reports;
- › audit fees, appointment and independence of the external auditor;
- › working capital management;
- › compliance with bank financial covenants;
- › management reporting;
- › investment planning and analysis;
- › investor relations strategy and initiatives;
- › financial reporting calendar and the black-out trading calendar for the year 2013;
- › updates on the functioning of IT systems;
- › integrity and compliance, with emphasis on implementation of the Company's revised Code of Business Conduct and Ethics; and
- › review and approval of the CAD's internal audit plan and budget for 2013.

Report of the Supervisory Board continued

Throughout the year the Audit Committee reviewed the Company's risk management and internal control systems, and the proper functioning of operational and business processes through the work of the CAD, the external auditor and directly with management. The CAD assessed processes in a number of departments in terms of their effectiveness and efficiency, their compliance with laws and regulations, their safety and proper reflection in Company reporting systems, and developed recommendations to Company management on enhancing controls and decreasing the inherent risks. Significant audit and forensic investigation findings of the CAD were reported to the Audit Committee on a regular basis. Status of follow-up actions by management in addressing CAD findings were regularly reviewed by the Audit Committee.

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 2012 the Nomination and Remuneration Committee consisted of Mr. Dorofeev (Chairman), Mr. Defforey, Mr. Tynkovan and Mr. DuCharme. The Nomination and Remuneration Committee held five meetings in 2012. Other members of the Supervisory Board and senior management were invited when necessary or appropriate.

During the year the Nomination and Remuneration Committee constantly evaluated leadership and human resources needs in relation to the Company's strategic and growth objectives. Considerable time was devoted to talent management and succession planning at the senior executive level, within the context of a broad review of the organization structure. The Committee particularly focused on succession issues related to the departure of Mr. Gusev as CEO of the Company, while strengthening the leadership of the Company's main business divisions. Following the resignation of Mr. Ashurkov as member of the Supervisory Board, the Nomination and Remuneration Committee discussed and proposed the nomination of Mr. Dorofeev as a new Supervisory Director. The Nomination and Remuneration Committee assisted in designing the Company's next generation incentive plan, with particular emphasis on the balance between short- and long-term compensation, appropriate target-setting and talent retention.

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:

- regular assessment of the members of the Management Board and the Executive Board;
- variable remuneration and the short and long term incentives of the Management Board and the Executive Board;
- appointment of senior managers based on selection criteria prepared in advance, as well as their remuneration in accordance with the Company's Remuneration Policy;
- Remuneration Policy for members of the Management Board and the Executive Board, including a scenario analysis of variable remuneration components as part of the annual salary review; and
- the composition, profile and competence of the Supervisory Board and the functioning of its committees, based on a self-assessment prepared by the Nomination and Remuneration Committee

The Remuneration Report on page 76 provides further details on the remuneration for the Management Board and the Supervisory Board, and includes the current Remuneration Policy for the Management Board and the Executive Board, as well as the outlook for 2013 and beyond. The Remuneration Policy is also available on the website of the Company.

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 2012 the Related Party Committee consisted of Mr. Tynkovan (Chairman) and Mr. Defforey. During the year the Related Party Committee considered a number of transactions which gave rise to the appearance of a conflict of interest with the Company. The following main transactions were discussed and/or approved by the Related Party Committee and the Supervisory Board during 2012, with due observance of best practice provisions II.3.2 to II.3.4 and III.6.1 to III.6.4 of the Dutch Corporate Governance Code, and the rules set forth in Chapter VI (Conflict of Interests) of the Rules Governing the Principles and Practices of the Supervisory Board, which Rules are available on the Company's website:

- insurance contracts with AlfaStrahovanie;
- telecommunication contract with VimpelCom; and
- revolving credit facilities, and other credit products within approved credit limits, with Alfa Bank.

Strategy Committee

The role of the Strategy Committee is described in its charter which is available on the Company's website. On 31 December 2012 the Strategy Committee consisted of Mr. Couvreur (Chairman), Mr. Defforey, Mr. Tynkovan and Mr. Dorofeev. The responsibilities of the Strategy Committee cover the review of the general strategy of the Company, including but not limited to the following main areas: overall growth and development strategy, financing strategy, budget and key performance indicators, and mergers and acquisitions.

The Strategy Committee held six meetings in 2012 including its annual offsite conference in July. All meetings were attended by the Chairman of the Audit Committee and the CEO; other senior managers were invited when necessary or appropriate. As part of its overall strategy review of the Company's commercial and staff divisions, the Strategy Committee addressed a variety of topics, with emphasis on the Company's strategy by format, organization structure, purchasing and logistics. The annual strategy conference in July was dedicated to the Company's overall medium- to long-term strategy, defining the parameters for the Company's multi-year business plan approved in the fall. Furthermore, the Strategy Committee discussed the Company's budget for 2013.

Corporate Governance

Both the Supervisory Board and the Management Board continued their efforts to ensure that the Company's practises and procedures comply with the Dutch Corporate Governance Code. In accordance with the Dutch Corporate Governance Code, a broad outline of the corporate governance structure of the Company is presented in the Corporate Governance Report.

Financial statements

This Annual Report and the 2012 consolidated financial statements, audited by PricewaterhouseCoopers Accountants N.V., were presented to the Supervisory Board in the presence of the Management Board and the external auditor. PricewaterhouseCoopers' report can be found on page 134.

The Supervisory Board recommends that the Annual General Meeting of Shareholders adopts the 2012 consolidated financial statements of X5 Retail Group N.V. The Annual General Meeting of Shareholders will be asked to release the members of the Management Board from liability for the exercise of the management of the Company's affairs and management. The appropriation of results approved by the Supervisory Board can be found on page 133.

The Supervisory Board wishes to thank the members of the Management Board and the Executive Board, as well as all employees, for their dedication and hard work at X5 in 2012.

The Supervisory Board

7 March 2013

Remuneration Report

This report has been prepared by the Supervisory Board of X5 Retail Group N.V. in accordance with the Dutch Corporate Governance Code. It contains the remuneration policy of the Management Board of the Company as well as the remuneration specifics of both the Management Board and the Supervisory Board for the financial year 2012. This report also addresses the way in which the remuneration policy will be pursued for the financial year 2013 and beyond.

Nomination and Remuneration Committee

Apart from its responsibilities in the area of selection, appointment and assessment of the Management Board and Supervisory Board members, the Nomination and Remuneration Committee (the 'Committee') is responsible for:

- ▶ preparing proposals for the Supervisory Board concerning the remuneration policy for the Management Board to be adopted by the General Meeting of Shareholders; and
- ▶ preparing proposals concerning the remuneration of individual members of the Management Board.

In carrying out its work in the area of remuneration, the Committee also takes into account the assessment and remuneration of the senior management reporting to the Management Board (the 'Executive Board') and the remuneration climate in general within the Company.

The Committee prepares its proposals independently after careful consideration, including taking into account the advice of independent advisors, when necessary. These advisors do not advise the members of the Management Board personally on their remuneration.

The current members of the Nomination and Remuneration Committee are Mr. Dorofeev (chairman), Mr. Defforey and Mr. Tynkovan.

Remuneration policy 2012

X5's remuneration policy and the individual employment contracts of the members of the Management Board are determined by the Supervisory Board within the framework of the remuneration policy, as adopted by the General Meeting of Shareholders in 2007, and subsequently amended (most recently in 2011), if and when required pursuant to ongoing developments and insights gained in this area, and in accordance with the Dutch Corporate Governance Code.

The objective of the remuneration policy is twofold:

- ▶ to create a remuneration structure that will allow the Company to attract, reward and retain qualified executives who will lead the Company in achieving its strategic objectives; and
- ▶ to balance short-term operational performance with the long-term objectives of the Company and value creation for its shareholders, with due regard to the risks to which variable remuneration may expose the Company.

The remuneration of members of the Management Board includes four elements: base salary, annual incentive (performance-based cash bonus), long-term incentive (performance-based equity instrument), and other arrangements.

Upon proposal of the Nomination and Remuneration Committee, and if in the interest of the Company, the Supervisory Board may at its own discretion deviate from the remuneration policy when offering a remuneration package to a newly appointed member of the Management Board or when amending the remuneration package of a current member of the Management Board, in the event of exceptional circumstances or if otherwise deemed appropriate.

The Supervisory Board has resolved that the remuneration policy shall equally apply to members of the Executive Board.

Benchmarking with industry peers

As a company with operations mainly in Russia, with international exposure due to its governance structure and listing on the London Stock Exchange, distinct benchmarking is applied to X5 base salaries as well as variable salary components. Base salaries are benchmarked against mainly Russian peers while variable salary components, including long-term incentive elements, are benchmarked against Western peers as well. The peer group applied to base salary benchmarking is currently composed of Russian companies equivalent in terms of size of business, complexity of operations, growth dynamics and corporate governance.

Base salary

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

Annual cash incentive

The bonus scheme for the members of the Management Board rewards both quantitative corporate indicators and personal, mission-related, key objectives. Members of the Management Board receive an 'on target' bonus opportunity equal to 50% of their base salary for achieving quantitative corporate indicators, and 50% of their base salary for achieving personal key objectives as set by the Supervisory Board. An additional 50% for 'stretch' performance is possible in case of extraordinary achievement.

The Supervisory Board sets the targets for the bonus scheme at the beginning of each financial (calendar) year. The quantitative corporate indicators include net sales and EBITDA, each indicator having equal weight. The personal performance targets include targets related to divisional performance, mission-related or key project-related targets, as well as qualitative behavioral targets. Both the corporate and personal performance measures are considered success factors for the Company in the short term, while also contributing to the achievement of the long-term objectives of the Company, including in particular building out and strengthening the Company's leading position in the Russian retail sector. X5 does not disclose the actual targets set, as this qualifies as commercially sensitive information.

Long-term incentive

Stock Option Plan

The Employee Stock Option Plan (ESOP) was approved by the General Meeting of Shareholders on 15 June 2007. The options granted under the ESOP each confer the right to a number of Global Depositary Receipts (GDRs), each GDR representing one-fourth of an ordinary share of Euro 1 par value in the capital of the Company. The options were granted in four tranches issued over a period of three years (2007 through 2009). The final tranche vested in May 2010 and will elapse on 20 November 2013. The options outstanding are conditional upon employment with the Group. The number of options granted to Management Board members and key employees were linked to pre-determined criteria of participation in the program, based on the level of responsibility within the Company.

Restricted Stock Unit Plan

In 2010 the Company launched its Restricted Stock Unit Plan (the 'Plan') for a small group of high-performance and high-potential senior executives, increasing the commitment of such participants to the business of X5 and promoting the alignment of their interests with those of the shareholders of the Company. The Plan was approved by the General Meeting of Shareholders on 25 June 2010.

The Plan provides for the annual grant of conditional rights to receive restricted stock units (RSUs), subject to i) the achievement of specific performance criteria of the Group and ii) continuous employment with the Group until the completion of the vesting period. Up to one third of the conditional RSUs granted to the CEO, and up to one quarter of the conditional RSUs granted to other participants, will be subject to the employment condition only. Members of the Supervisory Board may also be granted conditional RSUs. These RSUs shall not be subject to performance criteria. The General Meeting of Shareholders determines the number of conditional RSUs granted to members of the Supervisory Board.

The number of conditional RSUs granted on any grant date shall in principle be based on 200% of each participant's annual base salary, divided by the average market value¹ of a GDR on the relevant grant date. On the first anniversary of each respective grant date, and based on the Company's audited financial results, the Supervisory Board shall evaluate whether the performance targets have been met. The actual number of RSUs subsequently awarded will depend on the level of achievement of the performance targets and will be either 0%, 50% or 100% of the number of conditional RSUs granted, in addition to the RSUs granted subject to the employment condition only.

The performance criteria mainly relate to (i) the performance of the Group compared to the performance of a selected group of (comparable) competitors in achieving sustained growth and an increasing presence in its markets of operation but (ii) without sacrificing the EBITDA of the Company.

All RSUs to be awarded are subject to a further two-year vesting period and the condition of continuous employment with the Group. Upon vesting, the RSUs will be converted into GDRs registered in the participant's name, whereby each RSU is converted into one GDR. Subsequently, these GDRs are subject to a two-year lock-in period during which period the GDRs cannot be traded.

Other remuneration components

A number of other arrangements may be offered to members of the Management Board, such as an expense allowance, medical insurance, accident insurance and life insurance, in accordance with general policies approved by the Supervisory Board. The Company's policy does not allow personal loans and guarantees to members of the Management Board. The Company does not provide for pension arrangements in favor of members of the Management Board.

¹ The average market value is defined as 'on any particular day the volume-weighted average price of a GDR over the 30 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'.

Remuneration Report continued

Contracts of employment

The members of the Management Board have a written contract of employment with X5 Retail Group N.V. in the Netherlands and/or its operational Russian subsidiaries. The fixed and variable salary components stipulated in each employment contract reflect the relevant responsibilities of each member of the Management Board in the Netherlands and in Russia.

The current members of the Management Board are employed and appointed for a four-year period, in accordance with the Dutch Corporate Governance Code. For future new appointments to the Management Board, the term of the contract is also set at four years.

The Supervisory Board may recover from the Management Board members any variable remuneration awarded on the basis of incorrect financial information. Furthermore, the Supervisory Board has the discretionary authority to adjust the value of variable pay components originally awarded if the outcome proves to be unfair as a result of exceptional circumstances during the performance period.

The severance payment is in principle limited to a maximum of one year's base salary of the relevant member of the Management Board. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances.

Insurance and indemnity arrangements

Members of the Management Board and Supervisory Board, as well as certain senior management members, are insured under X5's directors and officers insurance policy.

Although the insurance policy provides for a wide coverage, X5's directors and officers may incur uninsured liabilities. Members of the Management Board, as well as members of senior management, 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, willful misconduct or intentional misrepresentation by such director or officer. In addition, the General Meeting of Shareholders approved the indemnity arrangements to be granted by the Company to members of the Supervisory Board.

Remuneration 2012

Management Board remuneration

The total remuneration of each member of the Management Board is determined in line with compensation levels in peer group companies. Based on the salary benchmarking survey conducted annually, the Nomination and Remuneration Committee proposed base salary adjustments for certain members of the Executive Board, including Mr. Gusev and Mr. Balfe. As per the salary review date 1 April 2012 the annual base salaries for the members of the Management Board were determined as follows (in USD):

	Position	Base salary
Andrei Gusev	Chief Executive Officer	1,350,788
Kieran Balfe	Chief Financial Officer	627,152
Frank Lhoëst	Company Secretary	353,357

For the current members of the Management Board the cash incentive level for the reporting year is based on non-achievement of the quantitative corporate performance indicators and full achievement of the personal performance targets for Mr. Lhoëst and non-achievement of the personal performance targets for Mr. Gusev and Mr. Balfe.

For the year ended 31 December 2012 the Management Board was entitled to a total short-term compensation of USD 1,855,677 (2011: USD 3,837,509).

Compensation overview for members of the Management Board for the financial year 2012 (USD):

	Position	Base salary 2012	Cash bonus 2012 ²	Equity-based remuneration ³
Andrei Gusev ¹	Chief Executive Officer	771,879	0	-486,443
Kieran Balfe	Chief Financial Officer	621,170	0	425,323
Frank Lhoëst ⁴	Company Secretary	353,357	109,271	354,095

¹ Mr. Gusev stepped down from the Management Board as per 12 July 2012.

² Bonus for the performance of the year reported and paid in cash in 2013.

³ The share based remuneration relates to the employee stock option plan and the restricted stock unit plan. Costs relate to the expenses recognized in the income statement for the period; reference is made to Notes 41 and 44 to the Financial Statements.

⁴ Excluding 16% Dutch crisis levy on Mr. Lhoëst's total remuneration in excess of EUR 150,000, expensed as an employer's tax in 2012.

As described in the Corporate Governance Report on page 64, Mr. Gusev stepped down from the Management Board on 12 July 2012. For management transition purposes, his contract was not terminated until 31 July 2012, followed by an additional three month period during which he remained available under a consultancy agreement. Mr. Gusev's termination package featured the following remuneration components (in USD):

Severance payment ¹	1,350,788
Consultancy fee	300,000

¹ 100% of base salary, in accordance with the Remuneration Policy.

Cash remuneration amounts were paid in either Russian Roubles or Euros and converted to USD for reporting purposes, using the average USD rate for 2012 to convert RUR amounts into USD, and average cross-rate EUR/USD for amounts paid in Euros. Cash bonus amounts will be paid in either Russian Roubles or Euros and converted to USD for reporting purposes, using the closing USD rate for 2012 to convert RUR amounts into USD, and closing cross-rate EUR/USD for amounts paid in Euros. The rates are available in Note 2 to the consolidated financial statements included in this Annual Report.

Supervisory Board remuneration

As described in the Corporate Governance Report on page 64, Mr. Ashurkov stepped down from the Supervisory Board at the Annual General Meeting of Shareholders on 14 June 2012. At that same meeting his successor, Mr. Dorofeev, was appointed.

When Mr. Gusev stepped down as CEO and member of the Management Board in July, the Supervisory Board delegated Mr. DuCharme to assume the CEO's responsibilities on a temporary basis. In connection herewith, Mr. Dorofeev took over Mr. DuCharme's position as Chairman of the Nomination and Remuneration Committee, while Mr. Defforey took over his position as member of the Related Party Committee. In fulfilling his delegated role, Mr. DuCharme was given the particular assistance of Mr. Defforey and Mr. Couvreur. Subject to approval of the General Meeting of Shareholders, the Supervisory Board proposed to compensate these exceptional, temporary, efforts by allocating the CEO's annual base salary (as disclosed above) and cash bonus to Mr. DuCharme on a pro rata basis. The Supervisory Board has also proposed that Mr. Defforey and Mr. Couvreur, receive additional compensation in terms of dedicated time and responsibilities.

