X5 RETAIL GROUP

Annual Report 2014

Delivering growth

Delivering growth

In 2014 we remained focused on strengthening retail basics, building the right team and fine tuning the operational model. This allowed us to reinforce our format value propositions and take advantage of the growth opportunities in the Russian retail market. The strong results we achieved this year demonstrate that we are on track to deliver balanced and sustainable growth.

+15.7%
increase in net selling space

About us

X5 is a leading Russian food retailer. Our strategy is to increase our share of the Russian retail market by developing and promoting modern retail principles to become the undisputed, long-term leader of the Russian retail industry.

Our core brands

Pyaterochka, a chain of conveniently located proximity stores, is one of Russia's leading retail brands. Pyaterochka stores are focused on simple, easy and economical shopping. The brand offers quality fresh products and a non-food assortment supported by attractive promotional events and customer communication. Pyaterochka accounted for 69.0% of X5's total 2014 net retail sales.

Read more on pages 20-23

Perekrestok is the leading national supermarket chain in Russia and one of the country's leading retail brands. Perekrestok strives to be the customer's first choice for fresh products supported by the right assortment and price strategy. Perekrestok accounted for 18.3% of X5's total 2014 net retail sales.

Read more on pages 24-27

Karusel is one of the largest hypermarket chains currently operating in the Russian market. It offers customers convenient one-stop shopping at fair prices in city locations with a wide range of quality food and non-food products, efficient service at cash registers, engaging weekly catalogues and a loyalty program. Karusel accounted for 11.0% of X5's total 2014 net retail sales.

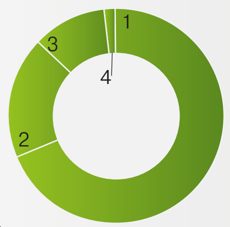
Read more on pages 28-31

Express convenience stores operate under the **Perekrestok Express** brand and offer convenient shopping and ready-to-eat meals for people in a hurry. Express stores accounted for 1.6% of X5's total 2014 net retail sales.

Read more on pages 32-35

Net retail sales by format (%)

1. Pyaterochka	69.0%
2. Perekrestok	18.3%
3. Karusel	11.0%
4. Express	1.6%



Note: net retail sales include revenue from E5.RU and Ukraine operations which ceased during the year.

Contents

Chief Executive Officer's strategic review

A successful year – turnaround on track and delivering growth

Stephan DuCharme
Chief Executive Officer

Dear Fellow Shareholders:
Your Company performed well in 2014, delivering good growth in retail sales which increased by 18.6% year-on-year. This was at the upper level of our forecast, driven by record organic expansion of 15.7%, or 349 thousand square meters, and contributing 8.8% to the year-on-year growth. Same store sales were responsible for the remaining 9.8% increase and were the Company's best annual like-for-like sales results in the last five years.

All our retail formats contributed to this success. That being said, the strong growth of our proximity format Pyaterochka, which accounts for approximately 70% of X5's net retail sales, was a key contributor to our 2014 results.

In terms of profitability, we were able to maintain margins in line with 2013, delivering EBITDA and net profit margins of 7.2% and 2.0%, respectively. In addition we increased EBITDAR (earnings before interest, taxes, depreciation/amortization and rent) margin by 20 basis points to 11.6%, mainly due to improvements in operating leverage at Pyaterochka. We also improved capital efficiency, increasing the Company's ROIC (before goodwill adjustments) by approximately 100 basis points to 20.1%.

Delivering growth

Our operational model allows each of the retail formats to respond to the needs of its customers, adjusting and improving value propositions on a continuous basis. It is this combination of focus and speed that has allowed X5 to return to growth. This approach is underpinned by our strong market position and buying terms, the improved relationship with suppliers, our strong and committed management team and the support of our shareholders.

The results we achieved at Pyaterochka during the year give us confidence that we have established the right platform for balanced and sustainable growth ahead. I take this opportunity to complement Olga Naumova and her team on their success in transforming Pyaterochka into a strong business and a modern proximity store banner.

During the year Pyaterochka built momentum, culminating in a 34% year-on-year increase in December's net retail sales, ahead of all format competitors. The new Pyaterochka model is underpinned by an improved, standardized store concept that hosts a better quality and wider range of products, and better in store processes supported by the cluster management system and opening process. This allowed Pyaterochka to add a record 907 stores in 2014, or approximately 340 thousand square meters; including the tactical acquisition of 116 stores from a former franchisee in Samara. In parallel we have ramped up investments in the store base, completing almost 500 store refurbishments during the year.

We also made significant progress with Perekrestok, our supermarket format. Having established its revised value proposition, which included the completion of an initial review of the product range and development of a new brand book, we opened Perekrestok's new concept store in Moscow in October followed by 12 further stores in this concept by year-end. The format will continue to roll out a new range based on high quality fresh products complimented by unique promotions in a comfortable, service based atmosphere to meet customer demand.

> "I believe that 2014 was a turning point for X5 in terms of the transformation of our business and that we proved to ourselves, our customers, our business partners and shareholders that we have the ability to get the business growing again."

At Karusel, our hypermarket format, we are still in the process of incorporating the results of the various pilot projects into operations and finalizing the Karusel brand book, which will be the blueprint for new store openings. During the year we also created a dedicated commercial division for the format that is conducting a full review of the format's product range, prices and promotions, which is especially important in the current environment. Once the format proposition is ready we will also be reinvesting in the ageing store base to bring new life to the existing portfolio.

Trading environment

We ended the year with X5 and the Russian consumer facing an increasingly challenging macro environment.

The economic sanctions and Russia's response in the form of a ban on certain food imports resulted in the disruption of X5's existing supply channels. At the time of the ban, the products in question represented approximately 5% of X5's sales and the establishment of new supply channels resulted in higher food inflation for those products.

I am pleased to say that thanks to the hard work of our commercial teams we have found substitutes for the affected products and as the new suppliers adjust to a different demand profile we will see a reduction in the initial inflation spike.

The economic sanctions combined with the collapse in global crude oil prices have also resulted in the overall worsening of Russia's economic conditions reflected in strong currency devaluation, higher inflation and increase in borrowing rates. This in turn has put pressure on the consumer in terms of high cost inflation, negative real income growth, significant increase in debt service costs and devaluation of savings.

At X5 we consider it an obligation to provide our customers with a reliable supply of high quality products at appropriate prices. In the current trading circumstances this has become more important especially for the more affected segments of the population. To this end, we are creating value for the customer by increasing our promotional offers and developing wider first price ranges. To help those affected most, we have initiated special offers on socially important products for senior citizens in addition to the regular discounts that they already enjoy.

As we saw in the fourth quarter, the trading environment had an impact on X5's traffic distribution, with customers favoring the value offer of proximity stores over those of supermarkets and hypermarkets. However, our multi-format model and newly enhanced value propositions provide consumers with an attractive price/value spectrum that enables us to do well in these circumstances.

The right team

The team is coming together. As we rolled out our new operating model, the need for additional competencies led us to reinforce the Executive Committee through internal promotions and new expertise.

In July, Svetlana Volikova transitioned from General Director of Karusel Hypermarkets to take up a new role with the Company as Director of Corporate Audit and Control. Svetlana was succeeded by Vardan Dashtoyan who has considerable entrepreneurial and client-focused experience, which will assist him as he manages the next phase in Karusel's development.

Also in July Sergey Piven, X5's Chief Financial Officer, informed us that he would be stepping down to pursue other opportunities. In October he was replaced by Elena Milinova. Elena brings a strong background in financial management and senior executive experience at large Russian companies, which she has already applied within X5 as we face the new realities of local and international financial markets.

In October, Vladimir Sorokin, who had previously introduced and led category management for Pyaterochka and was part of the development of its rebranding campaign, assumed the role of General Director for Perekrestok, replacing Janusz Lella. Vladimir's promotion highlights the progress we have made in developing internal talent and managing succession planning, and corresponds with the format's new phase of expansion.

Looking ahead

Whilst 2015 presents us with certain economic challenges, we also see many opportunities for X5 to grow market share. Our formats are continuing to improve their customer propositions and operational standards, and we have built up our capability to open more stores than we have in the past. We expect the current economic climate to accelerate the shift from traditional retail to modern retail as more new site opportunities become available and weaker retailers exit the industry.

Our plans call for further acceleration of growth, balanced across the organization, and include organic store growth, and investments in store refurbishments, logistics and IT infrastructure to support sustainable long-term growth. Our investments will be sound both from a customer and a financial perspective.

These results can only be delivered through the daily hard work of our 117,000-plus employees. We genuinely believe there is no more important asset at X5 than our people and we are committed to building a corporate environment and culture focused on supporting employee engagement throughout the organization.

I would like to thank the employees of X5 as well as our customers, suppliers, shareholders and the Supervisory Board for the support we received during the year.

Chief Executive Officer's strategic review continued

Strong progress this year

Our 2014 results have validated the effectiveness of the new operating model and our back-to-basics initiatives, and reflect our ability to grow the business.

- Effective multi-format business model delivering improved customer focus and growth
- Good progress with back-to-basics initiatives
- Disciplined investment in growth drivers
  – Product range and availability
  – Store refurbishments
  – Store openings
- Despite potential challenges, multiple growth opportunities in the dynamic Russian food retail market

2014 turnaround
Status

Пятёрочка

Value proposition meeting customer expectations – continued acceleration of refurbishments and store expansion

Перекресток супермаркет

Value proposition and store concept redefined – aggressive rollout of refurbishments and new concept, focus on operations and efficiencies

гипермаркет Карусель

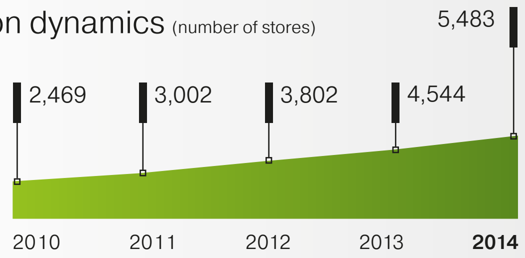
Value proposition – evaluating results from pilot projects to define Karusel hypermarket brand and developing new store location pipeline/land-bank, focus on operations and efficiencies

A Pyaterochka store opening

Building a platform for sustainable growth

Store expansion dynamics (number of stores)

31.9%
Five-year CAGR

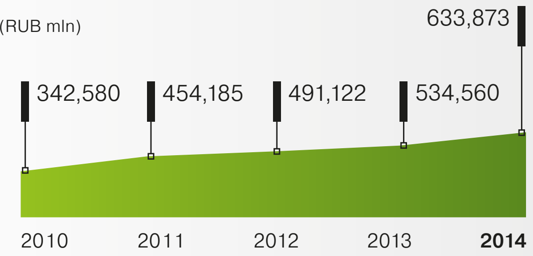


In 2014 X5 delivered record organic growth, increasing the number of stores by 21% and adding almost 350,000 square meters of selling space.

- X5 opened its 5,000th store during the year as well as the 500th Pyaterochka and 200th Perekrestok in our core Moscow stronghold
- Pyaterochka drove the increase in new stores and selling space, which increased by 23% and 24% respectively year-on-year in 2014

Total revenue (RUB mln)

18.0%
Five-year CAGR

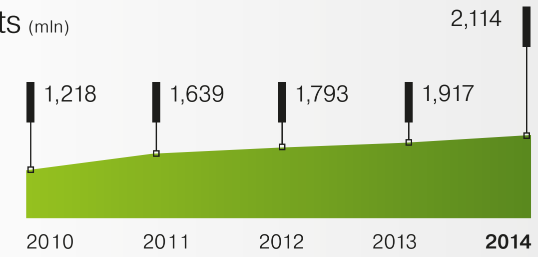


Revenue growth in 2014 was driven by selling space expansion and like-for-like store sales, which accounted for 8.8% and 9.8%, respectively, of the total 18.6% growth in 2014.

- Fastest top-line growth in more than five years
- Improving sales densities

Customer visits (mln)

16.3%
Five-year CAGR

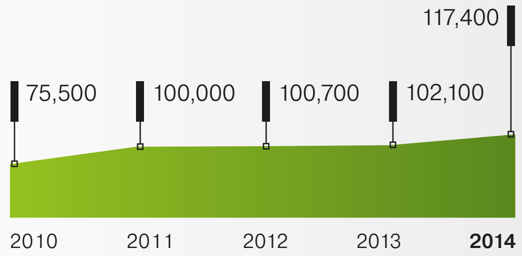


X5 recorded more than 2 billion customer visits in 2014 representing a 10% increase over the prior year. Approximately 1% came from increased customer visits from like-for-like stores.

- Customer focused value propositions support traffic and customer visits
- Pyaterochka increased like-for-like traffic by ~2%

Employees

11.4%
Five-year CAGR



X5's employees are our most important asset and we are focused on improving service and productivity through improvements in training and motivation.

- Revenue per average employee increased by 10%
- 2014 out-staffing decreased by 3ppt to 17%

Logistics

- Completed rollout of JDA Software in distribution centers (except for fresh)
- Continued with separation of distribution centers (DCs) between formats
- Standalone transportation department driving cost optimization

We made significant progress with the separation of distribution centers between Pyaterochka and Perekrestok/Karusel and are in a position to complete this in 2015. Providing dedicated logistics platforms has already demonstrated improvements to service levels.

- 6 ppt improvement in Pyaterochka service levels in the Central region
- 13% increase in DC space in 2014 compared to 2013

Management and corporate governance

- The right people for the right results
- Succession planning and development of internal talent
- Focus on development of corporate culture
- Planned Supervisory Board additions will improve independence

Focused on matching the right experience with the current phase of the format's transformation while at the same time building and utilizing the depth and experience resident in the organization to promote from within.

Chief Executive Officer's strategic review continued

Delivering on targets and creating opportunities

Our progress with back to basics initiatives and operational improvements allowed X5 to deliver on 2014 targets and positioned us to take further advantage of the favorable growth dynamics in the Russian retail market. The distinct brand positioning in our multi-format model presents customers with a wide range of options across the price/value spectrum and provides X5 more opportunities to capture a greater share of the customer wallet.

Brand differentiation: strong brands, clear value propositions, popular formats, improved execution, results

Metric	2014 guidance	2014 results	
Net retail sales growth, %	17.0%-19.0%	**18.6%**	✔
EBITDA margin, %	7.2%-7.5%	**7.2%**	✔
CAPEX, RUB billion	~34	**34.4**	✔
Selling space growth, %	15.0%+	**15.7%**	✔
Net debt/EBITDA, x	< 3.00x	**2.30x**	✔
Interest coverage ratio, x	> 2.75x	**3.76**	✔

Topline turnaround

What we said

The turnaround at X5 has been focused on the topline through a renewed focus on the customer via improved value propositions including assortment and in-store experience.

What we did

We delivered 2014 revenue at the top of our target range primarily due to the improvements associated with the launch of the 'New Pyaterochka' rebranding program, which featured a new and expanded assortment, a new store and refurbishment brand book as well as our progress on back to basics initiatives.

Read more on pages 54-57

Product range development

What we said

In order to deliver on our formats' value propositions we needed to create dedicated commercial departments based on category management principles, which allows us to deliver the products that our customers desire.

What we did

Comprehensive category reviews for each format resulting in expansion and rotation of the product range, improved promotional offers, better relationships with suppliers, and reinforcing the strategic positioning of the formats in the eye of the customer.

Read more on pages 16-37

Increase selling space

What we said

In order to reach our strategic targets for balanced growth we need to increase store openings and selling space additions across our formats, primarily through organic growth, but also through opportunistic and, tactical M&A opportunities.

What we did

In 2014 we delivered almost 350,000 square meters of selling space or a 15.7% increase over selling space as at 31 December 2013. This was primarily organic growth from Pyaterochka, which included the tactical acquisition of 116 stores in the Samara region. We also developed strong opening pipelines at Perekrestok and Karusel.

Read more on pages 16-35

Focus on cost control

What we said

We continue to focus on controlling costs and driving efficiencies throughout our operations in order to provide better value for our customers and improve shareholder returns.

What we did

In 2014 we delivered EBITDA in line with our target, primarily due to the optimization of operating costs and improvements in operating leverage.

Read more on pages 54-57

Disciplined capital management

What we said

We plan to finance our capital investment program primarily through internally generated cash flows, improve our returns on investment and maintain a net debt to EBITDA ratio below 3.0x.

What we did

During the year we improved the efficiency of store openings and refurbishments, primarily at Pyaterochka, which resulted in CAPEX coming in at our target level and improvements to our return on investment. We also financed the program mainly through our operating cash flow keeping net debt to EBITDA at 2.3x, well below our target.

Read more on pages 54-57

Chief Executive Officer's strategic review continued

An attractive marketplace

Focus on delivering growth with increasing emphasis on differentiation and innovation to take advantage of consumer and market trends.

20%
market share of top 5 retailers

Consumer trends

- Russian consumers are receptive to innovations in food retail
- Increase in household debt/interest payments – affecting consumer spend
- Private label – consumer appetite exists but a strong desire remains for choice, including branded products
- Consumer trading-down in certain categories in reaction to food inflation
- More aggressive promotions from retail chains offsetting inflation effects – well received by consumers
- Food consumption – the last to feel the impacts of weakening consumer spending
- Imported products desired and accepted by consumers

Increasingly challenging macro environment

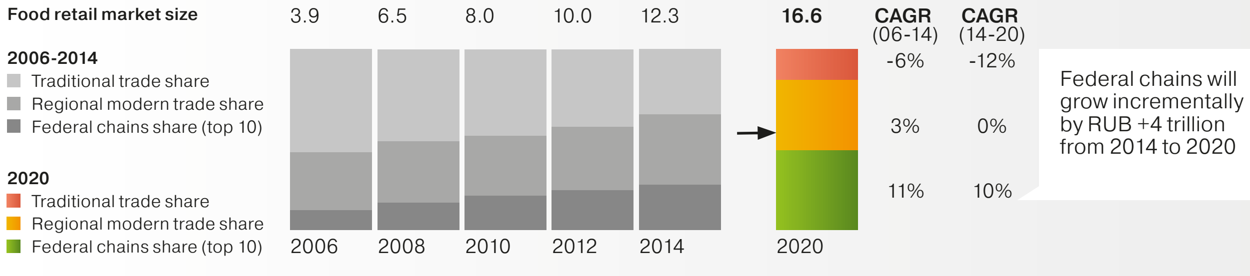
Positive trends

- Food inflation outpacing general cost inflation
- Low unemployment
- Acceleration of consumer transition to modern retail
- Low modern retail penetration
- Challenging macro environment harder on smaller operators

Negative trends

- Low GDP growth, declining investment and Rouble devaluation
- Declining consumer spending
- Sanctions
- Negative real wage growth

Shift from traditional trade to modern trade (RUB trillion)



	2006	2008	2010	2012	2014	2020
Modern format share	43%	49%	52%	57%	64%	83%
Federal chains share	11%	15%	19%	22%	25%	44%

Source: Rosstat, Euromonitor, Infoline, Company reports, X5 estimates.
Note: Federal chains include top 10 players in the Russian food retail market.

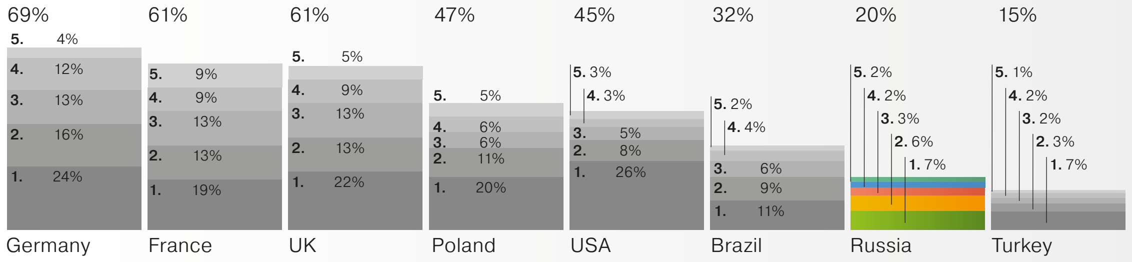
Trends in the market

- Growth in modern retail has significantly outpaced overall market growth in the past five years
- More government stimulus, with an increase/focus on social spending
- Strong purchasing power strength resulting in improved commercial terms
- Modern retail proving to be more attractive than traditional outlets

Favorable market fundamentals

- Russia is one of the largest grocery retail markets in Europe, with approximately USD 281 billion in sales, net of VAT (Source: Rosstat)
- Modern formats accounted for just 64% of the total 2014 Russian food retail market, including open markets (Source: Infoline)
- The top five Russian food retailers hold less than 20% of the market
- Low unemployment at 5.3%

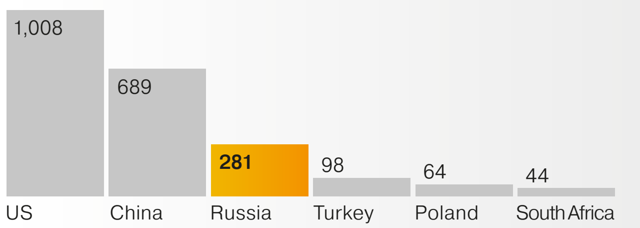
Top 5 grocery retailers (% of market share)



Germany	France	UK	Poland	USA	Brazil	Russia	Turkey
1. Edeka	1. Carrefour	1. Tesco	1. Jerónimo Mart.	1. Wal-Mart	1. Casino	1. Magnit	1. BIM
2. Schwarz Group	2. ITM Entreprises	2. Sainsbury	2. Schwarz Group	2. Kroger	2. Wal-Mart	2. X5 Retail Group	2. Migros
3. Aldi	3. Leclerc	3. Wal-Mart	3. Tesco	3. Albertson's	3. Carrefour	3. Auchan	3. A101
4. Rewe Group	4. Casino	4. Morrison	4. Auchan Group	4. Publix	4. Cencosud	4. Dixy	4. Yildiz
5. Metro Group	5. Auchan Group	5. Co-operative G.	5. Eurocash	5. Royal Ahold	5. Dia	5. Metro	5. Carrefour SA

Source: Company Reports, Planet Retail, Euromonitor.
Note: Totals may vary due to rounding.

Top global and CEEMEA food retail markets 2014 (USD bln)

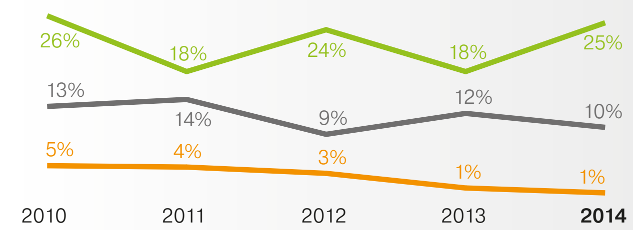


Russia's leading food retailers

	Company name	Net retail sales 2014, RUB mln	Percentage share in Top 10	Percentage share of total market
1	Magnit	742,964	27.2%	6.9%
2	X5 Retail Group	631,930	23.2%	5.9%
3	Auchan	334,107	12.3%	3.1%
4	Dixy	228,988	8.4%	2.1%
5	Metro	207,580	7.6%	1.9%
6	Lenta	193,988	7.1%	1.8%
7	O'key	149,916	5.5%	1.4%
8	Spar	86,221	3.2%	0.8%
9	Monetka	75,443	2.8%	0.7%
10	Seventh Continent	75,443	2.8%	0.7%
	Total	**2,726,581**	**100.0%**	**25.3%**

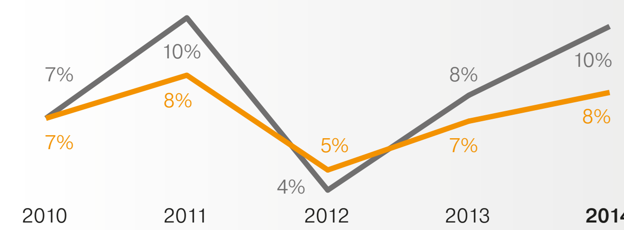
Source: Rostat,Infoline, Euromonitor, companies' data, X5 estimates.
Notes: Magnit sales do not include cosmetics stores' sales.

Food retail turnover vs Top 10 players and GDP (%)



Source: Rosstat, Company estimates, Euromonitor.

CPI vs food inflation in Russia (%)

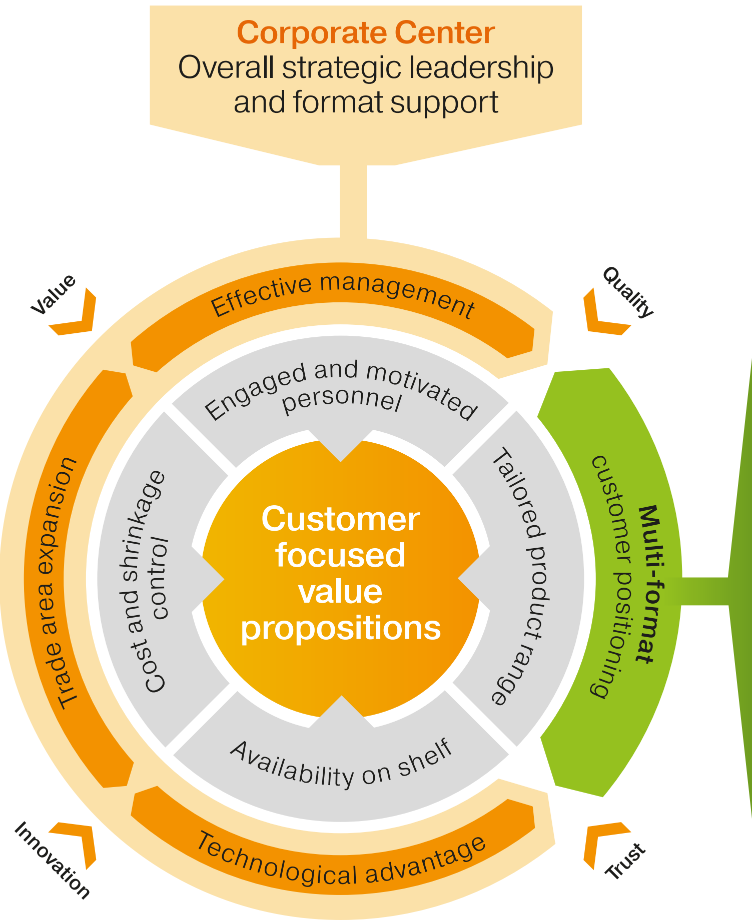


Source: Rosstat.

Our business model and strategy

Unique multi-format business model

Our multi-format organizational structure, reinforced by central support teams and strong strategic leadership, provides us with a unique opportunity to leverage our distinct format value propositions to capture greater wallet share by providing the best customer experience in the dynamic Russian food retail market.

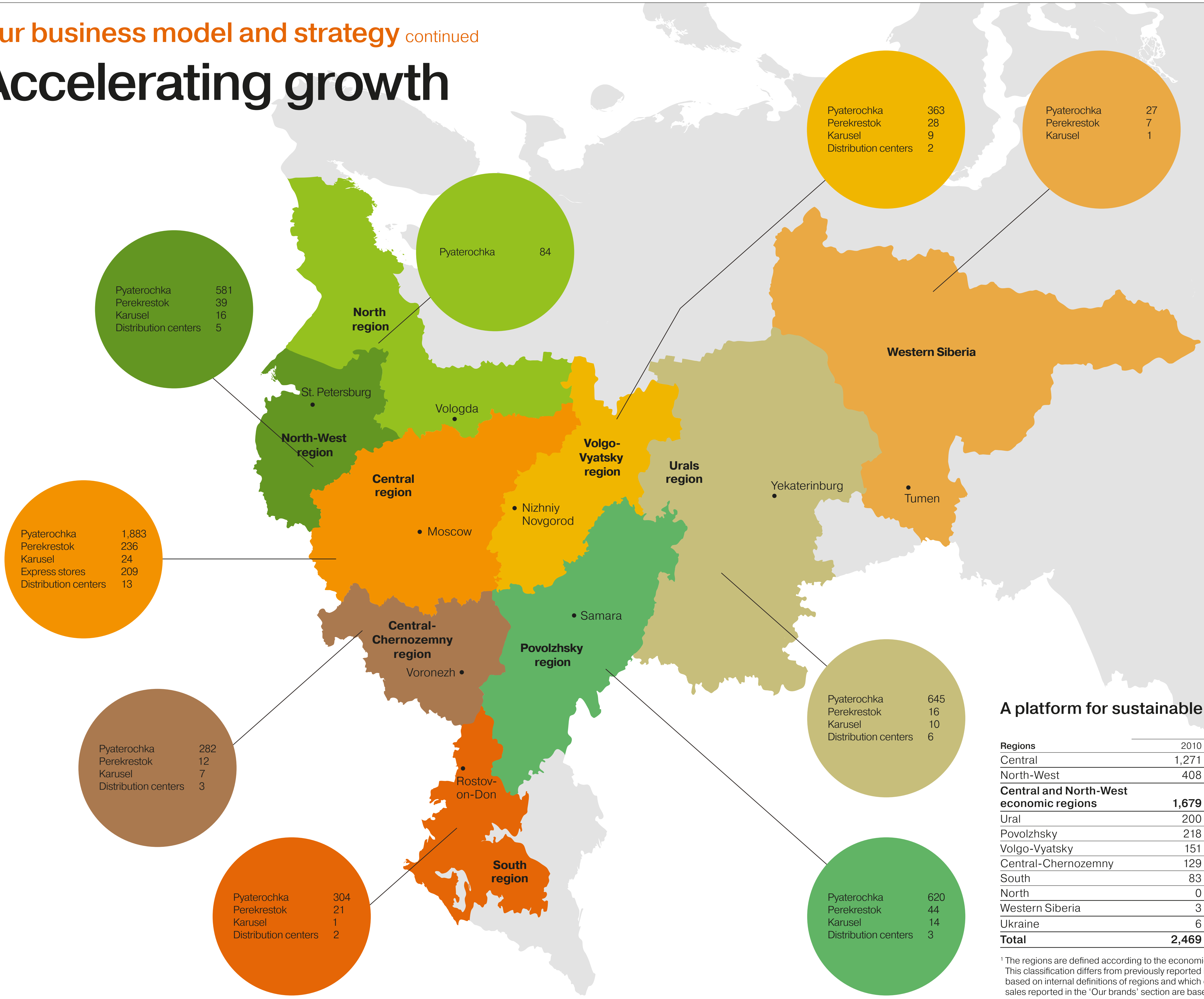


Brand formats	Brand operations	Brand focus/strategic objectives
Пятёрочка **Your neighbourhood store for daily shopping needs** Proximity store – located in residential areas, close to customers' homes; top-up shopping; everyday basket and basic needs; limited, focused range, with value for money first price and private label products; no-frills design to keep prices low; interesting promotions to entice customers to save more and make treats affordable.	› **4,789 stores** and 1,754 thousand sqm › **350 sqm** – average net selling space per store › **+4,000 products** – average range size › **69%** of X5's net retail sales › **16** – average number of employees per store	› rapidly expanding new store concept and refurbishment program › improving systems to aid productivity › developing private label/first price range › improving supply chain via dedicated logistics and new distribution center openings
Перекресток СУПЕРМАРКЕТ **Russia's favorite, high quality fresh supermarket** Premium shopping experience; prime, central locations in cities or transit hubs; accent on quality and fresh, exotic and unique range; focus on service; loyalty program to assist in ranging decisions.	› **403 stores** and 416 thousand sqm › **1,000 sqm** – average net selling space per store › **13,500 products** – average range size › **18%** of X5's net retail sales › **55** – average number of employees per store	› rolling out new store concept and refurbishment program › optimizing and introducing new product range › developing and improving private label range › improving operational standards › developing dedicated logistics for supermarkets and hypermarkets
гипермаркет **КАРУСЕЛЬ** **Destination store for all food and household needs** Destination, value for money shopping; good city locations, close to residential areas or easily accessible sites with good parking; wide range of food (multi-pack sizes/prepared food/counter service) and targeted non-food range; strong promotions and powerful loyalty program.	› **82 stores** and 359 thousand sqm › **3,000–4,500 sqm** – average net selling space per store › **17,000–25,000 products** – average range size › **11%** of X5's net retail sales › **196** – average number of employees per store	› finalizing brand repositioning and new store concept › upgrading existing stores to the new concept › improving operational standards › completing range review and expansion under category management principles › improving promotional calendar › developing new store pipeline
Перекресток ЭКСПРЕСС **Convenient, urban shopping for busy people** Convenient locations, primarily in Moscow and the Moscow region, close to homes, workplaces and public transportation; wide range of ready-to-eat meals; top-up shopping; fresh, quality products for people on the go.	› **209 stores** and 44 thousand sqm › **200 sqm** – average net selling space per store › **3,000 products** – average range size › **2%** of X5's net retail sales › **10** – average number of employees per store	› reviewing strategic plans
Tailoring formats' offers to customer needs	Efficient and high-caliber central support function	Maximizing the market opportunities

Creating value

Our business model and strategy continued

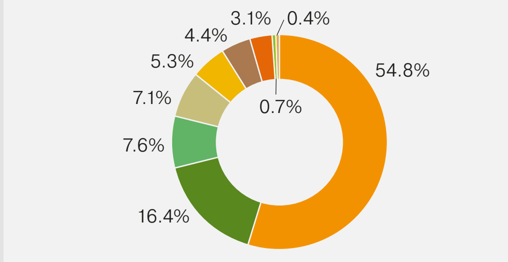
Accelerating growth



Key to growth – adding new stores

- Defend and expand 'home' core regions
- Expand in other regions and build critical mass
- Target new regions over time
- Synchronized/coordinated store/DC expansion/transportation
- Develop store opening pipeline and land-bank
- Take advantage of opportunistic M&A

2014 net retail sales by region (%)



Note: net retail sales include revenue from E5.RU and Ukraine operations which ceased during the year.