In the reporting year, the total cash remuneration of the Supervisory Board amounts to USD 2,136,856 (2011: USD 1,627,746).

	Cash Remuneration 2012	Extraordinary Cash Remuneration 2012	Equity based compensation ⁴
Hervé Defforey (Chairman) ¹	321,233	159,406	116,715
Mikhail Fridman	128,493		
Vladimir Ashurkov ²	58,179		
David Gould	256,987		
Alexander Tynkovan	154,192		137,818
Stephan DuCharme	198,094	944,016	229,710
Christian Couvreur	256,987	159,406	229,710
Dmitry Dorofeev ³	129,206		

¹ Excluding 16% Dutch crisis levy on Mr. Defforey's remuneration in excess of EUR 150,000, expensed as an employer's tax in 2012.

² Vladimir Ashurkov stepped down from the Supervisory Board on 14 June 2012.

³ Dmitry Dorofeev was appointed to the Supervisory Board on 14 June 2012.

⁴ The equity based remuneration relates to the stock option plan and the restricted stock unit plan. Costs relate to the expenses recognized in the income statement for the period; reference is made to notes 41 and 44 to the Financial Statements.

All remuneration amounts are paid in Euros and converted to USD for reporting purposes, using the average cross-rate EUR/USD. The rate is available in Note 2 to the consolidated financial statements included in this Annual Report.

Remuneration Report continued

Stock options

In November 2012 the term of options granted under tranche 3 of the Employee Stock Option Plan expired. Details of options held at 31 December 2012 by members of the Management Board and Supervisory Board, are set forth below:

	Granted in 2008	Granted in 2009	Tranche	Vesting date	Value per vesting date ¹	Exercised in 2012	Exercise price ²	GDR price on exercise date	Expiration date ³	Position 31 December 2012
Management Board										
Andrei Gusev	212,500		3	19/05/2009	nil		\$33.43		31/10/2012	
Supervisory Board										
Hervé Defforey	42,500		3	19/05/2009	nil		\$33.43		20/11/2012	
		70,000	4	19/05/2010	\$1,343,300		\$13.91		20/11/2013	70,000

¹ Intrinsic value (GDR closing price per 19 May 2009: USD 15.18; 19 May 2010: USD 33.10).

² The exercise price of the options under the third and fourth tranche is defined as the price equal to the Average Market Value (as defined below) per Depositary Receipt as of the grant dates 19 May 2008 and 19 May 2009 respectively. The Average Market Value is defined as 'on any particular day the volume weighted average price of a Depositary Receipt over the 30 immediately preceding calendar days. The volume weighted average price is calculated using the closing price of a Depositary Receipt taken from the Official List of the LSE'.

³ Mr. Gusev's contract terminated on 31 July 2012. His options granted under the third tranche were not exercised within three months after the employment termination date, as allowed under the ESOP Rules, and consequently elapsed.

Options granted under tranche 3 to Mr. Defforey also elapsed at market value below exercise price on 20 November 2012.

Restricted Stock Units

In 2012 the second tranche of RSUs was awarded based on the level of achievement of the performance targets as defined under the plan. This resulted in a 50% award of the performance-related conditionally granted RSUs, in addition to a 100% award of the RSUs granted subject to the employment condition only. Details of RSUs conditionally granted and awarded to members of the Management Board and Supervisory Board are set forth below:

	Tranche	Conditional Grant 2010	Conditional Grant 2011	Conditional Grant 2012	RSU Value on Grant Date ¹	RSUs awarded in 2011	RSUs awarded in 2012 ²	RSU Value on Award Date ¹	Award Date	RSUs outstanding as per 31/12/2012	Vesting date	End of lock-up period
Management Board												
Andrei Gusev ³	1	39,147			\$1,389,719	24,467		\$880,812	19/05/2011	16,311	19/05/2013	19/05/2015
	2		79,365		\$2,857,140		52,910	\$1,193,121	19/05/2012	17,637	19/05/2014	19/05/2016
	3			110,215	\$2,485,348				19/05/2013		19/05/2015	19/05/2017
Kieran Balfe	2		37,214		\$1,339,704		23,259	\$524,490	19/05/2012	23,259	19/05/2014	19/05/2016
	3			51,171	\$1,153,906				19/05/2013		19/05/2015	19/05/2017
Frank Lhoëst	1	14,438			\$512,549	9,024		\$324,864	19/05/2011	9,024	19/05/2013	19/05/2015
	2		21,832		\$785,952		13,645	\$307,695	19/05/2012	13,645	19/05/2014	19/05/2016
	3			28,769	\$648,741				19/05/2013		19/05/2015	19/05/2017
Supervisory Board												
Hervé Defforey	1	9,024			\$320,352	9,024		\$324,864	19/05/2011	9,024	19/05/2013	19/05/2015
	2		9,923		\$357,228		9,923	\$223,764	19/05/2012	9,923	19/05/2014	19/05/2016
	3			13,077	\$294,886				19/05/2013		19/05/2015	19/05/2017
Stephan DuCharme	1	7,219			\$256,275	7,219		\$259,884	19/05/2011	7,219	19/05/2013	19/05/2015
	2		7,939		\$285,804		7,939	\$179,024	19/05/2012	7,939	19/05/2014	19/05/2016
	3			10,461	\$235,896				19/05/2013		19/05/2015	19/05/2017
Alexander Tynkovan	1	4,331			\$153,751	4,331		\$155,916	19/05/2011	4,331	19/05/2013	19/05/2015
	2		4,763		\$171,468		4,763	\$107,406	19/05/2012	4,763	19/05/2014	19/05/2016
	3			6,277	\$141,546				19/05/2013		19/05/2015	19/05/2017
Christian Couvreur	1	7,219			\$256,275	7,219		\$259,884	19/05/2011	7,219	19/05/2013	19/05/2015
	2		7,939		\$285,804		7,939	\$179,024	19/05/2012	7,939	19/05/2014	19/05/2016
	3			10,461	\$235,896				19/05/2013		19/05/2015	19/05/2017

¹ RSU value on 25 June 2010: USD 35.50; RSU value on 19 May 2011: USD 36.00; RSU value on 19 May 2012: USD 22.55.

² 50% award of RSUs subject to performance test as per 19 May 2012, based on level of achievement of Plan KPIs.

³ Andrei Gusev's contract terminated on 31 July 2012. In accordance with the Rules of the restricted stock unit plan, one third of the number of RSUs awarded under tranche 1, and two thirds of the number of RSUs awarded under tranche 2, were forfeited.

Remuneration policy in 2013 and beyond

New variable compensation structure

During the course of 2012 the Nomination and Remuneration Committee reflected on the current policy and the balance between short- and long-term compensation and the Company's targets, taking into account the geographic and cultural environment in which the Company operates, as well as the volatility of global economic conditions.

In view hereof, and to enhance transparency and simplicity in the remuneration of the Company's senior key executives, the Nomination and Remuneration Committee proposes to combine the current short- and long-term variable components into one cash-based incentive plan. This plan intends to support both long-term value creation and short-term Company objectives.

The new plan no longer makes the distinction between short-term and long-term performance periods; the performance period for variable compensation will be one year. At the beginning of each performance period, the variable cash-based compensation is granted conditionally. After the performance year the amount of conditional variable compensation that can be allocated shall be established, based on the achievement of both individual and Company performance criteria.

The direct component, one-third of total variable remuneration, is awarded in the year following the performance year. The deferred component, i.e. the remaining two-thirds of the total variable remuneration, will be paid in equal parts on the second and third anniversary of the grant date, subject to continuous employment with the Group. This deferred component is intended to serve the objective of retaining the plan participants for a longer period of time.

Participants receive an 'on target' bonus opportunity based on both Company and individual performance criteria. The Supervisory Board shall determine the weight of each of the performance criteria prior to each performance year. Company performance criteria may include net sales, like-for-like sales and EBITDA. The personal performance targets include targets related to divisional performance, mission-related or key project-related targets, as well as qualitative behavioral targets. Both the corporate and personal performance measures are considered success factors for the Company in the short term, while also contributing to the achievement of the long-term objectives of the Company, including in particular strengthening the Company's leading position in the Russian retail sector.

The new incentive plan, and the consequent changes to the remuneration policy, will be submitted to the 2013 Annual General Meeting of Shareholders.

Supervisory Board remuneration

As of 1 January 2013 the remuneration of Supervisory Board members is subject to Dutch VAT. Whereas the new VAT rule will increase the total remuneration cost for the Company, this will not lead to an increase of the remuneration for the Supervisory Board members.

The Supervisory Board

7 March 2013

Risk management and internal control

Overview

Risks are an inherent part of doing business. X5, as any other company, is constantly dealing with risks and opportunities that can either negatively or positively influence its business. In order to minimize the negative impact of risks and to capitalize on opportunities, X5 has introduced a risk management and internal control system geared to providing transparency in our operations while being mindful of our risk appetite.

The overall objective of this system is to obtain reasonable assurance that the Company business objectives can be achieved and obligations to customers, shareholders, employees and society can be met.

Our risk management system is designed both to encourage entrepreneurial spirit and provide sufficient assurance that risk is fully understood and managed through a systematic process of risk identification, assessment and control.

We do, however, understand that risk management and internal control provide a reasonable, but not an absolute guarantee that we will achieve our objectives, because:

- risk identification and assessment are almost always subject to uncertainty as they deal with the future;
- certain risks are out of the Company's control, thus cannot be fully mitigated; and
- some control procedures may be degraded by human errors, carelessness, and errors of judgment or misunderstanding.

Accountability

The Management Board, supported by the Executive Board, has primary accountability for managing the risks associated with our activities, and for the establishment and adequate functioning of appropriate risk management and control systems.

The Supervisory Board and the Audit Committee, as stated in the Corporate Governance section of this Annual Report, are responsible for overall supervision and monitoring activities with respect to the internal control and risk management system.

Approach

The risk management and internal control process at X5 is guided by the recommendations of the Committee of Sponsoring Organizations (COSO) and its Enterprise Risk Management and Internal Control Integrated Frameworks.

X5 maintains a key risk register that details the key risks faced by the Company, key risk owners, and controls and procedures to be implemented for mitigating those risks. The content of the register is determined through regular discussions with senior management and reviewed by the Executive Board and the Audit Committee.

Risk profile

This section describes the main risks X5 currently faces that could have a significant impact on the achievement of the Company's strategic goals and objectives. X5 is exposed to additional risks that apply to all companies operating on the Russian market, and the retail market globally, as well as other risks that are not presently known to us.

Strategy

Throughout 2012, global economic conditions remained unstable and consumer confidence fragile. However, a combination of low inflation and an increase in social spending in Russia contributed to a relatively strong consumer and retail market for most of the year. Currently, there are signs of a gradual recovery in global economic conditions in 2013 and, in general, this should continue to support a positive outlook for the Russian retail market.

Russia officially joined the WTO in August 2012 and committed to reducing and binding import tariffs on all agricultural goods. The consequent export opportunities and transparency in trading relationships are expected to have a favorable impact on the retail industry.

- X5's leadership in the Russian retail market depends largely on how well we adapt our strategy in the context of the macroeconomic and competitive industry environment, and how well we communicate and execute the right strategic vision.

The Company has made a significant shift in its growth strategy, from reliance on acquisitions to increased focus on organic growth and new store openings. Meanwhile, the Company is in the process of reshaping its organization structure, towards decentralized, flexible and consumer-oriented businesses supported by efficient central functions. In 2012, the Company launched direct import activities to lower costs and improve quality, which should benefit from new opportunities resulting from Russia's WTO membership.

To ensure that the Company continues to pursue the right strategy, the Supervisory Board and its Strategy Committee, together with senior management, hold specific sessions on all key aspects of X5's business, to review internal and external issues that could influence our strategy.

Our strategic initiatives are described in the Chief Executive Officer's review section of this Annual Report.

We believe that by choosing and pursuing a carefully considered and well-executed strategic vision we strengthen our leadership position in the Russian retail market, and achieve long-term profitable growth for the benefit of our stakeholders.

Human resources

Our success in achieving the Company's strategic objectives relies heavily on the dedication of our employees and the effectiveness of our organization. In order to be an employer of choice, we recruit, develop and reward employees according to leading human resource (HR) practices. We constantly assess HR policies in order to effectively address the following risk factors:

- › our ability to recruit, train and retain the optimal number of staff at both managerial and operational levels;
- › our ability to create a balanced organisational structure that enables and motivates personnel to achieve key objectives; and
- › the success of our organisational transformation in fostering a new corporate culture, with strong internal communication and decision-making processes.

Throughout last year the Company remained focused on its transition to a new organizational model, entailing a number of changes at the senior management level. The new team is very familiar with the Russian retail market and X5 in particular, and is supported by dedicated and experienced staff, together with well-established internal business processes and IT functions.

The team also recognizes the importance of developing X5's corporate culture, with a focus on personal initiative and accountability at all levels, in order to achieve the Company's goals and objectives.

A competitive compensation package is provided to our executive and line managers, whose performance is evaluated through key performance indicators (KPIs) to ensure alignment with the Company's goals.

Due to X5's rapid growth we are continually hiring a significant number of new employees from the labor market and constantly improving and developing our recruitment methods. We have a strong commitment to our employees' integration and education, with programs in place to develop and promote talented employees through vertical and horizontal career-building opportunities. Corporate events and activities help us build a strong, motivated workforce eager to achieve X5's objectives.

Expansion

Our ongoing results and expansion plans for the future are significantly influenced by:

- › our ability to find and effectively manage retail locations and negotiate appropriate purchase and lease terms; and
- › effective development and implementation of plans and procedures to support organic growth.

The Company is developing new retail channels, for example through the launch of the convenience store format and the E5.RU online store, to diversify and expand its presence as a multi-format retailer, as well as opening new distribution centers to support the regional growth of its established retail formats.

X5's management pays particular attention and allocates significant resources to optimizing its organic expansion strategy and supporting processes. When identifying and leasing or purchasing suitable properties, our internal real estate professionals perform comprehensive feasibility studies to identify and reduce risks of not obtaining necessary approvals from various state and local authorities for construction work, and to secure X5's right to proceed with store openings and refurbishments. Our investment decisions are supported by a range of financial and non-financial indicators that provide reasonable assurance that we are obtaining attractive facilities at attractive prices.

Business support

In order to support current growth plans and build a foundation for future development, X5 invests in IT infrastructure and business support processes. The key risk factors associated with these are:

- › adequacy of IT facilities and systems for ensuring business continuity and supporting the growth of our business; and
- › availability of internal electronic and physical document-flow systems.

Following the successful implementation of the SAP IT platform launched in 2009, X5 uses the capabilities of its IT systems to provide the operations with adequate tools to efficiently run the business. During 2012, our key focus has been on supply chain tools, building the foundation for optimal replenishment of each and every store.

X5 is also working closely with its suppliers, Efficient Consumer Response (ECR) Russia and Electronic Data Interchange (EDI) providers to take full advantage of the Russian Ministry of Justice's approval of the automated exchange of sales invoices. X5 has developed a network to support the exchange process. The next step will involve connecting suppliers to the network, allowing for the exchange of sales invoices through EDI providers, who hold ECR Russia certificates, to increase efficiency in the supply chain process.

Risk management and internal control continued

Operations

Our customers are our main focus. In order to provide them with high-quality goods and services at a reasonable price, we constantly analyze and improve key operational processes such as assortment management (including private label), pricing, supplier relationships, merchandising, sales and customer relations.

The key risks and focus related to these activities are:

- our ability to define a product range that is in line with customer needs;
- our ability to provide our customers an attractive shopping experience;
- effective relationships with suppliers and producers of private label goods to support adequate availability of supply while meeting our quality standards;
- our ability to establish strict food safety and quality control policies and procedures and ensure full adherence to these at all times;
- our ability to maintain a competitive price position with our customers and remain socially responsible;
- effective inventory management to ensure the continuous flow of a wide selection of goods to our customers, while minimising shrinkage and excessive stock; and
- transport and warehouse logistics infrastructure and management systems to ensure efficient distribution across the entire supply chain.

The Company has enhanced its commitment to investing in store renovation, product range and improved availability of fresh and ultra-fresh products. Newly introduced employee motivation schemes, and measures improving operational efficiency, have resulted in a noticeable improvement in traffic recovery at supermarkets and hypermarkets.

Our corporate responsibility commitments, including community activities, HR development and food product safety procedures, are described in the 'Social, corporate and environmental responsibility' section of this Annual Report.

Financial and management reporting

Implementation of planning and budgeting functionality in SAP in 2012 allowed clear and transparent control over costs and investments, the alignment of strategic and operational planning, flexibility and timeliness of management decisions. In addition, it has significantly reduced the risk of failure of proper recording and classification of accounting transactions and has improved our ability to make accurate and reliable business projections. A crucial risk factor in this area is:

- availability of effective and reliable management reporting systems that support analysis of business results and strengthen decision-making processes.

SAP for Finance notably facilitates the improvement of internal controls over the financial reporting process and the availability of a wide range of management reports to support decision-making.

Integrity

Effective resource management depends to a significant extent on our ability to develop and promote a Company-wide culture of integrity, and prevent and detect corruption and fraud at all levels in the Company.

Whilst we continually strive to ensure adherence to X5's high integrity standards among our staff, the potential for fraud and other inappropriate activity exists at all levels of the business, from stores to senior management. In 2012, X5 introduced its revised Code of Business Conduct and Ethics (the 'Code of Conduct') which intends to help each employee understand and follow relevant compliance and integrity rules, and know when and where to ask for advice or report a breach of the Code. Company employees are required to participate in special training on acceptable business practices, and confirm their adherence to the ethical standards and rules reflected in the Code. The Company constantly emphasises its whistleblower policy and the 'ethics hotline' through which employees can report suspected violations of the Code, on an anonymous basis. Allegations of fraud are investigated by the Company's fraud investigation team. The findings of such investigations are reported to the Management Board and the Audit Committee of the Supervisory Board on a regular basis.