A platform for sustainable growth[1]

	Number of stores				
Regions	2010	2011	2012	2013	**2014**
Central	1,271	1,443	1,770	2,062	2,352
North-West	408	478	530	585	636
Central and North-West economic regions	**1,679**	**1,921**	**2,300**	**2,647**	**2,988**
Ural	200	254	391	509	671
Povolzhsky	218	280	371	470	678
Volgo-Vyatsky	151	221	276	326	400
Central-Chernozemny	129	162	209	252	301
South	83	140	198	243	326
North	0	11	32	59	84
Western Siberia	3	3	13	27	35
Ukraine	6	10	12	12	0
Total	**2,469**	**3,002**	**3,802**	**4,544**	**5,483**

[1] The regions are defined according to the economic classification of Russian regions promulgated by the Ministry of Economy. This classification differs from previously reported information regarding the regional breakdown of our store base, which was based on internal definitions of regions and which changed in 2013 for some brands. The regional breakdown of stores and sales reported in the 'Our brands' section are based on the new internal definitions for each brand.

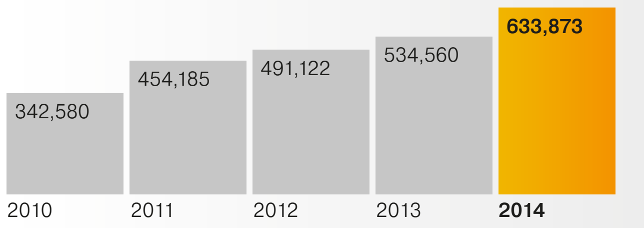
Highlights

Resilient performance in a developing marketplace

In 2014 X5 returned to growth and is now on track to deliver in line with the formats' value propositions, customer demands and market opportunities.

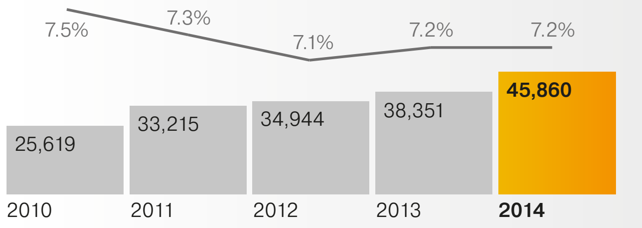
Financial highlights

Total revenues (RUB mln) Five-year CAGR 18.0%



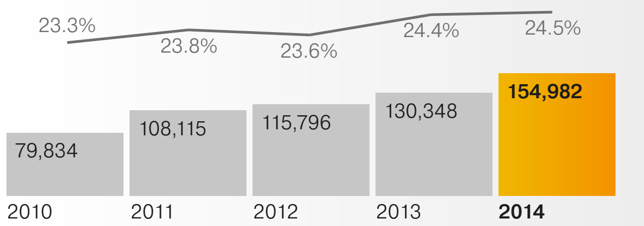
Source: Company data.

EBITDA (RUB mln)
EBITDA margin (%) Five-year CAGR 14.5%



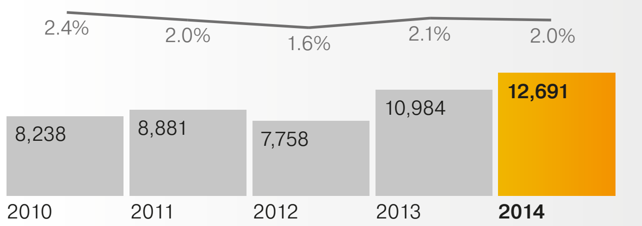
Source: Company data.

Gross profit (RUB mln)
Gross profit margin (%) Five-year CAGR 18.3%



Source: Company data.

Net profit (RUB mln)
Net profit margin (%)

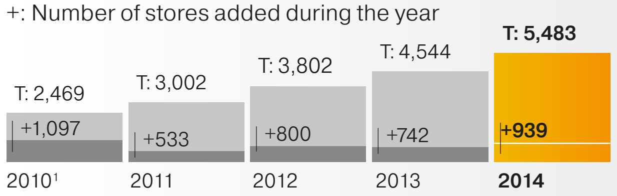


Source: Company data.
Note: excluding impairment effect of RUB 14,530 mln in 2012.

Operating highlights

Store expansion dynamics (number of stores) Five-year CAGR 31.9%

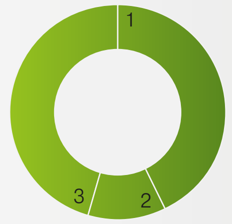
T: Total number of stores
+: Number of stores added during the year



[1] Includes acquisition of Kopeyka – 660 stores.

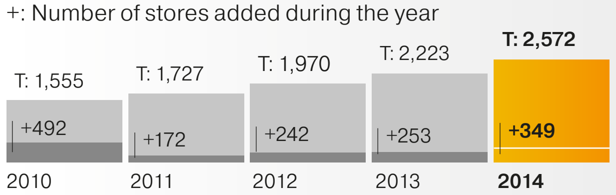
Store base breakdown by region 2014 (%)

1. Central region 42.9%
2. North-West region 11.6%
3. Other regions 45.5%



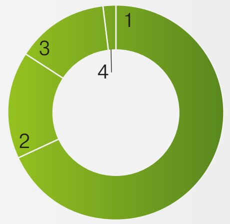
Selling space expansion dynamics (thd sqm) Five-year CAGR 19.3%

T: Total number of stores
+: Number of stores added during the year

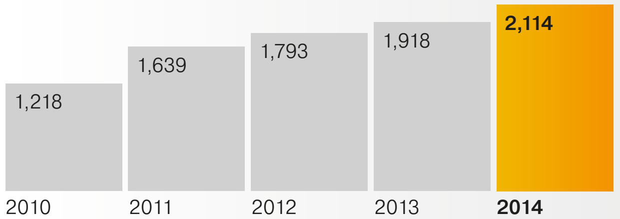


Selling space breakdown by format 2014 (%)

1. Pyaterochka 68.2%
2. Perekrestok 16.2%
3. Karusel 13.9%
4. Express 1.7%

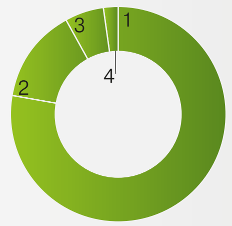


Customer visits (mln) Five-year CAGR 16.3%

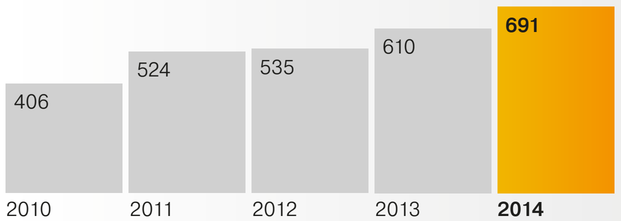


Customer visits breakdown by format 2014 (%)

1. Pyaterochka 77.80%
2. Perekrestok 14.30%
3. Karusel 5.80%
4. Express 2.10%

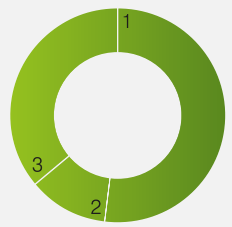


Distribution center space (thd sqm) Five-year CAGR 17.4%



Distribution center space breakdown 2014 (%)

1. Central 52.1%
2. North-West 12.0%
3. Other regions 35.9%



Operational review

Focusing on efficiency and meeting customer needs

+10% increase in employee productivity

>2bln customer visits in 2014

Our brands

Pyaterochka

Read more on pages 20-23

Perekrestok

Read more on pages 24-27

Karusel

Read more on pages 28-31

Perekrestok Express

Read more on pages 32-35

Logistics

X5 distribution center

Read more on pages 36-37

Product safety

Fresh seafood at Perekrestok

Read more on pages 38-39

X5 overview

X5 is Russia's second largest food retailer – one of the most exciting consumer markets in the world. We operate four brands in distinct market segments, with unique value propositions that appeal to a wide range of shoppers and budgets. The Company is in the final stage of a multi-year transformation strategy to position the business for sustainable long-term market leadership and financial success.

Total revenue in 2014 reached RUB 633.9 billion (USD 16.5 billion), an 18.6% increase in RUB terms compared to 2013. The increase comprised an 8.8% increase in sales from new stores driven primarily by the 15.7% increase in net selling space in 2014 and a 9.8% increase in like-for-like sales driven primarily by improvements in basket.

We operate the following retail chains in Russia: a chain of proximity stores under the Pyaterochka brand, a supermarket chain under the Perekrestok brand, a hypermarket chain under the Karusel brand and Express convenience stores primarily under the Perekrestok Express brand. At the end of 2014, X5 ceased operations at its E5.RU online retail channel to focus on the core food retail business.

X5 was established on 18 May 2006 from the merger between the Pyaterochka and Perekrestok retail chains. In June 2008, X5 acquired Karusel, enabling us to substantially strengthen our position in the hypermarket segment and become a truly 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.

Over the past three years we have been focused on a large-scale reorganization of our operations aimed at providing more autonomy to the brands and reinforcing the multi-format strategy. As part of our decentralized approach to managing the business we are adopting a new operational model that separated the commercial activities between formats and established a category management approach to developing format assortments. Under the new model we also began the process of separating the centralized logistics activities into two dedicated functions to reinforce individual brand strategies and provide focus on different brand value propositions. We also created a stand-alone transportation division to improve service and drive cost optimization. Please see pages 36-37 of this Annual Report for more information.

Our multi-format structure provides us with a unique opportunity to capitalize on the growing food retail market in Russia and in particular the ongoing penetration of modern retail in the fragmented Russian food retail market. The ratio of modern retail to traditional retail in Russia is significantly lower than that of more developed markets and with the top five food retailers accounting for less than 20% of total retail food sales there are tremendous opportunities for growth and consolidation.

The distinctive value proposition of each brand enables us to offer customers products they want at the most attractive prices. Our stores provide customers with multiple opportunities to purchase quality products in convenient locations, and allow X5 to capture a greater share of the consumer's wallet. They took advantage of this more than 2.1 billion times as we recorded a 10.2% increase in customer visits in 2014 compared to 2013.

X5 has a wide geographical coverage and as at 31 December 2014 we had 5,483 Company-operated stores, 939 of which were added during the year, increasing net selling space by 349 thousand square meters to 2,572 thousand square meters. We have the leading market position in Moscow and St. Petersburg, a significant presence in European Russia and the Urals, and also operate stores in Western Siberia.

Our store base includes 4,789 Pyaterochka proximity stores, 403 Perekrestok supermarkets, 82 Karusel hypermarkets and 209 Express convenience stores.

Our growth in 2014 was primarily the result of organic expansion, which resulted in the addition of almost 350 thousand square meters or a 15.7% increase in total net selling space at the end of the year. X5's total capital expenditures for 2014 amounted to RUB 34.4 billion (USD 896.2 million) of which the majority went to increasing and improving the store base while the remainder was spent on logistics, IT and strategic projects.

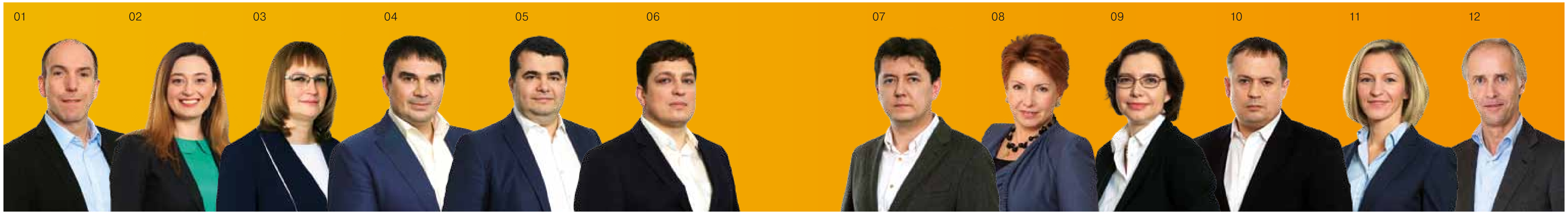
In order to support our national scale and rapid expansion, we have developed a robust supply chain to source and deliver products to the stores. X5 is one of the major buyers for many domestic and international food producers, enabling us to negotiate favorable terms from suppliers so that the consumer pays less in our stores. To ensure that products are efficiently transported to our shelves, we have developed a logistics infrastructure comprising 34 distribution centers, or 691 thousand square meters, which utilize modern technologies to provide efficient delivery of products to store shelves. In 2014, the Company's centralization level remained flat year-on-year at approximately 78%.

X5's employees are the Company's most valuable resource. In parallel with our rapid growth we have also invested in improving the quality of our workforce at both management and store levels. During 2014 there have been a number of changes to the Executive Committee as well as at store management level, to build on the work that has been completed thus far in the turnaround and drive the strategy forward.

Our extensive and diverse store base, wide geographical coverage, developed logistics and robust IT systems provide a strong platform for the further development and sustainable growth of our business.

Executive Committee

The right team – commitment, experience and expertise



01 **Stephan DuCharme**
X5 Chief Executive Officer
Chairman of the Management Board and the Executive Committee
Year of birth: 1964

Stephan has served on X5's Supervisory Board from 2008 to 2012. Previously he held positions with SUN Group, Alfa Group, the 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 and JSC SUEK. He graduated with distinction from the University of California at Berkeley and received his MBA from INSEAD.

02 **Elena Milinova**
X5 Chief Financial Officer
Year of birth: 1976

Elena has approximately 14 years of experience in financial management with leading Russian industrial companies as well as international professional services networks. Most recently, she served as CFO, Deputy CEO and Management Board Member for KAMAZ, a Russian public automotive manufacturing company, from 2011 to 2014. From 2009 to 2011 and 2007 to 2009 respectively she served as Government Relations Director and Corporate Finance Director for KAMAZ. Prior to that, she held the positions of CFO of Russian oil and gas company Geotransgaz as well as Head of Reporting and Investor Relations with Sollers ST, a leading Russian automotive manufacturing company. Elena started her professional career with PricewaterhouseCoopers in Russia.

03 **Olga Naumova**
General Director of Pyaterochka
Year of birth: 1972

Olga has over 20 years of managerial experience at senior executive level with leading Russian and international companies, including Rimera, Severstal and IBS. During this time she has effectively managed large teams in both Russian and international environments and has a track record of success in business integration and restructuring.

04 **Vladimir Sorokin**
General Director of Perekrestok
Year of birth: 1971

Vladimir joined X5 as deputy purchasing director, in June 2013 he became the director of category management for Pyaterochka and later was appointed General Director of Perekrestok. Vladimir has approximately 20 years of experience in the retail, FMCG and insurance industries and has held senior management positions at Alfa Insurance, Sun Interbrew and Gillette, where he has successfully led both strategy development and business transformation projects.

05 **Vardan Dashtoyan**
General Director of Karusel
Year of birth: 1971

Vardan has approximately 18 years of combined operational, managerial and entrepreneurial experience in retail, fast moving consumer goods and food manufacturing. During this time, he has served as CEO for Rolf Retail, one of the largest car dealers in Russia, as well as Business Development Manager for Danone Russia and Key Account Manager for Heinz Russia. Most recently he co-owned a successful confectionery manufacturing company in Moscow.

06 **Anton Mironenkov**
Business Development Director
Year of birth: 1976

Anton joined X5 as Deputy Director of the M&A Department in September 2006. In March 2011, he was appointed Director for M&A and Business Development and subsequently has held the positions of Director for Strategy and Business Development, and General Director of the Express convenience store format. From 2005 to 2006, Anton managed various projects in Alfa Group including the merger of Pyaterochka and Perekrestok. He began his business career in 2000 as an auditor at PricewaterhouseCoopers, and subsequently spent four years as an investment banker at Troika Dialog before becoming Vice President at Troika Dialog Asset Management in 2005.

07 **Dmitry Kholkin**
Chief Information Officer
Year of birth: 1979

Dmitry has over 10 years of management experience in IT and Finance. At X5 Dmitry held director level positions in charge of financial systems, IT operations and business support. Prior to joining X5 he held the position of regional finance manager for Wrigley. Dmitry graduated in 2001 from the State University of Management in Moscow with a degree in Information Technology.

08 **Vladlena Yavorskaya**
General Counsel
Year of birth: 1957

Vladlena has over 30 years of legal experience in both Russian and multinational enterprises. Prior to joining X5, she was Director of the Legal Department of Rolf, a leading automotive retail business in Russia. From 2001 to 2006, she was Director of the Legal Department of Wrigley, where she was responsible for Eastern Europe and the Middle East. Vladlena graduated from the Law faculty of Moscow State University.

09 **Elena Romanova**
Human Resources Director
Year of birth: 1970

Elena has approximately 20 years of management experience and 9 years of experience in human resources. Prior to joining X5 she was the Director of Organizational Development for Polyus Gold International. From 2012 to 2013, Elena was a partner in the Moscow office of the global executive search firm Heidrick & Struggles, and Director for Personnel at the steel and mining company Severstal from 2005 to 2009. Prior to that, she worked as a consultant for McKinsey & Company and the Coca-Cola Hellenic Bottling Company, where she was responsible for distribution and sales of regional division.

10 **Dmitry Agureev**
Security Director
Year of birth: 1970

Dmitry has approximately 23 years of experience working in government and corporate security including leading Russian and international companies. Prior to joining X5, he was the Director of Security at Volvo Group in Russia and also held senior security positions at Gazprom and Transneft. Dmitry holds degrees from the Moscow Suvorov Military Academy, Serpukhov Military Institute of Missile Troops and Russian Academy of Foreign Intelligence as well as an MBA.

11 **Elena Konnova**
Corporate Communication Director
Year of birth: 1971

Elena has approximately 20 years of experience in public relations with some of the largest Russian companies. Before joining X5 she worked as a PR representative for the Volga Group and Deputy General Director for PR at logistics company Transoil. Between 2009 and 2012 she held several positions at Gazpromneft, including Head of Communications for Foreign Subsidiaries, Director of Information and Communications and Deputy General Director of NIS (Oil Industry of Serbia). From 2003 to 2009, Elena worked at Ilim Group, as Head of the Press Office and then Director of Information and PR. Prior to that she worked for more than 10 years as a journalist for the Russian business press, including Kommersant and Expert.

12 **Frank Lhoëst**
Company Secretary
Member of the Management Board
Year of birth: 1962

Frank joined X5 in November 2007. He previously he 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 Frank established the Intellectual Property Group of Intertrust in the Netherlands.

Our brands

Pyaterochka proximity stores

Your neighborhood store for daily shopping needs

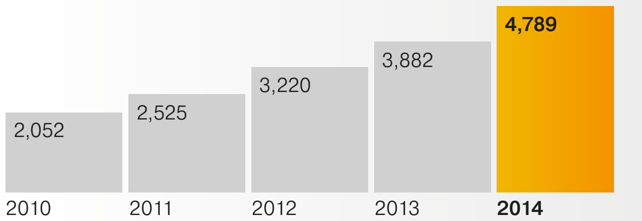
+15-20%
increase in the number of SKUs

907
new stores added in 2014

Our brands continued

Pyaterochka proximity stores

Store expansion
(number of stores)

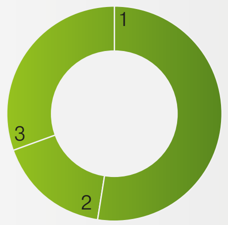


Source: Company data.

23.4% increase in 2014 number of stores

2014 net retail sales breakdown
(%)

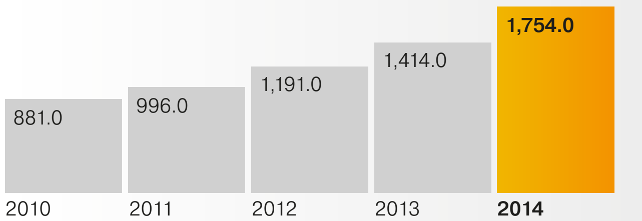
1. Central region	52.6%
2. North-West region	17.1%
3. Other regions	30.3%



Source: Company data.

Strong presence in Central and North-West regions

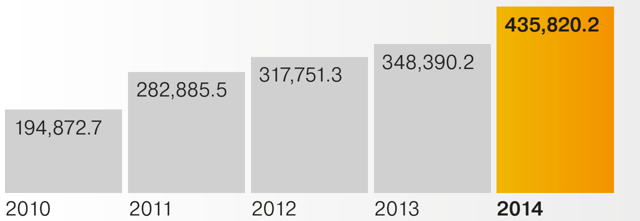
Selling space expansion
(thd sqm)



Source: Company data.

24.0% increase in 2014 selling space

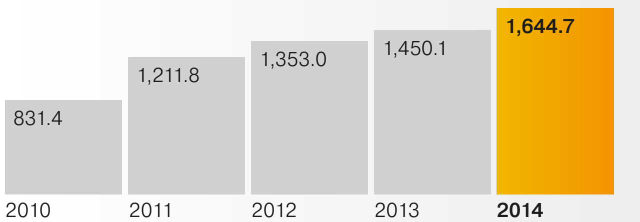
Net retail sales dynamics
(RUB mln)



Source: Company data.

25.1% increase in 2014 net retail sales

Customer visits
(mln)



13.4% increase in 2014 customer visits

+25% increase in net sales

Olga Naumova
General Director of Pyaterochka

"Our 2014 results demonstrate the effectiveness of Pyaterochka's rebranding program and the investments we made in our stores, product range, operations and people. During the year we delivered in line with our value proposition, and the consumer has responded accordingly."

Pyaterochka is our conveniently located proximity store, situated primarily in residential areas and close to shoppers' homes, where customers can always find quality goods at reasonable prices. It is also one of Russia's leading national brands and one of the first modern grocery retail chains to open in Russia. The brand was launched in St. Petersburg in February 1999 and as of 31 December 2014 included 4,789 stores in European Russia, the Urals and Western Siberia.

Pyaterochka stores are focused on easy and economical shopping. The brand offers quality fresh products and a non-food assortment supported by attractive promotions. The stores' range consists on average of approximately 4,000-plus items, with an average store size of approximately 350 square meters.

In 2014, Pyaterochka stores reported net retail sales of RUB 435,820 million (USD 11,343 million) representing a year-on-year increase of 25.1%, and accounting for 69% of X5's total 2014 net retail sales.

We added 907 net Pyaterochka stores or 340 thousand square meters of net selling space in 2014, the largest increase in organic growth in the format's history. During the year we celebrated a number of landmark openings, including the 4,000th Pyaterochka, and reaching 500 stores in Moscow. We plan to continue our store rollout and have improved our new store opening capabilities through the introduction of GIS software, which provides data on a locality's population, competition, social infrastructure, local market share, personal income and transport accessibility, thus simplifying our decision-making process on expansion.

To manage the size and diversity of our store base in a more efficient way, we introduced store 'clusters' as the main business unit for Pyaterochka, and by the end of 2014 we had a full management team in place to oversee the 67 clusters that comprise the Pyaterochka chain. Fully staffed, the new clusters allow us to be more responsive to changes in customer demand and to the competitive environment as well as providing more accountability and better communication with the central office.

In order to provide Pyaterochka stores with the necessary support to be successful in an increasingly competitive market, and in recognition of the distinct needs of proximity stores from the larger supermarket and hypermarkets, we are in the process of establishing a dedicated supply chain function for the brand that began in 2013, including dedicated commercial and logistics functions.

As a result we have increased the number of stock-keeping units (SKUs) in our assortment by 15% to 20%, thereby bringing the average to approximately 4,000 SKUs, including the weekly rotation of up to 50 new products primarily in the fresh category.

A key aspect of Pyaterochka's assortment strategy is its focus on freshness. In 2014, we expanded the range and increased the selling space for fresh products in our stores as well as strengthened quality control. Pyaterochka Store Directors have assumed the additional role of Freshness Directors and are responsible for the quality of fruit and vegetables, customer relations and service. In this new role they spend time on the trading floor and are always available to customers. Another aspect of the assortment strategy is the content of local goods in the assortment, which increased by 30% to 40% in 2014.

During the year we also continued with the separation of logistics services between the Company's formats. In 2014 Pyaterochka operated 18 distribution centers, two of which were opened during the year. We opened our flagship distribution center in Rostov which is the model for new openings and which provides us with capacity to accelerate growth in the South region. The creation of a dedicated logistics system for Pyaterochka is ongoing and will include construction of new distribution centers. The focus of the new system is the timely and efficient supply of current and new stores, improved distribution center productivity, lower operating costs and increased availability.

Also in 2014, Pyaterochka launched a series of pilot projects aimed at improving energy efficiency, and we plan to continue monitoring energy usage and adopting new store lighting technologies, both inside and out, which should lead to a significant decrease in energy expense.

We also continued with the store refurbishment program that was launched in 2013 to update store facades and equipment, improve in-store navigation and lighting and optimize trade areas. In 2014, we updated the refurbishment process to accommodate new store equipment standards and assortment in line with the Pyaterochka's updated brand book. As a result we refurbished 460 stores, which demonstrated an impressive +25.5% average like-for-like growth after re-opening. Moreover, selling space of those stores increased on average by 16% on the back of eliminating inefficient sublease space and optimizing back room storage space.

In order to ensure that our focus on the customer is sustainable we continue to invest in developing personnel through improvements in recruiting and training, as well as improved motivation programs and the development of a strong corporate culture. Through team-building and increased employee engagement we plan to decrease staff turnover, increase productivity, and retain and build operational expertise to provide a better experience for Pyaterochka customers.

Perekrestok supermarkets

Russia's favorite, high-quality fresh supermarket

Перекресток СУПЕРМАРКЕТ

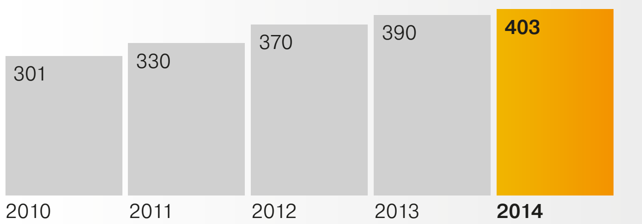
25%
rotation of product range

New
flagship store opened

Our brands continued

Perekrestok supermarkets

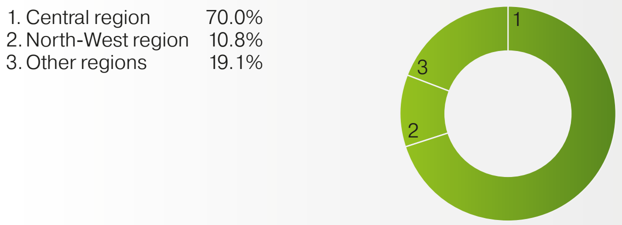
Store expansion
(number of stores)



Source: Company data.

3.3% increase in 2014 number of stores

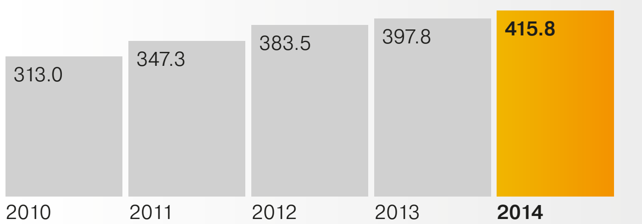
2014 net retail sales breakdown
(%)



Source: Company data.

Strong presence in Central region

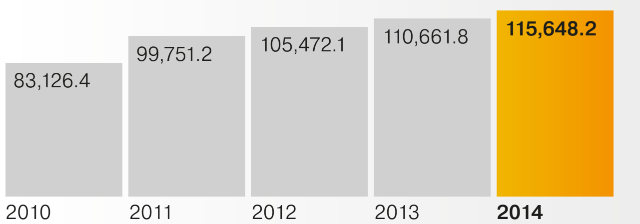
Selling space expansion
(thd sqm)



Source: Company data.

4.5% increase in 2014 selling space

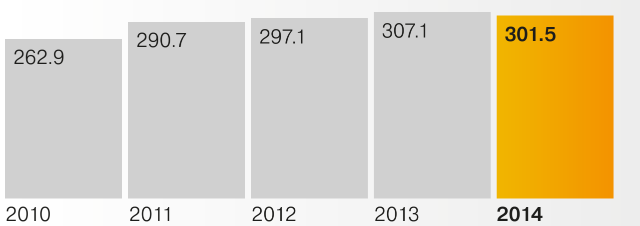
Net retail sales dynamics
(RUB mln)



Source: Company data.

4.5% increase in 2014 net retail sales

Customer visits
(mln)



1.8% decrease in 2014 customer visits

88%
decrease in out-staffed employees

Vladimir Sorokin
General Director of Perekrestok

“We made significant progress in 2014 developing and fine tuning the Perekrestok value proposition; including the updated product range to go along with the format’s new rebranding and refurbishment program. We continue to focus on service and operations in order to improve the shopping experience.”

Perekrestok, our supermarket brand, launched in 1995 and is the leading national supermarket chain in Russia and one of the first modern supermarkets to open in the Russian retail space.

As of 31 December 2014, the chain included 403 supermarkets located in European Russia and the Urals region, including 236 in the Central region, 39 in the North-West region and 128 stores in ‘Other’ regions[1].

Perekrestok strives to be the customer’s first choice for fresh products supported by the right complementary assortment and pricing strategy. The stores offer a range of approximately 13,500 stock-keeping units and target an average net selling space of approximately 1,000 square meters.

Perekrestok stores reported net retail sales of RUB 115,648 million (USD 3,010 million) in 2014, representing a year-on-year increase of 4.5%, in Russian Rouble terms, and accounting for 18.3% of X5’s total 2014 net retail sales.

In 2014, the chain opened 35 new stores, including the chain’s 400th supermarket, which was opened in Moscow, and Perekrestok had the honor of opening X5’s 5,000th store in Chelyabinsk. In terms of square meters, we added just 18,000 net square meters due to the divestiture of the format’s Ukrainian subsidiary and ongoing rationalization resulting in the net addition of 13 stores, including 12 stores in the Central region and one store in ‘Other’ regions. We also remodeled 27 supermarkets during the year mainly in the Central region, including the new flagship Perekrestok which was opened in Moscow in October. This store represents the new Perekerestok concept and serves as the brand book for new stores and store refurbishments.

The reopening of our flagship store is the culmination of the total experience and knowledge built up by the chain over the past 19 years of operations. The refurbishment of the store’s 1,668 square meters of selling space includes the installation of state-of-the-art equipment and an updated interior and exterior reflecting the supermarket’s new logo, refreshed corporate design and value proposition. The new concept is focused on efficient store layout and improved lighting resulting in more space and light in the store. Everything in the store is tailored to offer customers a better shopping experience including the zoning, location of promotional offers and even the interior colors are based on customer preferences.

We plan to continue investing to expand the network through new store openings and to carry out store refurbishments, to improve the customer experience in line with the new Perekrestok value proposition and brand book.

We recognize that in our core markets customers have become more demanding in terms of price, assortment quality and service. Based on this we have updated our positioning, assortment and pricing strategy and incorporated the changes during 2014.

At the start of the year Perekrestok’s commercial department, under the framework of category management principles, introduced initiatives targeted at assortment improvement. To better suit the needs of our customers we have expanded our range by approximately 5% to 13,500 SKUs and rotated about 25% of the assortment with an emphasis on quality and freshness at competitive prices. The product range is focused on fresh and ultra-fresh offerings, for instance we increased the offering of bread and bakery, culinary and own production, and fish and seafood products, and over 30% of the assortment is provided by local Russian producers. The new assortment started to hit the Central region’s store shelves in the fourth quarter of 2014 and will be rolled out to the remaining regions during the first quarter of 2015.

In 2014, we also introduced a new private label strategy based on a mono-brand label development and by 2016 we plan to gradually replace X5’s cross-format private label brands with Perekrestok individual brands. This will not only distinguish the Perekrestok supermarket positioning but also strengthen customer loyalty. In the second half of the year we introduced the format’s own private label brands ‘Perekrestok’ and ‘Prosto’, which have been well received by customers.

We continued to roll out the self-service checkout in Perekrestok stores which enjoys a high adoption rate among customers. This technology provides opportunities to increase operational efficiencies and customer loyalty.

The communication of ongoing changes has been an integral part of the rebranding process. We have targeted customers via billboards, weekly catalogues and TV ads, which have become another priority for our team in 2014. We position our stores as a destination where people go for a wide range of high quality goods and service as well a positive shopping experience. We have also worked closely with suppliers to increase our promotional offers, which have been tailored to target the customer segment with whom we want to build loyalty.

At the end of the third quarter of 2014, there was a change in leadership at Perekrestok and Vladimir Sorokin, previously in charge of category management for Pyaterochka, took over as General Director to drive the rollout and expansion of the new concept. Now that the brand book and assortment have been completed, the format is in a position to take advantage of the growth opportunities in the market and live up to its new marketing slogan – “Perekrestok – Choose the Best!”.

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

Our brands

Karusel hypermarkets

Destination store for all food and household needs

гипермаркет КАРУСЕЛЬ

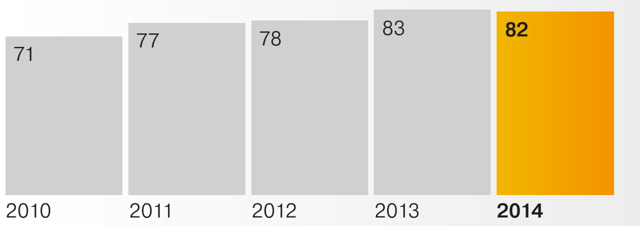
Increased product range by
5,500 SKUs

Loyalty program membership
>1.5mln

Our brands continued

Karusel hypermarkets

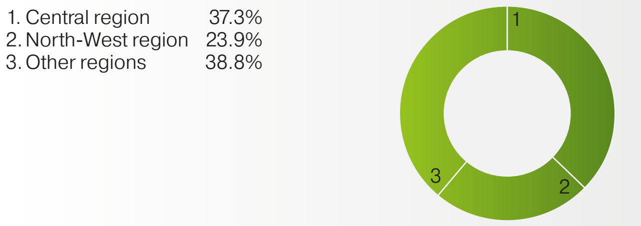
Store expansion
(number of stores)



Source: Company data.

1.2% decrease in 2014 number of stores

2014 net retail sales breakdown
(%)



Source: Company data.

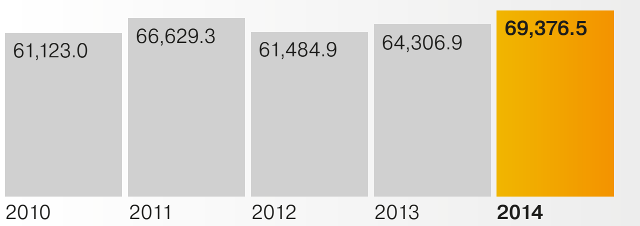
Nationwide operations

Selling space expansion
(thd sqm)

Source: Company data.

4.6% decrease in 2014 selling space

Net retail sales dynamics
(RUB mln)



Source: Company data.

7.9% increase in 2014 net retail sales

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

Customer visits
(mln)

0.7% increase in 2014 customer visits

+10% increase in sales densities

Vardan Dashtoyan
General Director of Karusel

"In 2014 we focused on establishing the right value proposition; supported by a new and expanded product range and the results from our pilot store and refurbishment projects. We plan to finalize the value proposition and accelerate growth in 2015."

Karusel is our 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, which significantly strengthened our position in this attractive and growing segment.

As of 31 December 2014, the chain included 82 hypermarkets located in European Russia and the Urals, and during the year we opened one new Karusel in the Central region.

Karusel hypermarkets offer customers convenient one-stop shopping at fair prices in city locations with a wide range of quality food and non-food products. The format is focused on expanding its product offer to improve the shopping experience across Karusel's diverse customer base supported by weekly catalogs and an exciting loyalty program.

The stores carry an average of between 17,000 and 25,000 stock-keeping units depending on the store size, comprising groceries, prepared ready-to-eat meals, baked goods and an extended range of non-food items and basic consumer products, as well as 8,000 additional seasonal items. The stores target an average net selling space of between 3,000 and 4,500 square meters.

In 2014 Karusel stores reported net retail sales of RUB 69,377 million (USD 1,806 million) representing a year-on-year increase of 7.9% in Russian Rouble terms, and accounting for 11% of X5's total 2014 net retail sales. The increase was supported by the 10.3% improvement in sales densities that Karusel achieved in 2014 and is a key focus for management.

During 2014, Karusel strengthened the format's operational team under the leadership of the new General Director, Vardan Dashtoyan, whose entrepreneurial, client-focused background will help lead the next phase of Karusel's expansion and development. Vardan has built a team of experienced retailers with strong track records of delivering results who are actively building operational excellence and developing process standards to ensure a superior shopping experience across the Karusel hypermarkets.

The team is focused on strengthening the format's new dedicated commercial division by developing a team of category managers to improve Karusel's product offer. As part of this effort, teams of federal and local buyers were formed to ensure that the Karusel range meets customer expectations and delivers locally-tailored value propositions in every city where we operate.

As a result, by the end of 2014 the team had successfully added 5,500 new products, including approximately 3,000 new products to the national range, and 2,500 new products to the local range, and significantly improved Karusel's promotional offers. The team will work to continue optimizing the hypermarket's assortment by introducing new products and rotating the existing range with a focus on locally produced goods and internal store production.

Over the past 18 months the format has conducted several pilot store and refurbishment projects. The projects have been focused on updating equipment, store layout and navigation, lighting and in-store design as well as improving customer service standards by honing motivation and training of store employees. As a result, pilot and refurbished stores delivered impressive results in 2014 – sales growth after reopening ranged between 14% and 84% year-on-year and traffic increased by between 8% and 51% year-on-year.

The new marketing and category management teams have launched a number of initiatives that we plan to complete in 2015 and that are focused on reviewing the brand platform and loyalty program, which had over 1.5 million members at the end of 2014. These include revisions to promotional offering and the mapping of a new private label strategy. The teams are also focusing their attention on improvements in communications and customer relationship management.

At the end of 2014, we had a robust pipeline of projects at various stages of development. In 2015 we will continue to see the strategic expansion of the Karusel chain, with a new format strategy to be drafted in the first quarter that will be based on the updated value proposition and delivery of the new hypermarket concept.

Our brands

Perekrestok Express

Convenient, urban shopping for busy people

Перекресток экспресс

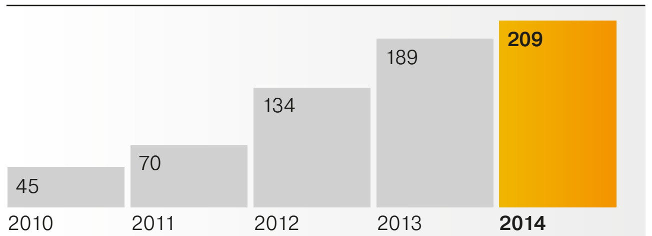
+28%
increase in net sales

+24%
increase in net selling space

Our brands continued

Perekrestok Express

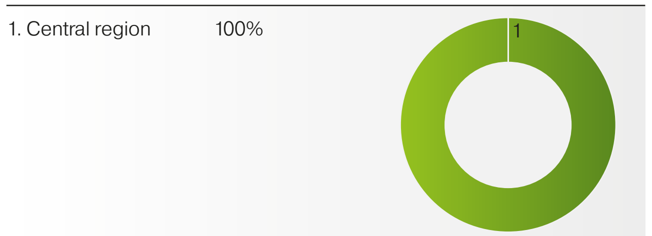
Store expansion
(number of stores)



Source: Company data.

10.6% increase in 2014 number of stores

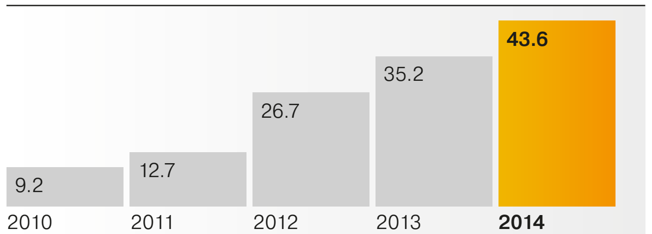
2014 net retail sales breakdown
(%)



Source: Company data.

Located in the most attractive region of the Russian market

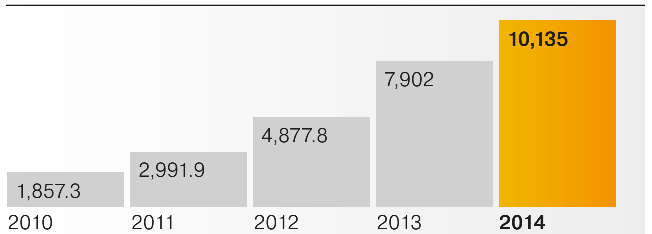
Selling space expansion
(thd sqm)



Source: Company data.

24% increase in 2014 selling space

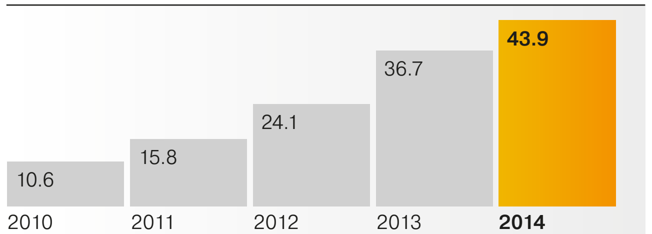
Net retail sales dynamics
(RUB mln)



Source: Company data.

28% increase in 2014 net retail sales

Customer visits
(mln)



19.6% increase in 2014 customer visits

Olga Nikitina
General Director of Perekrestok Express

"We continue to look for opportunities to improve the Perekrestok Express value proposition. In 2014, our customers reacted positively to the rollout of our mini cafes and coffee corners. We plan to continue innovating to provide better service and value for our customers."

X5 actively develops upmarket convenience stores under the Perekrestok Express brand. The chain was established in 2007 as a joint venture between the Company and local retail entrepreneurs. X5 gained operational control in 2010 and completed the acquisition in 2011. As of 31 December 2014, the chain included 209 stores located in Moscow and the Moscow region.

Currently, Express convenience stores operate primarily in Moscow and the Moscow region where they are independent from our other formats and have their own commercial and logistics functions and services. The chain has two distribution centers to supply stores.

Express stores target the profitable and less competitive market niche of small, close-to-customer stores, offering convenient shopping for people in a hurry. The Perekrestok Express brand offers ready-to-eat meals, which account for up to 25% of the stores' product range, and fresh produce in high-traffic zones – near subways, business centers and residential complexes. The stores target a net selling space of approximately 150–200 square meters and approximately 3,200 stock-keeping units.

Express Retail is actively developing a new business area, equipping its stores with mini cafés or coffee corners of 20–50 square meters. These are small comfortable areas where customers can have a cup of coffee with a snack or a warmed up meal out of a selection of fresh lunches. Popular at business centers, these areas help boost traffic and raise margins.

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.

In 2014, Express stores were our fastest growing chain and reported net retail sales of RUB 10,135 million (USD 264 million) representing a year-on-year increase of 28.3%, in Russian Rouble terms, and accounting for 1.6% of X5's total 2014 net retail sales. The increase was primarily due to the continued performance of stores opened over the last several years.

A café at Perekrestok Express

+20%
increase in customer visits

Logistics

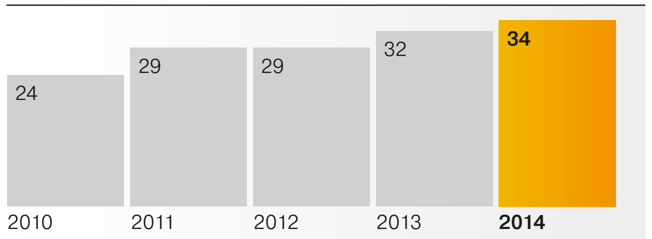
Improving efficiency across our multi-format brands

X5 is a leading Russian food retailer operating networks which encompass various retail formats with a strong foothold in European Russia, the Urals and Siberia. Clearly, a well-developed logistics infrastructure is key for our operational success.

Selling space and number of DCs by region

Region	Space th. sqm	Number of DCs
Central	359.7	13
North-West	82.8	5
Ural	58.9	6
Povolzhsky	71.7	3
Volgo-Vyatsky	41.9	2
Central-Chernozemny	34.2	3
South/North Caucasis	41.3	2
Total	**690.5**	**34**

Number of distribution centers



Distribution centers

During 2014, X5 opened five distribution centers, including three third party logistic providers (3PL) DCs in the Moscow, Nizhny Novgorod and Sverdlovsk regions, and two leased DCs in the Voronezh and Rostov regions. The Rostov distribution center has the additional advantage of banana ripening rooms. As part of our logistics optimization, we closed three distribution centers in the Moscow region.

In late 2014, X5 owned or leased 34 distribution centers with a total floor space of 691 thousand sqm, providing sufficient coverage for the Company's operations. Five are owned and operated by the Company, eight are managed by 3PLs, while the remaining distribution centers are leased and operated by X5.

Our distribution centers run an automated warehouse management system (WMS) featuring voice picking and weighing technology to ensure efficient monitoring of goods traffic and storage and optimize our shipping, receiving and picking operations. In 2014, we boosted our DC performance by an impressive 40% as measured by the number of pallets assembled from 94 pallets/hour in January 2014 to 134 pallets/hour in December 2014 at Pyaterochka.

Our centralization level generally remained flat at 78% against 2013.

We continued to decentralize our logistics operations, in line with our new operating model launched in 2013, to make sure that logistics services are tailored to the business models of our formats. Company-owned distribution centers are instrumental in maximizing product traffic centralization and optimizing deliveries and in-store product ranging. As at 31 December 2014, two distribution centers still provided shared services to Pyaterochka, Perekrestok and Karusel. We intend to finalize the logistics decentralization program by the end of 2015.

In 2014, X5 completed the rollout of JDA Software's replenishment and demand planning solution across its distribution centers (for categories other than ultra-fresh), optimizing office headcount and increasing in-store goods availability by category. The Company-wide SLT level (order processing based on timely deliveries) rose by 4.2% to 88.4% (in Pyaterochka by 3% to 88.5%, in Perekrestok by 6.5% to 88.3% and in Karusel by 8.9% to 87.8%), with an STL level of above 90% in the Central region, exceeding the Company's average due to the logistics separation by format implemented in 2013. This demonstrates that logistics decentralization has contributed to timely order processing. Coupled with improved operational standards adopted by our distribution centers and the transportation division, the above factor helped us optimize logistics costs management.

In 2015 we will continue working to improve logistics efficiency. One of our key areas of focus is to launch the JDA system at the store level and implement an auto-ordering system across supermarkets and hypermarkets.

Transport

In 2014, we set up a stand-alone division providing transportation services to our formats. Over the year, the Company sold part of its non-operational transportation fleet. As at 31 December 2014, our fleet comprised 1,438 trucks serving nearly half of X5's transportation operations.

Since the transportation division separation, we have significantly enhanced our operational efficiency through a program of initiatives, such as calculating driver bonuses based on scheduled routes and introducing tariffs per trip for retail chains. Route optimization has helped to reduce deviations between scheduled and actual distances by 1.5x, while also increasing transport turnaround by 7% across the Company and 35% in Moscow and the Moscow region.

Supply quality checking

One of our Moscow region distribution centers

Product safety and production quality

An active program of improvement

2014 progress

- X5 has developed a set of rules covering the entire food product chain from production to end consumption.
- In 2014, X5 conducted audits of 157 food product manufacturers, and 2,327 product items were sent to independent accredited testing facilities for analysis.
- X5's Quality Department is actively engaged in drafting national food standards, technical regulations, laws, and proposals on consumer rights protection.
- We are responsible for the quality and safety of all the products sold across our stores, and have a clear set of rules and guidelines to ensure that we meet the highest quality standards.

X5 has been consistently standardizing the quality control procedures used in supply chain management across the retail formats.

Ensuring our product safety and quality

Providing our customers with fresh products of the highest quality is among the Company's top priorities, achieved by implementing a set of rules and regulations across the entire food product chain from production to end consumption.

To ensure that our products are safe for consumption and for the environment and comply with retail standards and consumer requirements, we employ HACCP (Hazard Analysis and Critical Control Points) principles, as well as the following quality assurance practices:

- laboratory testing and analysis at research and development centers and accredited research laboratories;
- personnel training;
- safe product storage and handling;
- purchase of modern equipment and supplier audits.

As part of the ongoing evolution of our multi-format operating model, the Company's retail divisions have dedicated quality assurance functions, which together with the Commercial and Category Management Departments oversee all stages of the production cycle. The head office's Control Department is, inter alia, engaged in developing regulatory quality requirements, reviewing draft laws and interacting with industry associations and unions, such as the Consumer Market Participants Union, the Russian Union of Industrialists and Entrepreneurs, the All-Russian Association of SMEs (Opora), the Civic Chamber of the Russian Federation, the National Dairy Producers Union, the RusBrand Association of Branded Goods Manufacturers, the Seafood Processors Union, and the RusProdSoyuz Association of Food Manufacturers and Suppliers.

Maintaining high product quality is a priority for all our operational divisions. X5 Retail Group performs regular supplier audits by engaging independent accredited international audit organizations. We continuously refine quality specifications and standards for food products, private labels and packing materials.

In 2014, independent experts from SGS Vostok Ltd., a subsidiary of SGS Group, the world's leading inspection, verification, testing and certification company, audited Perekrestok distribution centers and stores for compliance with International Featured Standard (IFS) Logistics and IFS Food Store version 1 international standards, identifying areas for improvement for the quality control system in 2015.

Quality control at all stages of the product life cycle

Introducing goods to the product range

Before entering into supply contracts, suppliers provide product samples and documents certifying product quality, safety and origin to the Company's quality experts, who check them for compliance with the Company's and regulatory requirements.

Acceptance at distribution centers

Each batch of food products delivered to our distribution centers is subject to control for compliance with organoleptic standards (appearance, texture, taste and smell properties), as well as the Customs Union and other applicable federal standards. Fruit, vegetables and exotic fruit quality control is in line with national and United Nations Economic Commission for Europe (UNECE) standards, X5's quality catalogue, and acceptance criteria such as caliber, size and ripeness.

Quality control in stores

All our stores run the Quality Hour program: every morning, from 9 a.m. to 10 a.m., all products on shelves are sorted and checked for quality and freshness.

Additionally, as part of the New Pyaterochka initiative launched in October 2013, product freshness is now the personal responsibility of the store director who has also assumed the role of Freshness Director.

Interaction with consumers

The Company's consumer rights protection department carefully investigates all complaints received via numerous consumer feedback channels, in some cases making control purchases and sending product samples for analysis to verify the complaint. In addition, we regularly publish quality monitoring results in the Quality section on our website to keep consumers informed and prevent distribution of low-quality and counterfeit products. In case of any quality issues related to the products sold in our stores, such products are immediately withdrawn from sale and returned to the supplier. In 2014, we reviewed and provided substantiated responses to 1,995 complaints.

Audit of branded and private label products

In 2014, we conducted 145 audits of private label products and 12 audits of core branded products. 1,270 private label items and 1,057 core branded items were sent to independent accredited testing facilities for analysis, with 76 private label items, or 6.0% (against 355 items, or 9.5% in 2013) and 138 key core branded items, or 13.1%, failing to meet applicable quality requirements and returned to suppliers.

The analysis was aimed at verifying the product's organoleptic, physical, chemical and microbiological properties and, in some cases, the declared ingredients, specifically to identify any replacements with cheaper alternatives and any use of food additives, artificial colorants, sweeteners and preserving agents not indicated on the label.

Interaction with public authorities and self-regulating organizations

X5's Quality Department employees are current members of the technical committees (TCs) under the Governmental Agency for Technical Regulation and Metrology (Rosstandart), part of the Russian Ministry of Industry and Trade.

The TCs include:

- TC 226, Meat and Meat Products;
- TC 299, Fish and Non-Fish Preserves, Packaging and Control Methods;
- TC 300, Fish Products – Food, Feed Grade, Technical and Packaging;
- TC 347, Trade and Food Service Industry.

Fresh fish at a Perekrestok store

Since the beginning of 2014, the Quality Department has drafted 56 proposals on refining the existing legislation and amending specific legal acts regarding technical regulation, accreditation and standardization, food product quality and safety, veterinary control and supervision, sanitary and phyto-sanitary measures, and consumer rights protection. The Quality Department, jointly with the Retail Companies Association, the Consumer Market Participants Union, the Russian Union of Industrialists and Entrepreneurs, the All-Russian Association of SMEs (Opora), the Civic Chamber of the Russian Federation, and the Office of the Presidential Commissioner for Entrepreneurs' Rights, has also participated in developing a common industry-wide position and unifying retailers' efforts in such key areas as providing guaranteed product quality, protecting consumer rights, promoting HACCP principles among Russian manufacturers, ensuring public health protection and strengthening the social responsibility of food production and distribution market participants.

Russia's joining the World Trade Organization (WTO) in 2012 required harmonization of the Russian legislation with international rules, regulations and standards. X5's Quality Department is actively engaged in drafting national food standards, technical regulations, laws, and proposals on consumer rights protection. Since the beginning of 2014, the department has prepared 21 proposals for draft national standards, including those harmonized with the international ones. Department representatives are invited by a number of committees under the Codex Alimentarius Commission as experts to participate in developing food product standards, forming part of working groups for food product labeling and requirements for fresh fruit and vegetables. They also cooperate with the Eurasian Economic Commission (EEC) in the areas of technical regulation and entrepreneurship.

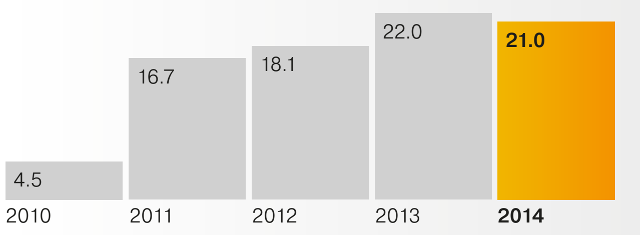
In 2014, upon the Department's initiative, the Retail Companies Association established a quality committee chaired by X5 Retail Group's Quality Director. The committee's goals include consumer rights protection, promoting Russian retailers' strong reputation for product quality, developing a common position and representing retailers' interests in relation to quality assurance matters. The committee held four meetings attended by the representatives of manufacturer associations and unions and resulting in 37 addresses to the EEC, the Government of the Russian Federation, Presidential Administration and federal executive authorities, review of 20 draft regulatory acts, and circulation of 219 memoranda, including those on legislative amendments.

Social, corporate and environmental responsibility

Taking our responsibilities seriously

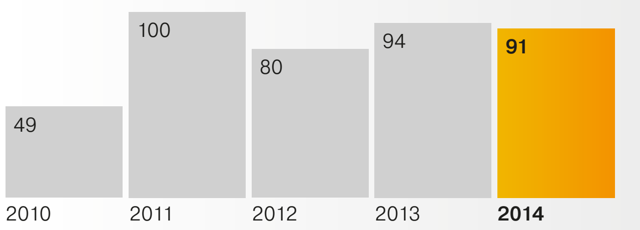
As a leading Russian retailer, we strive to be an exemplary corporate citizen. Being a good employer, supporting suppliers and delivering quality products to our customers are all obligations that we take seriously.

Money raised for children's surgeries
(RUB mln)



Source: Company data.

Number of children's surgeries



Source: Company data.

X5 and society

As a result of our national reach and the nature of our business, we contribute significantly to the local communities where we operate and to Russian society and the economy in general. Our stores span approximately 1,000 cities, towns and villages, including metropolitan areas such as Moscow, St. Petersburg, Yekaterinburg and Nizhny Novgorod, as well as smaller towns with just a few thousand inhabitants.

We offer quality products at reasonable prices and a modern retail shopping experience in both densely populated and remote regions. We employ thousands of people, and their families depend on us, our strategy and our performance for their livelihoods. We work with a large number of suppliers, including international, national and local companies, and they depend on us as much as we depend on them.

We pay special attention to our local product offerings and are committed to building strong relationships with local suppliers. We are looking to increase the levels of local sourcing not only to better meet the needs and preferences of local shoppers but also to support regional economies and contribute to their growth.

Life Line Charitable Foundation partnership

One of the main streams of our charitable activity is bringing together donations from customers and employees in the dedicated collection boxes installed in our stores to help children with severe health problems. This is part of the strategic partnership X5 has with the Life Line Charitable Foundation (the 'Foundation'), with whom we have worked since 2006 under the auspices of the Crossroads of Life, Karusel for Children and Gingerbread House collection box programs. Currently, we also support the Foundation via the Kindness Candy and Running for Life programs, which also consolidate financial support from X5's customers. The aim of our cooperation is to attract customers' attention to an important social problem and to provide a convenient way for them to extend help. In 2014, these programs helped raise over RUB 21 million, which provided surgical procedures for 91 sick children.

'Running for Life' charity marathon

Kindness Candy charity project

On 1 June 2014, to celebrate Children's Day, X5 and the Foundation launched the Kindness Candy (X5 private label product) charity project. Under the project, special candies sold for RUB 15 each are available in the checkout areas of all Perekrestok, Pyaterochka and Karusel stores, with RUB 5 from each purchase donated to finance surgeries through the Foundation. Between 1 June and 30 November 2014, X5 raised over RUB 2.5 million through Kindness Candy sales.

Running for Life charity marathon

Each year the X5 team participates in Running for Life, a charity running event organized by the Foundation and the United Way of Russia. In 2014 the race, held annually in Gorky Park at the heart of Moscow, attracted over 2,500 people. To participate, each runner donated RUB 1,000, collected by the organizers.

'Running for Life' charity marathon

Live Classics Contest

In April 2014, X5 signed a strategic cooperation agreement with Live Classics International Awards Foundation ('Live Classics'). The Live Classics Contest is a unique, large-scale project promoting reading among 11 and 12 year old children. Each year over two million children compete by reciting prose pieces from their favorite books. The project's goal is to encourage reading among children, promote the Russian language and literature, support talented children and drive international cooperation in education. X5 supports the Live Classics project at all stages and provides prizes, candy and food for participants and winners. The contest also includes special awards from X5 Retail Group and each of its retail chains.

X5 and the Nutcracker International Television Contest

The Company acted as a general partner of the 15th running of the Nutcracker International Television Contest for Young Musicians, which took place in Moscow from 2 to 9 December, 2014. The final round of the contest took place on 9 December at the Tchaikovsky Concert Hall and was broadcast live by the contest organizer, Russian Kultura TV channel, and by Radio Russia Kultura.

The Nutcracker Contest is the only annual televised children's musical contest in Russia. This year young musicians (up to 14 years old) from 11 countries competed in three rounds for the awards in wind, brass and percussion, strings and piano categories. The finalists' performances were evaluated by a distinguished panel of ten musical experts.

Supporting veterans

During 2014, over 900 veterans received various gift baskets of food from X5 for Easter, the Victory Day and the 73rd anniversary of the Battle of Moscow.

Supporting vulnerable population groups

We consider it to be our responsibility as a leading Russian food retailer to ensure, to the best of our ability, that 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. At most of our Pyaterochka, Perekrestok and Karusel stores, pensioners enjoy a 5% discount on weekdays from 9 a.m. to 1 p.m.

Electronic social certificates

In October 2013, the Moscow city government launched an electronic social certificates program. Those eligible to receive this card include senior citizens, multi-child families, the disabled and people suffering specific hardships. The cards have a monthly balance of RUB 500 that can be used to purchase food products. By the end of 2013, the certificate was valid in 147 Perekrestok and 2 Karusel stores. In 2014, we continued the program by rolling it out across all of X5's Moscow stores, enabling approximately 300,000 people to use their certificate in our stores. In light of the project's success in 2014, X5 reached agreement with the Moscow Government to continue financing the program in 2015. Many Russian regional authorities have taken note of the project's success and the program's expansion to the other Russian regions is now being discussed.

In 2014, X5 also allocated over RUB 3.5 million to support vulnerable segments of the population. The money went towards supporting orphanages in Kazan and Orenburg; the Children's World charity marathon in Kursk; the Ryazan rehabilitation treatment center for children with organic central nervous system diseases and cerebral palsy; the New Year's Eve charity program for orphanages in Voronezh and to other causes.

Social, corporate and environmental responsibility continued

X5 benefitting the community

Aid for Ukrainian refugees
During the summer of 2014, X5 provided significant humanitarian aid to Ukrainian refugees. Karusel and Pyaterochka retail chains, X5's Moscow, Lipetsk and Rostov-on-Don employees, as well as a number of our company's suppliers, took an active part in this endeavor.

The Karusel hypermarkets collected 10.5 metric tons of supplies, and suppliers and employees at the Company's head office collected approximately 4 and 2 metric tons respectively. The Rostov office supplied the refugees with RUB 225,000 worth of food products and our Lipetsk employees gathered RUB 232,580 to support temporary settlements for the refugees in the Belgorod region. In total, X5 collected and transferred over 22 metric tons of humanitarian aid, worth about RUB 2.5 million.

The supplies, including food products, hygiene and children's items, toys, diapers, bed linen, clothes, dishes and camping furniture were delivered within a week to the humanitarian aid reception centers of the Russian Ministry of Emergency Situations, Federal Migration Service, Red Cross and social welfare departments in the Russian regions housing the refugees.

Healthcare and sports
In 2014, X5 allocated over RUB 2.5 million to support healthcare and sports programs. This included financial help towards the cost of buying children's health examination equipment for a municipal hospital in Bronnitsy, renovating Lipetsk's ice rink and playing fields, launching the Be Healthy! social and pedagogical project in Yekaterinburg and organizing the athletic contest 'Belogorie Cross Spartakiad' held to mark the 60th anniversary of the Belgorod region.

Culture, education and historical heritage
In 2014, X5 invested over RUB 4 million into fostering culture and education. The Company also supported over 15 causes, including the restoration of Korennaya Pustyn Monastery, equipment purchase for an educational institution in the Tula region, the reconstruction of Rostov Cathedral and many others.

Human resources

X5's key human resources priorities encompass the effective recruitment and integration of new employees, personnel training and development, performance review and assessment, and loyalty and engagement enhancement. The Company's HR management system is based on the principles of fairness, respect and equal opportunity, as well as on promoting an open dialogue between management and personnel.

X5 is one of the largest employers in the Russian labor market, with a workforce of over 117,000 employees as of 31 December 2014. Most employees are engaged in retail operations (83%) and logistics (11%), with 6% working in the Moscow head office and regional offices. The total employee headcount is even greater, taking into account outsourced staff. As of 31 December 2014, the average share of outsourced employees in retail operations and logistics was 17% of the divisions' total workforce.

Employee benefits
In 2014, X5 expanded the benefits available to staff to include tickets to Children's New Year parties and special offers on camps for our employees' children. We also extended the number of office employees covered by life and accident insurance programs.

Other than that, the social benefits package remained unchanged and included:

- medical insurance;
- life insurance and accident insurance;
- corporate mobile communications plans;
- short-term disability payments (above statutory norms);
- additional payments to employees (financial support);
- additional vacation days;
- discounts for purchases in our stores; and
- transportation compensation and company buses for employees.

Senior employees in stores and office employees are eligible to participate in corporate insurance programs immediately after joining the Company. Those employees who do not qualify for insurance programs, as well as their family members, may access insurance coverage at X5's corporate rates.

Employees at our flagship Perekrestok store

Annual target-setting and performance measurement
In 2014, the Company continued with its annual target-setting and individual performance measurement program.

Annual target-setting helps focus the Company's and each employee's efforts on key business priorities. Targets set at the start of a year provide common direction and shape our team's work throughout the year. They are designed to be measurable, achievable, realistic and time bound; reaching them should require considerable yet realistic effort.

During the reporting period, we assessed the individual performance of our employees in 2013 and established targets for 2014, updating them in the middle of the year, so that our employees had an opportunity to discuss their progress against annual targets with their supervisors and assess their feedback.

Annual performance appraisals are used as a basis for awarding annual bonuses and making HR decisions with regard to career development and promotions.

Employee awards
X5 uses employee awards as a means of providing non-financial incentives in recognition of employees' achievements and contributions to the Company. In 2014, approximately 3,000 office, retail and logistics employees in Moscow and other regions received medals, certificates of honor, commendations and other corporate awards.