Regulatory environment and compliance

Our business is subject to various laws and regulations relating to, among other areas, land use, antitrust restrictions, alcoholic beverage sales, and our relationship with employees. The procedures for obtaining and renewing licenses and permits required by X5's operations and with respect to various quality, health and safety, packaging, labeling and distribution standards are subject to supervision and regulation by various government authorities and agencies. Russia is in a process of structural, economic and political transition, and the regulatory regimes applicable to X5's operations are still developing. Operating successfully in this regulatory environment thus depends on:

- our ability to identify, quickly respond to and attempt to modify proposed unfavorable changes in applicable laws and regulations stemming from changes in political and economic conditions; and
- our ability to correctly interpret and establish compliance with newly applicable standards in a timely manner.

The Company monitors regulatory developments and enforces a strong compliance regime. Moreover we engage with public and governmental organizations to ensure that the interests of our customers are represented. In addition, X5 is consulted on and invited to contribute to important government regulations concerning the retail industry.

Litigation

X5 is exposed to pervasive contractual and litigation risks due to the Company's operational scale, number of employees and scope of commercial activities including interactions with suppliers and vendors as well as real estate and M&A transactions.

Our legal team participates in every stage of important business activities and analyzes contract terms to minimize risks. In addition, we protect ourselves by seeking to comply with all applicable laws and regulations, and by vigorously preparing and defending our position in litigation and enforcing our rights in relation to contracts, using all means provided by law.

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to X5's transactions and activities could be challenged by the relevant regional and federal tax authorities.

Management regularly reviews the Company's compliance with applicable tax legislation, regulations and decrees, including current interpretations published by governmental authorities. It also thoroughly reviews judicial precedents resulting from tax disputes involving other companies operating in Russia. The Company further protects itself against tax risks by establishing appropriate provisions in its IFRS consolidated financial statements.

Note 34, 'Commitments and Contingencies' to the consolidated financial statements in this Annual Report contains a description of tax uncertainties and an estimate of the related liabilities.

Financial risks

The main financial risks faced by the Company relate to the availability of funds to meet business needs (liquidity and credit risks) and fluctuations in interest and foreign exchange rates. The central treasury function is responsible for managing the Company's monetary assets, funding requirements, interest rate, currency and credit exposures and the associated risks, as well as insurance of assets. The treasury function does not operate as a profit center and speculative transactions are strictly prohibited.

Note 30 'Financial Risk Management' to the consolidated financial statements in this Annual Report contains a detailed description of financial risks faced by the Company and the instruments it employs to mitigate these risks.

Management summary

The Management Board has reviewed and analyzed the risks to which the Company is exposed, as well as the effectiveness of the Company's internal risk management and control systems, over the course of 2012. The conclusions of this review have been shared with the Audit Committee and the Supervisory Board and discussed with X5's external auditors.

The Management Board believes that the risk management and control systems related to financial reporting risks have functioned properly during the year, and provide reasonable assurance that the Company's 2012 financial statements do not contain any errors of material importance.

In view of the above, the Management Board believes that it is in compliance with the requirements of II.1.4 and II.1.5 of the Dutch Corporate Governance Code.

In addition, in accordance with section 5.25c of the Dutch Financial Supervision Act, the Management Board confirms that to the best of its knowledge:

- › the annual financial statements provide an accurate and fair view of the assets, liabilities, financial position and profit or loss of the Company and its consolidated subsidiaries; and
- › the Annual Report gives an accurate and fair overview of the situation as per the balance sheet date, the state of affairs during the financial year of the Company and its consolidated subsidiaries included in the annual financial statements, together with a description of the principal risks it faces.

The Management Board

7 March 2013

International Financial Reporting Standards Consolidated Financial Statements

Dutch GAAP Company's Financial Statements and Independent Auditor's Report

31 December 2012

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Financial statements

Consolidated Statement of Financial Position

at 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Note	31 December 2012	31 December 2011
Assets			
Non-current assets			
Property, plant and equipment	10	4,147,265	3,824,893
Investment property	11	108,512	141,034
Goodwill	12	2,114,279	1,957,876
Intangible assets	13	503,483	601,026
Prepaid leases	14	53,392	81,068
Investment in associates	8	2,759	1,331
Available-for-sale investments	16	6,928	6,535
Other non-current assets	17	36,027	18,530
Deferred tax assets	29	143,787	136,801
		7,116,432	6,769,094
Current assets			
Inventories of goods for resale	15	1,114,894	895,007
Indemnification asset	34	29,833	52,149
Loans originated	16	3,033	19,811
Trade and other accounts receivable	17	420,565	361,783
Current income tax receivable		111,745	31,438
VAT and other taxes recoverable	18	378,001	295,913
Cash and cash equivalents	9	407,877	385,001
		2,465,948	2,041,102
Total assets		9,582,380	8,810,196
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	21	93,717	93,717
Share premium		2,049,592	2,049,592
Cumulative translation reserve		(581,043)	(709,693)
Retained earnings		628,083	754,580
Share-based payment reserve	28	11,452	7,776
		2,201,801	2,195,972
Total equity		2,201,801	2,195,972
Non-current liabilities			
Long-term borrowings	20	2,346,380	2,696,877
Long-term finance lease payable		113	1,347
Deferred tax liabilities	29	148,623	207,356
Long-term deferred revenue		676	1,261
Other non-current liabilities		71	3,175
		2,495,863	2,910,016
Current liabilities			
Trade accounts payable		2,396,934	1,906,365
Short-term borrowings	20	1,680,887	913,160
Share-based payments liability	28	496	2,396
Short-term finance lease payables		1,363	2,218
Interest accrued		20,980	12,422
Short-term deferred revenue		13,668	13,734
Current income tax payable		13,084	52,187
Provisions and other liabilities	19	757,304	801,726
		4,884,716	3,704,208
Total liabilities		7,380,579	6,614,224
Total equity and liabilities		9,582,380	8,810,196

Consolidated Income Statement

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Note	31 December 2012	31 December 2011
Revenue	23	15,795,249	15,455,088
Cost of sales	24	(12,071,058)	(11,776,132)
Gross profit		3,724,191	3,678,956
Selling, general and administrative expenses	24	(3,706,952)	(3,171,204)
Lease/sublease and other income	25	174,183	194,232
Operating profit		191,422	701,984
Finance costs	26	(336,958)	(301,937)
Finance income	26	11,098	4,244
Share of loss of associates		(90)	–
Net foreign exchange (loss)/gain		(2,496)	812
(Loss)/Profit before tax		(137,024)	405,103
Income tax benefit/(expense)	29	10,527	(102,912)
(Loss)/Profit for the year		(126,497)	302,191
(Loss)/Profit for the year attributable to:			
Equity holders of the parent		(126,497)	301,430
Non-controlling interest		–	761
Basic earnings per share for (loss)/profit attributable to the equity holders of the parent (expressed in USD per share)	22	(1.87)	4.44
Diluted earnings per share for (loss)/profit attributable to the equity holders of the parent (expressed in USD per share)	22	(1.86)	4.44

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Consolidated Statement of Comprehensive Income

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	31 December 2012	31 December 2011
(Loss)/Profit for the year	(126,497)	302,191
Other comprehensive income/(loss)		
Exchange differences on translation from functional to presentation currency	128,650	(135,425)
Change in fair value of available-for-sale investments	–	(249)
Other comprehensive income/(loss)	128,650	(135,674)
Total comprehensive income for the year	2,153	166,517
Total comprehensive income for the year attributable to:		
Equity holders of the parent	2,153	165,756
Non-controlling interest	–	761

Consolidated Statement of Cash Flows

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Note	31 December 2012	31 December 2011
(Loss)/Profit before tax		(137,024)	405,103
Adjustments for:			
Depreciation, amortization and impairment of property, plant and equipment, investment property and intangible assets	24	900,151	428,258
(Gain)/loss on disposal of property, plant and equipment		(2,494)	20,908
Finance costs, net	26	325,860	297,693
Impairment of trade and other accounts receivable	24	33,098	59,335
Share-based options expense/(income)	28	4,012	(40,372)
Amortization and impairment of prepaid lease		32,271	15,247
Net foreign exchange loss/(gain)		2,496	(812)
Loss from associate		90	–
Other non-cash items	34,10	(23,266)	4,065
Net cash from operating activities before changes in working capital		1,135,194	1,189,425
Increase in trade and other accounts receivable		(147,885)	(141,650)
(Increase)/decrease in inventories of goods for resale		(162,308)	75,899
Increase in trade payable		372,145	161,696
(Decrease)/increase in other accounts payable		(54,180)	78,167
Net cash generated from operations		1,142,966	1,363,537
Interest paid		(331,988)	(299,156)
Interest received		5,807	1,560
Income tax paid		(207,603)	(139,811)
Net cash from operating activities		609,182	926,130
Cash flows from investing activities			
Purchase of property, plant and equipment		(724,675)	(791,946)
Non-current prepaid lease		(13,794)	(8,309)
Acquisition of subsidiaries	7	(83,903)	(57,060)
Loans issued		–	(39,800)
Compensation from prepaid lease disposal		1,511	–
Repayment of loans issued		18,633	15,653
Proceeds from sale of property, plant and equipment		35,508	9,833
Purchase of intangible assets		(29,559)	(22,317)
Net cash used in investing activities		(796,279)	(893,946)
Cash flows from financing activities			
Proceeds from loans		1,274,190	1,549,138
Repayment of loans		(1,084,018)	(1,436,151)
Proceeds from sale of treasury shares		–	369
Principal payments on finance lease obligations		(2,555)	(2,269)
Net cash generated from financing activities		187,617	111,087
Effect of exchange rate changes on cash and cash equivalents		22,356	(29,032)
Net increase cash and cash equivalents		22,876	114,239
Movements in cash and cash equivalents			
Cash and cash equivalents at the beginning of the year		385,001	270,762
Net increase in cash and cash equivalents		22,876	114,239
Cash and cash equivalents at the end of the year		407,877	385,001

Financial statements

Consolidated Statement of Changes In Equity

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Attributable to equity holders of the parent							Non-controlling interest	Total
	Number of shares	Share capital	Share premium	Share-based payment reserve	Cumulative translation reserve	Retained earnings	Total shareholders' equity		
Balance as at 1 January 2011	67,813,947	93,712	2,049,144	5,965	(574,268)	470,980	2,045,533	1,658	2,047,191
Other comprehensive loss for the year	–	–	–	–	(135,425)	–	(135,425)	–	(135,425)
Profit for the year	–	–	–	–	–	301,430	301,430	761	302,191
Change in fair value of available for sale investments	–	–	–	–	–	(249)	(249)	–	(249)
Total comprehensive income for the year	–	–	–	–	(135,425)	301,181	165,756	761	166,517
Share-based payment compensation (Note 28)	–	–	–	1,811	–	–	1,811	–	1,811
Sale of treasury shares (Note 21)	5,086	5	448	–	–	–	453	–	453
Purchase of Retail Express	–	–	–	–	–	(17,581)	(17,581)	(2,419)	(20,000)
Balance as at 31 December 2011	67,819,033	93,717	2,049,592	7,776	(709,693)	754,580	2,195,972	–	2,195,972
Other comprehensive income for the year	–	–	–	–	128,650	–	128,650	–	128,650
Loss for the year	–	–	–	–	–	(126,497)	(126,497)	–	(126,497)
Total comprehensive income for the year	–	–	–	–	128,650	(126,497)	2,153	–	2,153
Share-based payment compensation (Note 28)	–	–	–	3,676	–	–	3,676	–	3,676
Balance as at 31 December 2012	67,819,033	93,717	2,049,592	11,452	(581,043)	628,083	2,201,801	–	2,201,801

Notes to Consolidated Financial Statements

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

1. 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 Prins Bernhardplein 200, 1097 JB Amsterdam, the Netherlands.

The main activity of the Group is the development and operation of grocery retail stores. As at 31 December 2012 the Group operated a retail chain of 3,802 soft-discount, supermarket, hypermarket and convenience stores under the brand names 'Pyaterochka', 'Perekrestok', 'Karusel' and 'Perekrestok Express' in major population centers in Russia, including but not limited to Moscow, St. Petersburg, Nizhniy Novgorod, Rostov-on-Don, Kazan, Samara, Lipetsk, Chelyabinsk, Perm, Ekaterinburg and Kiev, Ukraine (31 December 2011: 3,002 soft-discount, supermarket, hypermarket and convenience stores under the brand names 'Pyaterochka', 'Perekrestok', 'Karusel', 'Pyaterochka-Maxi' and 'Kopeyka'), with the following number of stores:

	31 December 2012	31 December 2011
Supermarket		
Central	210	192
North-West	35	34
Sredne-Volzhsky	31	26
Privolzhsky	17	16
South	18	15
Volgo-Vyatsky	24	21
Central-Chernozem	9	9
Ukraine	12	10
Ural region	14	7
	370	330
Soft discounter		
Central	1,398	1,159
North-West	510	438
Ural region	340	224
Volgo-Vyatsky	237	185
South	180	124
Sredne-Volzhsky	180	126
Privolzhsky	172	117
Central-Chernozem	203	152
	3,220	2,525

	31 December 2012	31 December 2011
Hypermarket		
North-West	17	17
Central	19	17
Privolzhsky	8	9
Volgo-Vyatsky	9	9
Sredne-Volzhsky	7	8
South	5	5
Central-Chernozem	7	6
Ural	6	6
	78	77
Convenience stores	134	70
Total stores	3,802	3,002

As at 31 December 2012, the Group's franchisees operated 422 stores (31 December 2011: 658 stores) across Russia.

As at 31 December 2012 the Company's principal shareholder is the Alfa Group Consortium, through its holding company CTF Holdings Limited ('CTF'), owning 47.86% of total issued shares in the Company, both directly (0.7%) and indirectly through Luckyworth Limited (25.54%) and Cesaro Holdings Limited (21.62%). CTF, registered in Gibraltar, is under the common control of Mr. Fridman, Mr. Khan and Mr. Kousmichoff (the 'Shareholders'). None of the Shareholders individually controls and/or owns 50% or more in CTF. As at 31 December 2012 the Company's shares are listed on the London Stock Exchange in the form of Global Depositary Receipts (GDRs), with each GDR representing an interest of 0.25 in an ordinary share (Note 21).

2. 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 2012 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 Netherlands Civil Code. In accordance with article 402 Book 2 of The Netherlands Civil Code the income statement in the Company Financial Statements is presented in abbreviated form.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

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2. Summary of significant accounting policies continued

2.2 Consolidated financial statements

Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are de-consolidated from the date that control ceases.

Associates are entities over which the Group has significant influence, but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognized at cost. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the post-acquisition profits or losses of associates is recorded in the consolidated income statement, and its share of post-acquisition movements in reserves is recognized in reserves. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition 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. The date of exchange is the acquisition date where a business combination is achieved in a single transaction. However, when a business combination is achieved in stages by successive share purchases, the date of exchange is the date of each exchange transaction; whereas the acquisition date is the date on which acquirer obtains control of the subsidiary.

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

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

Intercompany transactions, balances and unrealized gains on transactions between group companies are eliminated; unrealized 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.

2.3 Non-controlling interest

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Company. Non-controlling interest forms a separate component of the Group's equity.

The Group applies the economic entity model to account for transactions with owners of non-controlling interest. Any difference between the purchase consideration and the carrying amount of non-controlling interest acquired is recorded as a capital transaction directly in equity. The Group recognizes the difference between sales consideration and carrying amount of non-controlling interest sold as a capital transaction in the consolidated statement of changes in equity.

2.4 Foreign currency translation and transactions

a. Functional and presentation currency

Functional currency. The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currencies of the Group's entities are the national currency of the Russian Federation, Russian Rouble ('RUR') and the national currency of Ukraine, Ukrainian Hryvnia ('UAH'). Currently the Group's Ukraine business unit's contribution to the financial results of the Group is immaterial. The Group's presentation currency is the US Dollar ('USD'), which management believes is the most useful currency to adopt for users of these consolidated financial statements.

Translation from functional to presentation currency.

The results and financial position of each Group entity (none of which have a functional currency that is the currency of a hyperinflationary economy) are translated into the presentation currency as follows:

- i. assets and liabilities for each statement of financial position presented are translated at the closing rates at the date of that statement of financial position;
- ii. income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- iii. all resulting exchange differences are recognized as a separate component of other comprehensive income as a cumulative translation reserve.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in equity are reclassified to profit or loss.

b. Transactions and balances

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

At 31 December 2012, the official rate of exchange, as determined by the Central Bank of the Russian Federation, was USD 1 = RUR 30.3727 (31 December 2011: USD 1 = RUR 32.1961). The average rate for year ended 31 December 2012 was USD 1 = RUR 31.0930 (12 months 2011: USD 1 = RUR 29.3874).

2.5 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 Management Board determined retail operations as a single reportable segment.

2.6 Property, plant and equipment

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

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

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 to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in the consolidated income statement. An impairment loss recognized 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 to sell.

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

Land is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are as follows:

Buildings	20-50 years
Machinery and equipment	5-10 years
Refrigerating equipment	7-10 years
Vehicles	5-7 years
Other	3-5 years

Leasehold improvements are capitalized when it is probable that future economic benefits associated with the improvements will flow to the Company and the cost can be measured reliably. Capitalized leasehold improvements are depreciated over their useful lives but not longer than the terms of the respective leases.

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

2.7 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 recognizes the part of owned shopping centers 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 to sell. Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

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 20-50 years.

Fair value represents the price at which a property could be sold to a knowledgeable, willing party and has generally been determined using the comparative valuation approach. The Group did not engage an independent valuation specialist to assess the fair value of investment properties.

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Notes to Consolidated Financial Statements

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2. Summary of significant accounting policies continued

2.8 Intangible assets

a. Goodwill

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 allocated to groups of cash-generating units, which are expected to benefit from the synergies of the business combination. Such units or groups of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment.

b. Lease rights

Lease rights represent rights for favourable operating leases acquired in business combinations. Lease rights acquired in a business combination are recognized initially at fair value. Lease rights are amortized using the straight-line method over the lease term of the respective lease contracts – ranging from 5 to 50 years (20 on average).

c. Brand and private labels

Brand and private labels acquired in a business combination are recognized initially at fair value. Brand and private labels are amortized using the straight-line method over their useful lives:

	Useful lives
Brand	5-20 years
Private labels	1-8 years

d. Franchise agreements

Franchise agreements represent rights to receive royalties. Franchise agreements acquired in a business combination are recognized initially at fair value. Franchise agreements are amortized using the straight-line method over their useful lives that are, on average, ranging from 7 to 10 years (8 on average).

e. Other intangible assets

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

f. Prepaid leases

Prepaid leases are key money payments due to incumbent tenants for entering into lease contracts. Prepaid leases are amortized using the straight-line basis over their useful lives (terms of the lease contracts).

g. 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.

2.9 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 income statement on a straight-line basis over the period of the lease except preopening rentals capitalized as a part of retail store construction costs.

The Group leases retail outlets 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 unless the Group is virtually certain of the expected amount of the future lease payments in which case they are classified as minimum lease payments (Note 34).

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 recognized as prepaid leases.

2.10 Finance lease liabilities

Where the Group is a lessee in a lease, which transfers substantially all the risks and rewards incidental to ownership to the Group, the leased assets are capitalized in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are included in borrowings. The interest cost is charged to the consolidated income statement over the lease period using the effective interest method. The assets acquired under finance leases as well as leasehold improvements are depreciated over their useful life or the lease term, if shorter and if the Group is not reasonably certain that it will obtain ownership by the end of the lease.

2.11 Trade and other receivables

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

2.12 Inventories of goods for resale

Inventories at warehouses and retail outlets are stated at the lower of cost and net realizable value. Cost comprises direct costs of goods, transportation and handling costs. Cost is determined by the weighted average method. Net realizable 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 slow moving inventory where the expected time to sell exceeds norms established by the Group.

2.13 Financial assets and liabilities

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

Initial recognition of financial instruments

Financial assets at fair value through profit or loss are initially recorded at fair value. All other financial assets and liabilities are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. Subsequent to initial recognition, the fair values of financial instruments are measured at fair value by bid prices quoted on active markets. A gain or loss on initial recognition is only recorded if there is a difference between fair value and the transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

Impairment

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

Derecognition of financial assets

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

Derivative financial instruments and hedging activities

Financial assets at fair value through profit or loss are mainly derivatives.

Derivative financial instruments are recognized initially on a settlement date basis and subsequently remeasured at fair value. When derivative financial instruments are quoted on active markets subsequent remeasurement is based on active market quotations rather than valuation techniques. Derivative financial instruments including foreign exchange contracts, forward rate agreements, interest rate swaps and currency options are carried as trading assets or liabilities at fair value through profit or loss. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any these derivative instruments are recognized immediately in the consolidated income statement.

Loans and receivables

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term. Loans receivable and other receivables are carried at amortized cost using the effective interest rate method. Receivables are written off only in case of debtor's insolvency.

Available-for-sale investments

Available-for-sale investments are carried at fair value. Interest income on available for sale debt securities is calculated using the effective interest method and recognized in profit or loss. Dividends on available-for-sale equity instruments are recognized in profit or loss when the Group's right to receive payment is established. All other elements of changes in the fair value are deferred in other comprehensive income until the investment is derecognized or impaired at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognized in profit or loss when incurred as a result of one or more events ('loss events') that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognized in profit or loss – is removed from equity and recognized in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and such increase can objectively relate to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the current period's profit or loss.

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2. Summary of significant accounting policies continued

2.13 Financial assets and liabilities continued

Financial liabilities

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

2.14 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 with original maturities of three months or less.

2.15 Provisions

Provisions are recognized 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 balance sheet date.

2.16 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 recognized 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.

2.17 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.

2.18 Share-based payments

Employee stock option program

The Group issues options to certain employees that give the employees the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments.

Share-based payment transactions, or the components of such transactions, are accounted for as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

Share-based payments transactions are measured at the fair value of the compound financial instrument at the measurement date, taking into account the terms and conditions on which the rights to the cash or equity instruments were granted. The fair value is determined using the Black-Scholes option pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioral considerations.

A liability equal to the portion of the services received is recognized at the current fair value determined at each balance sheet date. The Group records an expense based on the fair value of options related to the shares expected to vest on a straight-line basis over the vesting period.

At the date of settlement, the Group will remeasure the liability to its fair value. If the Group issues equity instruments on settlement rather than paying cash, the liability will be transferred directly to equity, as the consideration for the equity instruments issued.

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 recognized as an expense over the vesting period and measured by reference to the market price of the GDRs which is determined at grant date.

2.19 Borrowings

Borrowings are initially recognized at their fair value, net of transaction costs, and are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated income statement 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 balance sheet date. Borrowing costs directly attributable to the acquisition, construction or production of assets necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalized as part of the costs of those assets.

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

2.20 Trade and other payables

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

2.21 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 recognized as share premium.

2.22 Dividends

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

2.23 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.

2.24 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.

2.25 Taxes

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 balance sheet date, taking into consideration applicable tax rates and tax exemptions.

Deferred income tax is provided, using the balance sheet 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 utilized. In accordance with the initial recognition exemption, 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 realized or the liability is settled, based on tax rates which are enacted or substantially enacted at the balance sheet date.

Taxes other than on income, interest and penalties are measured in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent. The Group provides against tax contingencies and the related interest and penalties where management can make a reliable estimate of the amount

of the additional taxes that may be due. 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.

Liabilities for such taxes, interest and penalties are measured at the best estimate of the expenditure required to settle the present obligation at the balance sheet date (Notes 29 and 34).

2.26 Income and expense recognition

Income and expenses are recognized on an accrual basis as earned or incurred. Recognition of the principal types of income and expenses is as follows:

a. Revenue

Revenue from the sale of goods through retail outlets is recognized at the point of sale. Revenue from franchisee fees is recognized based on contractual agreements over the term of the contracts. The up-front non-refundable franchisee fees received by the Group are deferred and recognized over contractual term. Revenue from advertising services is recognized based on contractual agreements. Revenues are measured at the fair value of the consideration received or receivable. Revenues are recognized net of value added tax.

The Group has a loyalty card scheme. Discounts earned by customers through loyalty cards, are recorded by the Group by allocating some of the consideration received from the initial sales transaction to the award credits and deferring the recognition of revenue.

b. Cost of sales

Cost of sales include 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.

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 recognized 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 amortization charges of non-current assets and other general and administrative expenses. Selling, general and administrative expenses are recognized on an accrual basis as incurred.

2. Summary of significant accounting policies continued

2.27 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 recognized whenever the carrying amount of an asset or the related cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in the consolidated income statement. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.28 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 finalized, any adjustments arising are recognized retrospectively.

2.29 Indemnification asset

The indemnification asset equivalent to the fair value of the indemnified liabilities is deducted from consideration transferred for the business combination if the selling shareholders of acquiree agreed to compensate possible claims or contingencies. Subsequent measurement of the indemnification asset and contingent liability will have no net impact on future earnings, unless the indemnification asset becomes impaired.

3. 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 recognized 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. No impairment loss on goodwill was recognized for the year ended 31 December 2012.

Provisional fair values of net assets of acquired businesses.

During the reporting period the Group made a several acquisitions (Note 7) and applied a number of estimates to define the provisional fair value of acquired businesses' net assets. In estimating the provisional values of property and lease rights, direct references to observable prices in an active market are used (market approach). Estimates of other assets and liabilities are consistent with the Group policies with regard to other subsidiaries.

Tax legislation. Russian tax, currency and customs legislation is subject to varying interpretations (Note 34).

Property, plant and equipment. The Group's management determines the estimated useful lives and related depreciation charges for its plant and equipment (Note 10). This estimate is based on projected product lifecycles and technical requirements. Management will increase the depreciation charge where useful lives are less than previously estimated lives or it will write-off or write-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 recognized in the consolidated income statement. For the year ended 31 December 2012 the Group recognized an impairment loss in the amount of USD 343,383.

Investment property. The Group's management determines the estimated useful lives and related depreciation charges for its investment properties (Note 11). This estimate is based on projected product lifecycles and technical requirements. Management will increase the depreciation charge where useful lives are less than previously estimated lives or it will write-off or write-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 recognized in the consolidated income statement. For the year ended 31 December 2012 the Group recognized an impairment loss in the amount of USD 25,900.

Fair value of lease rights. The Group's management determines the fair value of lease rights acquired in business combinations. The assessment of the fair value of lease rights is based on the estimate of the market rates of the lease (Note 13). For the year ended 31 December 2012 the Group recognized an impairment loss in the amount of USD 8,943.

Prepaid leases. The Group periodically assesses whether there is any indication that prepaid leases may be impaired. The Group performs assets impairment testing (Note 14). 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 recognized in the consolidated income statement. For the year ended 31 December 2012 the Group recognized an impairment loss in the amount of USD 19,690.

Inventories of goods for resale provisions. The Group provides for estimated inventory shrinkage on the basis of a 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 slow moving inventory where the expected time to sell exceeds norms established by the Group (Note 15).

Provision for impairment of trade and other receivables. The Group determines an allowance for doubtful accounts receivable at the end of the reporting period (Note 17). In estimating an allowance for uncollectible accounts receivable the Group takes into account the historical collectability of the outstanding accounts receivable balances supplemented by the judgement of management to exclude the impact of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

Fair value of franchise agreements. The Group's management determines the fair value of franchise agreements acquired in business combinations. The assessment of the fair value of franchise agreements is based on the income method using discounted royalty payments during the period of the agreements (Note 13).

Fair value of brand and private labels. The Group's management determines the fair value of brand and private labels acquired in business combinations. The assessment of the fair value of a brand is based on the income approach using the relief-from-royalty method. The assessment of fair value of private labels is based on either the income method using discounted annual savings for the remaining useful life of the labels or the cost method (Note 13). For the year ended 31 December 2012 the Group recognized an impairment in amount of USD 69,397.

4. Adoption of new and revised standards and interpretations and new accounting pronouncement

Certain new standards and interpretations became effective for the Group from 1 January 2012:

Disclosures – Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognized, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The amendment did not have any material effect on these consolidated financial statements.

Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendments to IFRS 1 (issued in December 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment regarding severe hyperinflation creates an additional exemption when an entity that has been subject to severe hyperinflation resumes presenting or presents for the first time, financial statements in accordance with IFRS. The exemption allows an entity to elect to measure certain assets and liabilities at fair value; and to use that fair value as the deemed cost in the opening IFRS statement of financial position. The IASB has also amended IFRS 1 to eliminate references to fixed dates for one exception and one exemption, both dealing with financial assets and liabilities. The first change requires first-time adopters to apply the derecognition requirements of IFRS prospectively from the date of transition, rather than from 1 January 2004. The second amendment relates to financial assets or liabilities where the fair value is established through valuation techniques at initial recognition and allows the guidance to be applied prospectively from the date of transition to IFRS rather than from 25 October 2002 or 1 January 2004. This means that a first-time adopter may not need to determine the fair value of certain financial assets and liabilities at initial recognition for periods prior to the date of transition. IFRS 9 has also been amended to reflect these changes. The Group does not expect the amendments to have any material effect on its financial statements.

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4. Adoption of new and revised standards and interpretations and new accounting pronouncement continued

Recovery of Underlying Assets – Amendments to IAS 12 (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012). The amendment introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale. This presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. SIC-21, *Income Taxes – Recovery of Revalued Non-Depreciable Assets*, which addresses similar issues involving non-depreciable assets measured using the revaluation model in IAS 16, *Property, Plant and Equipment*, was incorporated into IAS 12 after excluding from its scope investment properties measured at fair value. The Group does not expect the amendments to have any material effect on its financial statements.

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2012 and have not been early adopted:

IFRS 9, Financial Instruments Part 1: Classification and Measurement (issued in November 2009, effective for annual periods beginning on or after 1 January 2015, with earlier application permitted; not yet adopted by the EU). IFRS 9, issued in November 2010, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealized and realized fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income. While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2014, with earlier adoption permitted), which replaces all of the guidance on control and consolidation in IAS 27 'Consolidated and separate financial statements' and SIC-12 'Consolidation – special purpose entities'. The Group is currently assessing the impact of the new standard on its financial statements.

IFRS 11, Joint arrangements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2014, with earlier adoption permitted), which replaces IAS 31 'Interests in Joint Ventures' and SIC-13 'Jointly Controlled Entities – Non-Monetary Contributions by Venturers'. The Group does not expect the amendments to have any material effect on its financial statements.

IFRS 12, Disclosure of interest in other entities (issued in May 2011 and effective for annual periods beginning on or after 1 January 2014, with earlier adoption permitted), which requires new disclosures by entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. The Group is currently assessing the impact of the new standard on its financial statements.

IFRS 13, Fair value measurement (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), which aims to improve disclosures and achieve consistency by providing a revised definition of fair value. The Group is currently assessing the impact of the new standard on its financial statements.

IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures', (revised in May 2011 and effective for annual periods beginning on or after 1 January 2014, with earlier adoption permitted), which were changed by IFRS 10 'Consolidated Financial Statements' and IFRS 11 'Joint Arrangements'. The Group is currently assessing the impact of the new standard on its financial statements.

Amendments to IAS 1, Presentation of financial statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), which aim to improve the disclosure of items presented in other comprehensive income. The Group expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, Employee benefits (issued June 2011, effective for periods beginning on or after 1 January 2013), which makes changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The Group does not expect the amendments to have any material effect on its financial statements.

IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine, (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013), which considers when and how to account for the benefits arising from the stripping activity in mining industry. The Group does not expect the amendments to have any material effect on its financial statements.

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014), which clarifies the meaning of 'currently has a legally enforceable right of set-off'. The Group is considering the implications of the amendment, the impact on the Group and the timing of its adoption by the Group.

Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013), which requires disclosures that will enable users to better evaluate the effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Amendments to IFRS 1 First-time adoption of International Financial Reporting Standards – Government loans, which give first-time adopters of IFRSs relief from full retrospective application of accounting for certain government loans on transition. The Group does not expect the amendments to have any material effect on its financial statements.

Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013; not yet adopted by the EU), which consists of improvements to five standards. The Group is currently assessing the impact of the amendments on its financial statements.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued on 28 June 2012 and effective for annual periods beginning 1 January 2013; not yet adopted by the EU), which clarify the transition guidance in IFRS 10 'Consolidated Financial Statements' and provide additional transition relief from reporting comparative information under IFRS 10, IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of Interests in Other Entities'. The Group is currently assessing the impact of the amendments on its financial statements.

Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014; not yet adopted by the EU), which introduced a definition of an investment entity which will be required to carry its investee subsidiaries at fair value through profit or loss. The Group is currently assessing the impact of the amendments on its financial statements. Unless otherwise described above, the new interpretations are not expected to significantly affect the Group's consolidated financial statements.

5. Segment reporting

The Group identifies retailing operations as a single reportable segment.

The Group is engaged in management of retail stores located in Russia and Ukraine. The Group identified the segment in accordance with the criteria set forth in IFRS 8 and based on the way the operations of the Company are regularly reviewed by the chief operating decision maker to analyze performance and allocate resources among business units of the Group.

The chief operating decision-maker has been determined as the Management Board. The Management Board reviews the Group's internal reporting in order to assess performance and allocate resources. Management has determined a single operating segment being retailing operations including royalties, advertising, communications and rent income based on these internal reports data.

The segment represents the Group's retail business in the European part of Russia and Ukraine. Currently the Group's Ukraine business unit's contribution to the financial results of the Group is immaterial.

Within the segment all business components demonstrate similar economic characteristics and are alike as follows:

- the products and customers;
- the business processes are integrated and uniform: the Group manages its store operations centrally, sources products centrally, supporting functions like Purchasing, Logistics, Development, Finance, Strategy, HR, IT, etc. are centralized;
- the Group's activities are limited to a common market zone (i.e. Russia) with uniform legislation and regulatory environment.

The Management Board assesses the performance of the operating segment based on a measure of sales and adjusted earnings before interest, tax, depreciation, and amortization (EBITDA). Other information provided to the Management Board is measured in a manner consistent with that in the consolidated financial statements.

The accounting policies used for segments are the same as accounting policies applied for these consolidated financial statements as described in Note 2.

The segment information for the year ended 31 December 2012 is as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Retail sales	15,778,468	15,431,772
Other revenue	16,781	23,316
Revenue	15,795,249	15,455,088
EBITDA	1,123,844	1,130,242
Capital expenditure	902,067	850,099
Total assets	9,582,380	8,810,196
Total liabilities	7,380,579	6,614,224

Capital expenditure includes additions to intangible assets (Note 13 and Note 14).