In 2014, the Russian Federation's Ministry of Industry and Trade awarded 207 X5 employees 37 certificates of commendation and 170 certificates of honor, recognizing their long-term dedication to the retail industry, strong performance track record and considerable contribution to guiding and training the new generation of trade professionals. The award winners included top managers and retail, office and logistics employees of Pyaterochka, Karusel, Perekrestok and Perekrestok Express and were officially honored at their department's or retail chain's events.

Internal communications
Key objectives of our internal communications include communicating the Company's and retail chains' strategy to all employees, providing information support with regard to ongoing projects, and developing team spirit and corporate culture. By meeting these objectives, we boost our employees' motivation to achieve the Company's strategic goals.

In 2014, we used various communication channels to reach our goals, including:

- intranet;
- corporate newspapers for office employees and each retail chain;
- weekly electronic digests and newsletters;
- team building events, competitions, campaigns; and
- corporate conferences.

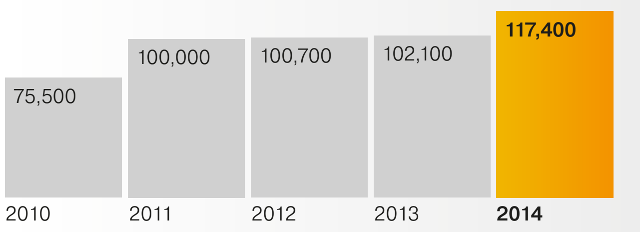
We are continuously improving our internal communication channels to ensure that they meet the needs of the Company and our employees.

In regional branches, we hold meetings to inform local staff of recent developments in the Company's strategy and policies, and arrange team building and other corporate events to facilitate better interaction between the corporate center and regional branches, as well as between departments within large divisions.

In 2014, we organized a number of corporate events, including conferences for top and middle managers, to discuss the strategy for 2014–2017 and determine the key work streams necessary for its implementation and success. Each of the retail chains also held strategic conferences to discuss strategy, value proposition and business priorities, in the course of which the best employees were presented with their awards.

The Pyaterochka retail chain organized celebrations for employees and their families to mark 15 years since the opening of the first store in St. Petersburg. All seven of the Company's divisions held summer festivals, with over 11,000 employees and their families attending.

X5 headcount



Social, corporate and environmental responsibility continued

Focusing on our employees' development

Human resources continued

For the second year running, we carried out the X5-Friday project, with office employees joining the sales floor to support store employees during the peak holiday season, while also receiving hands on experience and a practical understanding of our operations and business processes. In November and December, most office employees, including top managers, worked in stores for at least one day, laying out goods on shelves, attaching price labels to products, and assisting customers. In 2014, the project's reach was extended into all Russian regions where the Company has offices, and the number of participants tripled to 3,197 employees. The initiative provided the stores with much needed additional workforce during the peak season while also revealing areas for business process improvements and enhancing the interaction between the Moscow head office and the stores.

In 2014, the Pyaterochka chain continued its Mentors project, scaling it up to all regions of operations across the country. Each mentor, an office employee, will select a Pyaterochka store for supervision throughout the year helping to solve various issues which require immediate action from the office and providing hands-on assistance during peak seasons. Currently, more than 1,600 employees are part of this project.

X5 is an active supporter of corporate sports activities. In their free time, our employees play football and volleyball, and participate in championships competing with other retailers' teams. In 2014, our football team finished first in a number of tournaments.

For the third year in a row, we participated in the annual Running for Life charity run in Moscow, with our office, retail and logistics employees running 5,275 m and 10,550 m marathons. In 2014, a Pyaterochka store director once again finished in the top three in the 5,275 m run.

In 2014, for the first time in its history, X5 launched a joint educational initiative with one of its partners, Henkel. Our employees' children participated in two of Henkel's Researchers' World open lessons, learning many new and exciting things about physics and chemistry, and performing scientific experiments under experts' guidance. The key objective of this initiative is to educate the young generation and to attract their attention to sustainable development issues.

Recruitment

A smooth, customized recruitment process is crucial for a growing company of our scale, especially in the retail sector, due to high personnel turnover rates. To find and recruit 'best-fit' candidates to fill job vacancies quickly and efficiently, X5 has split recruitment processes between the Company's group HR function, based in the Moscow head office, and HR divisions across the regions and retail chains.

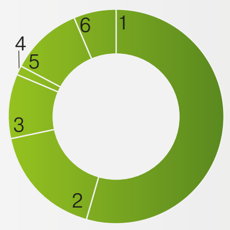
X5 Group's HR function is in charge of developing, implementing and maintaining recruitment standards across the retail chains. The Group HR function also provides advice and guidance in relation to corporate training at all levels and supervises overall HR activities by format.

The chains and regional HR divisions are responsible for recruiting store personnel in line with Company-wide procedures, and for advertising and marketing campaigns designed to hire new employees for our stores and distribution centers, and for maintaining a candidate pool for hard-to-fill positions.

In order to attract more technically qualified young professionals in 2014, the Company continued to cooperate with leading Russian universities, including the Moscow Energy Institute.

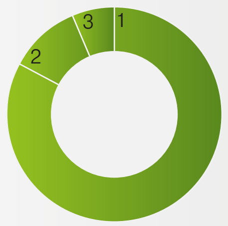
Personnel breakdown by format
(%)

1. Pyaterochka	54.6%
2. Perekrestok	17.4%
3. Karusel	9.7%
4. Express	1.3%
5. Logistics	10.8%
6. Office and other	6.3%



Personnel breakdown by type of operation
(%)

1. Stores	82.9%
2. Logistics	10.8%
3. Office and other	6.3%



Note: Format's employees include retail employees only.

Personnel training and development

Training and professional development of store and distribution center employees at all levels is essential for our business success and sustainable growth.

As of 31 December 2014, X5 had 79 training centers in 28 Russian regions, the majority of which are located in the Central and North-West regions.

Our training programs are available for employees at all levels, from senior management to store personnel. In 2014, training was provided to approximately 60,000 employees (equivalent to 120,000 man-days), compared to 53,000 employees (equivalent to 112,000 man-days) in 2013.

In 2014, the Company's focus was on developing distance learning, on-the-job training and customized programs to support strategic projects.

A total of 112,160 distance courses were completed over the year, with 25,775 employees taking customer relations and in-store business processes courses, 10,165 employees taking trade and office software courses, 11,300 employees taking SAP courses, and 13,905 employees taking introductory courses.

The Company's distance learning courses were aligned with a range of its strategic projects, covering X5's service quality, new customer loyalty programs, fresh product offering (5,838 employees enrolled), and transition to GK/Retail solution (one of the leading checkout solutions in Europe) and its releases (45,183 employees enrolled). New distance learning programs developed in 2014 included 20 product range courses, over 40 training videos on retail business processes, and loyalty program courses. The Company used its distance learning platform to test the knowledge of its sales force, with 82,000 store and distribution center employees assessed. Ongoing monitoring of the sales force knowledge enables timely and effective identification and implementation of required customer service improvement initiatives.

As part of its effort to develop on-the-job training opportunities in 2014, X5 selected and trained 2,355 mentors and 625 functional skill tutors (employees combining core and training responsibilities) who, in turn, trained over 22,000 employees. On-the-job training programs enable the Company to support its rapidly expanding business, providing fast, high quality training to its sales personnel.

In 2014, X5 paid special attention to introductory training programs for new office employees, which apart from the Company overview, included an in-store training session and a visit to a distribution center. Over 1,000 employees in the Moscow and regional offices received introductory training. Providing new employees with a better understanding of store and distribution operations from the start of their career is an important step in sustaining a customer-centric business.

Delegates at our 2014 management conference

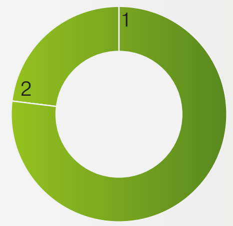
Women in our team

X5 is committed to the principles of equality, offering equal opportunities to female employees regardless of their position within the Company. Women make up 77% of our personnel, and 37% of our management positions are held by woman. (department heads and higher levels). As at the end of 2014, the Company's Executive Committee had five female members.

X5 provides additional financial support to women on maternity leave who have been with the Company for over a year, paying them base salaries several months before and after childbirth, in excess of the statutory requirements.

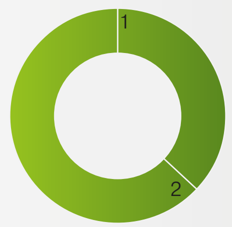
Gender structure of labor force
(%)

1. Women	77.0%
2. Men	23.0%



Share of women in managing positions (starting from department directors) (%)

1. Women	37.0%
2. Men	63.0%



Social, corporate and environmental responsibility continued

Ensuring a safe working environment

Health and safety

Overview

Ensuring the health and safety of our employees is a priority for X5. Based on current Russian legislation, the Company has a health and safety policy in place to cover workplaces across its retail, logistics and office functions. We are committed to promoting the highest health and safety standards by implementing advanced safety technologies and techniques, ongoing risk monitoring, analysis and mitigation.

To effectively manage and oversee compliance with the Company's health and safety policy and the applicable Russian legislation, we have established a centralized occupational health and safety department (OHS) responsible for developing the labor safety policy and standards, internal health and safety guidelines and regulations, and coordinating health and safety activities across the Company. Our regional branches have dedicated OHS functions in charge of health and safety in the respective retail chains. In addition, we employ qualified health and safety specialists across all X5 distribution centers and transportation divisions and pay special attention to occupational safety in divisions with the highest accident rates, such as the transportation divisions.

Our OHS specialists have the following responsibilities:

- to ensure compliance with the applicable federal and regional laws, regulations and standards;
- to identify, evaluate and analyze operational risks;
- to provide health and safety training courses and updates for employees;
- to motivate employees to comply with local health and safety regulations;
- to improve working conditions;
- to organize employee medical examinations and screenings.

Logistics activity at one of our Distribution Centers

Medical examinations

Medical examinations and screenings are an effective measure of monitoring our employees' health and diagnosing occupational diseases at early stages. Our aim is to detect promptly, to prevent and contain contagious and parasitic diseases, and to take action to mitigate health risks and provide the required treatment. X5's personnel employed in retail, logistics and transportation undergo annual medical examinations.

Control and monitoring

X5 carries out regular monitoring and internal audits of workplaces to ensure compliance with the Company's health and safety policy and federal laws, and to identify potential areas for OHS improvements. Internal audits are performed by OHS specialists in the relevant retail chains.

In 2014, the Company conducted 1,051 internal audits. Audit findings and recommendations were reflected in audit reports, and relevant measures were taken to remedy identified violations. Over 90% of violations were eliminated within 10 days (against 80% in 2013), with deadlines and schedules set out to remedy the remaining 10%.

New legislative provisions taking effect in 2014 prompted the Company to carry out a special assessment of working conditions in retail and logistics and upgrade workplaces in line with regulatory occupational safety requirements, as part of its health and safety obligations.

We carried out significant work to identify potentially hazardous activities, areas and equipment, as understanding these risks is a key to improvement. Bringing working conditions in line with national occupational requirements helped us to minimize additional insurance payments to the Pension Fund, to optimize rebates (surcharges) applicable to occupational injury and disease insurance rates, and to assess occupational hazards quickly and efficiently.

Employee training

To reduce health and safety risks, raise awareness and provide the required qualifications, X5 has arranged special training programs both for OHS specialists and other employees.

All our managers (store, distribution center, logistics and transportation unit directors, store-based department heads, security heads, and other managers) are required to take OHS training courses in specialized training centers. These employees are responsible for delivering health and safety briefings to their teams and implementing safety practices across their areas of responsibility. In 2014, over 2,000 managers completed such courses. New employees receive a safety briefing upon joining the Company, and in the course of their work if required. In addition, employees working in hazardous environments (for example, electricians, forklift and truck operators) receive regular specialized training.

Injury statistics

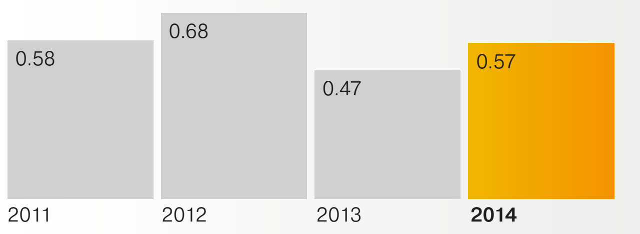
In spite of our efforts to minimize risks and prevent accidents, our business scale makes it hard to completely avoid any occupational injuries. 2014 saw a number of accidents resulting in injuries of varying severity. We investigated these accidents and took action to reduce the underlying risks and minimize the impact. Most injuries were minor and required minimum disability leave. The severity rate indicating an average number of work days lost per accident decreased from 53.8 days in 2013 to 41.0 days in 2014. The accident frequency rate, indicating the number of accidents per 1,000 employees, went up slightly, from 0.47 in 2013 to 0.57 in 2014, due to business expansion.

Compensation

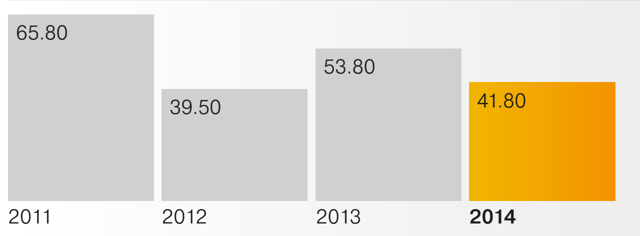
To compensate for health damage caused by a workplace accident, the Company has put in place the following initiatives:

- insuring each employee against industrial accidents and occupational diseases;
- making payments to injured persons (through federal social insurance authorities) in the event of severe accidents and to employee dependants in case of loss of breadwinner;
- providing post-accident rehabilitation and health resort treatment (through federal social insurance authorities);
- providing financial aid from the Company's budget in the event of severe or fatal accidents.

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



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



Social, corporate and environmental responsibility continued

Helping to protect environment

Environmental program and safety

Environmental friendliness is key for X5's successful and sustainable long-term development. As our business has grown and evolved, so has our environmental impact. Industrial packaging, bakery waste and waste from preparing meat and fish for sale, used frying oil, polyethylene bags, electricity consumed by refrigeration and lighting equipment, and vehicle exhaust are all examples of how a modern retail company impacts the environment.

X5 strives to fully comply with the Russian legislative requirements and the highest international environmental protection standards wherever possible. We believe that environmental care is not just a part of a large company's social responsibility – it also gives ample opportunities to improve business efficiency and reduce costs, and in some cases, even to generate additional income. While we are still on the first steps of this journey, we can already see achievements in environmental safety.

Waste recycling and disposal
Currently, waste generated by stores is transferred to third parties either for utilization and burial at landfill sites or for further recycling. We have made a list of recyclable waste to be disposed of by third parties, significantly reducing the quantities to be buried and, as a result, the negative environmental impact from landfills, while also cutting our expenses for landfill use and generating income from the sales of recyclable waste.

In 2014, we expanded our list of recyclable waste and increased its volume for sale. Apart from recycling cardboard, polyethylene, used oil, plastic boxes, stretch wrap, banana boxes and polystyrene, we started selling broken shopping trolleys. This helped us generate additional income and reduce our bulk waste removal expenses.

The Company sells its domestic solid waste, in particular used oil from Perekrestok and Karusel grills and roasters, to a specialist company which uses it as feedstock for bio-fuel production.

In 2014, we developed recyclable material shipment regulations to optimize shipment control and boost our profits.

Eco-bags and eco-sacks
Store packaging and polyethylene bags have a considerable share of waste in landfill sites and disposal areas. As part of our environmental protection initiative and to meet the demand from our eco-friendly customers, we have started selling eco-bags and eco-sacks at Perekrestok and Karusel stores.

Eco-sacks made of recycled paper can carry up to three kilograms and cost around RUB 10. They are easy to use and decompose rapidly.

Eco-bags made of spunbond, a material produced from oil by-products, can accommodate bulky purchases, replacing eight to ten plastic bags, and cost RUB 20. They can be recycled up to ten times.

In 2014, Perekrestok and Karusel chains sold approximately 1,365,000 eco-bags and eco-sacks, compared to 1,270,000 in 2013 highlighting the growing popularity of these items.

Returnable containers
To minimize supply waste and the waste resulting from transportation of products from the distribution centers to the stores we use reusable containers returned to suppliers after deliveries, as well as wooden pallets and trays that are returned to the distribution centers.

The Green Russia National Environmental Volunteering Event
In September 2014, we took part in the Green Russia National Environmental Volunteering Event covering 83 regions and engaging over 5 million people. In Moscow, the campaign took place in the Setun River Valley Nature Reserve. Over a thousand people, including employees of X5, Russian Railways, Gazprom and other Green Russia partners, participated in the river valley clean-up, while children took quizzes, attended workshops and environmental classes, and played eco-themed games. The winners were awarded prizes from X5. Representing X5, Pyaterochka's employees also took part in the campaign in Krasnodar, Yekaterinburg and other cities. This major clean-up event was sponsored by the Green Russia social movement and supported by the Russian Ministry of Natural Resources and Environment, the Federal Service for Supervision of Natural Resources, the Ministry of Culture, the Ministry for Civil Defence, Emergencies and Elimination of Consequences of Natural Disasters, the Ministry of Defence, and the Chamber of Commerce and Industry of Russian Federation.

Environmental initiatives in logistics
We manage environmental risks separately for our distribution centers and transportation divisions. Our distribution centers transfer plastic shrink wrap, cardboard and packing materials, as well as domestic solid waste, for recycling. The transportation division disposes of car tires and tubes, batteries, ferrous and non-ferrous metals, car oil and other materials as required by Russian legislation.

Our most significant environmental impact comes from our transportation unit where we use various approaches to minimize the damage caused by transportation from the distribution centers to stores. X5 has its own transportation fleet, as well as vehicles provided by third parties, to cover 40–45% of our cargo transportation. Contractors are responsible for compliance with environmental requirements, and transportation services agreements stipulate that the trucks meet all legislative requirements, including environmental ones.

We use certified service stations to provide maintenance to our trucks in line with the legislation and norms established by truck manufacturers based on either the number of kilometers on the odometer or the vehicle's working life.

Daily vehicle condition monitoring, including exhaust systems, is part of mechanics' and drivers' responsibilities. If serious failures are detected, the vehicle is withdrawn from use and sent for repair.

In addition, we do not purchase used or outdated vehicles, and over 90% of our transportation fleet meets Euro 3 and Euro 5 standards. Since 2014, we have been purchasing only Euro 4 or higher class vehicles, fueled with high-quality fuel from reliable producers.

Thanks to new distribution centers opened in 2014 in Nizhny Novgorod, Yekaterinburg, Voronezh and Rostov-on-Don, there was only a marginal increase in the total kilometers driven by X5 trucks despite opening new stores. The average number of kilometers driven by an X5 truck were 122,000 km in 2012, 124,000 km in 2013, and 129,000 km in 2014.

Energy consumption and efficiency
The cost of utilities, as a percentage of net sales, amounted to 2.1% in 2014. Out of this, approximately 1.5% represents utility payments, while the remaining 0.6% is made up of cleaning expenses, telecommunications, and other expenses, demonstrating that the energy efficiency program outstrips any other environmental initiative in yielding tangible results. Energy consumption accounts for approximately 80% to 85% of total utilities expense, with heating and water consumption representing approximately 10%–15% and 5%, respectively. Therefore, our energy efficiency program has the most pronounced impact on our cost base of all our environmental initiatives.

Currently approximately 40% of energy consumption is attributable to refrigeration equipment, 20% to lighting and the remainder to other equipment, air conditioning systems and other energy consumption sources.

Recognizing the importance of improved energy efficiency, we have been implementing energy saving technologies since 2011. These have included refrigeration equipment upgrades and installation of power consumption monitoring systems across all our retail chains as well as modernization of existing lighting in our Pyaterochka stores.

In 2013, the installation of automatic monitoring systems for the volume and quality of electrical energy consumed was rolled out, and in mid-2014 the systems monitoring and control center was commissioned. Analysis of the results will enable us to cut electricity costs and further expand the use of energy efficient technologies.

In mid-2014, we launched Russia's first refrigeration equipment monitoring center. It enables stores operating the system to control energy consumption, while also improving the ability to manage servicing companies and boosting quality control of the refrigerated goods, in order to ensure compliance with the HACCP principles. During the first two quarters of 2015 the system will be rolled out to all the Pyaterochka and Karusel stores.

We continue to test various energy efficiency technologies. In 2013–2014, we installed glass modules on refrigeration equipment in selected stores. Based on the results of these pilots, the Perekrestok chain has decided to use the technology to upgrade all of its existing refrigeration equipment.

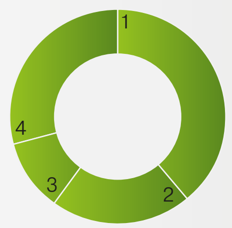
The Pyaterochka refurbishment program is also based on energy efficient technologies, including the installation of improved energy efficient refrigeration and lighting equipment producing more light for less energy.

Our focus on energy efficient technologies applies not only to our stores, but also to our offices. After the successful launch of the 'Turn off the lights and save money' program at our Moscow headquarters in 2013 and the installation of highly efficient photodiode indoor lighting equipment, electricity consumption dropped by 63%. Following the office outdoor lighting upgrade in 2014, we also expect to see substantial energy and cost savings in 2015 and significantly better outside lighting during the night.

While we have already made certain progress in reducing utilities expenses, we see the potential for further savings by implementing new technologies and more efficient consumption controls.

Energy consumption structure
(%)

1. Refrigeration equipment	39%
2. Lighting	21%
3. Power equipment	11%
4. Other	29%



Risk management

Identifying and managing our risks

Overview

Risk is an inherent part of doing business. A key activity for any business is to identify the principal risks it faces and to develop and monitor appropriate controls. The management of these risks is based on a balance of risk and reward determined through careful assessment of both the potential likelihood and impact as well as risk appetite. The Group maintains a Key Risk Register of the principal risks faced by the Group, including the likelihood and impact of risks and the controls and procedures implemented to mitigate them.

We do, however, understand that risk management provides 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 and rapidly changing environment;
- certain risks are out of the Company's control, and 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 Committee, 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 as well as ISO 31000 'Risk Management – Principles and guidelines'. 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 Committee and the Audit Committee.

Risk profile

The section below sets out the principal risks faced by the Group, and examples of relevant key controls and mitigating factors. The Management Board considers these to be the most significant risks faced by the Group. They do not comprise all the risks associated with the Group and they are not set out in any order of priority.

Risk	Description	Mitigation
Strategy	› If our strategy follows a wrong direction or is not sufficiently clear, effectively communicated or implemented, the business may suffer. Risks to delivering the strategy need to be properly understood and managed to deliver long-term growth for the benefit of all stakeholders. › X5's position 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 direction.	› X5's multi-year strategy that has been approved by the Supervisory Board includes both plans for growth and financial targets. To ensure that the Company's strategy is successfully delivered, the strategy is broken down into plans which form the core of managements' objectives. In addition progress is reviewed regularly by the executive team and quarterly by a sub-committee of the Supervisory Board. The strategic direction is refreshed annually to ensure that all changing factors are taken into account.
External environment	› Significant changes to the economic environment can challenge the existing business strategy and materially impact financial performance. Not adapting quickly to new situations can lead to a competitive disadvantage. › In 2014 the Russian economic conditions became significantly less stable. Falling oil prices coupled with US and EU economic sanctions introduced against Russia and retaliatory food import embargoes led to a sharp increase in food prices and currency devaluation, reducing banking liquidity and causing a dramatic drop in consumer confidence. › The unpredictable outlook presents an acute challenge to X5 in the year ahead.	› The fundamentals of X5's trading strategy remain sound. Food retail is underdeveloped in Russia and there is a latent consumer demand for better choice and quality and better value for money. › Organic expansion will continue to utilize the Group's strong internal cash generation and local currency borrowings. For more information on the Company's mitigation of liquidity risks please see Note 29 'Financial risk management' to the Consolidated Financial Statements in this Annual Report. › The change in consumer sentiment has been detected early and all of X5's trading formats have quickly adapted their value propositions to better serve the changing customer needs.
Human resources	› Our ability to succeed can be limited by a failure to recruit, train and retain the optimal number of staff at both managerial and operational levels; and by a failure to create a balanced organizational structure that enables and motivates personnel to achieve key objectives.	› The current team recognizes the importance of developing X5's corporate culture, with a focus on shared business values, 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 well-defined targets, set in advance and in alignment with the Company's goals. › We are continually hiring a significant number of new employees and constantly improving and developing our recruitment methods. › Our remuneration packages are benchmarked annually enabling us to attract talent with a competitive proposition. › Our Talent Development Program meets the succession and capability needs of our businesses and enables career development across the Company, helping employees realize their full potential.
Health and safety	› Prevention of foodborne illnesses as well as injury or loss of life to both employees and customers is of utmost importance. Failures could damage customer trust and confidence, impacting our customer loyalty and ultimately our financial results.	› Clear policies and procedures that cover the entire food product chain from production to end consumption are in place, enabling us to manage health and product safety risks across the business and comply with all applicable regulations. › Supplier terms and conditions and product specifications set clear standards for product and raw material safety and quality which suppliers are expected to comply with. › The Company has a health and safety policy in place to cover workplaces across its retail, logistics and office functions. We are committed to promoting the highest health and safety standards by implementing advanced safety technologies and techniques, ongoing risk monitoring, analysis and mitigation. › To effectively manage and oversee compliance with the Company's health and safety policy and the applicable Russian legislation, we have established a centralized occupational health and safety department (OHS) responsible for developing the labor safety policy and standards, internal health and safety guidelines and regulations, and coordinating health and safety activities across the Company.

Risk management continued

A strong system of assessment and mitigation

Risk	Description	Mitigation
Property	› The acquisition, development and management of property sites carry inherent risk. Challenges may arise in relation to obtaining planning or other consents; compliance with varying country safety, design and construction standards; tenant management; and maintaining a cost-effective estate with the right balance of freehold and leasehold sites and maintaining them to an acceptable standard.	› When identifying, leasing, purchasing or refurbishing suitable properties, our real estate divisions identify regulatory and other risks related to construction work. › 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 reasonable prices. › The Company has made a significant shift in its growth strategy, from reliance on acquisitions to increased focus on opening new stores organically. › The performance of the estate is monitored and reviewed on an ongoing basis and a refurbishment program for stores is in place to maintain and optimize the estate.
Business support	› The Group is reliant on its IT systems and operational infrastructure in order to trade efficiently. Failure of key systems could have a significant impact on our business.	› The Company has extensive controls in place to maintain the integrity and efficiency of its IT systems, including detailed recovery plans in the event of a significant failure. › We continue to invest in IT to respond to the growing range of IT-related threats and risks. › New innovations and upgrades to systems are ongoing to improve both the customer experience and colleague efficiency. › Prior to introducing system changes, rigorous testing is completed.
Operations	› Effective and consistent management of our multi-site operations is key to earning continued loyalty from our customers. In addition we must stay in touch with changing customer needs to ensure we remain a favored destination over that of our competition.	› We use trading and research data to regularly assess our performance in meeting customer priorities around prices, product range, availability and service. Our operational plans are derived from this analysis and targeted to deliver noticeable improvements to the areas that need improvement. Recent programs in store renovation, category management, product range development and improved availability of fresh and ultra-fresh products are examples of such plans. › To be more responsive to meeting customer needs we have introduced our new operating model, which provides more autonomy to format directors, improves accountability and decision making processes. This is supported by relevant KPIs, regular reviews and motivation systems which are aimed at improving operational standards.
Integrity	› Inability to set and promote a company-wide culture of ethical integrity, and failure to detect or prevent corruption and fraud can lead to a leakage in economic value and significant reputation damage.	› Our ethical standards are made clear to all staff and suppliers upon commencement of involvement with X5 and are publically accessible on our website and Annual Report. Whilst the potential for fraud and other inappropriate activity exists at all levels of the business, we continually strive to maintain high ethical standards through regular communication and training, self-compliance returns, an active whistblower program, and vigorous follow up of allegations or breach alerts. The findings of such investigations are reported to the Management Board and the Audit Committee 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.	› By permanently monitoring regulatory developments we strive to ensure that all existing and forthcoming regulations are complied with. › 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 suppliers' contracts, real estate and M&A transactions.	› Our legal team participates in every stage of important business activities and analyzes contract terms to minimize risks. We are strongly committed to comply with all applicable laws and regulations, and to enforce our rights in litigation if necessary, using all means provided by law.
Taxation	› Russian tax 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, as well as current interpretations published by governmental authorities and relevant jurisprudence. › Note 33 '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 Group relate to the availability of short- and long-term funding to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by parties to financial transactions and to ability mitigate any adverse financial impact resulting from materialized risks.	› The Group finances its operations by a combination of retained profits, disposals of property assets, debt capital market issues, commercial paper, bank borrowings and leases. The central treasury function is responsible for managing the Company's monetary assets, funding requirements, interest rate and credit exposures and the associated risks, as well as insurance of assets. The Group Treasury function has clear policies and operating procedures which are regularly reviewed and audited. › Foreign exchange risks are mitigated by Russian Rouble denominated debt financing. The financial risks, together with a description of the instruments to mitigate these risks, are covered in more detail in Note 29 'Financial Risk Management' to this Annual Report.

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 2014. 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 internal control systems related to financial reporting risks have functioned properly during the year, and provide reasonable assurance that the Company's 2014 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 2014 Consolidated Financial Statements, prepared in accordance with IFRS as adopted by the European Union, 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 2014 Consolidated Financial Statements, together with a description of the principal risks it faces.

The Management Board
19 March 2015

Financial review

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

The following is a review of our financial condition and results of operations as of 31 December 2014 and for the year ended in conjunction with our audited Consolidated Financial Statements as of and for the years ended 31 December 2014 and 2013. The Consolidated Financial Statements and the related notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Overview

X5 is the second largest food retailer in Russia, one of the most dynamic consumer markets in the world. We operate four distinct brands in various market segments from economy to premium, with unique value propositions and offerings that appeal to a wide range of shoppers and budgets. Our retail operations, including sourcing, production, distribution and sales of principally food products, are conducted primarily within the Russian Federation.

The Company operates the following retail chains: a proximity store chain under the Pyaterochka brand, a supermarket chain under the Perekrestok brand, a hypermarket chain under the Karusel brand, convenience stores under the Perekrestok Express brand. An online retail channel under the E5.RU brand ceased operations as of 31 December 2014.

Progress was strong in 2014 with new space growth of 15.7%, revenue growing by 18.6% and EBITDA up by 19.6%, all compared to 2013. However our operations and financial results began to be significantly influenced in the second half of the year by the changes in the macroeconomic environment in Russia. Import bans on food products as well as the collapse in global crude oil prices resulted in a sharp currency devaluation, a rise in inflation and borrowing rates and a decline in financial liquidity. The impact of these changes is already being felt by our customers and is likely to have an increasing impact in 2015.

Selected macroeconomic data

	Q1		Q2		Q3		Q4		FY	
Russian macroeconomic indicators, year-on-year comparison	2013	**2014**	2013	**2014**	2013	**2014**	2013	**2014**	2013	**2014**
RUB/USD exchange rate, average for the period	30.4	**35.0**	31.6	**35.0**	32.8	**36.2**	32.5	**47.7**	31.8	**38.5**
CPI	7.1%	**6.4%**	7.2%	**7.6%**	6.4%	**7.7%**	6.4%	**9.6%**	6.8%	**7.8%**
Food inflation	8.5%	**7.3%**	8.7%	**9.4%**	6.5%	**10.5%**	7.2%	**13.2%**	7.7%	**10.1%**
PPI	4.4%	**4.2%**	2.7%	**8.3%**	4.4%	**6.1%**	2.4%	**5.7%**	3.5%	**6.1%**
Real wage growth	4.5%	**4.5%**	6.2%	**2.5%**	6.4%	**0.6%**	3.9%	**(1.2%)**	5.3%	**1.3%**
Unemployment rate	5.8%	**5.5%**	5.4%	**5.0%**	5.3%	**4.9%**	5.5%	**5.2%**	5.5%	**5.2%**
Retail turnover	4.1%	**3.6%**	3.6%	**1.9%**	4.1%	**1.4%**	4.0%	**3.1%**	3.9%	**2.5%**
Food retail turnover	1.6%	**1.1%**	2.3%	**0.0%**	3.5%	**(0.4%)**	2.6%	**(0.9%)**	2.5%	**(0.1%)**

Results of operations for the year ended 31 December 2014 compared to the year ended 31 December 2013

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2014 and 2013.