A reconciliation of EBITDA to loss for the year is provided as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
EBITDA	1,123,844	1,130,242
Depreciation, amortization and impairment	(932,422)	(428,258)
Operating profit	191,422	701,984
Finance cost, net	(325,860)	(297,693)
Net foreign exchange result	(2,496)	812
Share of loss of associates	(90)	–
(Loss)/Profit before income tax	(137,024)	405,103
Income tax benefit/(expense)	10,527	(102,912)
(Loss)/Profit for the year	(126,497)	302,191

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6. Subsidiaries

Details of the Company's significant subsidiaries at 31 December 2012 and 31 December 2011 are as follows:

Company	Country	Nature of operations	Ownership (%)	
			31 December 2012	31 December 2011
Agroaspekt OOO	Russia	Retailing	100	100
Agrotorg OOO	Russia	Retailing	100	100
Alpegru Retail Properties Ltd.	Cyprus	Real estate	100	100
GSWL Finance Ltd.	Cyprus	Financing	100	100
Key Retail Technologies Ltd.	Gibraltar	Holding company	100	100
Perekrestok Holdings Ltd.	Gibraltar	Holding company	100	100
Sladkaya Zhizn N.N. OOO	Russia	Retailing	100	100
Speak Global Ltd.	Cyprus	Holding company	100	100
TH Perekrestok ZAO	Russia	Retailing	100	100
X5 Finance OOO	Russia	Bond issuer	100	100
X5 Nedvizhimost ZAO	Russia	Real estate	100	100
X5 Retail Group Ukraine ZAT	Ukraine	Retailing	100	100
TD Kopeyka OAO	Russia	Holding Company	100	100
Kopeyka-Moscow OOO	Russia	Retailing	100	100
TF Samara-Product OOO	Russia	Retailing	100	100
Kopeyka-Voronezh OOO	Russia	Retailing	100	100
Kopeyka-Povolzhye OOO	Russia	Retailing	100	100

7. Acquisition of subsidiaries

In 2012 the Group acquired several businesses of other retail chains in Russian regions.

These 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 2012 as though the acquisition date had been the beginning of that period.

Details of assets and liabilities acquired and the related goodwill are as follows:

	Provisional values at the acquisition date
Trade and other accounts receivable	231
Intangible assets (Note 13)	15,628
Property, plant and equipment (Note 10)	21,795
Deferred tax assets	4,613
Deferred tax liability	(600)
Net assets acquired	41,667
Goodwill (Note 12)	37,826
Total acquisition cost	79,493
Net cash outflow arising from the acquisition	77,432

The Group assigned provisional 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 finalize the purchase price allocation within 12 months from the acquisition date.

The purchase consideration comprises cash and cash equivalents of USD 77,432 and deferred consideration of USD 2,061.

The goodwill recognized is attributable to: i) the business concentration in the Russian regions and ii) expected cost synergies from the business combination.

8. Related party transactions

Parties are generally considered to be related if one party has the ability to control the other party, is under common control or can exercise significant influence over the other party in making financial or operational decisions. 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 2012 are provided below. The ownership structure is disclosed in Note 1.

Alfa Group Consortium

The following transactions were carried out with members or management of Alfa Group Consortium:

	Relationship	2012	2011
CTF Holdings Ltd.	Ultimate parent company		
Management services received		1,452	1,417
Recharged expenses		63	112
Alfa-Bank	Under common control		
Interest expense on loan received		34,384	18,706
Commission income		702	1,023
Interest income		116	205
Bank charges		159	1,013
Rent revenue		684	348
VimpelCom	Under significant influence of CTF Holdings Ltd.		
Communication services received		9,242	6,255
Commission for mobile phone payments processing rendered by the Group to VimpelCom		297	650
Rent revenue		331	219
AlfaInsurance	Under common control		
Insurance expenses		4,480	3,088
Megafon	Under significant influence of CTF Holdings Ltd.		
Commission for mobile phone payments processing rendered by the Group to Megafon		1,150	547
Rent revenue		600	363

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8. Related party transactions continued

The consolidated financial statements include the followings balances with members of the Alfa Group Consortium:

	Relationship	2012	2011
CTF Holdings Ltd.	Ultimate parent company		
Other accounts payable		36	23
Alfa-Bank	Under common control		
Cash and cash equivalents		25,437	74,018
Receivable from related party		690	506
Short-term loans payable		493,865	347,868
Other accounts payable		407	264
Long-term loans payable		–	93,179
Accrued interests		399	–
AlfaInsurance	Under common control		
Receivable from related party		174	7
Other accounts payable		312	526
VimpelCom	Under significant influence of CTF Holdings Ltd.		
Receivable from related party		160	288
Other accounts payable		993	1,292
Megafon	Under significant influence of CTF Holdings Ltd.		
Receivable from related party		81	392
Other accounts payable		614	73

Alfa-Bank

The Group has an open credit line with Alfa-Bank with a maximum limit of RUR 19,300 million or USD 635,439 (31 December 2011: RUR 15,100 million or USD 469,001). At 31 December 2012 the Group's liability under this credit line amounted to USD 493,865 with interest rates of 7.8-8.3% p.a. (31 December 2011: USD 441,047) and available credit line of USD 141,574 (31 December 2011: USD 27,954). The Group has certain purchase agreements under which the Group settles its liabilities to Alfa-Bank in accordance with factoring arrangements concluded between vendors of goods and Alfa-Bank.

Magazin Budushego

In 2012 the Group together with Rosnano and Sitronics made additional investments in Magazin Budushego. The amount paid by the Group equaled to USD 1,406, the share in associate didn't change and equals to 33.34%. At 31 December 2012 investment in associate equals to USD 2,759 and for the year then ended total assets, liabilities, revenue and loss of associate are not significant. The Group did not have significant balances and transactions with associate.

Key management personnel compensation

Key management personnel compensation is disclosed in Note 27.

9. Cash and cash equivalents

	31 December 2012	31 December 2011
Cash in hand – Roubles	48,022	39,827
Cash in hand – Ukrainian Hryvnia	302	240
Bank current account – Roubles	82,694	139,053
Bank current account – Ukrainian Hryvnia	35	3
Bank current accounts and deposits – US Dollars	552	9,463
Cash in transit – Roubles	273,512	189,376
Cash in transit – Ukrainian Hryvnia	1,438	1,037
Short-term deposits – Roubles	1,321	5,983
Other cash equivalents	1	19
	407,877	385,001

The bank accounts represent current accounts. Interest income on overnights/term deposits is immaterial. Cash in transit is cash transferred from retail outlets to bank accounts and bank card payments being processed.

The Group assesses credit quality of outstanding cash and cash equivalents balances as high and considers that there is no significant individual exposure. Maximum exposure to credit risk at the reporting date is the carrying value of cash and bank balances.

Credit quality of cash and cash equivalents balances are summarized as follows (current ratings):

Bank	Moody's	Fitch	S&P	31 December 2012	31 December 2011
Alfa-Bank	Ba1	BBB-	BB+	25,437	74,018
Sberbank	Baa1	BBB	–	39,744	49,694
Raiffeisenbank	Baa3	BBB+	BBB	903	9,557
HSBC	Aa3	AA-	AA-	703	8,524
MCB	B1/NP	BB-	B+	9,298	5,337
Gazprombank	Baa3	–	BBB-	577	2,080
VTB	Baa1	–	BBB	325	1,364
Other banks				6,294	3,928
Cash in transit and in hand				324,595	230,480
Other monetary assets				1	19
Total				407,877	385,001

10. Property, plant and equipment

	Land and buildings	Machinery and equipment	Refrigerating equipment	Vehicles	Other	Construction in progress	Total
Cost							
At 1 January 2011	3,124,553	418,298	261,852	83,252	208,602	254,260	4,350,817
Additions	1,106	777	675	121	171	792,201	795,051
Transfers (Note 11)	250,647	72,404	81,333	25,502	74,795	(517,306)	(12,625)
Assets from acquisitions (Note 7)	13,250	1,620	2,816	19	361	27	18,093
Disposals	(24,485)	(15,722)	(12,656)	243	(4,846)	(16,146)	(73,612)
Translation movement	(187,281)	(28,054)	(20,480)	(6,704)	(17,832)	(35,935)	(296,286)
At 31 December 2011	3,177,790	449,323	313,540	102,433	261,251	477,101	4,781,438
Additions	–	–	–	–	–	812,042	812,042
Transfers (Note 11)	485,013	52,160	149,368	133,094	125,784	(945,419)	–
Assets from acquisitions (Note 7)	–	38	271	–	38	21,448	21,795
Disposals	(34,410)	(10,151)	(4,836)	(19)	(6,383)	(33,489)	(89,288)
Translation movement	201,525	27,965	22,260	9,277	18,275	25,435	304,737
At 31 December 2012	3,829,918	519,335	480,603	244,785	398,965	357,118	5,830,724

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10. Property, plant and equipment continued

	Land and buildings	Machinery and equipment	Refrigerating equipment	Vehicles	Other	Construction in progress	Total
Accumulated depreciation							
At 1 January 2011	(376,750)	(154,733)	(92,344)	(18,518)	(96,430)	(21,017)	(759,792)
Depreciation charge	(126,963)	(66,922)	(37,348)	(15,491)	(49,452)	(981)	(297,157)
Disposals	17,329	8,312	7,784	24	3,104	–	36,553
Translation movement	29,449	18,190	7,288	2,310	5,404	1,210	63,851
At 31 December 2011	(456,935)	(195,153)	(114,620)	(31,675)	(137,374)	(20,788)	(956,545)
Depreciation charge	(136,150)	(68,455)	(48,678)	(28,781)	(61,637)	–	(343,701)
Impairment charge	(211,759)	(31,159)	(12,454)	(50,672)	(19,511)	(17,828)	(343,383)
Disposals	14,417	5,773	2,543	5	2,581	7,327	32,646
Translation movement	(36,079)	3,473	(25,745)	(682)	(11,946)	(1,497)	(72,476)
At 31 December 2012	(826,506)	(285,521)	(198,954)	(111,805)	(227,887)	(32,786)	(1,683,459)
Net book value at 31 December 2012	3,003,412	233,814	281,649	132,980	171,078	324,332	4,147,265
Net book value at 31 December 2011	2,720,855	254,170	198,920	70,758	123,877	456,313	3,824,893
Net book value at 1 January 2011	2,747,803	263,565	169,508	64,734	112,172	233,243	3,591,025

Construction in progress predominantly relates 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 are collateralised by land and buildings including investment property as of 31 December 2012.

Impairment test

At the end of 2012 management performed impairment test of land, buildings, construction in progress, vehicles, equipment and other items of property, plant and equipment. The approach for determination of the recoverable amount of an asset was different for each listed class of property, plant and equipment.

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. 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 to sell or value in use.

The resulted impairment charge primarily arose from underperforming stores, mainly in the hypermarket format, where changes to the strategy and operating model have not improved historical performance.

Fair value less costs to sell

The Group defines fair value less costs to sell of the item of land and buildings and construction in progress either by reference to current observable prices on an active market or to market value determined by independent appraiser. The fair value less costs to sell of vehicles is determined based on prices on an active market.

Value in use

For items of land, buildings and construction in progress the discounted free cash flow approach is applied and covered a 10 year period from 2013. The free cash flows are based on the current budgets and forecasts approved by key management. For the subsequent years, the data of the strategic plan are extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. The projections are made in the functional currency of the Group and discounted at the Group weighted average cost of capital (12%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economical 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 estimates.

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.

For items of vehicles which cannot generate future cash inflows, value in use is determined as zero.

Value in use of equipment and other property, plant and equipment items is defined by selective testing of physical condition.

11. Investment property

The Group held the following investment properties at 31 December 2012 and 31 December 2011:

	2012	2011
Cost		
Cost at 1 January	163,769	162,119
Transfer from property, plant and equipment (Note 10)	–	12,625
Disposals	(9,170)	(961)
Translation movement	9,615	(10,014)
Cost at 31 December	164,214	163,769
Accumulated depreciation		
Accumulated depreciation at 1 January	(22,735)	(16,476)
Depreciation charge	(6,762)	(7,881)
Impairment charge	(25,900)	–
Disposals	1,792	111
Translation movement	(2,097)	1,511
Accumulated depreciation at 31 December	(55,702)	(22,735)
Net book value at 31 December	108,512	141,034
Net book value at 1 January	141,034	145,643

Rental income from investment property amounted to USD 29,608 (2011: USD 32,390). Direct operating expenses incurred by the Group in relation to investment property amounted to USD 11,989 (2011: USD 10,277). There were not 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 2012 amounted to USD 118,440 (31 December 2011: USD 363,158).

Impairment test

At the end of 2012 management performed impairment test of investment property by identifying non-core assets which the Group intends to sell.

The evaluation is performed consistently with the approach for impairment testing of PPE (Note 10).

12. Goodwill

Movements in goodwill arising on the acquisition of subsidiaries at 31 December 2012 and 31 December 2011 are:

	2012	2011
Cost		
Gross book value at 1 January	4,017,508	4,201,013
Acquisition of subsidiaries (Note 7)	37,826	47,284
Translation to presentation currency	242,225	(230,789)
Gross book value at 31 December	4,297,559	4,017,508
Accumulated impairment losses		
Accumulated impairment losses at 1 January	(2,059,632)	(2,175,817)
Translation to presentation currency	(123,648)	116,185
Accumulated impairment losses at 31 December	(2,183,280)	(2,059,632)
Carrying amount at 31 December	2,114,279	1,957,876
Carrying amount at 1 January	1,957,876	2,025,196

Goodwill impairment test

Goodwill is monitored for internal management purposes at the operating segment level being retail trading in Russia (CGU).

Goodwill is tested for impairment at the CGU level by comparing carrying values of CGU assets to their recoverable amounts. The recoverable amount of CGU is determined as the higher of fair value less cost to sell or value in use.

Fair value less costs to sell

The Group defines fair value less costs to sell of the CGU by reference to an active market, i.e. as a market capitalization of the Group on the London Stock Exchange, since the Group's activities other than retail trade in Russia do not have a significant effect on the fair value. For indication purposes fair value less costs to sell of the CGU will be lower than its carrying amount if the GDR price falls below the level of USD 8.12 per GDR. The market capitalization of the Group at 31 December 2012 amounted to USD 4,842,279 significantly exceeding the carrying value of the CGU. Costs to sell are considered to be insignificant.

Value in use

The discounted free cash flow approach is utilized. For the 10 year period from 2013 the free cash flows are based on the current budgets and forecasts approved by key management. For the subsequent years, the data of the strategic plan are extrapolated based on the consumer price index as obtained from external resources and based on key performance indicators inherent to the strategic plan. The projections are made in the functional currency of the Group and discounted at the Group weighted average cost of capital (12%). Inflation rates are in line with consumer price index forecast published by the Ministry of Economical 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 estimates.

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12. Goodwill continued

Model applied for impairment testing is not sensitive to assumptions used by management because fair value less cost to sell and value in use are significantly greater than carrying values of 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 CGU exceeded its carrying amount therefore no impairment was recognized.

13. Intangible assets

Intangible assets comprise the following:

	Brand and private labels	Franchise agreements	Software and other	Lease rights	Total
Cost					
At 1 January 2011	558,416	87,490	90,829	166,463	903,198
Additions	–	–	22,296	103	22,399
Acquisition of subsidiaries (Note 7)	4,076	–	–	10,480	14,556
Disposals	–	(13,506)	(428)	(1,459)	(15,393)
Translation movement	(30,372)	(3,493)	(6,792)	(9,883)	(50,540)
At 31 December 2011	532,120	70,491	105,905	165,704	874,220
Additions	17	–	29,636	12,623	42,276
Acquisition of subsidiaries (Note 7)	–	–	–	15,628	15,628
Disposals	–	–	(183)	(8,793)	(8,976)
Translation movement	31,946	4,232	7,096	10,118	53,392
At 31 December 2012	564,083	74,723	142,454	195,280	976,540
Accumulated amortization					
At 1 January 2011	(87,371)	(41,810)	(9,743)	(45,420)	(184,344)
Amortization charge	(63,240)	(16,520)	(25,825)	(17,635)	(123,220)
Disposals	–	13,506	417	1,180	15,103
Translation movement	10,182	2,495	2,841	3,749	19,267
At 31 December 2011	(140,429)	(42,329)	(32,310)	(58,126)	(273,194)
Amortization charge	(58,268)	(8,719)	(13,662)	(21,416)	(102,065)
Impairment charge	(69,397)	–	–	(8,943)	(78,340)
Disposals	–	–	99	1,108	1,207
Translation movement	(11,459)	(2,748)	(2,275)	(4,183)	(20,665)
At 31 December 2012	(279,553)	(53,796)	(48,148)	(91,560)	(473,057)
Net book value at 31 December 2012	284,530	20,927	94,306	103,720	503,483
Net book value at 31 December 2011	391,691	28,162	73,595	107,578	601,026
Net book value at 1 January 2011	471,045	45,680	81,086	121,043	718,854

Impairment test

At the end of 2012 management performed impairment test of lease rights and brands.

The evaluation for lease rights is performed consistently with the approach for impairment testing of property, plant and equipment (Note 10).

The evaluation for brands is performed at the lowest level of identifiable cash flows, which is generally at the individual unit level. 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 unit with their carrying values. The recoverable amount of the unit is determined as the higher of fair value less cost to sell or value in use.

Fair value less costs to sell

No active market exists for retail brands therefore value in use is used for impairment test purpose.

Value in use

Value in use is determined for each brand under which the store is performing. Discounted free cash flow approach is applied and covered a 10 year period from 2013. The free cash flows are based on the current budgets and forecasts approved by key management. For the subsequent years, the data of the strategic plan are extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. The projections are made in the functional currency of the Group and discounted at the Group weighted average cost of capital (12%). Inflation rates are in line with consumer price index forecast published by the Ministry of Economical 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 estimates.

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.

All the stores under Kopeyka brand were rebranded, therefore value in use of Kopeyka brand is equal to zero.

14. Prepaid leases

Prepaid leases comprise the following:

	2012	2011
Cost		
Cost at 1 January	125,202	132,438
Additions	10,326	8,299
Disposals	(13,311)	(792)
Reclassification	–	(7,686)
Translation movement	7,447	(7,057)
Cost at 31 December	129,664	125,202
Accumulated amortization		
Accumulated amortization at 1 January	(44,134)	(32,576)
Amortization charge	(12,581)	(14,569)
Impairment charge	(19,690)	–
Disposals	3,466	–
Translation movement	(3,333)	3,011
Accumulated amortization at 31 December	(76,272)	(44,134)
Net book value at 31 December	53,392	81,068
Net book value at 1 January	81,068	99,862

In 2011 the Group reclassified prepayments to landlords to other non-current assets under IAS 17 'Leases'.

Impairment test

At the end of 2012 management performed impairment test of intangible assets.

The evaluation is performed consistently with the approach for impairment testing of PPE (Note 10).

15. Inventories of goods for resale

Inventories of goods for resale as of 31 December 2012 and 31 December 2011 comprise the following:

	31 December 2012	31 December 2011
Inventories of goods for resale	1,179,381	968,636
Less: provision for shrinkage and slow moving stock	(64,487)	(73,629)
	1,114,894	895,007

Inventory shrinkage and slow moving stock recognized as cost of sales in the consolidated income statement amounted to USD 423,209 (2011: USD 345,619).

16. Financial instruments by category

	Loans and receivables	Available-for-sale investments	Total
31 December 2012			
Assets as per consolidated statement of financial position			
Available-for-sale investments	–	6,928	6,928
Trade and other receivables excluding prepayments	367,624	–	367,624
Loans originated	3,033	–	3,033
Cash and cash equivalents	407,877	–	407,877
Total	778,534	6,928	785,462
		Financial liabilities at amortized cost	

31 December 2012	
Liabilities as per consolidated statement of financial position	
Borrowings (excluding finance lease liabilities)	4,027,267
Interest accrued	20,980
Finance lease liabilities	1,476
Trade and other payables excluding statutory liabilities and advances	2,908,529
Total	6,958,252

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16. Financial instruments by category continued

	Loans and receivables	Available- for-sale investments	Total
31 December 2011			
Assets as per consolidated statement of financial position			
Available-for-sale investments	–	6,535	6,535
Trade and other receivables excluding prepayments	300,191	–	300,191
Loans originated	19,811	–	19,811
Cash and cash equivalents	385,001	–	385,001
Total	705,003	6,535	711,538

	Financial liabilities at amortized cost
31 December 2011	
Liabilities as per consolidated statement of financial position	
Borrowings (excluding finance lease liabilities)	3,610,037
Interest accrued	12,422
Finance lease liabilities	3,565
Trade and other payables excluding statutory liabilities and advances	2,312,234
Total	5,938,258

17. Trade and other accounts receivable

	31 December 2012	31 December 2011
Trade accounts receivable	348,126	311,238
Advances made to trade suppliers	36,092	7,573
Other receivables	97,328	70,083
Prepayments	71,742	68,699
Accounts receivable for franchise services	1,249	1,416
Receivables from related parties (Note 8)	1,105	1,193
Provision for impairment of trade and other receivables	(135,077)	(98,419)
	420,565	361,783

All classes of receivables are categorized as loans and receivables under IAS 39 classification. The carrying amounts of the Group's trade and other receivables are primarily denominated in Russian Roubles. Other non-current assets are mainly represented by long-term prepayments for rent.

Trade receivables

There are balances of USD 55,661 that in accordance with accounting policies are past due but not impaired as at 31 December 2012 (31 December 2011: USD 65,198).

The ageing of these receivables based on days outstanding is as follows:

	31 December 2012	31 December 2011
2-6 months	37,029	55,216
Over 6 months	18,632	9,982
	55,661	65,198

Movements on the provision for impairment of trade receivables are as follows:

	2012	2011
At 1 January	(41,030)	(24,461)
Addition of provision for receivables impairment	(11,868)	(33,336)
Release of provision for receivables impairment	16,636	14,214
Receivables written off as uncollectable	4,065	–
Translation movement	(1,651)	2,553
At 31 December	(33,848)	(41,030)

The creation and release of the provision for impaired receivables have been included in general and administrative costs in the consolidated income statement.

The individually impaired trade receivables mainly relate to debtors that expect financial difficulties or there is likelihood of the debtor's insolvency. It was assessed that a portion of the receivables is expected to be recovered.

The ageing of amounts receivable that are individually impaired based on days outstanding is as follows:

	31 December 2012	31 December 2011
3-6 months	490	2,610
Over 6 months	33,358	38,420
	33,848	41,030

For those receivables that are neither past due nor impaired the Group considers the credit quality as high. Trade receivables are mainly bonuses from suppliers of goods for resale receivable on quarterly basis with a low historic default rate. The maximum exposure to credit risk at the reporting date is the carrying amount of each class of receivable mentioned above. The Group does not hold any collateral as security.

Other receivables, advances made to trade suppliers, prepayments and receivables for franchise services

There are balances of USD 50,262 that in accordance with accounting policies are past due but not impaired as at 31 December 2012 (31 December 2011: USD 17,052).

The ageing of these receivables based on days outstanding is as follows:

	31 December 2012	31 December 2011
2-6 months	24,588	7,424
Over 6 months	25,674	9,628
	50,262	17,052

Movements on the provision for impairment of other receivables and prepayments are as follows:

	2012	2011
At 1 January	(57,389)	(12,855)
Addition of provision for receivables impairment	(68,408)	(57,900)
Release of provision for receivables impairment	16,096	7,236
Receivables written off as uncollectable	13,865	–
Translation movement	(5,393)	6,130
At 31 December	(101,229)	(57,389)

The creation and release of the provision for impaired receivables has been included in general and administrative costs in the consolidated income statement.

The individually impaired other receivables mainly relate to debtors that expect financial difficulties or there is likelihood of the debtor's insolvency. It was assessed that a portion of the receivables are expected to be recovered.

The ageing of amounts receivable that are individually impaired based on days outstanding is as follows:

	31 December 2012	31 December 2011
3-6 months	1,328	2,475
Over 6 months	99,901	54,914
	101,229	57,389

For those receivables that are neither past due nor impaired the Group considers the credit quality as high. The maximum exposure to credit risk at the reporting date is the carrying amount of each class of receivable mentioned above. The Group does not hold any collateral as security.

18. VAT and other taxes recoverable

	31 December 2012	31 December 2011
VAT recoverable	365,283	274,636
Other taxes recoverable	12,718	21,277
	378,001	295,913

VAT recoverable related to property, plant and equipment of USD 6,141 (31 December 2011: USD 17,552) is recorded within current assets because management expects it will be recovered within 12 months after the balance sheet date. The terms of recovery of VAT depend on the registration of certain property, plant and equipment or stage of completion of the construction works and fulfilment of other conditions in compliance with Russian tax legislation, therefore there are risks that recovering the balance may take longer than 12 months.

19. Provisions and other liabilities

	31 December 2012	31 December 2011
Taxes other than income tax	141,773	232,688
Provisions and liabilities for tax uncertainties (Note 34)	47,436	119,382
Accrued salaries and bonuses	191,843	149,481
Payables to landlords	14,345	19,121
Other accounts payable and accruals	198,803	194,850
Accounts payable for property, plant and equipment	106,604	42,417
Advances received	56,500	43,787
	757,304	801,726

There are no significant amounts of payables to foreign counterparties as at 31 December 2012 and 31 December 2011.

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20. Borrowings

31 December 2012				
	Interest rate, % p.a.	Current During 1 year	Non-current In 1 to 4 years	Total
RUR Club loan	MosPrime 3M +2.5%	405,223	–	405,223
RUR Bonds TH Kopeyka series BO-01	7%	4,136	–	4,136
RUR Bonds TH Kopeyka series BO-02	9%	98,773	–	98,773
RUR Bonds X5 Finance series 01	7.95%	–	229,004	229,004
RUR Bonds X5 Finance series 04	7.75%	–	189,858	189,858
RUR Bonds X5 Finance series BO-01	9.5%	–	164,274	164,274
RUR Bilateral Loans	MosPrime 3M +2.6%-2.7%	–	817,532	817,532
RUR Bilateral Loans	7.75%-9.8%	1,172,755	945,712	2,118,467
Total borrowings		1,680,887	2,346,380	4,027,267

31 December 2011				
	Interest rate, % p.a.	Current During 1 year	Non-current In 1 to 3 years	Total
RUR Club loan	MosPrime 1M +2.5%	–	380,343	380,343
RUR Bonds TH Kopeyka series 02	16.5%	54,197	–	54,197
RUR Bonds TH Kopeyka series 03	9.8%	64,018	–	64,018
RUR Bonds TH Kopeyka series BO-01	9.5%	93,720	–	93,720
RUR Bonds TH Kopeyka series BO-02	9%	–	93,317	93,317
RUR Bonds X5 Finance series 01	7.95%	–	215,758	215,758
RUR Bonds X5 Finance series 04	7.75%	–	179,105	179,105
RUR Bilateral Loans	MosPrime 1-3M +2.7%-3.1%	7,193	498,023	505,216
RUR Bilateral Loans	6.9%-9.8%	689,368	1,330,331	2,019,699
RUR Loans from acquisition	0%-13%	4,664	–	4,664
Total borrowings		913,160	2,696,877	3,610,037

In February 2012 the Group redeemed Kopeyka's bonds series 02 and 03 in the total amount of RUR 3.8 billion with the coupon rates at 16.5% and 9.8% per annum, respectively.

In June 2012 the Group signed additional agreements with Credit Bank of Moscow to increase total limit up to RUR 5.5 billion. In June 2012 the Group signed new committed credit line with Sberbank in the total limit of RUR 10 billion available for 3 years.

In July the Group fulfilled its obligations in respect of RUR 3 billion Kopeyka bonds. As a result of put option realization bonds series BO-01 with notional amount of RUR 2.87 billion were repaid by the Group. Coupon rate for the remaining portion was set at the level of 7.00%.

In August 2012 the Group entered into a new RUR 9 billion long-term loan from VTB Capital for 3.5 years.

In April 2012 Sberbank approved for the Group new 3 year limit in the amount of RUR 4 billion. In September 2012 the line was executed by the Group.

In October 2012 the Group signed new committed credit lines with Sberbank in the total limit of RUR 20 billion available for 5 years.

In October 2012 the Group has successfully placed BO-01 new series corporate bonds in the amount of RUR 5 billion with annual coupon rate of 9.5% and 3-year maturity.

All borrowings at 31 December 2012 are shown net of related transaction costs of USD 18,722 which are amortized over the term of loans using the effective interest method (31 December 2011: USD 19,097). Borrowing costs capitalized for the year ended 31 December 2012 amounted to USD 10,365 (2011: USD 5,546). Capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 8.70% (2011: 5.34%).

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), minimum level of EBITDA/Net Interest expense (2.75).

21. Share capital

As at 31 December 2012 the Group had 190,000,000 authorized ordinary shares of which 67,819,033 ordinary shares are outstanding and 74,185 ordinary shares held as treasury stock. The nominal par value of each ordinary share is EUR 1.

No dividends were paid or declared during the year ended 31 December 2012 and the year ended 31 December 2011.

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 are calculated as follows:

	2012	2011
(Loss)/Profit attributable to equity holders of the parent	(126,497)	301,430
Weighted average number of ordinary shares in issue	67,819,033	67,816,117
Effect of share options granted to employees, number of shares	9,692	33,531
Weighted average number of ordinary shares for the purposes of diluted earnings per share	67,828,725	67,849,648
Basic earnings per share for (loss)/profit from continuing operations (expressed in USD per share)	(1.87)	4.44
Diluted earnings per share for (loss)/profit from continuing operations (expressed in USD per share)	(1.86)	4.44

23. Revenue

	2012	2011
Revenue from sale of goods	15,778,468	15,431,772
Revenue from franchise services	3,059	6,073
Revenue from other services	13,722	17,243
	15,795,249	15,455,088

24. Expenses by nature

	2012	2011
Cost of goods sold	11,486,465	11,245,485
Staff costs (Note 27)	1,645,444	1,519,601
Operating lease expenses	652,067	614,220
Depreciation, amortization	465,109	428,258
Impairment	467,313	–
Other store costs	305,872	291,755
Utilities	342,361	342,218
Other	413,379	505,799
	15,778,010	14,947,336

Operating lease expenses include USD 630,949 (2011: USD 595,014) of minimum lease payments and contingent rents of USD 21,118 (2011: USD 19,206).

Provision for impairment of trade and other receivables amounted to USD 33,098 for the year ended 31 December 2012 (2011: USD 59,335).

25. Operating lease/sublease income

The Group leases part of its store space to companies selling supplementary goods and services to customers. The lease arrangements are operating leases, the majority of which are short-term. The future minimum lease payments receivable under non-cancellable operating leases are as follows:

	31 December 2012	31 December 2011
Not later than 1 year	63,226	62,764
Later than 1 year and no later than 5 years	24,088	19,738
Later than 5 years	3,782	4,346
	91,096	86,848

The future minimum lease payments receivable under non-cancellable operating subleases are as follows:

	31 December 2012	31 December 2011
Not later than 1 year	19,612	19,519
Later than 1 year and no later than 5 years	1,761	316
Later than 5 years	–	2
	21,373	19,837

The rental income from operating leases recognized in the consolidated income statement amounted to USD 162,194 (2011: USD 177,409). There were no contingent rents recognized in the consolidated income statement in the year ended 31 December 2012 (2011: nil).

26. Finance income and costs

	2012	2011
Interest expense	339,962	290,099
Interest income	(11,098)	(4,244)
Other finance costs, net	(3,004)	11,838
	325,860	297,693

Other finance costs include transaction costs of USD 7,043 written-off to the consolidated income statement (2011: USD 12,907) (Note 20).

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27. Staff costs

	2012	2011
Wages and salaries	1,286,913	1,209,392
Social security costs	354,519	350,581
Share-based payments expense/(income)	4,012	(40,372)
	1,645,444	1,519,601

Key executive management personnel

The Group key management personnel consists of Management Board and Supervisory Board members, having authority and responsibility for planning, directing and controlling the activities of the Company as a whole. Members of the Management Board and Supervisory Board of the Group receive compensation in the form of a short-term compensation in cash (including, for Management Board members, an annual cash bonus and share-based payments (Note 28)). For the year ended 31 December 2012 members of the Management Board and Supervisory Board of the Group were entitled to total short-term compensation of USD 5,970 (2011: USD 9,542), including accrued annual target bonuses of USD 109 (2011: USD 1,822) payable on an annual basis subject to meeting annual performance targets and termination payment of USD 1,351 (2011: 2,863). As at 31 December 2012 the total amount of GDRs for which options were granted to members of the Management Board and Supervisory Board under the ESOP was 70,000 (31 December 2011: 325,000 GDRs) and conditional rights under LTI plan was 258,449 (31 December 2011: 258,885). During the year ended 31 December 2012 the Group recognized expenses from share-based compensation to Management Board and Supervisory Board members in amount of USD 1,007 (2011: income of USD 18,769). The total intrinsic value of vested share options amounted to USD 276 as at 31 December 2012 (31 December 2011: USD 625).

28. Share-based payments

Employee stock option program

In 2007 the Group introduced an employee stock option program (ESOP) for its key executives and employees. Each option that may be granted under the ESOP carries the right to one GDR. The program ran in four tranches granted over the period to 19 May 2009. The vesting requirement of the program is the continued employment of participants. The first, second and third tranches expired as at 31 December 2012. Participants of the ESOP can exercise their share options granted under fourth tranche until 20 November 2013, at any time except black-out periods defined by Group's Code of Conduct of Insider Dealing, exercise price of the fourth tranche are USD 13.91.

In total, during the year ended 31 December 2012 the Group recognized an income related to the ESOP in the amount of USD 896 (income recognized during the year ended 31 December 2011: USD 41,480). At 31 December 2012 the share-based payments liability amounted to USD 496 (31 December 2011: USD 2,396). The equity component was effectively zero as at 31 December 2012 (31 December 2011: zero). The total intrinsic value of vested share options amounted to USD 423 as at 31 December 2012 (31 December 2011: USD 1,629).

Details of the share options outstanding are as follows:

	Number of share options	2012 Weighted average exercise price, USD	Number of share options	2011 Weighted average exercise price, USD
Outstanding at the beginning of the period	653,700	28.0	4,056,550	25.7
Exercised during the period	(78,000)	14.7	(3,006,850)	24.9
Forfeited during the period	(468,200)	33.4	(396,000)	28.8
Outstanding at the end of the period	107,500	13.9	653,700	28.0
Exercisable at 31 December	107,500	13.9	653,700	28.0

The fair value of services received in return for the share options granted to employees is measured by reference to the fair value of the share options granted which is determined at each reporting date. The estimate of the fair value of the services received is measured based on the Black-Scholes model. Expected volatility is determined by calculating the historical volatility of the Group's share price over the period since May 2006. Management assumes that holders will exercise the options on the expiry date of the options due to behavioral considerations. Other key inputs to the calculation of ESOP liability were as follows:

	31 December 2012	31 December 2011
GDR price	17.85	22.84
Expected volatility	49%	52%
Risk-free interest rate	2%	3%
Dividend yield	0%	0%

Employee stock plan

In 2010 the Group introduced its next generation long term incentive plan in the form of a Restricted Stock Unit Plan (RSU Plan) for its key executives and employees. Each Restricted Stock Unit (RSU) that may be granted under the RSU Plan carries the right to one GDR. The program runs in four tranches granted over the period to 19 May 2014. Over the period of four calendar years starting 2010, the RSU Plan provides for the annual grant of conditional rights to RSUs, subject to i) the achievement of specific performance criteria of the Group (KPIs) and ii) continuous employment with the Group until the completion of the vesting period. The KPIs mainly relate to (i) the performance of the Group compared to the performance of a selected group of comparable competitors in achieving sustained growth and an increasing presence in its markets of operation and (ii) maintain agreed profitability ratio of the Group at a pre-defined level.

Members of the Supervisory Board may be granted conditional RSUs not subject to performance criteria. The General Meeting of Shareholders determines the number of conditional RSUs granted to members of the Supervisory Board. The RSU Plan, as well as the first tranche of conditional RSUs in favour of members of the Supervisory Board, was approved by Annual General Meeting of Shareholders on 25 June 2010. The first tranche will vest on 19 May 2013. Upon vesting the RSUs will be converted into GDRs registered in the participant's name. Subsequently, GDRs are subject to a two-year lock-in period during which period the GDRs cannot be traded.