Income statement highlights

RUB million[1]	2014	2013	% change year-on-year
Revenue	**633,873**	534,560	18.6%
including net retail sales[2]	**631,930**	532,692	18.6%
Pyaterochka	**435,820**	348,390	25.1%
Perekrestok	**115,648**	110,662	4.5%
Karusel	**69,376**	64,307	7.9%
Express	**10,135**	7,902	28.3%
E5.RU	**950**	1,431	(33.6%)
Gross profit	**154,982**	130,348	18.9%
Gross profit margin, %	**24.5%**	24.4%	
EBITDA	**45,860**	38,350	19.6%
EBITDA margin, %	**7.2%**	7.2%	
Operating profit	**28,288**	25,296	11.8%
Operating profit margin, %	**4.5%**	4.7%	
Profit for the period	**12,691**	10,984	15.5%
Profit margin, %	**2.0%**	2.1%	

Net retail sales

In 2014, X5's net retail sales grew by 18.6% primarily due to an increase in new selling space and higher food inflation in 2014 as compared to 2013.

Net 2014 RUB retail sales dynamics, year-on-year % change	Average ticket	Numbers of customers	Net retail sales
Pyaterochka	10.4%	13.4%	25.1%
Perekrestok	6.7%	(1.8%)	4.5%
Karusel	7.4%	0.6%	7.9%
Express	6.7%	19.6%	28.3%
E5.RU	10.9%	(40.1%)	(33.6%)
X5 Retail Group	7.7%	10.2%	18.6%

Selling space growth, square meters	As at 31 Dec 2014	As at 31 Dec 2013	% change year-on-year
Pyaterochka	**1,754,250**	1,414,102	24.1%
Perekrestok	**415,788**	397,750	4.5%
Karusel	**358,593**	375,808	(4.6%)
Express	**43,612**	35,223	23.8%
X5 Retail Group	**2,572,243**	2,222,883	15.7%

2014 like-for-like[3] results, % growth year-on-year	Sales	Traffic	Basket
Pyaterochka	13.3%	1.6%	11.5%
Perekrestok	2.1%	(2.9%)	5.2%
Karusel	5.1%	(1.8%)	7.1%
Express	3.3%	(1.8%)	5.2%
X5 Retail Group	**9.8%**	**0.6%**	**9.2%**

[1] Please note that in this and other tables immaterial deviations in the calculation of % changes, subtotals and totals are explained by rounding.
[2] Net of VAT and revenue from wholesale operations.
[3] Like-for-like comparisons of retail sales between two periods are comparisons of retail sales in local currency (including VAT) generated by the relevant stores. The stores that are included in like-for-like comparisons are those that have operated for at least twelve full months. Their sales are included in like-for-like calculation starting from the day of the store's opening. We include all stores that fit our like-for-like criteria in each reporting period.

Financial review continued

Pyaterochka's strong performance relative to our other formats in 2014 is due to the success of the rebranding work completed in 2013 leading to:

- improved assortment and promotional offer;
- updated store look with more modern feel and upgraded fixtures; and
- better shelf availability of products due to improvements in logistics.

Gross profit margin
The Company's 2014 gross profit margin amounted to 24.5%, a 7 bp increase compared to 2013.

RUB million	2014	2013	% change year-on-year
Staff costs	(51,138)	(43,187)	18.4%
% of revenue	8.1%	8.1%	
Lease expenses	(28,150)	(22,807)	23.4%
% of revenue	4.4%	4.3%	
D&A, including impairment of assets	(17,571)	(13,055)	34.6%
% of revenue	2.8%	2.4%	
Impairment of assets	(2,660)	128	n/a
% of revenue	0.4%	n/a	
Utilities	(13,105)	(11,398)	15.0%
% of revenue	2.1%	2.1%	
Third-party services	(6,365)	(4,687)	35.8%
% of revenue	1.0%	0.9%	
Other store costs	(10,086)	(9,375)	7.6%
% of revenue	1.6%	1.8%	
Other expenses	(7,097)	(6,249)	13.6%
% of revenue	1.1%	1.2%	
Total SG&A	**(133,512)**	(110,757)	20.5%
% of revenue	**21.1%**	20.7%	

In FY 2014, SG&A expenses as a percentage of revenue increased by 34 bp year-on-year to 21.1%, primarily due to the effect of impairment loss in 2014.

Staff costs in 2014, as a percentage of revenue, remained in line year-on-year primarily due to benefits from the ongoing optimization of administrative, operational and out-staffed employees that were partially offset by an increase in wages and benefits of retail employees.

Lease expenses in 2014, as a percentage of revenue, increased year-on-year by 17 bp to 4.4% primarily due to higher rents from new store openings, the effect of foreign-currency-linked lease agreements as well as the increase in the percentage of leased space in our real estate portfolio to 58.6% at 31 December 2014 compared to 56.3% in the corresponding period of 2013.

Depreciation, amortization and impairment expense, as a percentage of revenue, increased year-on-year by 33 bp in 2014 due to the addition of new stores and the increase in spend on the refurbishment of the existing store portfolio as well as the impairment of land, buildings and equipment in 2014.

Third party services, as a percentage of revenue, increased by 13 bp year-on-year in 2014 mainly due to increased investment in customer communication and loyalty costs.

Other store costs as a percentage of revenue declined year-on-year by 16 bp in 2014 due to optimization of expenditures on security, repair and maintenance.

Utilities and other expenses remained constant year-on-year as a percentage of revenue in 2014.

As a result of the factors discussed above, EBITDA in 2014 totaled RUB 45,860 million, or 7.2% of revenue compared to RUB 38,350 million, or 7.2% of revenue, in the corresponding period of 2013.

Non-operating gains and losses

RUB million	2014	2013	% change year-on-year
Operating profit	**28,288**	25,296	11.8%
Net finance costs	(12,058)	(10,934)	10.3%
Share of loss of associates	(37)	(16)	131.3%
Net FX result	25	77	(67.5%)
Profit before tax	**16,218**	14,423	12.4%
Income tax expense	(3,527)	(3,439)	2.6%
Net profit	**12,691**	10,984	15.5%
Net profit margin, %	2.0%	2.1%	–

The weighted average effective interest rate on X5's total debt for 2014 increased to 10.0% per annum from 8.7% per annum in 2013 due to rising interest rates in the local debt market.

In 2014, X5's effective tax rate was 21.7% compared to 23.8% in the corresponding period of 2013. The lower effective tax rate in 2014 is due to the one-off elimination of a RUB 749 million tax provision in 2014. The Russian statutory income tax rate for both periods was 20.0%. The difference between X5's effective and statutory tax rates is primarily due to the impact of non-deductible expenses.

Consolidated cash flow

RUB million	2014	2013	% change year-on-year
Net cash from operating activities	**28,567**	28,387	0.6%
Net cash from operating activities before changes in working capital	45,766	38,817	17.9%
Change in working capital	(2,212)	2,319	n/a
Net interest and income tax paid	(14,987)	(12,749)	17.6%
Net cash used in investing activities	**(29,737)**	(21,059)	41.2%
Net cash generated from/(used in) financing activities	**19,344**	(12,093)	n/a
Effect of exchange rate changes on cash and cash equivalents	(162)	(12)	n/a
Net increase/(decrease) in cash and cash equivalents	**18,012**	(4,777)	n/a

The decrease in working capital changes in 2014 was mainly due to an increase in inventories related to improving availability and promotions as well as greater end-of-year supplier bonuses as part of improved trade terms.

In 2014, net interest and income tax paid increased due to the higher average cost of debt in 2014 compared to 2013 and lower tax advances paid in Q4 2013 compared to Q4 2014.

Net cash used in investing activities, which generally consisted of payments for property, plant and equipment increased in 2014 compared to 2013, and reflects store expansions and a stepped-up reconstruction and maintenance program of existing stores.

Net cash generated from financing activities in 2014 was primarily related to the drawdown of long-term credit facilities in December 2014 in order to reduce liquidity and refinancing risk and improve the quality of the Company's loan portfolio.

Liquidity update

RUB million	31 Dec 14	% in total	31 Dec 13	% in total
Total debt	**130,986**		110,523	
Short-term debt	15,834	12.1%	30,680	27.8%
Long-term debt	115,152	87.9%	79,843	72.2%
Net debt	**105,363**		102,912	
Net debt/EBITDA	**2.30x**[1]		2.68x[2]	
EBITDA/Interest expense	**3.76x**[1]		3.48x[2]	

At 31 December 2014, the Company had access to RUB 84.2 billion in undrawn credit lines with major Russian and international banks.

[1] Based on consolidated EBITDA and net interest expense of RUB 45,860 million and RUB 12,186 million, respectively.
[2] Based on consolidated EBITDA and net interest expense of RUB 38,350 million and RUB 11,015 million, respectively.

Governance

In this section

Introduction from our Chairman

An effective system of governance and stewardship

Dmitry Dorofeev
Chairman

> As a large employer, customer and public company we are committed to operating in a sustainable way to the benefit of all our stakeholders. Employing more people, supporting suppliers and delivering results are all obligations we take seriously."

Dear Stakeholders
This has been an important year for X5 in terms of the progress the Company has made in realizing the key strategic directions that were laid out last year. The team's efforts have positioned the Company to return to sustainable growth with the consequential benefits for all stakeholders.

Strategy delivering results
We have delivered solid growth in revenue and selling space in 2014. These results validate and highlight the benefits of our multi-format strategy, which provides us opportunities to better serve the nation's diverse needs from food retail, as well as the big improvements made in the year to the formats' operations.

Although we have seen further optimization of X5's operating structure and changes to the Executive Committee during 2014, our strategy has remained intact. The focus of these changes is to build on the new operational model introduced in 2013, and the work completed during 2014, to more effectively capitalize on this strategy.

Management's progress in determining and refining the appropriate value propositions resident in the multi-format structure and executing our back to basic initiatives has positioned us to take advantage of the structural shift from traditional to modern trade in the Russian retail market. This applies as well and maybe more so during periods of market volatility and stress, which may actually accelerate this shift.

I would like to thank Stephan and his team for the work they have done to establish a platform for sustainable future growth and congratulate them for successfully delivering on all of the Company's 2014 targets.

Sustainable growth
I consider the pursuit of balanced, sustainable and profitable growth to be one of the core objectives of this Board as well as the underlying driver for X5's strategy. Accordingly, we will continue to drive efficiencies throughout the organization and leverage our scale and infrastructure to improve returns on shareholder capital. At X5 we take corporate citizenship seriously and recognize that in order for the Company to continue to grow and develop the communities where we operate must do so as well. Being a good employer, supporting suppliers and delivering quality products to our customers is part of our sustainable long-term winning proposition.

Governance and the Board
X5 has established a solid governance framework and our Board has a strong independent composition with relevant retail, finance and strategy expertise. This diversity provides management with valuable counsel and support as they translate our strategic objectives into X5's operations.

There were no changes to the Board's composition during 2014 however, based on our continued efforts to improve the Board's composition, as well as our annual assessment work, there are a number of changes that will be put to the shareholders at X5's next Annual General Meeting (AGM) in 2015.

The Board plans to nominate Geoff King, a former senior finance executive for Tesco plc, the UK multinational grocery and general merchandise retailer, and Peter Demchenkov, current Chief Executive Officer of Alidi, a leading Russian provider of distribution and logistics services.

David Gould, Alexander Tynkovan and Alexander Malis will be stepping down at the next AGM. The Board wishes to thank the departing members for their significant contribution during the years they served. As Chairman of the Audit Committee since 2006, David Gould substantially contributed to the development of the Company's finance function, risk management and internal controls. Alexander Tynkovan has proven invaluable to the Company for his dedicated and independent approach since joining the Board in 2008. Finally, the Board expresses its gratitude for Alexander Malis' contribution during X5's recent transition period.

I would also like to personally thank all my Board colleagues for their diligence and support throughout the year as we worked to guide and support the Company's strategic direction.

The future
While it was necessary to implement fundamental change to the way X5 was managed, we never lost sight of the need to focus the business on a strategy that builds capability and invests to deliver balanced and long-term sustainable growth.

The market volatility and uncertainty we faced at the end of 2014 are expected to persist into 2015 and 2016. Notwithstanding that, we remain confident and excited about the opportunities resident in the Russian retail market and our ability to capitalize on them.

The focus has been on assembling a strong team dedicated to delivering performance and sustainable growth that is able to adapt to the evolving market environment and take advantage of opportunities that come along first and foremost to the benefit of our customers and by extension to all other stakeholders.

X5 exists for your benefit and we thank you for your ongoing support of this great company.

Corporate Governance report

As a public company under Dutch law, with global depositary receipts listed on the London Stock Exchange, X5 Retail Group N.V. (the 'Company' or 'X5') is subject to the Dutch Corporate Governance Code (the 'Code'). The full text of the Code can be viewed on X5's website at www.x5.ru.

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

The Management and Supervisory Boards

X5 has a two-tier board structure, 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.

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, and for financing and external communication. The Management Board is required to report related developments to, and discusses the internal risk management and control systems with the Supervisory Board and its Audit Committee.

X5 also has an Executive Committee that is comprised of business leaders and leaders with functional expertise, allowing both the functions and the business operations to be represented at the highest level in the Company. The Executive Committee supports the Management Board in managing the general affairs of X5 and its day-to-day operations, ensuring that the Company can effectively implement its strategy and achieve its objectives. The Management Board is ultimately responsible for the actions and decisions of the Executive Committee, and the overall management of X5.

The Management Board consists of two members, Stephan DuCharme, the Chief Executive Officer and Frank Lhoëst, the Company Secretary. In 2014 the composition of the Management Board changed: from 1 June 2014 Sergey Piven and Vladlena Yavorskaya stepped down from the Management Board, while retaining their positions of, respectively, Chief Financial Officer and General Counsel at the level of the Executive Committee. It is believed that the repositioning of these functions better reflects the distinct statutory and internal roles of the Management Board and the Executive Committee, and the day-to-day executive responsibilities of the Executive Committee at the group's operational level. Prior to these changes – on 1 May 2014 – the Company's Articles of Association were amended, allowing the Company to have a smaller number of Management Board members in its statutory two-tier board structure.

The table below shows the 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	2013	2017
Frank Lhoëst	1962	Company Secretary	2007	2015

The Supervisory Board proposes to the General Meeting of Shareholders the re-appointment of Frank Lhoëst, whose current term as member of the Management Board comes to an end in 2015.

Supervisory Board

The Supervisory Board is responsible for advising and supervising the Management Board and 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.

The General Meeting of Shareholders determines the number of members of the Supervisory Board. The Supervisory Board currently consists of eight members. The current members, including their biographies, are presented on page 68.

The Supervisory Board has prepared a profile of its size and composition, taking account of the nature of the Company's business and its activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board evaluates its profile and composition annually. The evaluation in 2014 resulted in substantial changes in the composition of the Supervisory Board that will occur in 2015: at the time of the 2015 Annual General Meeting of Shareholders David Gould, Alexander Tynkovan and Alexander Malis will be stepping down from the Supervisory Board. To fill the vacancies the Supervisory Board nominated two new independent Supervisory Board members, Geoff King and Peter Demchenkov. For further details please refer to the Supervisory Board report on page 70.

Supervisory Board members are appointed for a period of up to four years and may be re-elected, whereby the total term of office may not exceed twelve years. The Supervisory Board has prepared a retirement and reappointment schedule to prevent, to the greatest extent possible, re-appointments occurring simultaneously. Both the Supervisory Board profile and rotation plan can be viewed on the Company's website.

The table below shows the current members of the Supervisory Board and their respective terms of appointment:

Name	Year of birth	Position	Year of initial appointment	End of current term of appointment
Dmitry Dorofeev	1977	Chairman	2012	2016
Mikhail Fridman	1964	Member	2006	2017
David Gould*	1969	Member	2006	2018
Alexander Tynkovan*	1967	Member	2008	2016
Christian Couvreux	1950	Member	2010	2018
Alexander Malis*	1972	Member	2013	2017
Igor Shekhterman	1970	Member	2013	2017
Pawel Musial	1968	Member	2013	2017

* David Gould, Alexander Tynkovan and Alexander Malis will step down from the Supervisory Board as per the 2015 Annual General Meeting of Shareholders.

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 overseeing the integrity of X5's Financial Statements, system of internal business controls and risk management, financing and finance related strategies, tax planning, the Company's compliance with legal and regulatory requirements, as well as the qualifications, performance and independence of the external auditor and the performance of the internal audit function.

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

The Nomination and Remuneration Committee also advises in respect of the selection and appointment of members of the Supervisory Board, the Management Board and the Executive Committee. 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 in respect of 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
Dmitry Dorofeev	Member	Member		Member
Mikhail Fridman				
David Gould	Chairman	Member		
Alexander Tynkovan		Member	Chairman	Member
Christian Couvreux	Member		Member	Chairman
Alexander Malis				Member
Igor Shekhterman		Chairman		
Pawel Musial				Member

Gender diversity

Pursuant to the Dutch '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, X5's Management and Supervisory Boards are not balanced in accordance with the Act. This deviation is unintentional; while X5 generally aims for a diverse composition, diversity is not a decisive factor when finding the most suitable candidate for any of the Company's boards. Nevertheless, the Company continues to recruit female executives, as demonstrated by the composition of the Executive Committee in which five out of eleven positions are held by women.

Corporate Governance report continued

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 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, whereby the total term of office may not exceed twelve years. 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 74, 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 by X5 to enter into a transaction involving a conflict of interest with a member of the Management Board or a member of the Supervisory Board that is of material significance to 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 2014 is included in the Report of the Supervisory Board on page 70.

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 of 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 General Meeting of 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 authorize the Management Board or the Supervisory Board to issue shares and grant subscriptions for shares, to authorize the Management Board or the Supervisory Board to restrict or exclude pre-emptive rights of shareholders upon issuance of shares, to authorize 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 3% of X5's issued share capital 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 of Association, are entitled to attend and/or vote at a General Meeting of Shareholders are entitled to address the General Meeting of Shareholders. X5 uses the Bank of New York Mellon, the depositary for X5's GDR facility (the 'Depositary'), to enable GDR holders to exercise their voting rights represented by the shares underlying the GDRs. As described in the 'Terms and Conditions of the Global Depositary Receipts', holders of GDRs may instruct the Depositary with regard to the exercise of the voting rights connected to the shares underlying their GDRs. Alternatively, upon request of the holders of such depositary receipts, the Depositary will grant a proxy to such holders who wish to vote in person at a General Meeting of Shareholders. Persons who hold a written proxy may represent shareholders at a General Meeting of Shareholders. The written proxy must be duly executed and legalized in accordance with the applicable laws, and may be submitted electronically.

Voting rights
Each share confers the right to cast one vote at the General Meeting of Shareholders. There are no restrictions, either under Dutch law or in the Articles of Association, on the right of non-residents of the Netherlands or foreign owners to hold 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 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. 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 do not need 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: 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%.

The following table lists the shareholders on record on 28 February 2015 in the AFM's public register that hold an interest of 3% or more in the share capital of the Company:

Shareholder	Date of disclosure	Capital interest and voting rights[1]
CTF Holdings Ltd.	2 August 2007	48.41%
Axon Trust	22 December 2009	11.43%
Genesis Asset Managers, LLP	16 July 2012	5.23%
T. Row Price Associates Inc.	11 September 2012	4.99%
Coronation Fund Managers Ltd.	21 January 2015	5.10%

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

Securities owned by board members
The members of the Management Board and Supervisory Board and X5's other senior management are subject to the Company's 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.

Corporate Governance report continued

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 securities 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 GDRs 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-in capital plus any reserves required to be maintained by Dutch law; and
- X5 and its subsidiaries would not, as a result, hold shares or GDRs thereof with an aggregate nominal value exceeding half of the issued share capital.

In 2014 the Management Board has been authorized to acquire up to 10% of the shares or GDRs thereof. This authorization is valid through 25 October 2015. 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 GDRs thereof, the Management Board requires the Supervisory Board's prior approval for such purchase.

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

Issue of new shares and pre-emptive rights
Shares in X5 may be issued, and rights to subscribe for shares may be granted, pursuant to a resolution of the General Meeting of Shareholders or another corporate body of X5 to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. In 2014, the General Meeting of Shareholders approved a delegation of this authority to the Supervisory Board, relating to the issuance and/or granting of rights to acquire up to 6,789,322 shares (10% of the issued share capital) through 25 October 2015.

Upon the issue of new shares, holders of X5's shares have a pre-emptive right to subscribe for shares in proportion to the aggregate amount of their existing holdings of X5's shares. According to the Company's Articles of Association, this pre-emptive right does not apply to any issue of shares to employees of X5 or a Group company. Pre-emptive rights may be restricted or excluded pursuant to a resolution of the General Meeting of Shareholders or another corporate body of X5 to which the General Meeting of Shareholders has delegated such authority for a time not exceeding five years. The General Meeting of Shareholders has delegated the authority to restrict or exclude the pre-emptive rights of shareholders upon the issue of shares and/or the granting of rights to subscribe for shares to the Supervisory Board through 25 October 2015.

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

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

In May 2014 the Company's Articles of Association were amended, setting the statutory framework for the new composition of the Management Board. The current text of the Articles of Association is available on the Company'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 the independence of the auditor.

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 as 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 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 GDRs 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 eight 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.

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. Meanwhile, as evidenced by the nominations of Geoff King and Peter Demchenkov, the Supervisory Board is committed to improving the ratio between independent and non-independent board members.

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 – previously separate – 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 David Gould and Dmitry 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. Following the changes in the Supervisory Board composition that are proposed to take place at the 2015 Annual General Meeting of Shareholders, the Supervisory Board is committed to bringing the composition of the Audit Committee in line with the Code and the Audit Committee's terms of reference.

III.7.1: No grant of shares and options to members of the Supervisory Board
As determined by the General Meeting of Shareholders, the independent members of the Supervisory Board participate in the Company's restricted stock unit plan. X5 acknowledges that the award of shares to members of the Supervisory Board constitutes a deviation from the Code. However, in order to attract and reward experienced individuals with a track record that is of specific relevance to the Company, X5 believes it is necessary to allow members of the Supervisory Board to participate in the Company's equity-based remuneration plan. This structure aligns the interests of Supervisory Board members with those of shareholders and strengthens their commitment and confidence in the future of the Company. Equity-based awards to members of the Supervisory Board are not subject to performance criteria, and shall be determined by the General Meeting of Shareholders.

Supervisory and Management Boards

Supervisory Board

01 **Dmitry Dorofeev**
Chairman
Year of birth: 1977

Dmitry 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 for Alfa Group's companies. Dmitry also serves as a member of the Supervisory Board of Alfa Group. Prior to joining Alfa Group, he worked at McKinsey & Company in Moscow from 2004. From 2000 to 2004, he also held various positions at Ernst & Young in St. Petersburg and in Moscow. Dmitry received his MSc at the D. Ustinov Baltic State Technical University 'Voenmeh', Faculty of International Industrial Management. He also graduated from the Bodø Graduate School of Business in Norway, Faculty of International Business. Dmitry qualified as a Chartered Certified Accountant (ACCA) in 2004.

02 **Mikhail Fridman**
Member of the Supervisory Board
Year of birth: 1964

Mikhail Fridman, a Russian citizen, serves as Chairman of the Supervisory Board of Alfa Group and is one of Alfa Group's principal founders. He is a member of the Supervisory Board of VimpelCom Ltd and a member of the Board of Directors of Alfa-Bank Russia. Mikhail is also a member of the International Advisory Board of the Council of Foreign Relations (USA). He graduated from the Moscow Institute of Steel and Alloys.

03 **David Gould**
Chairman of the Audit Committee
Year of birth: 1969

David Gould is a member of the Supervisory Board of X5 Retail Group N.V. He qualified as a CPA in 1992 and as a CFA charter holder since 1999. David Gould formerly held positions at PricewaterhouseCoopers from 1992-2000. He earned a BA with honors from Colgate University (1991) and holds an MBA-MSc from Northeastern University (1992).

04 **Alexander Tynkovan**
Chairman of the Related Party Committee
Year of birth: 1967

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

05 **Christian Couvreux**
Chairman of the Strategy Committee
Year of birth: 1950

Christian Couvreux, 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 Méridionale. More recently he acted as a retail consultant in Asia, in particular in Thailand, Vietnam, Indonesia and the Philippines. Christian holds a MSc in Economic Sciences from the University of Paris and an MBA from the French business school HEC.

06 **Igor Shekhterman**
Chairman of Nomination and Remuneration Committee
Year of birth: 1970

Igor Shekhterman, a Russian citizen, is the managing partner in RosExpert, the Russian alliance partner of Korn/Ferry International. He was one of the founders of the RosExpert Company in 1996. Igor started his career as finance manager at the Russian branch of Beoluna, the Japanese jewelry producer. He holds a BA in Finance from business schools in France and Denmark.

07 **Alexander Malis**
Member of the Strategy Committee
Year of birth: 1972

Alexander Malis, a Russian citizen, has been CEO of Euroset Group since April 2009. From 2008 to 2009 he was head of broadband access development at VimpelCom Group. From 1995 Alexander served in various capacities at Corbina Telecom, including the last two years as CEO. Since 2006 he has also served as CEO of CJSC Investelectrosvyaz and acting CEO of CJSC Cortec (a Corbina Telecom trademark). From 1990 to 1995 he was a financial consultant at RusConsult. Alexander graduated from the Moscow State University of Commerce with a specialization in Financial Accounting and Audit. He received his PhD from the Research Institute of Finance in 1998.

08 **Pawel Musial**
Member of the Supervisory Board
Year of birth: 1968

Pawel Musial, a Polish citizen, is CEO of Profi Rom Food, one of the largest supermarket chains in Romania, following positions on the Supervisory Board of, consecutively, Ukraine Eko Market (Chairman) and Profi Rom Food since 2008. From 2006 to 2007 he was Chief Commercial Officer and a member of the Managment Board of X5, having previously been General Director and Chief Operating Officer of the Perekrestok chain since 2004. Prior to joining Perekrestok, Pawel held senior management positions in the food retail industry in Poland, including five years with Tesco Polska, with his last position as Regional Director. He graduated from the Warsaw University of Life Sciences (SGGW) with an engineering degree in nutrition technology.

Management Board

01 **Stephan DuCharme**
Chief Executive Officer
(Biography on page 18)

02 **Frank Lhoëst**
Company Secretary
Year of birth: 1962
(Biography on page 19)

Report of the Supervisory Board

The Supervisory Board is charged with supervising the policies of the Management Board and the general course of 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 acts in accordance with the interests of the Company and its affiliated businesses. It also takes into account the relevant interest of the Company's stakeholders and, to that end, considers 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 eight members. The Supervisory Board reviews its size and composition on an annual basis, taking into account the evolving nature of X5's business and activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board profile is published on X5's corporate website.

At the Annual General Meeting of Shareholders on 25 April 2014, both Christian Couvreux and David Gould were re-appointed for an additional four-year term, following their nomination in accordance with the retirement and re-appointment schedule of the Supervisory Board.

During the second half of 2014 the Supervisory Board extensively reflected on its composition and profile, also in the context of the annual Board assessment. This resulted in the nomination, in December 2014 and March 2015, of Geoff King and Peter Demchenkov as new Supervisory Board members. If appointed by the General Meeting of Shareholders, these individuals will succeed David Gould, Alexander Tynkovan and Alexander Malis, who are stepping down as members of the Supervisory Board at the time of the 2015 Annual General Meeting of Shareholders.

Geoff King was nominated in view of his extensive financial and retail experience, including almost 22 years at Tesco where he held various senior level finance positions. Peter Demchenkov is CEO of Alidi, a leading provider of distribution and logistics services in Russia, and is nominated for his particular experience in those areas. The Supervisory Board strongly believes that the appointment of these individuals will strengthen the independence and the relevant expertise of the Supervisory Board.

The Supervisory Board wishes to thank David Gould, Alexander Tynkovan and Alexander Malis for their significant contribution during the years they served on X5's Supervisory Board.

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

Induction

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

In 2014 the Supervisory Board developed a comprehensive presentation outlining the regulatory framework for members of the Supervisory Board. This presentation will be updated when necessary, and serve as a useful guide for new Supervisory Board members who need to familiarize themselves with the external and internal rules, regulations and policies that apply to them.

Meetings of the Supervisory Board

In 2014 the Supervisory Board held five meetings. Further resolutions in writing were taken when necessary during the year. On each of five occasions in 2014 the Supervisory Board meeting was preceded by meetings of the Audit Committee and the Strategy Committee. The same applies for the Nomination and Remuneration Committee, with one exception in July. The Related Party Committee convened throughout the year, as and when necessary. In 2014 the Supervisory Board continued its practice of having all meetings of the Strategy Committee attended by all members of the Supervisory Board. As a result the Supervisory Board effectively convened five times for two consecutive days, thus ensuring sufficient time for the meetings and discussions on specific themes, such as operational performance, strategy and management development. All these meetings included feedback sessions with members of the Executive Committee.

All meetings were attended by the full Supervisory Board, apart from the meeting in December which was not attended by Alexander Malis. The CEO and CFO attended the meetings, and other members of senior management were regularly invited to present to the Supervisory Board. In 2014 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 March at which the 2013 Annual Report and Financial Statements were recommended for adoption by the Annual General Meeting of Shareholders. In between the Supervisory Board meetings, several informal meetings and telephone calls took place among Supervisory Board members and members of the Management Board and other Company management, to consult with each other on various topics, and ensure that the Supervisory Board remains well informed about the running of the Company operations.

In fall the Supervisory Board conducted a self-assessment and appraised its functioning, profile, competence and composition, as well as its relationship with the Executive Committee. This time, the evaluation was performed by an external party by means of a questionnaire and individual interviews, based upon which a report of the results was prepared. Items assessed and subsequently discussed included: composition and independence of the Supervisory Board, meeting and decision-making processes, level of skills and expertise, individual contributions and relationship with the Executive Committee. In addition to the self-assessment by the Supervisory Board members, input was also solicited and received from selected members of the Executive Committee including the members of the Management Board. The main conclusions of the evaluation were discussed by the Supervisory Board. The Supervisory Board attaches great value to these evaluations. They ensure continuous focus on the quality of the activities, composition and functioning of the Supervisory Board and its Committees and relationship with the Executive Committee.

During 2014 the Supervisory Board reviewed various matters related to the Company's activities, operational results, strategies and management, and devoted considerable time to the ongoing assessment of the drivers and initiatives to increase sales dynamics and sustainable growth, with a continued focus on the 'back to retail basics' campaign launched in 2013. Main topics included:

- work on the distinct value propositions of the core formats, through re-branding (Pyaterochka and Perekrestok), ambitious store refurbishment programs across all formats, improved category management principles, pricing strategy, and operational efficiency and service at store level;
- the expansion of Pyaterochka's existing store base through the acquisition of 116 stores in the Samara region;
- the in-depth review of parameters and conditions for the hypermarket strategy, based on a critical assessment of the format's operations and performance;
- the strategy for X5's convenience store format Perekrestok Express;
- the analysis of e-commerce activities, in food retail in general and for X5 in particular, leading to the termination of commercial operations at E5.RU;
- the governance structure supporting the new operating structure, functional and operational leadership, and implications for the role and size of the head office;
- the new motivation system supporting the three-year Strategic Plan approved in September;
- the increasingly challenging economic climate in Russia, and its impact on the food retail business, X5 and its customers.

Other topics included:

- the financial reporting process and in particular the approval of the 2013 Annual Report and review of the 2014 half-yearly and quarterly financial reports;
- the reports by the internal and external auditors;
- the regular assessment of the members of the Management Board and the Executive Committee, including talent management and succession planning;
- the composition of the Management Board;
- selection, appointment and remuneration of new members of the Executive Committee – including the new CFO – and other senior managers of the Company,
- the annual review of the composition of the Supervisory Board and its committees;
- an ongoing performance review of the various functions and business divisions of the Company;
- the financing strategy;
- the development and expansion strategy;
- risk management;
- the review and approval of the annual budget.

Meetings of the committees

Audit Committee

The role of the Audit Committee is described in its charter which is available on the Company's website. On 31 December 2014 the Audit Committee consisted of David Gould (Chairman), Christian Couvreux and Dmitry Dorofeev. In 2014 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 Chief Financial Officer, 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 external auditor without the presence of management.

Throughout 2014 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. Senior operational management was invited to all physical Audit Committee meetings, to report progress in aged inventory and loss prevention plans. The Audit Committee also thoroughly analyzed the Company's underperforming stores, as well as the financial planning methodology of new stores.

Report of the Supervisory Board continued

The Audit Committee further discussed topics including:

- the 2013 Annual Report and Financial Statements;
- the external auditor's report with respect to accounting and audit issues and internal control recommendations in respect of their audit of the 2013 Consolidated Financial Statements;
- quarterly interim financial reports and trading updates;
- audit fees, appointment and independence of the external auditor;
- tax planning and risks;
- review of risks and risk mitigation measures related to factoring;
- review of results of an external valuation of the CAD function by an independent appraiser;
- integrity and compliance;
- review and approval of the CAD's audit plan and budget for 2015;
- financial reporting calendar and the black-out trading calendar for the year 2015.