In total, during the year ended 31 December 2012 the Group recognized expenses related to the RSU plan in the amount of USD 4,908 (during the year ended 31 December 2011: USD 1,108). At 31 December 2012 the equity component was USD 11,452 (31 December 2011: 7,776) and liability component was USD 478 (31 December 2011: 1,161). 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 are as follows:

	2012		2011	
	Number of conditional rights	Weighted average fair value, USD	Number of conditional rights	Weighted average fair value, USD
Outstanding at the beginning of the period	840,083	35.84	832,702	35.50
Granted during the period	602,689	22.55	568,609	36.00
Forfeited during the period	(389,719)	35.91	(561,228)	35.50
Outstanding at the end of the period	1,053,053	28.21	840,083	35.84

29. Income tax

	Year ended 31 December 2012	Year ended 31 December 2011
Current income tax charge	52,360	163,594
Deferred income tax benefit	(62,887)	(60,682)
Income tax (benefit)/charge for the year	(10,527)	102,912

The theoretical and effective tax rates are reconciled as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
(Loss)/Profit before taxation	(137,024)	405,103
Theoretical tax at the effective statutory rates ¹	(27,405)	81,032
Tax effect of items which are not deductible or assessable for taxation purposes:		
Share-based payments expense/(income)	225	(5,387)
Effect of income taxable at rates different from standard statutory rates	(20,593)	(15,680)
Expenses on inventory shrinkage and surpluses	50,036	49,908
Unrecognized tax loss carry forwards for the year	4,024	–
Deferred tax expenses arising from the write-down of the deferred tax asset	3,292	–
Other non-deductible expenses and non-taxable income	(20,106)	(6,961)
Income tax (benefit)/charge for the year	(10,527)	102,912

¹ Profit before taxation on Russian operations is assessed based on the statutory rate of 20%, profit before taxation on Ukrainian operations is assessed based on the statutory rate of 21%.

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for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

29. Income tax continued

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated income statement are attributable to the following items for the year ended 31 December 2012:

	31 December 2011	Credited to profit and loss	Deferred tax on business combinations (Note 7)	Recognized in equity for translation differences	31 December 2012
Tax effects of deductible temporary differences and tax loss carryforwards					
Tax losses available for carry forward	66,899	28,350	–	4,689	99,938
Property, plant and equipment and Investment property	21,398	4,642	2,019	1,375	29,434
Intangible assets and Prepaid lease	32	3,731	–	91	3,854
Inventories of goods for resale	36,249	(338)	–	2,168	38,079
Accounts receivable	27,762	(11,403)	–	1,396	17,755
Accounts payable	100,233	(20,315)	–	5,535	85,453
Other	9,907	4,661	2,594	782	17,944
Gross deferred tax asset	262,480	9,328	4,613	16,036	292,457
Less offsetting with deferred tax liabilities	(125,679)	(15,088)	–	(7,903)	(148,670)
Recognized deferred tax asset	136,801	(5,760)	4,613	8,133	143,787
Tax effects of taxable temporary differences					
Property, plant and equipment and Investment property	(183,222)	31,830	–	(8,721)	(160,113)
Intangible assets and Prepaid lease	(118,866)	30,540	–	(6,412)	(94,738)
Accounts receivable	(20,014)	(13,761)	–	(1,528)	(35,303)
Accounts payable	(1,921)	(1,400)	–	(148)	(3,469)
Other	(9,012)	6,350	(600)	(408)	(3,670)
Gross deferred tax liability	(333,035)	53,559	(600)	(17,217)	(297,293)
Less offsetting with deferred tax assets	125,679	15,088	–	7,903	148,670
Recognized deferred tax liability	(207,356)	68,647	(600)	(9,314)	(148,623)

Deferred tax assets and liabilities and the deferred tax charge in the consolidated income statement are attributable to the following items for the year ended 31 December 2011:

	31 December 2010	Credited to profit and loss	Deferred tax on business combinations (Note 7)	Recognized in equity for translation differences	31 December 2011
Tax effects of deductible temporary differences and tax loss carryforwards					
Tax losses available for carry forward	44,861	26,769	–	(4,731)	66,899
Property, plant and equipment and Investment property	39,303	(15,153)	–	(2,752)	21,398
Intangible assets and Prepaid lease	654	(643)	–	21	32
Inventories of goods for resale	40,115	(1,888)	–	(1,978)	36,249
Accounts receivable	24,128	5,384	7	(1,757)	27,762
Accounts payable	79,325	27,547	–	(6,639)	100,233
Other	21,517	(11,956)	185	161	9,907
Gross deferred tax asset	249,903	30,060	192	(17,675)	262,480
Less offsetting with deferred tax liabilities	(118,712)	(13,928)	(192)	7,153	(125,679)
Recognized deferred tax asset	131,191	16,132	–	(10,522)	136,801

29. Income tax continued

Deferred income tax continued

	31 December 2010	Credited to profit and loss	Deferred tax on business combinations (Note 7)	Recognized in equity for translation differences	31 December 2011
Tax effects of taxable temporary differences					
Property, plant and equipment and Investment property	(176,699)	(15,659)	(1,762)	10,898	(183,222)
Intangible assets and Prepaid lease	(141,337)	19,181	(2,911)	6,201	(118,866)
Inventories of goods for resale	(6,798)	7,050	–	(252)	–
Accounts receivable	(41,601)	21,217	–	370	(20,014)
Accounts payable	–	(2,103)	–	182	(1,921)
Other	(10,254)	936	(185)	491	(9,012)
Gross deferred tax liability	(376,689)	30,622	(4,858)	17,890	(333,035)
Less offsetting with deferred tax assets	118,712	13,928	192	(7,153)	125,679
Recognized deferred tax liability	(257,977)	44,550	(4,666)	10,737	(207,356)

Temporary differences on unremitted earnings of certain subsidiaries amounted to USD 470,086 (2011: USD 848,798) for which the deferred tax liability was not recognized as such amounts are being reinvested for the foreseeable future.

The current portion of the deferred tax liability amounted to USD 59,391 (31 December 2011: USD 35,726), the current portion of the deferred tax asset amounted to USD 159,942 (31 December 2011: USD 118,894).

Management believes that the future taxable profits in tax jurisdictions that suffered a loss in the current or preceding years will be available to utilize the deferred tax asset of USD 99,938 recognized at 31 December 2012 for the carryforward of unused tax losses (31 December 2011: USD 66,899). Unused tax losses are available for carry forward for a period not less than seven years depending on the tax residence of every certain company of the Group.

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 currency exposure with respect to import purchases. The exposure is not significant for the Group.

Interest rates risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash inflows are substantially independent of changes in market interest rates. Interest rate risk (MosPrime rate risk) arising from floating rate borrowings is managed through the balanced credit portfolio, using different types of financing instruments on the basis of fixed and floating rates.

If MosPrime had been 200 basis points lower/higher in 2012 with all other variables held constant, post-tax loss for the year would have been USD 16,198 (2011: USD 21,968) lower/higher.

b. Credit risk

Financial assets, which are potentially subject to credit risk, consist principally of cash and cash equivalents held in banks, trade and other receivables (Note 9 and Note 17). Due to the nature of its main activities (retail sales to individual customers) the Group has no significant concentration of credit risk. Cash is placed in financial institutions which are considered at the time of deposit to have minimal risk of default. The Group has policies in place to ensure that in case of credit sales of products and services to wholesale customers only those with an appropriate credit history are selected. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded. In accordance with the Group treasury policies and exposure management practices, counterparty credit exposure limits are continually monitored and no individual exposure is considered significant.

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30. Financial risk management continued

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 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, 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 and as at the balance sheet date at spot foreign exchange rates:

Year ended 31 December 2012	During 1 year	In 1 to 4 years
Borrowings	1,989,095	2,632,563
Trade payables	2,396,934	–
Gross finance lease liabilities	1,363	113
Other finance liabilities	511,593	–
	4,898,985	2,632,676
Year ended 31 December 2011	During 1 year	In 1 to 3 years
Borrowings	1,183,138	3,069,639
Trade payables	1,906,365	–
Gross finance lease liabilities	2,218	1,347
Other finance liabilities	405,870	–
	3,497,591	3,070,986

At 31 December 2012 the Group has net current liabilities of USD 2,418,768 (31 December 2011: USD 1,663,106) including short-term borrowings of USD 1,680,887 (31 December 2011: USD 913,160).

At 31 December 2012 the Group had available bank credit lines of USD 2,686,623 (31 December 2011: USD 1,648,026).

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 programs. Part of the short term of the liquidity risk 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 the 4th quarter, when the free cash flow allows for the repayment of debts. Part of the existing lines in the local currency (RUR) are 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 program is highly discretionary. The Group optimizes its cash outflows by managing the speed of execution of current capex projects and by delaying future capital extensive programs, 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

The Russian Federation displays certain characteristics of an emerging market. Tax, currency and customs legislation is subject to varying interpretations and contributes to the challenges faced by companies operating in the Russian Federation.

The international sovereign debt crisis, stock market volatility and other risks could have a negative effect on the Russian financial and corporate sectors. Management determined impairment provisions by considering the economic situation and outlook at the end of the reporting period. Provisions for trade receivables are determined using the 'incurred loss' model required by the applicable accounting standards. These standards require recognition of impairment losses for receivables that arose from past events and prohibit recognition of impairment losses that could arise from future events, no matter how likely those future events are.

The future economic development of the Russian Federation is dependent upon external factors and internal measures undertaken by the government to sustain growth, and to change the tax, legal and regulatory environment. Management believes it is taking all necessary measures to support the sustainability and development of the Group's business in the current business and economic environment.

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 recognized under IFRS 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), minimum level of EBITDA/Net Interest expense (2.75). These ratios are included as covenants into loan agreements (Note 20). The Group is in compliance with externally imposed capital requirements.

33. Fair value of financial instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

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. The Russian Federation continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments.

Financial assets carried at amortized cost. The fair value of floating rate instruments is normally their carrying amount. 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.

Carrying amounts of trade and other financial receivables approximate fair values.

Liabilities carried at amortized cost. The fair value of bonds is based on quoted market prices. Fair values of other liabilities are determined using valuation techniques. Carrying amounts of trade and other payables approximate fair values.

The fair value of bonds traded on the MICEX is determined based on active market quotations and amounted to USD 680,571 at 31 December 2012 (31 December 2011: USD 698,816). The carrying value of these bonds amounted to USD 686,045 at 31 December 2012 (31 December 2011: USD 700,115) (Note 20). The fair value of long-term borrowings amounted to USD 1,762,869 at 31 December 2012 (31 December 2011: USD 2,212,813). 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 2012, the Group operated 2,603 stores through rented premises (31 December 2011: 2,043). There are two types of fees in respect of operating leases payable by the Group: fixed and variable. For each store fixed rent payments are defined in the lease contracts. The variable part of rent payments is predominantly denominated in RUR and normally calculated as a percentage of turnovers. Fixed rent payments constitute the main part of operating lease expenses of the Group as compared to the variable rent payments.

During 2012 the Group reassessed the cancellation conditions for long-term lease agreements. On the basis of historical experience of lease terminations and legal practice, the reassessment resulted in non-cancellable leases being reclassified to cancellable leases.

The Group entered into a number of short-term and long-term lease agreements which are cancellable by voluntary agreement of the parties or by payment of termination compensation. The expected annual lease payments under these agreements amounts to USD 439,928 (net of VAT) (2011: USD 349,763).

Capital expenditure commitments

At 31 December 2012 the Group contracted for capital expenditure of USD 83,141 (net of VAT) (2011: USD 65,309).

Legal contingencies

In the normal course of business the Group is involved in periodic legal cases. Management does not anticipate any material negative impact on the resolution of these cases.

Taxation environment

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking 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 the past may be challenged as not having been in compliance with Russian tax laws applicable at the relevant time. In particular, the Supreme Arbitration 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. 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.

Russian transfer pricing legislation initially introduced on 1 January 1999 and further amended from 1 January 2012 provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions if the transaction prices deviate from the arm's length level:

➤ Transfer pricing rules effective until 31 December 2011.

According to the Russian transfer pricing rules effective during the period up to 31 December 2011, controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective of whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice in this respect is contradictory.

Inter-company transactions undertaken by the companies of the Group for the period up to 31 December 2011 are potentially subject to transfer pricing controls established by Article 40 of the Russian Tax Code. Tax liabilities arising from inter-company transactions are determined using actual transaction prices. It is possible with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the brief nature of the current Russian transfer pricing rules, the impact of any such challenge cannot be reliably estimated; however, it may be significant to the financial condition and operations of the entity.

34. Commitments and contingencies continued

➤ **Amended transfer pricing rules effective from 1 January 2012.** Amended Russian transfer pricing legislation took effect from 1 January 2012. The new transfer pricing rules appear to be more technically elaborate and, to a certain extent, better aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD). The new 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 new transfer pricing legislation.

Given that the practice of implementation of the new Russian transfer pricing rules has not yet developed, the impact of any challenge of the Group's transfer prices cannot be reliably estimated; however, it may be significant to the financial conditions and/or the overall operations of the Group.

Deductibility of interest payable under intra-group financing arrangements is subject to various limitations under the Russian tax legislation which, in combination with applicable tax treaties may be interpreted in various ways. The impact of such interpretation may be significant to the financial condition and operations of the Group and depends on the development of case-specific administrative and court practice on the matter.

The Group includes companies incorporated outside of Russia. Tax liabilities of the Group are determined on the assumption that these companies are not subject to Russian profits tax because they do not have a permanent establishment in Russia. The Russian tax legislation does not provide detailed rules on taxation of foreign companies. It is possible that with the evolution of the interpretation of these rules and the changes in the approach of the Russian tax authorities, the non-taxable status of some or all of the foreign companies of the Group in Russia may be challenged. The impact of any such challenge cannot be reliably estimated.

Russian tax legislation does not provide definitive guidance in many areas. 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.

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 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 recognized under IFRS, could be several times the additional 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.

Provisions and liabilities for tax uncertainties are attributable to profit tax and non-profits tax risks with expiration within three years, in 2012 the Group net released provision of USD 70,158 including net release non-income tax of USD 12,344, income tax net release of USD 27,214 and net release of USD 30,600 indemnified by previous shareholders of acquired companies.

At the same time management has recorded liabilities for income taxes and provisions for taxes other than income taxes in the amount of USD 54,723 at 31 December 2012 (31 December 2011: USD 119,382) in these consolidated financial statements as their best estimate of the Group's liability related to tax uncertainties as follows:

Balance at 1 January 2011	165,896
Increases due to acquisitions during the year recorded as part of the purchase price allocation (Note 7)	1,223
Release of provision	(42,094)
Translation movement	(5,643)
Balance at 31 December 2011	119,382
Release of provision	(109,186)
Accrual of provision	75,251
Offset of provision	(36,223)
Translation movement	5,499
Balance at 31 December 2012	54,723

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Company's Statement of Financial Position

at 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Note	31 December 2012	31 December 2011
Assets			
Non-current assets			
Financial assets	36	2,651,397	2,408,937
		2,651,397	2,408,937
Current assets			
Financial assets	36	91	113,370
Amounts due from subsidiaries		5,701	76,000
Prepaid expenses		130	–
Cash and cash equivalents		84	1,159
		6,006	190,529
Total assets		2,657,403	2,599,466
Equity and liabilities			
Paid up and called up share capital	37	89,826	87,778
Share premium account		2,049,592	2,049,592
Share-based payments	41	11,452	7,776
Other reserves		758,471	459,089
Profit of the year		(126,497)	301,430
Currency translation reserve		(581,043)	(709,693)
Total equity		2,201,801	2,195,972
Non-current liabilities			
Bank loans	38	–	380,344
Loan from group company	39	6,110	–
		6,110	380,344
Current liabilities			
Bank loans	38	405,223	–
Amounts due to group companies		35,692	9,174
Accrued expenses and other liabilities	40	8,081	10,333
Share-based payment liability	41	496	2,396
Corporate income tax	43	–	1,247
		449,492	23,150
Total equity and liabilities		2,657,403	2,599,466

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Company's Income Statement

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

	Notes	31 December 2012	31 December 2011
Other income/(expenses) after tax	42	(9,805)	30,063
Result on participating interest after tax	36	(116,692)	271,367
Profit after taxation		(126,497)	301,430

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Notes to Company's Financial Statements

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

35. 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 a holding for a retail chain.

Basis of presentation

The Company financial statements of X5 Retail Group N.V. 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 Dutch GAAP accounting principles applied for the Company accounts are similar to those used in the IFRS Consolidated Financial Statements (refer to Note 2 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. Consequently the consolidated financial statements of the group for the year ending 31 December 2012 have been prepared accordingly.

In accordance with Section 362 paragraph 7, Part 9 of Book 2 of the Dutch Civil Code, the presentation currency in the annual report is USD as a result of the international bifurcation of the Company. As the Company mainly exploits Russian grocery stores in four formats (soft-discount, 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. Reference is made to section 2.5 (a) of the notes to the Consolidated Financial Statements for the accounting policy in regard of the translation from functional currency to presentation currency.

Unless stated otherwise all amounts are in thousands of US Dollars.

Financial assets and liabilities

Derivative financial instruments are recognized at cost or at fair value. Changes in the value of these derivative financial instruments are recognized in the income statement upon transfer of the instrument to another party or if the instrument is impaired.

Investments in group companies

Investments in group companies are entities (including intermediate subsidiaries and special purpose entities) over which the Company has control, i.e. the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Group companies are recognized from the date on which control is transferred to the Company or its intermediate holding entities. They are derecognized 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 equity 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 remeasurement against the book value is accounted for in the income statement.

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 income statement. 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 recognized 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 recognize 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 recognize a provision.

Amounts due from group companies

Amounts due from group companies are stated initially at fair value and subsequently at amortized cost. Amortized cost is determined using the effective interest rate.

Shareholders' Equity

Issued and paid up share capital, which is denominated in Euro, is restated into US Dollar at the exchange rate as of balance date in accordance with section 373 sub 5 of book 2 of the Dutch Civil Code. The difference is settled in the other reserves.

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Notes to Company's Financial Statements

for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

36. Financial assets

a. Movements in the interests in group companies have been as follows:

	31 December 2012	31 December 2011
Opening balance	2,104,077	1,871,681
Acquisitions/capital contribution	247,190	28,086
Divestment of group companies	(30)	–
(Loss)/profit from group companies for the year	(116,692)	271,367
Foreign exchange differences/other movements	114,130	(67,057)
Closing balance	2,348,675	2,104,077

A complete list of group companies has been disclosed in the consolidated financial statements (refer to Note 7 of consolidated financial statements).

b. Movements in the loans to group companies have been as follows:

	31 December 2012	31 December 2011
Opening balance	418,230	814,509
Settlement/Repayment	(135,191)	(381,887)
Additions	–	14,453
Other movements/foreign exchange differences	19,774	(28,845)
Closing balance	302,813	418,230
Non-current financial assets	2,651,397	2,408,937
Current financial assets	91	113,370
Total Financial assets	2,651,488	2,522,307

Loans provided to following group companies:

Group Company	Currency	Date of maturity
Perekrestok Holdings Ltd.	RUR	December 2014

During 2012 the loan to GSWL Finance Ltd. has been repaid. The loan receivable to Perekrestok Holdings Ltd. denominated in RUR amounts to RUR 9,194,497. The loan has not been secured and attracts up to Mosprime 1 m +4.5% interest per annum.

In 2010 the Company entered into agreements with its 100% subsidiary Perekrestok Holdings limited, pursuant to which the Company has limited its debtor and currency exchange risks with respect to its finance activities. In 2012, an addendum to the agreement was entered into in which the compensation between parties was agreed. The compensation is included in other income (expenses).

37. Shareholders' equity

	Share capital	Share premium	Other reserves	Profit/(Loss)	Share-based payment (equity)	Currency translation adjustment	Total
Balance as at 1 January 2011	89,850	2,049,144	203,154	271,688	5,965	(574,268)	2,045,533
Sales of treasury shares	5	448	–	–	–	–	453
Share-based compensation (Note 28)	–	–	–	–	1,811	–	1,811
Transfer	–	–	271,688	(271,688)	–	–	–
Currency translation	(2,077)	–	2,077	–	–	(135,425)	(135,425)
Change in fair value of available-for-sale investments	–	–	(249)	–	–	–	(249)
Acquisition of non-controlling interest (Note 7)	–	–	(17,581)	–	–	–	(17,581)
Result for the period	–	–	–	301,430	–	–	301,430
Balance as at 1 January 2012	87,778	2,049,592	459,089	301,430	7,776	(709,693)	2,195,972
Share-based compensation	–	–	–	–	3,676	–	3,676
Transfer	–	–	301,430	(301,430)	–	–	–
Currency translation	2,048	–	(2,048)	–	–	128,650	128,650
Result for the period	–	–	–	(126,497)	–	–	(126,497)
Balance as at 31 December 2012	89,826	2,049,592	758,471	(126,497)	11,452	(581,043)	2,201,801

A statutory undistributable reserve is maintained for currency translation adjustment recorded mainly as the result of translation between functional and presentation currencies.

Share capital issued

The authorized share capital of the Company amounts to EUR 190,000,000 divided into 190,000,000 shares of EUR 1 each. As at 31 December 2012, the issued and paid-up share capital amounts to EUR 67,819,033 and consists of 67,819,033 shares of EUR 1 each (2011: 67,819,033). This has been recalculated into USD with an exchange rate of EUR 1 = USD 1.3245 (2011: EUR 1 = USD 1.2943) in the Company financial statements.

In April 2010 1,746,505 ordinary shares were transferred in exchange for Global Depositary Receipts ('GDR'). These shares were issued in 2008 as part of the consideration paid for the Karusel hypermarket chain. The increase in the size of listing on the Main Market of the London Stock Exchange did not affect the number of outstanding shares, which remains unchanged at 67,893,218, while the number of GDRs admitted to trading on the London Stock Exchange's Regulated Market increased by 6,986,020. Following this conversion, 100% of the Group share capital is held in the form of GDRs.

38. Bank loans

Movement in the bank loans have been as follows:

	31 December 2012	31 December 2011
Opening balance	380,344	793,887
(Repaid)/Received (Club loan)	–	(400,000)
Transaction costs capitalized (Club loan)	–	35
Amortization of transaction costs capitalized (Club loan)	1,999	8,240
Currency rate exchange differences	22,880	(21,818)
Closing balance	405,223	380,344

The club loan is for three years, to 2013, consists of RUR-denominated facility (RUR equivalent of USD 405,000) and will pay a margin of 250 basis points over MosPrime. No collateral is provided for this facility (Note 20). The bank loan balance is net of capitalized expenses of USD 12 million.

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for the year ended 31 December 2012

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39. Loan from group company

	31 December 2012	31 December 2011
GSWL Finance Ltd.	6,110	–

The loan payable to GSWL Finance Ltd. denominated in RUR amounts to RUR 185,591,022. The loan has not been secured and attracts 11% interest per annum and matures in December 2014.

40. Accrued expenses

The current liabilities contain accrued expenses and non-income tax payable.

41. Share-based payment liability

X5 Retail Group N.V. operates both cash and equity settled share-based compensation plans in the form of its Employee Stock Option Plan and Restricted Stock Unit Plan.

Employee Stock Option Plan

X5 Retail Group N.V. accounts for a receivable insofar the options granted to employees of the group are recharged to its subsidiaries, in case there is no recharge the fair value of the options are treated as an investment in the subsidiary. 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 Employee Stock Option Plan:

	2012	2011
Share-based payments liability as at 31 December	(496)	(2,396)
(Income)/expense	(4,093)	2,168

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 2010 plan includes a funding arrangement with the subsidiaries which is recorded as an expense in the subsidiary and as an income in the accounts of the Company for the amount of the funding that has been transferred in the financial year.

The following is included in the entity's accounts for the Restricted Stock Unit Plan:

	2012	2011
Equity share-based payment reserve as at 31 December	(11,452)	(7,776)
Non-income tax payable	(161)	(161)
(Income)/expense	(7,301)	(19,186)

42. Other income and expenses after tax

	31 December 2012	31 December 2011
Interest income from group companies	41,756	56,345
Other (expenses)/income	(20,507)	802
Interest expenses	(36,226)	(39,073)
General and administrative expenses	(6,536)	(14,119)
Share-based payment/RSU program	11,394	17,018
Currency exchange rate differences	(115)	8,544
Loss from disposal of group companies	(28)	–
Income tax benefit (Note 43)	457	546
	(9,805)	30,063

In accordance with the Dutch legislation article 2:382a the total audit fees related to the accounting organisation PricewaterhouseCoopers Accountants N.V. amounted to USD 172 (2011: USD 162).

43. Income tax expense

	31 December 2012	31 December 2011
Operating (loss)/profit before tax	(10,262)	30,609
Current income tax	230	546
Deferred income tax benefit	227	–
Effective tax rate	4%	(2%)
Applicable tax rate	25.0%	25.0%

The effective tax rate differs from the applicable tax rate due to non-taxable income and expenses that are disallowed for income tax purposes, mainly in relation to share-based compensation and intercompany financing resulting in a fiscal loss for the year. The fiscal loss will be offset against expected future profits.

44. Directors

The Company has a Management Board and a Supervisory Board. The total remuneration of all Board members is disclosed as set out below. Further reference is made to the Remuneration Report on page 76 and Notes 27 and 28 in the consolidated financial statements.

Supervisory Board

Supervisory Board members were paid a remuneration in cash which accrued evenly throughout the year in proportion to the period of service. Four members of the Supervisory Board participate in the Company's Stock Option Plan and/or Restricted Stock Unit Plan. The number of stock options and restricted stock units granted 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.

In 2012 the Supervisory Board members received a remuneration of:

	Base salary 2012	Additional remuneration 2012 ²	Share-based compensation 2012 ³
H. Defforey ¹	321	159	117
M. Fridman	128	–	–
D. Gould	257	–	–
V. Ashurkov (resigned 14/06/2012)	58	–	–
A. Tynkovan	154	–	138
S. DuCharme	198	944	230
C. Couvreur	257	159	230
D. Dorofeev (per 14/06/2012)	129	–	–
	1,502	1,262	715

¹ Excluding 16% Dutch crisis levy on Mr. Defforey's remuneration in excess of Euro 150,000, expensed as an employer's tax in 2012.

² The additional Remuneration 2012 relates to the temporary assumption and support for the CEO role in 2012.

³ The share-based compensation includes the Stock Option Plan and Restricted Stock Unit Plan and include benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

In 2011 the Supervisory Board members received a remuneration of:

	Base salary 2011	Share-based compensation 2011
H. Defforey	348	(1,987)
M. Fridman	139	–
D. Gould	278	–
V. Ashurkov	139	–
A. Tynkovan	167	87
S. DuCharme	278	(160)
C. Couvreur	278	144
	1,627	(1,916)

In 2012 number of stock options granted to Supervisory Board members:

	No. of options granted in 2012	No. of options granted prior 2012	No. of options exercised in 2012	Cancellation	No. of options outstanding as at 31 December 2012
H. Defforey	–	112,500	–	42,500	70,000
	–	112,500	–	42,500	70,000

The exercise price amounts to USD 13.91 and the expiration date of the options is 20 November 2013.

In 2011 number of stock options granted to Supervisory Board members:

	No. of options granted in 2011	No. of options granted prior 2011	No. of options exercised in 2011	Cancellation	No. of options outstanding as at 31 December 2011
H. Defforey	–	112,500	–	–	112,500
S. DuCharme	–	32,500	32,500	–	–
	–	145,000	32,500	–	112,500

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for the year ended 31 December 2012

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44. Directors continued

in 2012 number of restricted stock units granted to Management Board and Supervisory Board members:

	Tranche	Conditional Grant 2010	Conditional Grant 2011	Conditional Grant 2012	RSUs awarded in 2011	RSUs awarded in 2012 ¹	RSUs outstanding as per 31/12/2012
Management Board							
A. Gusev ²	1	39,147			24,467		16,311
	2		79,365			52,910	17,637
	3			110,215			
K. Balfe	2		37,214			23,259	23,259
	3			51,171			
F. Lhoëst	1	14,438			9,024		9,024
	2		21,832			13,645	13,645
	3			28,769			
Supervisory Board							
H. Defforey	1	9,024			9,024		9,024
	2		9,923			9,923	9,923
	3			13,077			
S. DuCharme	1	7,219			7,219		7,219
	2		7,939			7,939	7,939
	3			10,461			
A. Tynkovan	1	4,331			4,331		4,331
	2		4,763			4,763	4,763
	3			6,277			
C. Couvreur	1	7,219			7,219		7,219
	2		7,939			7,939	7,939
	3			10,461			

¹ 50% award of RSUs subject to performance test as per 19 May 2012, based on level of achievement of Plan KPIs; RSUs granted to Supervisory Board members are not subject to performance criteria.

² Andrei Gusev's contract terminated on 31 July 2012. In accordance with the Rules of the Restricted Stock Unit Plan, one third of the number of RSUs awarded under tranche 1, and two thirds of the number of RSUs awarded under tranche 2, were forfeited.

In 2011 number of restricted stock units granted to Management Board and Supervisory Board members:

	Tranche	Conditional Grant 2010	Conditional Grant 2011	RSUs awarded in 2011	RSUs outstanding as per 31/12/2011
Management Board					
A. Gusev	1	39,147		24,467	24,467
	2			79,365	
L. Khasis	1	128,817		28,626	28,626
K. Balfe	2			37,214	
F. Lhoëst	1	14,438		9,024	9,024
	2			21,832	
Supervisory Board					
H. Defforey	1	9,024		9,024	9,024
	2			9,923	
S. DuCharme	1	7,219		7,219	7,219
	2			7,939	
A. Tynkovan	1	4,331		4,331	4,331
	2			4,763	
C. Couvreur	1	7,219		7,219	7,219
	2			7,939	

Management Board

The short-term cash remuneration of the Management Board members consists of the base salary and the annual bonus. All members of the Management Board participate in the Company's Stock Option Plan and/or Restricted Stock Unit Plan. The number of stock options and restricted stock units granted and outstanding to the members of the Management Board is shown below. For the calculation of the intrinsic value and further details refer to Note 27.

	Base salary 2012	Bonus 2012 ¹	Share-based compensation 2012 ²	Other 2012 ⁴	
A. Gusev	772	–	(486)	1,651	Resigned per 31 July 2012
K. Balfe	621	–	425	–	
F. Lhoëst ³	353	109	354	–	
	1,746	109	293	1,651	

¹ Bonus for the performance of the year reported and paid in cash in 2013.

² The share-based compensation includes the Stock Option Plan and Restricted Stock Unit Plan and include benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

³ Excluding 16% Dutch crisis levy on Mr. Lhoëst's total remuneration in excess of EUR 150,000, expensed as an employer's tax in 2012.

⁴ Includes 1,351 base salary and 300 consultancy fee.

	Base salary 2011	Bonus 2011	Share-based compensation 2011	Other 2011
A. Gusev	1,021	1,090	758	–
K. Balfe	638	583	250	–
F. Lhoëst	357	149	137	–
L. Khasis	1,214	–	(17,998)	2,863
	3,230	1,822	(16,853)	2,863

In 2012 number of stock options granted to Management Board members:

	No. of options granted in 2012	Number of options granted prior 2012	No. of options exercised in 2012	Cancellation	No. of options outstanding as at 31 December 2012
A. Gusev (resigned 31 July 2012)	–	212,500	–	212,500	–
	–	212,500	–	212,500	–

In 2011 number of stock options granted to Management Board members:

	No. of options granted in 2011	Number of options granted prior 2011	No. of options exercised in 2011	Cancellation	No. of options outstanding as at 31 December 2011
A. Gusev	–	212,500	–	212,500	–
L. Khasis	–	2,531,250	2,531,250	–	–
	–	2,743,750	2,531,250	212,500	–

Resigned per
1 June 2011

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for the year ended 31 December 2012

(expressed in thousands of US Dollars, unless otherwise stated)

45. Staff numbers and employment costs

The Company has no employees and hence incurred no wages, salaries or related social security charges during the reporting period, nor during the previous year, other than those for the Management and Supervisory Board.

46. Contingent rights and liabilities

Reference is made to the commitments and contingencies as disclosed in Note 34 in the consolidated financial statements. Guarantees are irrevocable assurances that the Company will make payments in the event that another party cannot meet its obligations. The Group has the following guarantees issued under obligations of its group companies:

	31 December 2012	31 December 2011
Irrevocable offer to holders of X5 Finance bonds	419,160	395,421
Guarantee for Agrotorg	1,028,022	969,801
Guarantee for TH Perekrestok	800,169	475,315
Guarantee for Agroaspekt	301,257	284,196
Guarantee for Kaiser	–	12,587

47. Related party transaction

Refer to Note 8 of the consolidated financial statements; all group companies are also considered related parties.

Statutory director's compensation

Statutory director's compensation is disclosed in Note 44.

Loans to group companies

For loans issued to and interest income from group companies refer to Note 39.

48. Subsequent events

In January 2013 Supervisory Board of X5 Retail Group N.V. approved increasing the total credit limit with Alfa-bank up to RUR 24 billion.

In February 2013 the Group signed additional agreements with Credit Bank of Moscow to increase total limit up to RUR 7 billion.

Amsterdam, 7 March 2013

Management Board

Frank Lhoëst
Kieran Balfe

Supervisory Board

Hervé Defforey
Mikhail Fridman
David Gould
Alexander Tynkovan
Christian Couvreur
Dmitry Dorofeev

Other information

Auditor's report

Auditor's report is included on page 134.

Statutory profit appropriation

In Article 28 of the Company statutory regulations the following has been stated concerning the appropriation of result.

On proposal of the Supervisory Board, the General meeting shall determine how the results of the financial year shall be allocated to the reserves.

It will be proposed to deduct the loss for the year of USD 126,497 from the other reserves.

To: the General Meeting of Shareholders X5 Retail Group N.V.

Report on the financial statements

We have audited the accompanying financial statements 2012 of X5 Retail Group N.V., Amsterdam as set out on pages 86 to 132. The financial statements include the consolidated financial statements and the company financial statements. The consolidated financial statements comprise the consolidated statement of financial position as at 31 December 2012, the consolidated income statement, the statements of comprehensive income, changes in equity and cash flows for the year then ended and the notes, comprising a summary of significant accounting policies and other explanatory information. The company financial statements comprise the company balance sheet as at 31 December 2012, the company income statement for the year then ended and the notes, comprising a summary of accounting policies and other explanatory information.

Management's responsibility

Management is responsible for the preparation and fair presentation of these financial statements and for the preparation of the management board report, both in accordance with International Financial Reporting Standards as adopted by the European Union and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, management is responsible for such internal control as it determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion with respect to the consolidated financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2012, and of its result and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Dutch Civil Code.

Opinion with respect to the company financial statements

In our opinion, the company financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2012, and of its result for the year then ended in accordance with Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Pursuant to the legal requirement under Section 2: 393 sub 5 at e and f of the Dutch Civil Code, we have no deficiencies to report as a result of our examination whether the management board report, to the extent we can assess, has been prepared in accordance with Part 9 of Book 2 of this Code, and whether the information as required under Section 2: 392 sub 1 at b-h has been annexed. Further we report that the management board report, to the extent we can assess, is consistent with the financial statements as required by Section 2: 391 sub 4 of the Dutch Civil Code.

Amsterdam, 7 March 2013

PricewaterhouseCoopers Accountants N.V.

P.C. Dams RA

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X5 Retail Group

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