In July 2014 the Audit Committee appointed Svetlana Volikova, previously General Director of Karusel Hypermarkets, as new Head of CAD. 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. Significant audit and forensic investigation findings of the CAD were reported to the Audit Committee on a regular basis. The status of follow-up actions by management in addressing CAD findings were regularly reviewed by the Audit Committee.

According to the new Dutch law on Auditor Independence, the Company is required to change its external audit firm every eight years, starting 1 January 2016. In order to comply with the mandatory firm rotation, it was decided that a new external auditor will be selected in 2015.

Finally, within the context of the enterprise risk management review, the Audit Committee extensively reviewed the risks of the economic sanctions and the subsequent economic crisis in Russia, in particular the risks relating to limited financing and product availability, high food inflation, and increased pressure on the purchasing power of customers.

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 2014 the Nomination and Remuneration Committee consisted of Igor Shekhterman (Chairman), Dmitry Dorofeev, Alexander Tynkovan and David Gould. The Nomination and Remuneration Committee held four meetings in 2014. Other members of the Supervisory Board and senior management were invited when necessary or appropriate.

In accordance with the retirement and re-appointment schedule of the Supervisory Board, the Committee discussed and proposed the re-appointment of Christian Couvreux and David Gould for a new term until 2018.

In the second half of the year, the Nomination and Remuneration Committee extensively reviewed the composition of the Supervisory Board, leading to the nomination of Geoff King and Peter Demchenkov as new Supervisory Board members in December 2014 and March 2015, respectively.

During the year the Nomination and Remuneration Committee continued to review the organization and governance structure, as well as leadership and human resources needs in relation to the Company's multi-format operating structure and growth objectives. Specific attention was given to the composition and profile of the Management Board and Executive Committee. In June Sergey Piven and Vladlena Yavorskaya stepped down from the Management Board, while retaining their positions of Chief Financial Officer and General Counsel at operational group level respectively. Later in the year, the Executive Board was renamed the Executive Committee in order to better reflect its internal role versus the statutory role of the Management Board. Moreover, functions and operations are represented in dedicated management committees reporting to the Executive Committee, ensuring a coordinated approach in specific corporate focus areas including business reporting, HR, IT, Communication and Ethics.

When Sergey Piven's resignation was announced in July, the Nomination and Remuneration Committee was actively involved in the selection and appointment of his successor, Elena Milinova.

In terms of remuneration, the Nomination and Remuneration Committee discussed the principles of a new motivation system to support the three-year Strategic Plan approved by the Supervisory Board in September. The new system is proposed to substitute the current deferred cash incentive plan with a short-term incentive plan based on annual performance of both corporate and individual targets, and a long-term incentive plan based on ambitious corporate targets to be achieved in two stages of consecutively three and two years.

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 Executive Committee and Management Board;
- variable remuneration of the members of the Executive Committee, and review and approval of corporate and individual targets under the current deferred cash incentive plan;
- appointment of senior managers based on selection criteria prepared in advance, as well as their remuneration in accordance with the Company's remuneration policy.

The Remuneration report on page 74 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 Committee, as well as the outlook for 2015 and beyond.

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 2014 the Related Party Committee consisted of Alexander Tynkovan (Chairman) and Christian Couvreux. 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. More specifically, the Related Party Committee discussed the following transactions:

- insurance contracts with AlfaStrahovanie;
- foreign exchange agreements, bond issues, revolving credit facilities and other bank products with Alfa Bank;
- service agreements with CTF Holdings Ltd.;
- agreements for executive search services with RosExpert;
- consultancy agreements with SC B-Brand SRL and OMEGA.

These transactions were discussed and/or approved by the Related Party Committee and the Supervisory Board 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 are available on the Company's website. The Supervisory Board assessed that, to the extent any of the listed transactions constitutes a conflict of interest for certain members of the Supervisory Board, such conflict does not undermine the independent judgment of these Board members while performing their duties for X5.

Strategy Committee

The role of the Strategy Committee is described in its charter which is available on the Company's website. On 31 December 2014 the Strategy Committee consisted of Christian Couvreux (Chairman), Dmitry Dorofeev, Alexander Tynkovan, Alexander Malis and Pawel Musial. The responsibilities of the Strategy Committee include 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 five meetings in 2014. All meetings were attended by all other members of the Supervisory Board as well as the Chief Executive Officer and the Chief Financial Officer, and included feedback sessions with members of the Executive Committee. In 2014 the Strategy Committee continued to review the Company's initiatives to increase sales dynamics and sustainable growth, with a focus on enhanced value propositions of the core formats, refurbishment of stores along with organic expansion, dedicated logistics and supply chain, category management, pricing strategy, operational efficiency and service at store level, succession planning, staff motivation systems, and M&A opportunities. The meeting in September was dedicated to the Company's medium-term strategy, resulting in the approval of the three-year Strategic Plan. In December, the Strategy Committee discussed the Company's budget for 2015.

Corporate Governance

Both the Supervisory Board and the Management Board continued their efforts to ensure that the Company's practices 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 2014 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 130.

The Supervisory Board recommends that the General Meeting of Shareholders adopts the 2014 Consolidated Financial Statements of X5 Retail Group N.V. The 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. The appropriation of results approved by the Supervisory Board can be found on page 129.

The Supervisory Board would like to take this opportunity to express its appreciation for all the efforts and achievements of the Executive Committee and all X5 employees in 2014.

The Supervisory Board
19 March 2015

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 2014. This report also addresses the way in which the remuneration policy will be pursued for the financial year 2015 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;
- 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 addresses the assessment and remuneration of the senior managers on the Executive Committee, 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 own remuneration.

The current members of the Nomination and Remuneration Committee are Igor Shekhterman (Chairman), Dmitry Dorofeev, Alexander Tynkovan and David Gould.

Remuneration Policy 2014

The remuneration of the individual members of the Management Board is determined by the Supervisory Board within the framework of the remuneration policy. The remuneration policy was first adopted by the General Meeting of Shareholders in 2007 and has since been amended several times, most recently in 2013.

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 for the risks to which variable remuneration may expose the Company.

The current remuneration structure of the members of the Management Board includes three elements: base salary, annual incentive in the form of a performance-based and partially deferred cash bonus, 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 deemed appropriate.

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

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 salaries 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 with 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 salaries is April 1.

Deferred Cash Incentive Plan

The cash-based incentive plan launched in 2013 for members of the Management Board and other key executives no longer makes the distinction between short-term and long-term performance period. At the beginning of each annual performance period, the variable cash-based compensation is granted conditionally. After the performance year the amount of conditional variable compensation that can be allocated is determined based on the achievement of both individual and company performance criteria. The on-target payout as a percentage of annual base salary is set at a level of 300% divided in three equal components payable over a three year period.

The direct component, one third of total variable remuneration, is paid 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 for achieving 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 include revenue and EBITDA. 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.

In 2014 the Nomination and Remuneration Committee reviewed the principles of a new incentive system as an important part of the Company's strategic plan, while also taking into account the rapidly changing macroeconomic circumstances in Russia.The new incentive plan is described in further detail below, and will be proposed to the 2015 Annual General Meeting of Shareholders.

Restricted Stock Unit Plan

In 2013 the third and final tranche under the Restricted Stock Unit Plan ('the Plan') was awarded to participating members of senior management. The Plan, approved by the General Meeting of Shareholders in 2010, provided for the annual grant of conditional rights to receive restricted stock units ('RSUs'), subject to the achievement of specific performance criteria and continuous employment with the Group until the completion of a two-year vesting period.

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.

The Plan remains in place for independent members of the Supervisory Board. RSU awards to members of the Supervisory Board shall not be subject to performance criteria, and are determined by the General Meeting of Shareholders.

Other remuneration components

A number of other arrangements may be offered to members of the Management Board, such as 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.

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 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.

New clawback legislation introduced in the Netherlands from 1 January 2014 strengthens the Company's ability to revise and claw back directors' variable pay components if they are excessive or wrongly awarded. Under the new rules the Supervisory Board may recover from the Management Board members all or part of a paid bonus if such bonus is based on incorrect information regarding the underlying targets or the conditions of the bonus. Furthermore, the Supervisory Board has the discretionary authority to adjust an unpaid bonus to an appropriate amount if payment of the bonus is considered unreasonable or unfair. The new rules also introduce the obligation to deduct from a director's remuneration any increase in the value of any equity based pay components, in case (i) a public offer is announced, (ii) the General Meeting approves a resolution about a significant change in the identity or character of the Company or its businesses, as referred to in section 2:107a (1) of the Dutch Civil Code, or (iii) a merger or demerger decision is taken.[1]

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. The General Meeting of Shareholders approved the indemnity arrangements to be granted by the Company to members of the Supervisory Board.

[1] Act dated 11 December 2013 regarding an amendment to the Dutch Civil Code and the Dutch Financial Supervision Act in connection with the authority to adjust and clawback bonuses and profit sharing of directors and day-to-day policy makers. The provisions introducing the obligation to deduct increases in value of equity based pay components are of a temporary nature and will expire on 1 July 2017, unless extended.

Remuneration report continued

Remuneration 2014

Management Board remuneration

As described in the Corporate Governance Report on page 62, the composition of the Management Board changed in 2014. Both Mr. Sergey Piven and Mrs. Vladlena Yavorskaya stepped down from the Management Board on 1 June 2014, while remaining members of the Company's Executive Committee. Subsequenty, on 15 September 2014, Mr. Piven resigned as CFO of the Company, to be succeeded by Mrs. Elena Milinova.

The total remuneration of each member of the Management Board is determined in line with compensation levels in peer group companies. With respect to the Chief Executive Officer the Supervisory Board applied its discretionary authority to deviate from the remuneration policy. In particular, Stephan DuCharme's reward package does not include a severance arrangement. Instead, he shall be entitled to a minimum annual compensation package of USD 4,000,000. Should this amount exceed the annual payout on the basis of the fixed and variable remuneration components, Stephan shall be entitled to the difference upon completion of his full term as Chief Executive Officer.

For 2014 the Supervisory Board determined that the achievement of Company performance targets represents 70% of the total on-target bonus opportunity for CEO, while his individual performance targets have a weight of 30%. For the Company Secretary such ratio is 50/50. Under the Deferred Cash Incentive Plan, the on-target payout as a percentage of base salary is set at a level of 300% for the CEO, and 210% for the Company Secretary. In view of the performance of the Company in 2014, the cash incentive level for the CEO is based on full achievement of both Company and individual performance targets, with an additional 28.5% for extraordinary achievement, resulting in a 328.5% payout as a percentage of base salary. In addition, the Supervisory Board applied its discretion to deviate from the remuneration policy by awarding an extraordinary bonus to the CEO in the amount of RUB 20 million, payable in 2015. For the Company Secretary the payout as a percentage of base salary was determined at 162.75%. In accordance with the rules of the Deferred Cash Incentive Plan, one third of the total incentive award will be paid in 2015, and two thirds is deferred and will be paid in equal parts in 2016 and 2017, subject to continuous employment with the Group.

Compensation overview for members of the Management Board for the financial year 2014 (expressed in millions of Russian Roubles):

	Position	Base salary	Cash bonus[1]	Share based compensation[2]	Severance payment
Stephan DuCharme	Chief Executive Officer	42	108	9	–
Sergey Piven[3]	Chief Financial Officer	7	6	1	9
Vladlena Yavorskaya[3]	General Counsel	5	6	–	–
Frank Lhoëst	Company Secretary	14	15	4	–

[1] For the current members of the Management Board, Stephan DuCharme and Frank Lhoëst, the 2014 cash bonus is composed of the short-term component of the cash incentive for the performance of the year 2014 (i.e. one third reported and paid in cash in 2015), the deferred component of the cash incentive for the performance of the year 2013 and, for the CEO, an additional discretionary bonus for 2014. All deferred components (i.e. two thirds of the total annual cash incentive awarded under the deferred cash incentive plan) are paid in equal parts in the two consecutive years following the year of the short-term payout, subject to continuous employment with the Group.

[2] Since 2013 members of the Management Board no longer participate in the Company's Restricted Stock Unit Plan. The share based compensation reflects the accrued amounts related to previous awards under the Restricted Stock Unit Plan and includes benefits resulting from the reduction in the value of the cash settled share based payment compensation.

[3] Sergey Piven and Vladlena Yavorskaya stepped down from the Management Board on 1 June 2014, while remaining members of the Company's Executive Committee. Sergey Piven subsequently resigned as Chief Financial Officer on 15 September 2014. The figures for these members reflect their compensation as members of the Management Board until 1 June 2014.

In 2014 the Management Board was entitled to a total short term compensation of RUB 243 million (2013: RUB 149 million). For a compensation overview for the full year 2014, please refer to Note 26 to the Financial Statements.

Supervisory Board remuneration

The remuneration principles for the Supervisory Board, adopted by the General Meeting of Shareholders in 2013 are as follows: Chairman EUR 250,000, members chairing a committee EUR 200,000, and other members EUR 100,000. Furthermore:

- any non-independent member of the Supervisory Board who is affiliated with, engaged or employed by, either directly or indirectly, a legal entity or person, including through an affiliated entity (other than the Company and its downstream affiliates), that holds at least 30% of the voting rights in the Company, shall waive his/her remuneration entitlement for acting as a member of the Supervisory Board; and
- independent members of the Supervisory Board are entitled to participate in the Company's Restricted Stock Unit Plan, as X5 believes it is necessary to allow members of the Supervisory Board to align their interests with those of shareholders and strengthen their commitment and confidence in the future of the Company.

In the reporting year, the total cash remuneration of the Supervisory Board amounts to RUB 100 million (2013: RUB 96 million). For a compensation overview for the full year 2014, please refer to Note 26 to the Financial Statements.

Restricted Stock Units

In 2014 the fourth tranche of RSUs was awarded to the independent members of the Supervisory Board.

Details of RSUs awarded and outstanding to members of the Management Board and Supervisory Board are set forth in Notes 26 and 27 to the Financial Statements.

Remuneration Policy in 2015 and beyond

In 2014 the remuneration policy as described in this report was applied.

During the course of 2014 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 Company's strategic plan defined during the year.

The new incentive plan that is proposed to start as from 2015, substitutes the current deferred cash incentive plan with:

- a short-term cash incentive based on annual performance of quantitative corporate indicators (including net revenue and EBITDA) and personal performance targets (including mission-related or key project-related targets, as well as qualitative behavioral targets);
- a long-term cash incentive in two stages of consecutively 3 and 2 years, with bonus awards for all participants linked to revenue targets, without sacrificing EBITDA.

A more detailed description of the proposed incentive plan will be submitted to the 2015 Annual General Meeting of Shareholders.

The Supervisory Board
19 March 2015

Financial Statements

International financial reporting standards
Consolidated Financial Statements

Company Financial Statements
and independent auditor's report

31 December 2014

Contents

Consolidated statement of financial position

at 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2014	31 December 2013	1 January 2013
Assets				
Non-current assets				
Property, plant and equipment	10	**150,328**	134,998	125,964
Investment property	11	**3,718**	3,468	3,296
Goodwill	12	**65,684**	64,503	64,216
Other intangible assets	13	**14,618**	15,505	16,914
Investment in associates	8	**31**	68	84
Available-for-sale investments		**213**	210	210
Other non-current assets	16	**2,251**	1,717	1,094
Deferred tax assets	28	**3,568**	4,946	4,367
		240,411	225,415	216,145
Current assets				
Inventories	14	**47,084**	37,465	33,863
Indemnification asset	7, 33	**240**	–	906
Loans originated		**–**	7	92
Trade and other accounts receivable	16	**21,464**	15,537	12,774
Current income tax receivable		**2,610**	2,165	3,394
VAT and other taxes recoverable	17	**13,488**	13,897	11,481
Cash and cash equivalents	9	**25,623**	7,611	12,388
		110,509	76,682	74,898
Total assets		**350,920**	302,097	291,043
Equity and liabilities				
Equity attributable to equity holders of the parent				
Share capital	20	**2,457**	2,456	2,455
Share premium		**46,218**	46,126	46,016
Cumulative translation reserve		**–**	(44)	(48)
Retained earnings		**41,789**	29,098	18,114
Share-based payment reserve	27	**94**	170	338
		90,558	77,806	66,875
Total equity		**90,558**	77,806	66,875
Non-current liabilities				
Long-term borrowings	19	**115,152**	79,843	71,266
Long-term finance lease payable		**–**	–	3
Deferred tax liabilities	28	**3,924**	5,339	4,514
Long-term deferred revenue		**13**	21	21
Other non-current liabilities		**–**	–	2
		119,089	85,203	75,806
Current liabilities				
Trade accounts payable		**92,001**	81,244	72,801
Short-term borrowings	19	**15,834**	30,680	51,053
Share-based payments liability				15
Short-term finance lease payables		**–**	4	41
Interest accrued		**693**	814	637
Short-term deferred revenue		**555**	159	415
Current income tax payable		**1,770**	238	397
Provisions and other liabilities	18	**30,420**	25,949	23,003
		141,273	139,088	148,362
Total liabilities		**260,362**	224,291	224,168
Total equity and liabilities		**350,920**	302,097	291,043

Consolidated statement of profit and loss

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2014	31 December 2013
Revenue	22	**633,873**	534,560
Cost of sales	23	**(478,891)**	(404,212)
Gross profit		**154,982**	130,348
Selling, general and administrative expenses	23	**(133,512)**	(110,757)
Lease/sublease and other income	24	**6,818**	5,705
Operating profit		**28,288**	25,296
Finance costs	25	**(12,175)**	(11,003)
Finance income	25	**117**	69
Share of loss of associates		**(37)**	(16)
Net foreign exchange gain		**25**	77
Profit before tax		**16,218**	14,423
Income tax expense	28	**(3,527)**	(3,439)
Profit for the period		**12,691**	10,984
Profit for the period attributable to:			
Equity holders of the parent		**12,691**	10,984
Basic earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	**187.02**	161.92
Diluted earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	**187.02**	161.92

Consolidated statement of comprehensive income

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	31 December 2014	31 December 2013
Profit for the period	**12,691**	10,984
Other comprehensive income		
Items that may be reclassified subsequently to profit and loss		
Exchange differences on translation from functional to presentation currency	**(23)**	4
Reclassification of cumulative translation reserve attributable to disposed subsidiaries	**67**	–
Total items that may be reclassified subsequently to profit and loss, net of tax	**44**	4
Other comprehensive income, net of tax	**44**	4
Total comprehensive income for the period, net of tax	**12,735**	10,988
Total comprehensive income for the period attributable to:		
Equity holders of the parent	**12,735**	10,988

Consolidated statement of cash flows

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2014	31 December 2013
Profit before tax		**16,218**	14,423
Adjustments for:			
Depreciation, amortization and impairment of property, plant and equipment, investment property and intangible assets	23	**17,572**	13,054
(Gain)/loss on disposal of property, plant and equipment, investment property and intangible assets		**(496)**	132
Finance costs, net	25	**12,058**	10,934
Impairment of trade and other accounts receivable	23	**533**	348
Share-based options expense/(income)	27	**32**	(23)
Net foreign exchange gain		**(25)**	(77)
Loss from associate		**37**	16
Other non-cash items	33	**(163)**	10
Net cash from operating activities before changes in working capital		**45,766**	38,817
Increase in trade and other accounts receivable		**(7,312)**	(6,246)
Increase in inventories		**(9,283)**	(3,601)
Increase in trade payable		**10,566**	8,356
Increase in other accounts payable		**3,817**	3,810
Net cash generated from operations		**43,554**	41,136
Interest paid		**(11,771)**	(10,433)
Interest received		**117**	34
Income tax paid		**(3,333)**	(2,350)
Net cash from operating activities		**28,567**	28,387
Cash flows from investing activities			
Purchase of property, plant and equipment	10	**(28,260)**	(20,322)
Acquisition of subsidiaries	7	**(2,297)**	(737)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		**1,651**	1,055
Purchase of other intangible assets	13	**(831)**	(1,055)
Net cash used in investing activities		**(29,737)**	(21,059)
Cash flows from financing activities			
Proceeds from loans		**70,655**	29,804
Repayment of loans		**(51,307)**	(41,852)
Principal payments on finance lease obligations		**(4)**	(45)
Net cash generated from/(used in) financing activities		**19,344**	(12,093)
Effect of exchange rate changes on cash and cash equivalents		**(162)**	(12)
Net increase/(decrease) in cash and cash equivalents		**18,012**	(4,777)
Movements in cash and cash equivalents			
Cash and cash equivalents at the beginning of the year		**7,611**	12,388
Net increase/(decrease) in cash and cash equivalents		**18,012**	(4,777)
Cash and cash equivalents at the end of the year		**25,623**	7,611

Consolidated statement of changes in equity

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	Attributable to equity holders of the parent							
	Number of shares	Share capital	Share premium	Share–based payment reserve	Cumulative translation reserve	Retained earnings	Total shareholders' equity	Total
Balance as at 1 January 2013	**67,819,033**	**2,455**	**46,016**	**338**	**(48)**	**18,114**	**66,875**	**66,875**
Other comprehensive income for the period	–	–	–	–	4	–	4	4
Profit for the period	–	–	–	–	–	10,984	10,984	10,984
Total comprehensive income for the period	**–**	**–**	**–**	**–**	**4**	**10,984**	**10,988**	**10,988**
Share-based payment compensation (Note 27)	–	–	–	(57)	–	–	(57)	(57)
Transfer of vested equity rights	25,632	1	110	(111)	–	–	–	–
Balance as at 31 December 2013	**67,844,665**	**2,456**	**46,126**	**170**	**(44)**	**29,098**	**77,806**	**77,806**
Balance as at 1 January 2014	**67,844,665**	**2,456**	**46,126**	**170**	**(44)**	**29,098**	**77,806**	**77,806**
Other comprehensive income for the period	–	–	–	–	44	–	44	44
Profit for the period	–	–	–	–	–	12,691	12,691	12,691
Total comprehensive income for the period	**–**	**–**	**–**	**–**	**44**	**12,691**	**12,735**	**12,735**
Share-based payment compensation (Note 27)	–	–	–	17	–	–	17	17
Transfer of vested equity rights	23,078	1	92	(93)	–	–	–	–
Balance as at 31 December 2014	**67,867,743**	**2,457**	**46,218**	**94**	**–**	**41,789**	**90,558**	**90,558**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, 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 2014 the Group operated a retail chain of 5,483 proximity stores, supermarket, hypermarket and express stores under the brand names 'Pyaterochka', 'Perekrestok', 'Karusel' and 'Perekrestok Express' in major population centres in Russia, including but not limited to Moscow, St. Petersburg, Nizhniy Novgorod, Rostov-on-Don, Kazan, Samara, Lipetsk, Chelyabinsk, Perm and Yekaterinburg (31 December 2013: 4,544 proximity stores, supermarket, hypermarket and express stores under the brand names 'Pyaterochka', 'Perekrestok', 'Karusel' and 'Perekrestok Express'), with the following number of stores:

	31 December 2014	31 December 2013
'Perekrestok' – Supermarket		
Central	**236**	224
Povolzhye	**44**	44
North-West	**39**	39
Volgo-Vyatsky	**28**	26
North Caucasus	**21**	18
Ural	**16**	12
Central-Chernozemny	**12**	9
Western Siberia	**7**	6
Ukraine	**–**	12
	403	390
'Pyaterochka' – Proximity stores		
Central	**1,883**	1,626
Ural	**645**	486
Povolzhye	**620**	412
North-West	**581**	529
Volgo-Vyatsky	**363**	291
North Caucasus	**304**	224
Central-Chernozemny	**282**	236
North	**84**	59
West Siberia	**27**	19
	4,789	3,882
'Karusel' – Hypermarket		
Central	**24**	23
North-West	**16**	17
Povolzhye	**14**	14
Ural	**10**	11
Volgo-Vyatsky	**9**	9
Central-Chernozemny	**7**	7
Western Siberia	**1**	1
North Caucasus	**1**	1
	82	83
Express	**209**	189
Total stores	**5,483**	**4,544**

As at 31 December 2014 the Company's principal shareholder is CTF Holdings Limited ('CTF'). CTF owns 47.86% of total issued shares in the Company, indirectly through Luxaro Retail Holding S.a.r.l. CTF, registered in Gibraltar, which is 100% owned by three individuals: Mr. Fridman, Mr. Khan and Mr. Kuzmichev (the 'Shareholders'). None of the Shareholders individually controls and/or owns 50% or more of CTF. As at 31 December 2014 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 20).

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

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 2014 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 statement of profit or loss 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.

2.2 Consolidated Financial Statements

Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. The existence and effect of substantive rights, including substantive potential voting rights, are considered when assessing whether the Group has power over another entity. For a right to be substantive, the holder must have practical ability to exercise that right when decisions about the direction of the relevant activities of the investee need to be made. The Group may have power over an investee even when it holds less than a majority of voting power in an investee. In such a case, the Group assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of an investee's activities or apply only in exceptional circumstances, do not prevent the Group from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries other than those acquired from parties under common control. 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. Transaction costs related to the acquisition and incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt as part of the business combination are deducted from the carrying amount of the debt and all other transaction costs associated with the acquisition are expensed. The date of exchange is the acquisition date where a business combination is achieved in a single transaction. However, when a business combination is achieved in stages by successive share purchases, the date of exchange is the date of each exchange transaction; whereas the acquisition date is the date on which acquirer obtains control of the subsidiary.

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

Goodwill is 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 the consolidated statement of profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed and reviews the 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.

Purchases of subsidiaries from parties under common control are accounted for using the predecessor values method. Under this method the Consolidated Financial Statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented or, if later, the date when the combining entities were first brought under common control. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts.

The predecessor entity is considered to be the highest reporting entity in which the subsidiary's IFRS financial information was consolidated. Related goodwill inherent in the predecessor entity's original acquisitions is also recorded in these Consolidated Financial Statements. Any difference between the carrying amount of net assets, including the predecessor entity's goodwill, and the consideration for the acquisition is accounted for in these Consolidated Financial Statements as an adjustment to other reserve within equity.

2.3 Associates

Associates are entities over which the Group has significant influence (directly or indirectly), but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. Dividends received from associates reduce the carrying value of the investment in associates. Other post-acquisition changes in the Group's share of net assets of an associate are recognized as follows: (i) the Group's share of profits or losses of associates is recorded in the consolidated profit or loss for the year as share of result of associates, (ii) the Group's share of other comprehensive income is recognized in other comprehensive income and presented separately, (iii); all other changes in the Group's share of the carrying value of net assets of associates are recognized in profit or loss within the share of result of associates.

However, 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.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

2.4 Foreign currency translation and transactions

a. Functional and presentation currency

Functional currency. The functional currencies of the Group's entities are the national currency of the Russian Federation, Russian Rouble (RUB) 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 and the Ukrainian business units were disposed of with effect from March 2014. Since 1 January 2014 the presentation currency of the Group was changed from the US Dollar to the Russian Rouble (RUB), which management believes is the most useful currency to adopt for users of these Consolidated Financial Statements.

b. Transactions and balances

Monetary assets and liabilities denominated in foreign currencies are translated into 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.

2.5 Change in presentation currency

The comparative information has been restated for the effect of adoption of the new presentation currency in the following way: the Consolidated Statement of Financial Position items except for equity items were translated at the official exchange rate of the Central Bank of the Russian Federation as at the statement date, equity items were translated at the official exchange rate of the Central Bank of the Russian Federation as at the dates of historical transactions, the Consolidated Statement of Profit or Loss and Consolidated Statement of Cash Flows items were translated at the average official exchange rate of the Central Bank of the Russian Federation for the period of the statements. The cumulative translation reserve was reduced to the amount attributable to the Ukrainian entities. The balance of the translation reserve in the comparative period, that does not apply to the Ukrainian entities has been ascribed to the relevant items in the Consolidated Statement of Financial Position and Retained earnings.

2.6 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.

2.7 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 statement of profit or loss. An impairment loss recognized for an asset in prior years is reversed if there has been a favorable 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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

2. Summary of significant accounting policies continued

2.7 Property, plant and equipment continued

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 life.

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

2.8 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 centres that are leased to third party retailers as investment property, unless they represent insignificant portions of the property and are used primarily to provide auxiliary services to retail customers not provided by the Group rather than to earn rental income. After purchase or construction of the building the Group assesses the main purpose of its use and, if the main purpose is to earn rental income or for capital appreciation, or both, the building is classified as investment property.

Investment properties are stated at cost less accumulated depreciation and provision for impairment, where required. If any indication exists that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs 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 without changes in the carrying amount and cost of that property for measurement or disclosure purposes. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are 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 income approach. The Group engaged an independent valuation specialist to assess the fair value of investment properties. The measurement is classified in level 3 of the fair value hierarchy.

2.9 Intangible assets

a. Goodwill

Goodwill is carried at cost less accumulated impairment losses. Goodwill represents the excess of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date over the fair value of the net assets of the acquired subsidiary at the date of exchange. Goodwill is not deductible for tax purposes.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is tested on a single segment level.

b. Lease rights

Lease rights represent rights for favorable 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 range 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 and other directly attributable costs 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.

2.10 Operating leases

Leases of assets under which substantially all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease except preopening rentals capitalized as a part of retail store or distribution center construction costs.

The Group leases retail outlets and distribution centers 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 33).

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.

2.11 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 statement of profit or loss 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.

2.12 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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

2. Summary of significant accounting policies continued

2.13 Financial assets and liabilitie

The Group classifies its financial assets into the following measurement categories: 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 category of financial assets.

Initial recognition of financial instruments

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.

Impairment

The Group reviews the carrying value of its financial assets on a regular basis. If the carrying value of an asset 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.

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 statement of profit or loss in the period in which they arise. Other financial liabilities are carried at amortized cost.

2.14 Loans, trade and other 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. 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 statement of profit or loss. 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 impairment account within the profit or loss for the year.

2.15 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 and subsequent gains are recognized in other comprehensive income. 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.

2.16 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments used for meeting short-term cash commitments.

2.17 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.

2.18 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.

2.19 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.

2.20 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 a 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.

2.21 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 statement of profit or loss over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the 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.

The commencement date for capitalization is when (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

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

The Group capitalizes borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalized are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalized.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

2. Summary of significant accounting policies continued

2.22 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.

2.23 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.

2.24 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 authorised for issue.

2.25 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.

2.26 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.

2.27 Taxes

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if Financial Statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Current income tax liabilities (assets) are measured in accordance with IAS 12, *Income Taxes*, based on legislation that is enacted or substantively enacted at the 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.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted only within the individual companies of the Group.

The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognized based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period. Adjustments for uncertain income tax positions are recorded within the income tax charge.Provisions are maintained, and updated if necessary, for the period over which the respective tax positions remain subject to review by the tax and customs authorities, being 3 years from the year of filing.

2.28 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 the 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 they relate 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 store 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.

2.29 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 statement of profit or loss. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.30 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.

2.31 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 the 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.

2.32 Offsetting of financial assets and financial liabilities

Accounts receivable and accounts payable are offset and the net amount is presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognized amounts; and intends to settle on a net basis.

2.33 Reclassification

The Group has made reclassification of prepaid leases into intangible assets, as they meet the definition of intangible assets.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

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. 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 events indicating triggers of goodwill impairment occurred for the year ended 31 December 2014. For the year ended 31 December 2014 goodwill attributable to the sold Ukrainian subsidiary was disposed.

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 33).

Property, plant and equipment. The Group's management determines the estimated useful lives and related depreciation charges for its plant and equipment (Note 10). The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets. Management 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 statement of profit or loss. For the year ended 31 December 2014 the Group recognized an impairment loss in the amount of RUB 2,530 (year ended 31 December 2013: an impairment gain in the amount of RUB 62).

Investment property. The Group's management determines the estimated useful lives and related depreciation charges for its investment properties (Note 11). 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 statement of profit or loss. For the year ended 31 December 2014 the Group recognized an impairment gain in the amount of RUB 43 (year ended 31 December 2013: an impairment gain in the amount of RUB 380).

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). The Group periodically assesses whether there is any indication that lease rights may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognized in the consolidated statement of profit or loss. For the year ended 31 December 2014 the Group recognized an impairment gain in the amount of RUB 84 (year ended 31 December 2013: an impairment loss in the amount of RUB 232).

Prepaid leases. The Group periodically assesses whether there is any indication that prepaid leases may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognized in the consolidated statement of profit or loss. For the year ended 31 December 2014 the Group recognized an impairment gain in the amount of RUB 58 (year ended 31 December 2013: an impairment loss in the amount of RUB 82).

Inventories of goods for resale provisions. The Group provides for estimated inventory shrinkage on the basis of historical shrinkage as a percentage of cost of sales. This provision is adjusted at the end of each reporting period to reflect the historical trend of the actual physical inventory count results. The Group also provides for slow moving inventory where the expected time to sell exceeds norms established by the Group (Note 14).

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 16). 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.

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). The Group periodically assesses whether there is any indication that lease rights may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognized in the consolidated statement of profit or loss. For the year ended 31 December 2014 the Group recognized an impairment loss in the amount of RUB 196 (year ended 31 December 2013: nil).

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). The Group periodically assesses whether there is any indication that brand and private labels may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset and if it is less than the carrying amount an impairment loss is recognized in the consolidated statement of profit or loss. For the year ended 31 December 2014 the Group recognized no impairment loss (year ended 31 December 2013: nil).

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

New standards, interpretations and amendments to IFRSs effective for the financial year beginning 1 January 2014 are not expected to have a material impact on the Group, except for the following:

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). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The standard clarified that a qualifying right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy. The amendment resulted in the cessation of offsetting trade receivables and payables as it didn't meet the criteria of 'enforceable right of set-off', the comparative balances as at 31 December 2013 were restated by the increase of trade receivables and respectively trade payables by RUB 194.

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2014 and have not been early adopted:

IFRS 9, Financial Instruments: Classification and Measurement (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). Key features of the standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortized cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortized cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in 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.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The Group is considering the implications of the standard and the impact on the Group.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

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

IFRIC 21 – Levies (issued on 20 May 2013 and effective for annual periods beginning 1 January 2015). The interpretation clarifies the accounting for an obligation to pay a levy that is not income tax. The obligating event that gives rise to a liability is the event identified by the legislation that triggers the obligation to pay the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its Financial Statements under the going concern assumption, does not create an obligation. The same recognition principles apply in Interim and Annual Financial Statements. The application of the interpretation to liabilities arising from emissions trading schemes is optional. The Group is currently assessing the impact of the amendments on its Consolidated Financial Statements.

Annual Improvements to IFRSs 2012 (issued in December 2013 and effective for annual periods beginning on or after 1 July 2014, unless otherwise stated below; not yet adopted by the EU). The improvements consist of changes to seven standards.

- IFRS 2 was amended to clarify the definition of a 'vesting condition' and to define separately 'performance condition' and 'service condition'. The amendment is effective for share-based payment transactions for which the grant date is on or after 1 July 2014.
- IFRS 3 was amended to clarify that (1) an obligation to pay contingent consideration which meets the definition of a financial instrument is classified as a financial liability or as equity, on the basis of the definitions in IAS 32, and (2) all non-equity contingent consideration, both financial and non-financial, is measured at fair value at each reporting date, with changes in fair value recognized in profit and loss. Amendments to IFRS 3 are effective for business combinations where the acquisition date is on or after 1 July 2014.
- IFRS 8 was amended to require (1) disclosure of the judgements made by management in aggregating operating segments, including a description of the segments which have been aggregated and the economic indicators which have been assessed in determining that the aggregated segments share similar economic characteristics, and (2) a reconciliation of segment assets to the entity's assets when segment assets are reported.
- The basis for conclusions on IFRS 13 was amended to clarify that deletion of certain paragraphs in IAS 39 upon publishing of IFRS 13 was not made with an intention to remove the ability to measure short-term receivables and payables at invoice amount where the impact of discounting is immaterial.
- IAS 16 and IAS 38 were amended to clarify how the gross carrying amount and the accumulated depreciation are treated where an entity uses the revaluation model.
- IAS 24 was amended to include, as a related party, an entity that provides key management personnel services to the reporting entity or to the parent of the reporting entity ('the management entity'), and to require to disclose the amounts charged to the reporting entity by the management entity for services provided.

The Group is currently assessing the impact of the amendments on its Consolidated Financial Statements.

Annual Improvements to IFRSs 2013 (issued in December 2013 and effective for annual periods beginning on or after 1 July 2014; not yet adopted by the EU). The improvements consist of changes to four standards:

- The basis for conclusions on IFRS 1 is amended to clarify that, where a new version of a standard is not yet mandatory but is available for early adoption; a first-time adopter can use either the old or the new version, provided the same standard is applied in all periods presented.
- IFRS 3 was amended to clarify that it does not apply to the accounting for the formation of any joint arrangement under IFRS 11. The amendment also clarifies that the scope exemption only applies in the Financial Statements of the joint arrangement itself.
- The amendment of IFRS 13 clarifies that the portfolio exception in IFRS 13, which allows an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis, applies to all contracts (including contracts to buy or sell non-financial items) that are within the scope of IAS 39 or IFRS 9.
- IAS 40 was amended to clarify that IAS 40 and IFRS 3 are not mutually exclusive. The guidance in IAS 40 assists preparers to distinguish between investment property and owner-occupied property. Preparers also need to refer to the guidance in IFRS 3 to determine whether the acquisition of an investment property is a business combination.

The Group is currently assessing the impact of the amendments on its Consolidated Financial Statements.

Clarification of Acceptable Methods of Depreciation and Amortization – Amendments to IAS 16 and IAS 38 (issued on 12 May 2014 and effective for the periods beginning on or after 1 January 2016; not yet adopted by the EU). In this amendment, the IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The Group is currently assessing the impact of the amendments on its Financial Statements.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2017; not yet adopted by the EU). The new standard introduces the core principle that revenue must be recognized when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognized, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognized if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalized and amortized over the period when the benefits of the contract are consumed. The Group is currently assessing the impact of the new standard on its Consolidated Financial Statements.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after 1 January 2016; not yet adopted by the EU). These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business. A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are held by a subsidiary. The Group is currently assessing the impact of the amendments on its Financial Statements.

Annual Improvements to IFRSs 2014 (issued on 25 September 2014 and effective for annual periods beginning on or after 1 January 2016; not yet adopted by the EU). The amendments impact four standards:

- IFRS 5 was amended to clarify that change in the manner of disposal (reclassification from 'held for sale' to 'held for distribution' or vice versa) does not constitute a change to a plan of sale or distribution, and does not have to be accounted for as such.
- The amendment to IFRS 7 adds guidance to help management determine whether the terms of an arrangement to service a financial asset which has been transferred constitute continuing involvement, for the purposes of disclosures required by IFRS 7.
- The amendment also clarifies that the offsetting disclosures of IFRS 7 are not specifically required for all interim periods, unless required by IAS 34.
- The amendment to IAS 19 clarifies that for post-employment benefit obligations, the decisions regarding discount rate, existence of deep market in high-quality corporate bonds, or which government bonds to use as a basis, should be based on the currency that the liabilities are denominated in, and not the country where they arise. IAS 34 will require a cross reference from the Interim Financial Statements to the location of 'information disclosed elsewhere in the interim financial report'.

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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

5. Segment reporting

The Group identifies retail operations as a single reportable segment.

During the year ended 31 December 2014 the Group was engaged in management of retail stores located in Russia and Ukraine. In March 2014 the Group has disposed of its Ukraine business unit, whose contribution to the financial results of the Group was immaterial. The Group identified the segment in accordance with the criteria set forth in IFRS 8 and based on the way the operations of the Group 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 retail 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.

During the year ended 31 December 2014 within the segment all business components demonstrated 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 Transport logistics, Investment Control, Finance, Strategy, HR, IT 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, amortization and impairment (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 the segment 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 2014 is as follows:

	Year ended 31 December 2014	Year ended 31 December 2013
Retail sales	633,577	533,916
Other revenue	296	644
Revenue	**633,873**	534,560
EBITDA	**45,860**	38,350
Capital expenditure	34,433	22,580
Total assets	**350,889**	302,097
Total liabilities	**260,331**	224,291

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

	Year ended 31 December 2014	Year ended 31 December 2013
EBITDA	**45,860**	38,350
Depreciation, amortization and impairment	(17,572)	(13,054)
Operating profit	**28,288**	25,296
Finance cost, net	(12,058)	(10,934)
Net foreign exchange result	25	77
Share of loss of associates	(37)	(16)
Profit before income tax	**16,218**	14,423
Income tax expense	(3,527)	(3,439)
Profit for the year	**12,691**	10,984

As at 31 December 2014 the decentralization process has almost finished, leading to separation of significant functions (Category management, Warehousing logistics, Development, Supporting functions, etc.) by retail chains within the Group. In this respect from the beginning of the 2015 financial year the Group intends to consider the retail chains as separate segments.

6. Subsidiaries

Details of the Company's significant subsidiaries at 31 December 2014 and 31 December 2013 are as follows:

			Ownership (%)	
Company	Country	Nature of operations	31 December 2014	31 December 2013
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
Kopeyka-Moscow OOO	Russia	Retailing	100	100
Krasnoborskoye OOO	Russia	Real estate	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
TD Kopeyka OAO	Russia	Holding company	100	100

7. Acquisition of subsidiaries

In October 2014 the Group acquired a 100% share of Agrotorg-Samara, a Russian retail chain which operated soft discounter stores in the Samara region of Russia.

In the year ended 31 December 2014 the acquired business of Agrotorg-Samara contributed revenue of RUB 298 and a net loss of RUB 312 from the date of acquisition. If the acquisition of Agrotorg-Samara had occurred on 1 January 2014, the Group's revenue for the year ended 31 December 2014 would have been RUB 638,175 and the Group's net profit for the year ended 31 December 2014 would have been RUB 12,796. Estimates of contribution of revenue and profit to the Group are based on proforma information derived from Agrotorg-Samara Consolidated Financial Statements prepared in accordance with IFRS.

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

	Provisional values at the acquisition date
Property, plant and equipment (Note 10)	752
Other intangible assets (Note 13)	113
Inventories	387
Trade and other accounts receivable	116
Current income tax receivable	24
VAT and other taxes recoverable	4
Cash and cash equivalents	66
Long-term borrowings	(595)
Deferred tax liability	(35)
Trade accounts payable	(466)
Short-term borrowings	(133)
Interest accrued	(3)
Current income tax payable	(99)
Provisions and other liabilities	(444)
Net assets acquired	(313)
Goodwill (Note 12)	810
Total acquisition cost	**497**
Net cash outflow arising from the acquisition	**431**

The Group assigned provisional values to net assets acquired based on the estimates of an independent appraiser. The Group will finalize the purchase price allocation within 12 month from the acquisition date.

The purchase consideration comprises cash and cash equivalents paid of RUB 770 compensated by indemnification asset deducted from consideration transferred for the business combination.

An indemnification asset of RUB 273, equivalent to the fair value of the indemnified liability, has been recognized by the Group. The selling shareholders of Agrotorg-Samara OOO have contractually agreed to indemnify potential tax and other contingencies that may become payable in respect of the Agrotorg-Samara OOO company.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

7. Acquisition of subsidiaries continued

The goodwill recognized is attributable to: i) the business concentration in the Samara region and its neighboring areas and ii) expected cost synergies from the business combination.

Other acquisitions

In 2014 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 2014 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
Other intangible assets (Note 13)	253
Property, plant and equipment (Note 10)	760
Deferred tax assets	39
Net assets acquired	1,052
Goodwill (Note 12)	494
Total acquisition cost	**1,546**
Net cash outflow arising from the acquisition	**1,546**

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 RUB 1,546.

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

The Group proceeded with the rebranding and full integration of acquired retail chains into the Group's operational structure immediately after acquisition, therefore post acquisition separate financial information for these businesses is not relevant.

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 2014 are provided below. The ownership structure is disclosed in Note 1.

The following transactions were carried out with related parties:

	Relationship	2014	2013
CTF Holdings Ltd.	Ultimate parent company		
Management services received		**54**	47
Recharged expenses		**2**	2
Alfa-Bank	Under common control (ceased to be a related party during 2014)		
Interest expense on loan received		**1,235**	1,058
Rent revenue		**2**	14
Commission income		**8**	8
Bank charges		**3**	5
VimpelCom	Under common control (ceased to be a related party during 2014)		
Communication services received		**190**	123
Commission for mobile phone payments processing rendered by the Group		**1**	1
Rent revenue		**2**	15
Other	Under common control		
Purchases from related party		**1,383**	653
Rent revenue		**–**	55
Insurance expenses		**127**	40
Other operating expenses		**103**	6
Bonuses from related parties		**306**	155
Other	Other		
Other operating expenses		**54**	–

The Consolidated Financial Statements include the followings balances related parties:

	Relationship	2014	2013
CTF Holdings Ltd.	Ultimate parent company		
Other accounts payable		**–**	–
Alfa-Bank	Under common control (ceased to be a related party during 2014)		
Cash and cash equivalents		**–**	564
Other receivable from related party		**–**	1
Other accounts payable		**–**	18
VimpelCom	Under common control (ceased to be a related party during 2014)		
Other accounts payble		**–**	42
Other	Under common control		
Trade accounts payable		**263**	184
Other accounts payable		**13**	33
Trade accounts receivable		**42**	20
Other receivable from related party		**21**	5
Other	Other		
Other accounts payable		**6**	–

Alfa-Bank

As at 31 December 2014 Alfa-Bank ceased to be a related party to the Group (as at 31 December 2013 the Group had an open credit line with Alfa-Bank with a maximum limit of RUB 24,000, liability under this credit line was zero, available credit line was RUB 24,000).

Magazin Buduschego

The Group together with Rosnano and Sitronix has investments in Magazin Budushego. The share in associate equals 33.34%, no additional payments were made during the year 2014. Starting from December 2014 the associate is in the process of liquidation. At 31 December 2014 the investment in the associate equals RUB 31 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 the associate.

Key management personnel compensation

Key management personnel compensation is disclosed in Note 26.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

9. Cash and cash equivalents

	31 December 2014	31 December 2013
Cash in hand – Roubles	1,870	1,778
Cash in hand – Ukrainian Hryvnia	–	10
Bank current account – Roubles	5,766	2,432
Bank current account – Ukrainian Hryvnia	–	3
Bank current accounts and deposits – US Dollars	13	39
Cash in transit – Roubles	4,630	3,329
Cash in transit – Ukrainian Hryvnia	–	20
Short-term deposits – Roubles	13,344	–
	25,623	7,611

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 2014	31 December 2013
Alfa-Bank	Ba1	BBB-	BB+	3,214	564
Sberbank	Ba1	BBB	–	2,544	1,682
Raiffeisenbank	Ba1	BBB	BBB-	6	24
HSBC	Aa3	AA-	A+	13	44
MCB	–	BB	BB-	317	127
Gazprombank	Baa2	BBB-	BBB-	2	6
VTB	Ba1	–	BBB-	13,018	15
Other banks				9	12
Cash in transit and in hand				6,500	5,137
Total				25,623	7,611

10. Property, plant and equipment

	Land and buildings	Machinery and equipment	Refrigerating equipment	Vehicles	Other	Construction in progress	Total
Cost							
At 1 January 2013	116,325	15,774	14,597	7,435	12,118	10,846	177,095
Additions	–	–	–	–	–	20,600	20,600
Transfers	14,528	2,704	3,390	45	2,276	(22,943)	–
Assets from acquisitions	–	–	–	–	–	309	309
Disposals	(517)	(1,833)	(1,093)	(159)	(763)	(1,376)	(5,741)
Translation movement	10	7	4	–	11	–	32
At 31 December 2013	130,346	16,652	16,898	7,321	13,642	7,436	192,295
Additions	–	–	–	–	–	30,164	30,164
Transfers	13,848	3,558	4,824	44	3,802	(26,076)	–
Transfers to investment property (Note 11)	(2,086)	–	–	–	–	–	(2,086)
Assets from acquisitions (Note 7)	664	28	40	–	20	760	1,512
Disposals	(1,375)	(1,475)	(1,295)	(506)	(836)	(218)	(5,705)
Translation movement	(15)	(15)	(10)	–	(8)	(23)	(71)
At 31 December 2014	**141,382**	**18,748**	**20,457**	**6,859**	**16,620**	**12,043**	**216,109**
Accumulated depreciation and impairment							
At 1 January 2013	(25,103)	(8,672)	(6,042)	(3,396)	(6,922)	(996)	(51,131)
Depreciation charge	(4,209)	(1,653)	(1,767)	(864)	(2,129)	–	(10 622)
Impairment charge	(3,449)	(246)	(232)	–	(10)	(78)	(4,015)
Reversal of impairment	2,631	–	–	953	432	61	4,077
Disposals	132	1,760	1,048	125	727	615	4,407
Translation movement	18	2	(3)	–	3	(33)	(13)
At 31 December 2013	(29,980)	(8,809)	(6,996)	(3,182)	(7,899)	(431)	(57,297)
Depreciation charge	(4,859)	(2,017)	(2,153)	(925)	(2,577)	–	(12,531)
Impairment charge	(3,390)	(432)	(318)	(98)	(338)	(298)	(4,874)
Reversal of impairment	2,176	72	17	–	1	78	2,344
Transfers to investment property (Note 11)	1,505	–	–	–	–	–	1,505
Disposals	999	1,428	1,254	448	811	93	5,033
Translation movement	9	8	7	2	15	(2)	39
At 31 December 2014	(33,540)	(9,750)	(8,189)	(3,755)	(9,987)	(560)	(65,781)
Net book value at 31 December 2014	**107,842**	**8,998**	**12,268**	**3,104**	**6,633**	**11,483**	**150,328**
Net book value at 31 December 2013	100,366	7,843	9,902	4,139	5,743	7,005	134,998
Net book value at 1 January 2013	91,222	7,102	8,555	4,039	5,196	9,850	125,964

Depreciation charge, impairment charge, reversal of impairment were included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2014 and 31 December 2013.

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 33). No loans are collateralized by land and buildings including investment property as of 31 December 2014.

Impairment test

At the end of 2014 management performed an 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 the recoverable amount of the individual store/unit with its carrying value. The recoverable amount of store/unit is determined as the higher of fair value less cost to sell or value in use.
The resulting impairment charge arose primarily from underperforming stores. At the same time the Group recognized the reversal of previously recorded impairment charges due to improved performance of certain stores.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

10. Property, plant and equipment continued

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 an 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 2014 onwards. The free cash flows are based on the current budgets and forecasts approved by the management. For the subsequent years, the data of the strategic business plan are extrapolated based on the consumer price indices as obtained from external resources and key performance indicators inherent to the strategic plan. The projections are made in the functional currency of the Group on a post-tax basis and discounted at the Group post-tax weighted average cost of capital (13.46%). 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 knowledge.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions. If the revised estimated discount rate consistently applied to the discounted cash flows had been 200 b.p. higher than management's estimates, the Group would need to reduce the carrying value of property, plant and equipment, investment property and intangible assets by RUB 911, if 200 b.p. lower – increase by RUB 756. If the annual revenue growth rate used in calculations of value in use had been 200 b.p. higher, the Group would need to increase the carrying value of property, plant and equipment, investment property and intangible assets by RUB 936, if 200 b.p. lower – decrease by RUB 1,281.

11. Investment property

The Group held the following investment properties at 31 December 2014 and 31 December 2013:

	2014	2013
Cost		
Cost at 1 January	4,911	4,988
Transfer from fixed assets	2,086	–
Disposals	(487)	(77)
Cost at 31 December	6,510	4,911
Accumulated depreciation and impairment		
Accumulated depreciation at 1 January	(1,443)	(1,692)
Depreciation charge	(184)	(166)
Impairment charge	(3)	(47)
Reversal of impairment	46	427
Transfer from fixed assets	(1,505)	–
Disposals	297	35
Accumulated depreciation at 31 December	(2,792)	(1,443)
Net book value at 31 December	3,718	3,468
Net book value at 1 January	3,468	3,296

Depreciation charge, impairment charge, and reversal of impairment were included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2014 and 31 December 2013.

Rental income from investment property amounted to RUB 2,054 (2013: RUB 1,014). Direct operating expenses incurred by the Group in relation to investment property amounted to RUB 405 (2013: RUB 361). There were no significant direct operating expenses incurred by the Group in relation to investment property that did not generate rental income.

Management estimates that the fair value of investment property at 31 December 2014 amounted to RUB 7,426 (31 December 2013: RUB 6,992).

Impairment test

At the end of 2014 management performed an impairment test of investment property by identifying non-core assets which the Group intends to sell.

The evaluation performed and reasons for it are consistent with the approach for impairment testing of PPE (Note 10).

12. Goodwill

Movements in goodwill arising on the acquisition of subsidiaries at 31 December 2014 and 31 December 2013 are:

	2014	2013
Cost		
Gross book value at 1 January	130,815	130,528
Acquisition of subsidiaries (Note 7)	1,304	287
Disposal of subsidiaries	(123)	–
Gross book value at 31 December	131,996	130,815
Accumulated impairment losses		
Accumulated impairment losses at 1 January	(66,312)	(66,312)
Accumulated impairment losses at 31 December	(66,312)	(66,312)
Carrying amount at 1 January	64,503	64,216
Carrying amount at 31 December	65,684	64,503

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 RUB 334 (or USD 5.93 per GDR (stated in US Dollars). The market capitalization of the Group at 31 December 2014 amounted to RUB 186,325 (or ths. USD 3,311,946) 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 2014 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 on a post-tax basis and discounted at the Group post-tax weighted average cost of capital (13.46%). 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 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 the discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions.

Impairment test

The recoverable amount of the CGU calculated on a value in use basis exceeded its carrying amount therefore no impairment was recognized.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

13. Other intangible assets

Other intangible assets comprise the following:

	Brand and private labels	Franchise agreements	Software and other	Prepaid lease	Lease rights	Total
Cost						
At 1 January 2013	17,133	2,269	4,327	3,938	5,931	33,598
Additions	3	–	955	377	3	1,338
Acquisition of subsidiaries	–	–	–		46	46
Disposals	–	(78)	(1)	(435)	(56)	(570)
At 31 December 2013	17,136	2,191	5,281	3,880	5,924	34,412
Additions	–	–	968	119	–	1,087
Acquisition of subsidiaries (Note 7)	–	–	–		366	366
Disposals	–	(61)	(94)	(455)	(271)	(881)
At 31 December 2014	**17,136**	**2,130**	**6,155**	**3,544**	**6,019**	**34,984**
Accumulated amortization and impairment						
At 1 January 2013	(8,491)	(1,634)	(1,462)	(2,317)	(2,781)	(16,685)
Amortization charge	(871)	(237)	(500)	(315)	(471)	(2,394)
Impairment charge	–	–	–	(181)	(377)	(558)
Reversal of impairment	–	–	–	99	145	244
Disposals	–	72	1	360	53	486
At 31 December 2013	(9,362)	(1,799)	(1,961)	(2,354)	(3,431)	(18,907)
Amortization charge	(812)	(166)	(493)	(232)	(371)	(2,074)
Impairment charge	–	(196)	(119)	(23)	(93)	(431)
Reversal of impairment	–	–	–	81	177	258
Disposals	–	61	90	435	202	788
At 31 December 2014	(10,174)	(2,100)	(2,483)	(2,093)	(3,516)	(20,366)
Net book value at 31 December 2014	**6,962**	**30**	**3,672**	**1,451**	**2,503**	**14,618**
Net book value at 31 December 2013	**7,774**	**392**	**3,320**	**1,526**	**2,493**	**15,505**
Net book value at 1 January 2013	**8,642**	**635**	**2,865**	**1,621**	**3,150**	**16,913**

Amortization charge, impairment charge, the reversal of impairment were included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2014 and 31 December 2013.

Impairment test

At the end of 2014 management performed an impairment test of lease rights, prepaid leases and franchise agreements.

The evaluation performed and reasons for it are consistent with the approach for impairment testing of property, plant and equipment (Note 10).

Also the Group recognized an impairment of software attributable to its online retail channel, which ceased commercial operations from 1 January 2015.

14. Inventories

Inventories as of 31 December 2014 and 31 December 2013 comprise the following:

	31 December 2014	31 December 2013
Inventories	**49,824**	39,556
Less: provision for shrinkage and slow moving stock	**(2,740)**	(2,091)
	47,084	37,465

Inventory shrinkage and slow moving stock recognized as cost of sales in the consolidated statement of profit or loss amounted to RUB 18,473 (2013: RUB 15,044).

15. Financial instruments by category

	Loans and receivables	Available-for-sale investments	Total
31 December 2014			
Assets as per consolidated statement of financial position			
Available-for-sale investments	**–**	**213**	**213**
Trade and other receivables excluding prepayments	**19,045**	**–**	**19,045**
Loans originated	**–**	**–**	**–**
Cash and cash equivalents	**25,623**	**–**	**25,623**
Total	**44,668**	**213**	**44,881**

	Financial liabilities at amortized cost
31 December 2014	
Liabilities as per consolidated statement of financial position	
Borrowings	**130,986**
Interest accrued	**693**
Trade and other payables excluding statutory liabilities and advances	**113,858**
Total	**245,537**

	Loans and receivables	Available-for-sale investments	Total
31 December 2013			
Assets as per consolidated statement of financial position			
Available-for-sale investments	–	210	210
Trade and other receivables excluding prepayments	14,257	–	14,257
Loans originated	7	–	7
Cash and cash equivalents	7,611	–	7,611
Total	21,875	210	22,085

	Financial liabilities at amortized cost
31 December 2013	
Liabilities as per consolidated statement of financial position	
Borrowings	110,523
Interest accrued	814
Finance lease liabilities	4
Trade and other payables excluding statutory liabilities and advances	99,374
Total	210,715

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

16. Trade and other accounts receivable

	31 December 2014	31 December 2013
Trade accounts receivable	18,194	13,564
Advances made to trade suppliers	1,301	726
Other receivables	1,787	1,968
Prepayments	1,993	1,658
Accounts receivable for franchise services	21	15
Receivables from related parties (Note 8)	65	26
Provision for impairment of trade and other receivables	(1,897)	(2,420)
	21,464	15,537

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 in the amount of RUB 2,134 (31 December 2013: 1,543).

Trade receivables

There are balances of RUB 107 that in accordance with accounting policies are past due but not impaired as at 31 December 2014 (31 December 2013: RUB 705).

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

	31 December 2014	31 December 2013
2-6 months	107	705
	107	705

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

	2014	2013
At 1 January	(433)	(1,028)
Addition of provision for receivables impairment	(135)	(187)
Release of provision for receivables impairment	57	231
Receivables written off as uncollectable	251	551
At 31 December	(260)	(433)

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

The individually impaired trade receivables mainly relate to debtors that expect financial difficulties or where 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 2014	31 December 2013
3-6 months	97	12
Over 6 months	309	535
	406	547

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 a 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 RUB 317 that in accordance with accounting policies are past due but not impaired as at 31 December 2014 (31 December 2013: RUB 643).

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

	31 December 2014	31 December 2013
2-6 months	317	643
	317	643

Movements on the provision for impairment of other receivables and prepayments are as follows:

	2014	2013
At 1 January	(1,987)	(3,074)
Addition of provision for receivables impairment	(1,151)	(1,059)
Release of provision for receivables impairment	747	697
Receivables written off as uncollectable	754	1,449
At 31 December	(1,637)	(1,987)

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

The individually impaired other receivables mainly relate to debtors that expect financial difficulties or where 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 2014	31 December 2013
3-6 months	441	246
Over 6 months	1,560	2,268
	2,001	2,514

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.

17. VAT and other taxes recoverable

	31 December 2014	31 December 2013
VAT recoverable	13,227	13,533
Other taxes recoverable	261	364
	13,488	13,897

VAT recoverable related to property, plant and equipment of RUB 335 (31 December 2013: RUB 191) 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.

18. Provisions and other liabilities

	31 December 2014	31 December 2013
Taxes other than income tax	6,141	5,381
Provisions and liabilities for tax uncertainties (Note 33)	882	1,096
Accrued salaries and bonuses	6,838	6,546
Payables to landlords	717	702
Other accounts payable and accruals	8,420	7,050
Accounts payable for property, plant and equipment	5,882	3,832
Advances received	1,540	1,342
	30,420	25,949

There are no significant amounts of payables to foreign counterparties as at 31 December 2014 and 31 December 2013.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

19. Borrowings

The Group had the following borrowings at 31 December 2014 and 31 December 2013:

Current	Interest rate, % p.a. 2014	Interest rate, % p.a. 2013	Final maturity year	Fair value 2014	Fair value 2013	Carrying value 2014	Carrying value 2013
RUB Bonds X5 Finance series 01	–	7.95%	2014	–	6,930	–	6,954
RUB Bonds X5 Finance series 04	–	7.75%	2014 (put option)	–	**5,756**	–	5,766
RUB Bonds X5 Finance series BO-01	**9.5%**	–	2015	**4,850**	–	**5,000**	–
RUB Bilateral Loans	**9.0%**	6.94%-9.0%	2015	**10,834**	17,960	**10,834**	17,960
Total current borrowings				**15,684**	30,646	**15,834**	30,680

Non-current	Interest rate, % p.a. 2014	Interest rate, % p.a. 2013	Final maturity year	Fair value 2014	Fair value 2013	Carrying value 2014	Carrying value 2013
RUB Club loan	**MosPrime +2.5%/ 2.75%**	MosPrime +2.5%/ 2.75%	2018	**14,871**	14,801	**14,871**	14,801
RUB Bonds X5 Finance series 04	**10.50%**		2016	**6,959**	–	8,000	
RUB Bonds X5 Finance series BO-01	–	9.5%	2015		5,055		5,000
RUB Bonds X5 Finance series BO-02	**9.1%**	9.1%	2016	**4,364**	4,993	**4,994**	4,990
RUB Bonds X5 Finance series BO-03	**8.85%**	8.85%	2016	**4,690**	4,970	**4,997**	4,995
RUB Bilateral Loans	**MosPrime 3m+1.85% -2.6%**	MosPrime 3m+1.85% -2.6%	2016	**21,436**	13,895	**21,436**	13,895
RUB Bilateral Loans	**8.51%- 11.36%**	6.94%- 9.0%	2017	**47,114**	36,145	**60,854**	36,162
Total non-current borrowings				**99,434**	79,859	**115,152**	79,843
Total borrowings				**115,118**	110,505	**130,986**	110,523

In February 2014 the Group made a remaining RUB 7.5 billion drawdown from the 3-year long-term facility with VTB Capital with the total facility amount of RUB 12.5 billion (RUB 5 billion tranche was disbursed in December 2013).

In March 2014 the Group signed a new committed credit line with Sberbank with a total limit of RUB 15 billion for 3 years. The line was fully utilized by the Group in April 2014.

In June 2014 as the result of X5 Finance corporate bonds series 04 oferta (put-option) the Group sold 2,233,503 treasury bonds (that were previously held by intragroup companies) to external investors. The new annual rate for the next 4 semi-annual coupons was fixed at 10.5%.

In July 2014 the Group made several drawdowns with a total amount of RUB 15 billion under executed long-term credit agreements with Alfa-bank with maturity up to 3 years.

In December 2014 the Group made several drawdowns with a total amount of RUB 31 billion out of long-term committed credit lines with Sberbank with final maturity in 2017.

All borrowings at 31 December 2014 are shown net of related transaction costs of RUB 394 which are amortized over the term of the loans using the effective interest method (31 December 2013: RUB 701). Borrowing costs capitalized for the year ended 31 December 2014 amounted to RUB 128 (2013: RUB 83). The capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 9.70% (2013: 8.42%).

In accordance with loan facilities the Group maintains an optimal capital structure by tracking certain covenants: the maximum level of Net Debt/EBITDA (4.00/4.25 after acquisition), and the minimum level of EBITDA/Net Interest expense (2.75). At 31 December 2014 the Group complied with these covenants under loan facilities.

20. Share capital

As at 31 December 2014 the Group had 190,000,000 authorized ordinary shares (31 December 2013: 190,000,000) of which 67,867,743 ordinary shares are outstanding (31 December 2013: 67,844,665) and 25,475 ordinary shares are held as treasury stock (31 December 2013: 48,553) The nominal par value of each ordinary share is EUR 1.

No dividends were paid or declared during the year ended 31 December 2014 and the year ended 31 December 2013.

21. Earnings per share

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Company tby the weighted average number of ordinary shares in issue during the year, excluding treasury shares.

Earnings per share are calculated as follows:

	2014	2013
Profit attributable to equity holders of the parent	**12,691**	10,984
Weighted average number of ordinary shares in issue	**67,859,817**	67,834,947
Effect of share options granted to employees, number of shares	**370**	–
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**67,860,187**	67,834,947
Basic earnings per share for profit from continuing operations (expressed in RUB per share)	**187.02**	161.92
Diluted earnings per share for profit from continuing operations (expressed in RUB per share)	**187.02**	161.92

22. Revenue

	2014	2013
Revenue from sale of goods	**633,577**	533,916
Revenue from franchise services	**56**	112
Revenue from other services	**240**	532
	633,873	534,560

23. Expenses by nature

	2014	2013
Cost of goods sold	**454,429**	382,323
Staff costs (Note 26)	**61,987**	54,382
Operating lease expenses	**30,577**	24,744
Depreciation, amortization	**14,912**	13,182
Impairment of non-current assets	**2,660**	(128)
Other store costs	**12,810**	11,713
Utilities	**13,707**	11,940
Other	**21,321**	16,813
	612,403	514,969

Operating lease expenses include RUB 29,709 (2013: RUB 24,149) of minimum lease payments and contingent rents of RUB 868 (2013: RUB 595).

Impairment of trade and other receivables amounted to RUB 533 for the year ended 31 December 2014 (2013: RUB 348).

The fees listed below relate to the procedures applied to the Group by accounting firms and external auditors as referred to in article 1(1) of the Dutch Accounting Firms Oversight Act (Dutch acronym: Wta):

	2014	2013
Financial statement audit	**57**	63
Tax services	**52**	44
Other non audit services	**5**	–
	114	107

24. 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 2014	31 December 2013
Not later than 1 year	**2,148**	1,928
Later than 1 year and no later than 5 years	**986**	776
Later than 5 years	**375**	138
	3,509	2,842

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

24. Operating lease/sublease income continued

The future minimum lease payments receivable under non-cancellable operating subleases are as follows:

	31 December 2014	31 December 2013
Not later than 1 year	491	524
Later than 1 year and no later than 5 years	40	38
Later than 5 years	7	–
	538	562

The rental income from operating leases recognized in the consolidated statement of profit or loss for the year ended 31 December 2014 amounted to RUB 5,691 (2013: RUB 5,322). The contingent rents recognized in the consolidated statement of profit or loss in the year ended 31 December 2014 amounted to RUB 58 (2013: nil).

25. Finance income and costs

	2014	2013
Interest expense	11,646	10,605
Interest income	(109)	(64)
Other finance costs, net	521	393
	12,058	10,934

Other finance costs include transaction costs of RUB 385 written-off to the consolidated statement of profit or loss (2013: RUB 254) (Note 19).

26. Staff costs

	2014	2013
Wages and salaries	48,166	42,651
Social security costs	13,277	11,754
Share-based payments expense/(income)	544	(23)
	61,987	54,382

For the year ended 31 December 2014 statutory pension contributions amounted to RUB 8,517 (2013: RUB 7,325).

Key executive management personnel

The Group key management personnel consists of members of the Management Board and Supervisory Board, and other key management personnel, having authority and responsibility for planning, directing and controlling the activities of the Group as a whole. Members of the Management Board and other key management personnel receive a base salary and a partly deferred cash incentive; independent members of the Supervisory Board receive an annual base compensation in cash and share-based payments.

Management Board

The remuneration of the Management Board members consists of the base salary and the short-term and deferred components of the deferred cash incentive plan.

Remuneration of the current members of the Management Board:

Name	Year	Base salary	Cash bonus[1]	Share based compensation[2]	Total
S. DuCharme[3]	2014	42	108	9	159
	2013	42	42	12	96
F. Lhoëst[3]	2014	14	15	4	33
	2013	13	9	4	26
Total current members	2014	56	123	13	192
	2013	55	51	16	122

[1] The 2014 cash bonus is composed of the short-term component of the cash incentive for the performance of the year 2014 (i.e. one third reported and paid in cash in 2015), the deferred component of the cash incentive for the performance of the year 2013 and additional discretionary bonus for 2014. All deferred components, i.e. two thirds of the total annual cash incentive awarded under the deferred cash incentive plan, are paid in equal parts in the two consecutive years following the year of the short-term payout, subject to continuous employment with the Group.

[2] Since 2013 members of the Management Board no longer participate in the Group's Restricted Stock Unit Plan. The share based compensation reflects the accrued amounts related to previous awards under the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share based payment compensation.

[3] Excluding 16% Dutch crisis levy on total remuneration in excess of EUR 150,000, expensed as an employer's tax in 2013 in the amount of RUB 0.23 for Mr. S. DuCharme and in the amount of RUB 2.29 for Mr. F. Lhoëst.

Remuneration of the former members of the Management Board:

Name	Year	Base salary	Cash bonus	Severance/ Exit payment	Share based compensation	Total
S. Piven[1]	2014	7	6	9	1	23
	2013	11	11	–	3	25
V. Yavorskaya[2]	2014	5	6	–	–	11
	2013	5	5	–	–	10
K. Balfe[3]	2013	4	–	10	(22)	(8)
Total former members	2014	12	12	9	1	34
	2013	20	16	10	(19)	27

[1] Mr. Piven stepped down from the Management Board on 1 June 2014, while remaining member of the Group's Executive Committee. He subsequently resigned as CFO on 15 September 2014. The figures reflect Mr. Piven's compensation as member of the Management Board until 1 June, 2014. His compensation for the full year 2014 is as follows: base salary RUB 12, cash bonus RUB 9 , share-based compensation RUB 1 and severance payment RUB 9.

[2] Mrs. Yavorskaya stepped down from the Management Board on 1 June 2014, while remaining member of the Group's Executive Committee. The figures reflect her compensation as member of the Management Board until 1 June 2014. Her compensation for the full year 2014 is as follows: base salary RUB 12 and cash bonus 2014 RUB 13.

[3] Mr. Balfe resigned per 15 March 2013.

Restricted Stock Units (RSU) awarded and outstanding to members of the Management Board:

	Tranche	RSUs awarded in 2011	RSUs awarded in 2012	RSUs awarded in 2013	Year of vesting	RSUs vested	Value on vesting date[1]	GDRs locked-up as per 31/12/2014[2]	End of lock-up period	RSUs outstanding as per 31/12/2014	RSUs outstanding as per 31/12/2013
S. DuCharme	1	7,219	–	–	2013	7,219	4	7,219	2015	–	–
	2	–	7,939	–	2014	7,939	5	7,939	2016	–	7,939
	3	–	–	28,830	2015	–	–	–	2017	28,830	28,830
S. Piven[3]	3	–	–	7,217	2015	–	–	–	2017	–	7,217
F. Lhoëst	1	9,024	–	–	2013	9,024	5	9,024	2015	–	–
	2	–	13,645	–	2014	13,645	8	6,908	2016	–	13,645
	3	–	–	7,192	2015	–	–	–	2017	7,192	7,192

[1] Vesting date is 19 May of each respective year of vesting.

[2] Number of GDRs held during lock-up period equals the number of vested RSUs minus GDRs sold to cover taxes, if any.

[3] Mr. S. Piven stepped down from the Management Board on 1 June 2014, and resigned as CFO on 15 September 2014. Two thirds of the number of RSUs awarded under tranche 3 (i.e. 4,811 Restricted Stock Units) were settled in cash at the amount of RUB 3.

Supervisory Board

Supervisory Board members were paid remuneration in cash which accrued evenly throughout the year in proportion to the period of service. In 2013 the Group changed its remuneration principles for the Supervisory Board. In accordance with the new principals, the non-independent supervisory directors Mr. Dorofeev, Mr. Fridman and Mr. Gould are no longer remunerated by the Group. Independent members of the Supervisory Board also participate in the Group's Restricted Stock Unit Plan.

The number of 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 27.

Remuneration of the members of the Supervisory Board:

	Base remuneration[1]		Additional remuneration[2]		Share-based compensation[3]	
	2014	2013	2014	2013	2014	2013
D. Dorofeev	–	5	–	–	–	–
M. Fridman	–	2	–	–	–	–
D. Gould	–	4	–	–	–	–
A. Tynkovan	10	7	8	10	6	5
C. Couvreux[4]	10	9	–	5	8	8
A. Malis	5	2	–	7	2	–
I. Shekhterman	10	4	8	16	3	1
P. Musial	5	1	24	10	1	–
H. Defforey[5]	–	2	–	2	–	(4)
	40	36	40	50	20	10

[1] The annual membership fee for independent Supervisory Board members is determined and paid in Euro, as follows: chairman EUR 250,000, members chairing a committee EUR 200,000 and other members EUR 100,000.

[2] Additional cash remuneration for extraordinary time and efforts spent on key strategic projects in relation to the Group's ongoing transition in 2013-2014, the remuneration related to 2014 is subject to approval of the General Meeting of Shareholders.

[3] The share based compensation reflects the accrued amounts related to the Restricted Stock Unit Plan (see table below) as well as the Employee Stock Option Plan in 2013, and includes benefits resulting from the reduction in the value of the cash settled share based payment compensation.

[4] Excluding 16% Dutch crisis levy on Mr. Couvreux's remuneration in excess of Euro 150,000, expensed as an employer's tax in 2013 in the amount of RUB 0.39.

[5] Mr. Defforey resigned on 15 March 2013.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

26. Staff costs continued

Restricted Stock Units awarded and outstanding to members of the Supervisory Board:

	Tranche	Conditional grant 2014	RSUs awarded in 2011	RSUs awarded in 2012	RSUs awarded in 2013	RSUs awarded in 2014	Year of vesting	RSUs vested	Value on vesting date[1]	GDRs locked-up as per 31/12/2014[2]	End of lock-up period	RSUs outstanding as per 31/12/2014	RSUs outstanding as per 31/12/2013
A. Tynkovan	1	–	4,331	–	–	–	2013	4,331	3	2,858	2015	–	–
	2	–	–	4,763	–	–	2014	4,763	3	3,143	2016	–	4,763
	3	–	–	–	6,277	–	2015	–	–	–	2017	6,277	6,277
	4	–	–	–	–	10,830	2016	–	–	–	2018	10,830	–
	5	15,793	–	–	–	–	2017	–	–	–	2019	–	–
C. Couvreux	1	–	7,219	–	–	–	2013	7,219	4	7,219	2015	–	–
	2	–	–	7,939	–	–	2014	7,939	5	7,939	2016	–	7,939
	3	–	–	–	10,461	–	2015	–	–	–	2017	10,461	10,461
	4	–	–	–	–	14,768	2016	–	–	–	2018	14,768	–
	5	15,793	–	–	–	–	2017	–	–	–	2019	–	–
A. Malis	4	–	–	–	–	3,692	2016	–	–	–	2018	3,692	–
	5	7,897	–	–	–	–	2017	–	–	–	2019	–	–
I. Shekhterman	4	–	–	–	–	7,384	2016	–	–	–	2018	7,384	–
	5	15,793	–	–	–	–	2017	–	–	–	2019	–	–
P. Musial	4	–	–	–	–	2,461	2016	–	–	–	2018	2,461	–
	5	7,897	–	–	–	–	2017	–	–	–	2019	–	–

[1] Vesting date is 19 May of each respective year of vesting.
[2] Number of GDRs held during lock-up period equals the number of vested RSUs minus GDRs sold to cover taxes, if any.

Other key management personnel

The short-term cash remuneration of the other key management personnel consists of the base salary and the annual bonus.

	Base salary 2014	Bonus[1] 2014
Other key management personal	9	8

[1] Short-term component of the cash incentive for performance in the year 2014 paid in cash in 2015.

27. Share-based payments

Restricted Stock Unit 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 several tranches granted over the period starting May 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) maintaining the 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 favor of members of the Supervisory Board, was approved by the Annual General Meeting of Shareholders on 25 June 2010. During the year ended 31 December 2014 11,650 GDRs out of 102,528 vested under the first tranche in 2013 were waived and paid in cash. In May 2014 the Group vested 114,285 GDRs under the second tranche of long term incentive plan out of treasury stock; 8,660 of them were transferred directly to participants, 10,325 were waived and the remaining 95,300 GDRs were locked-in for 2 years in accordance with RSU plan rules. The third, fourth and fifth tranches will vest on 19 May 2015, 19 May 2016 and 19 May 2017 respectively. Upon vesting the RSUs are 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 2014 the Group recognized expenses related to the RSU plan in the amount of RUB 32 (income recognized during the year ended 31 December 2013: RUB 25). At 31 December 2014 the equity component was RUB 94 (31 December 2013: RUB 170). 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:

	2014		2013	
	Number of conditional rights	**Weighted average fair value, RUB**	Number of conditional rights	Weighted average fair value, RUB
Outstanding at the beginning of the period	**318,531**	**830.48**	1,053,053	851.03
Granted during the period	**63,173**	**608.64**	39,135	577.63
Vested during the period	**(92,310)**	**1,000.48**	(102,528)	1,082.59
Forfeited during the period	**(53,969)**	**1,025.42**	(671,129)	809.47
Outstanding at the end of the period	**235,425**	**659.61**	318,531	830.48

28. Income tax

	Year ended 31 December 2014	Year ended 31 December 2013
Current income tax charge	**3,674**	3,142
Deferred income tax (benefit)/charge	**(147)**	297
Income tax charge for the year	**3,527**	3,439

The theoretical and effective tax rates are reconciled as follows:

	Year ended 31 December 2014	Year ended 31 December 2013
Profit before taxation	**16,218**	14,423
Theoretical tax at the effective statutory rates*	**3,244**	2,885
Tax effect of items which are not deductible or assessable for taxation purposes:		
Effect of income taxable at rates different from standard statutory rates	**(952)**	(637)
Expenses on inventory shrinkage and surpluses	**1,086**	1,268
Unrecognized tax loss carry forwards for the year	**254**	118
Deferred tax expenses arising from the write-down of the deferred tax asset	**483**	109
Other non-taxable income	**(588)**	(304)
Income tax charge for the year	**3,527**	3,439

* 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 18% for 2014 and 19% for 2013.

Effective 1 January 2014, 39 Russian subsidiaries of the Group formed a consolidated group of taxpayers (CGT) with ZAO 'Torgovy Dom 'PEREKRESTOK' acting as the responsible CGT member.

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss are attributable to the following items for the year ended 31 December 2014:

	31 December 2013	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	Disposal of subsidiaries	**31 December 2014**
Tax effects of deductible temporary differences and tax loss carry forwards:					
Tax losses available for carry forward	3,932	(269)	–	74	**3,589**
Property, plant and equipment and investment property	798	(583)	30	40	**205**
Other intangible assets	124	(161)	42	–	**5**
Inventories	1,668	808	–	–	**2,476**
Accounts receivable	200	(72)	–	–	**128**
Accounts payable	3,182	328	4	–	**3,514**
Other	301	(80)	–	–	**221**
Gross deferred tax asset	10,205	(29)	76	114	**10,138**
Less offsetting with deferred tax liabilities	(5,259)	(1,307)	(4)	–	**(6,570)**
Recognized deferred tax asset	4,946	(1,336)	72	114	**3,568**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

28. Income tax continued

Tax effects of taxable temporary differences:

	31 December 2013	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	Disposal of subsidiaries	**31 December 2014**
Property, plant and equipment and investment property	(5,957)	443	(44)	–	(5,558)
Other intangible assets	(2,498)	273	(28)	–	(2,253)
Accounts receivable	(1,905)	(559)	–	–	(2,464)
Accounts payable	(10)	9	–	–	(1)
Other	(228)	10	–	–	(218)
Gross deferred tax liability	(10,598)	176	(72)	–	(10,494)
Less offsetting with deferred tax assets	5,259	1,307	4	–	6,570
Recognized deferred tax liability	(5,339)	1,483	(68)	–	(3,924)

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss are attributable to the following items for the year ended 31 December 2013:

	31 December 2012	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	Disposal of subsidiaries	31 December 2013
Tax effects of deductible temporary differences and tax loss carry forwards:					
Tax losses available for carry forward	3,035	897	–	–	3,932
Property, plant and equipment and investment property	894	(94)	(2)	–	798
Other intangible assets	117	(45)	52	–	124
Inventories	1,157	511	–	–	1,668
Accounts receivable	539	(339)	–	–	200
Accounts payable	2,595	587	–	–	3,182
Other	545	(244)	–	–	301
Gross deferred tax asset	8,882	1,273	50	–	10,205
Less offsetting with deferred tax liabilities	(4,515)	(744)	–	–	(5,259)
Recognized deferred tax asset	4,367	529	50	–	4,946
Tax effects of taxable temporary differences:					
Property, plant and equipment and investment property	(4,863)	(1,094)	–	–	(5,957)
Other intangible assets	(2,877)	379	–	–	(2,498)
Accounts receivable	(1,072)	(833)	–	–	(1,905)
Accounts payable	(105)	95	–	–	(10)
Other	(112)	(116)	–	–	(228)
Gross deferred tax liability	(9,029)	(1,569)	–	–	(10,598)
Less offsetting with deferred tax assets	4,515	744	–	–	5,259
Recognized deferred tax liability	(4,514)	(825)	–	–	(5,339)

Temporary differences on unremitted earnings of certain subsidiaries amounted to RUB 27,603 (2013: RUB 23,752) for which the deferred tax liability was not recognized as such amounts are being reinvested for the foreseeable future.

The current portion of the gross deferred tax liability amounted to RUB 2,929 (31 December 2013: RUB 2,424). The current portion of the gross deferred tax asset amounted to RUB 6,251 (31 December 2013: RUB 5,158).

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 RUB 3,589 recognized at 31 December 2014 for the carry forward of unused tax losses (31 December 2013: RUB 3,932).

The Group estimates unrecognized potential deferred tax assets in respect of unused tax loss carry forwards of RUB 1,284 (2013: RUB 307).

Unused tax losses are available for carry forward for a period not less than six years depending on the tax residence of every certain company of the Group.

29. Financial risk management

Financial risk management is a part of the integrated risk management and internal control framework described in the 'Corporate Governance' section of this Annual Report. The primary objectives of 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 the Corporate Finance Department. The Corporate Finance Department monitors and measures financial risks and undertakes steps to limit their influence on the Group's performance.

a. Market risk

Currency risk

The Group is exposed to foreign exchange risk arising from foreign currency denominated assets and liabilities with respect to import purchases. As at 31 December 2014 the Group does not have significant assets and liabilities denominated in foreign currency, thus the exposure is not significant for the Group.

Interest rates risk

As the Group has no significant floating 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 2014 with all other variables held constant, post-tax loss for the year would have been RUB 564 (2013: RUB 339) 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 16). 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 (Note 9). 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.

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's 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:

	During 1 year	**In 1 to 4 years**
Year ended 31 December 2014		
Borrowings	**34,136**	**131,497**
Trade payables	**92,001**	–
Gross finance lease liabilities	–	–
Other finance liabilities	**21,857**	–
	147,994	**131,497**

	During 1 year	In 1 to 5 years
Year ended 31 December 2013		
Borrowings	40,137	88,902
Trade payables	81,244	–
Gross finance lease liabilities	4	–
Other finance liabilities	18,130	–
	139,515	**88,902**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014
(expressed in millions of Russian Roubles, unless otherwise stated)

29. Financial risk management continued

c. Liquidity risk continued

At 31 December 2014 the Group has net current liabilities of RUB 30,764 (31 December 2013:RUB 62,406) including short-term borrowings of RUB 15,834 (31 December 2013: RUB 30,680).At 31 December 2014 the Group had available bank credit lines of RUB 84,200 (31 December 2013: RUB 100,810). At 31 December the Group had RUB bonds available for issue on MICEX of RUB 20,000 (31 December 2013: RUB 28,000).

Management regularly monitors the Group's operating cash flows and available credit lines to ensure that these are adequate to meet the Group's ongoing obligations and its expansion programs. Part of the short-term liquidity risk is seasonal, with the highest peak in the 1st quarter and strong cash generation in the 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 (RUB) are provided on a rolling basis which is closely monitored by detailed cash flow forecasts and 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 by 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.

30. 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 Russian Federation displays certain characteristics of an emerging market. Its economy is particularly sensitive to oil and gas prices. The legal, tax and regulatory frameworks continue to develop and are subject to frequent changes and varying interpretations. During 2014 the Russian economy was negatively impacted by a decline in oil prices and ongoing political tension in the region and international sanctions against certain Russian companies and individuals. As a result during 2014:

- the CBRF exchange rate fluctuated between 32.7292 and 56.2584 roubles per USD;
- the CBRF key refinancing interest rate increased from 5.5% p.a. to 17.0% p.a. including an increase from 12.0% p.a. to 17.0% p.a. on 16 December 2014;
- the RTS stock exchange index ranged between 1,445 and 791;
- access to international financial markets to raise funding was limited for certain entities; and
- capital outflows increased compared to prior years.

The financial markets continue to be volatile and are characterized by frequent significant price movements and increased trading spreads. Subsequent to 31 December 2014:

- the CBRF exchange rate fluctuated between 56.2584 and 63.5083 roubles per USD;
- Russia's credit rating was downgraded by Fitch Ratings in January 2015 to BBB-, whilst Standard & Poor's cut it to BB+ and Moody's Investors Service cut it to BA1/ Not Prime (NP), putting it below investment grade for the first time in a decade. Fitch Ratings still have Russia as investment grade. However, all these rating agencies indicated a negative outlook, meaning further downgrades are possible.
- the RTS stock exchange index ranged between 791 and 884;
- bank lending activity decreased as banks are reassessing the business models of their borrowers and their ability to withstand the increased lending and exchange rates; and
- the CBRF key refinancing interest rate decreased from 17.0% p.a. to 15.0% p.a.

These events may have a further significant impact on the Group's future operations and financial position, the effect of which is difficult to predict. The future economic and regulatory situation and its impact on the Group's operations may differ from management's current expectations.

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.

31. 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. The Group is in compliance with externally imposed capital requirements.

In accordance with loan facilities the Group maintains an optimal capital structure by tracking certain requirements: the maximum level of Net Debt/EBITDA (4.00/4.25 after acquisition), and the minimum level of EBITDA/Net Interest expense (2.75). These ratios are included as covenants into loan agreements (Note 19). At 31 December 2014 the Group complied with requirements under loan facilities.

32. 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 the 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 RUB 20,863 at 31 December 2014 (31 December 2013: RUB 27,704). The measurement is classified in level 1 of the fair value hierarchy. The carrying value of these bonds amounted to RUB 22,991 at 31 December 2014 (31 December 2013: RUB 27,705) (Note 19). The fair value of long-term borrowings amounted to RUB 83,421 at 31 December 2014 (31 December 2013: RUB 64,841). The measurement is classified in level 2 of the fair value hierarchy. The sensitivity analysis shows that the increase/decrease of the effective interest rate by 10% leads to the decrease/increase of fair value of long-term borrowings by RUB 1,897 at 31 December 2014. The fair value of short-term borrowings was not materially different from their carrying amounts.

33. Commitments and contingencies

Commitments under operating leases

At 31 December 2014, the Group operated 3,901 stores through rented premises (31 December 2013: 3,159 stores). 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 RUB 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.

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 amount to RUB 20,260 (net of VAT) (2013: RUB 15,650).

Capital expenditure commitments

At 31 December 2014 the Group contracted for capital expenditure for the acquisition of property, plant and equipment of RUB 10,448 (net of VAT) (2013: RUB 4,373).

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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

33. Commitments and contingencies continued

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.

- **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 Organization 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. The level of impact for 2014 is expected to be less than for preceding years since the prices of transactions between related parties which are the members of CGT (consolidated group of taxpayers) are not subject to transfer pricing control.

Deductibility of interest payable under intra-group financing arrangements is subject to various limitations under 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 current 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-year 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-profit tax risks with expiration within three years. In 2014 the Group net released a provision of RUB 521 including net accrued non-income tax of RUB 175, income tax net release of RUB 645 and net release of RUB 51 indemnified by previous shareholders of acquired companies.

In 2013 the Group net accrued a provision of RUB 596 including net accrued non-income tax of RUB 212, income tax net accrued of RUB 1,287 and net release of RUB 903 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 RUB 2,595 at 31 December 2014 (31 December 2013: RUB 1,268) in these Consolidated Financial Statements as their best estimate of the Group's liability related to tax uncertainties as follows:

Balance at 1 January 2013	1,662
Release of provision	(2,880)
Accrual of provision	3,476
Offset of provision	(990)
Balance at 31 December 2013	1,268
Increases due to acquisitions during the year recorded as part of the purchase price allocation (Note 7)	273
Release of provision	(4,424)
Accrual of provision	3,903
Offset of provision	1,575
Balance at 31 December 2014	**2,595**

Company statement of financial position

at 31 December 2014 (before appropriation of profit)

(expressed in millions of Russian Roubles, unless otherwise stated)

	Note	31 December 2014	31 December 2013
Assets			
Non-current assets			
Financial assets	35	**105,813**	83,780
		105,813	83,780
Current assets			
Financial assets	35	**–**	8,847
Amounts due from subsidiaries		**521**	307
Prepaid expenses		**3**	2
VAT receivable		**8**	–
Cash and cash equivalents		**3**	8
		534	9,165
Total assets		**106,347**	92,945
Equity and liabilities			
Paid up and called up share capital	36	**4,638**	3,050
Share premium account		**46,218**	46,126
Share-based payment reserve	40	**94**	170
Other reserves		**26,917**	17,476
Result for the year		**12,691**	10,984
Total equity		**90,558**	77,806
Non-current liabilities			
Bank loans	37	**14,871**	14,801
Loan from group company	38	**344**	58
		15,216	14,859
Current liabilities			
Amounts due to group companies		**524**	3
Accrued expenses and other liabilities	39	**47**	270
Other tax payable		**2**	8
		573	281
Total equity and liabilities		**106,347**	92,945

Company statement of profit or loss

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

	Notes	31 December 2014	31 December 2013
Other expenses after tax	41	**(890)**	(349)
Result on participating interest after tax	35	**13,581**	11,333
Profit/(loss) after taxation		**12,691**	10,984

Notes to the Company Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

34. Accounting principles

General

The Company was incorporated as a limited liability Company under the laws of The Netherlands on 13 August 1975 and has its statutory seat in Amsterdam. The Company is publicly owned. The principal activity of the Company is to act as the listed holding company for a retail chain operating mainly in Russia.

Basis of presentation

The Company Financial Statements have been prepared in accordance with accounting principles generally accepted in the Netherlands, in accordance with Part 9 of Book 2 of the Dutch Civil Code (art 362.8).

Accounting principles

Unless stated otherwise below, the accounting principles applied for the Company accounts are similar to those used in the IFRS Consolidated Financial Statements (refer to Note 2 to the Consolidated Financial Statements). The consolidated accounts of companies publicly listed in the European Union must be prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and adopted by the European Commission.

As the Company mainly exploits grocery stores in the Russian Federation, the functional currency of the Company is the Russian Rouble as this is the currency of its primarily business environment and reflects the economic reality. Unless stated otherwise all amounts are in millions of Russian Rouble ('RUB').

Change in accounting policy

From 1 January 2014 the presentation currency of the Company Financial Statements of X5 Retail Group N.V. was changed from the US Dollar to the Russian Rouble ('RUB'), which management believes is the most useful currency to adopt for users of these Financial Statements. As described in Note 2.5 of the Consolidated Financial Statements the comparative information has been restated for the effect of adoption of the new accounting policy in the following way: the Statement of Financial Position items except for equity items, other than share capital, were translated at the official exchange rate of the Central Bank of the Russian Federation as at the statement date; equity items, other than share capital, were translated at the official exchange rate of the Central Bank of the Russian Federation as at the dates of historical transactions; share capital has been translated at the exchange rate applicable on the balance sheet dates, the difference has been included in other reserve; and the statement of profit or loss was translated at the average official exchange rate of the Central Bank of the Russian Federation for the period of the statements. The comparative information in the Notes has also been restated.

Investments in group companies

Investments in group companies are entities (including intermediate subsidiaries and structured entities) over which the Company has control, because the Company (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. Group companies are 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 the acquisition of investments in group companies, consistent with the approach identified in the Consolidated Financial Statements. Investments in group companies are presented in accordance with the net asset value method. When an acquisition of an investment in a group company is achieved in stages, any previously held equity interest is remeasured to fair value on the date of acquisition. The measurement against the book value is accounted for in the statement of profit and loss.

When the Company ceases to have control over a group company, any retained interest is measured to its fair value, with the change in carrying amount to be accounted for in the statement of profit or loss. When parts of investments in group companies are bought or sold, and such transaction does not result in the loss of control, the difference between the consideration paid or received and the carrying amount of the net assets acquired or sold, is directly 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 share capital, which is denominated in Euro, is translated into Russian Roubles ('RUB') at the official exchange rate of the Central Bank of the Russian Federation as at 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.

35. Financial assets

	31 December 2014	Restated 31 December 2013
a. Movements in the interests in group companies have been as follows:		
Opening balance	**81,105**	71,336
Acquisitions/capital contribution	**212**	7,483
Divestment of group companies/capital repayments	**(120)**	(9,047)
Profit from group companies for the year	**13,581**	11,333
Closing balance	**94,778**	81,105

A complete list of group companies has been disclosed in the Consolidated Financial Statements (refer to Note 6 of the Consolidated Financial Statements). Above indicated movements in 2013 are all related to the internal group restructuring program.

b. Movements in the loans to group companies have been as follows:		
Opening balance	11,522	9,197
Settlement/repayment	(783)	(351)
Additions	296	2,675
Foreign exchange differences	1	–
Closing balance	11,035	11,522
Non-current financial assets	105,813	83,780
Current financial assets	–	8,847
Total financial assets	105,813	92,627

Loans provided to the following group companies:	Currency	Maturity date
GSWL Finance Ltd	RUB	August 2016
Perekrestok Holdings Ltd.	RUB	December 2016
X5 Capital S.A.R.L	EUR	December 2017

In loans receivable there are amounts to Grasswell Ltd. and Perekrestok Holdings Ltd. denominated in RUB.

The total amount of the loans is RUB 11,035 (2013: RUB 11,522). The loans have not been secured and attract up to MosPrime 1m+4.5% interest per annum with Perekrestok Holdings Ltd. and up to MosPrime 1m+3.6% interest per annum with GSWL Finance Ltd.

On 16 September and 24 October 2014 the Company entered in to the new loans facility agreement with X5 Capital S.A.R.L. The subject of the agreement is the establishment of the loan up to EUR 500,000 (RUB 34). As at 31 December 2014 the total loan issued amounted to EUR 39,273 (RUB 2.7). The loans have not been secured and attract up to 4% interest per annum and 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 2014, an addendum to the debtor agreement was entered into in which the compensation between parties was agreed. The compensation is included in other income (expenses). The agreement in respect to the currency exchange risks was terminated effective 1 January , 2014.

Notes to the Company Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

36. Shareholders' equity

	Share capital[1]	Share premium	Other reserves	Profit	Share-based payment (equity)	Total
Balance as at 1 January 2013 (restated)	2,728	46,016	21,726	(3,933)	338	66,875
Share-based compensation (Note 27)	–	–	–	–	(57)	(57)
Transfer	–	–	(3,933)	3,933	–	–
Currency translation	321	–	(317)	–	–	4
Transfer of vested equity rights	1	110	–	–	(111)	–
Result for the period	–	–	–	10,984	–	10,984
Balance as at 1 January 2014 (restated)	3,050	46,126	17,476	10,984	170	77,806
Share-based compensation (Note 27)	–	–	–	–	17	17
Transfer	–	–	10,984	(10,984)	–	–
Currency translation	1,586	–	(1,542)	–	–	44
Transfer of vested equity rights	2	92	(1)	–	(93)	–
Result for the period	–	–	–	12,691	–	12,691
Balance as at 31 December 2014	**4,638**	**46,218**	**26,917**	**12,691**	**94**	**90,558**

[1] Share capital translated of the year-end exchange rate EUR/RUB of 68.3427 (2013: 40.2286)

Share capital issued

As at 31 December 2014 the Group had 190,000,000 authorized ordinary shares (31 December 2013: 190,000,000) of which 67,867,743 ordinary shares are outstanding (31 December 2013: 67,819,033) and 25,475 ordinary shares held as treasury stock (31 December 2013: 48,553). The nominal par value of each ordinary share is EUR 1.

Other reserves as at 31 December 2014 include nil (31 December 2013: RUB (44)) translation reserve.

No dividends were paid or declared during the year ended 31 December 2014 and the year ended 31 December 2013.

37. Bank loans

The movement in the bank loans have been as follows:

	31 December 2014	31 December 2013
Opening balance	14,801	12,308
Repaid (Club loan)	–	(12,308)
New (Club loan)	–	14,726
Amortization of transaction costs capitalized (Club loan)	71	74
Closing balance	**14,871**	14,801

The balance represents the club loan facility with 2.5–2.75 % margin over MosPrime. The loan's maturity is 2018. No collateral is provided for this facility. There is no change in carrying amount to be accounted for in the income statement.

38. Loan from group company

	31 December 2014	31 December 2013
Trade House Perekrestok	344	58

The loan payable to Trade House Perekrestok denominated in RUB amounts to RUB 344 (2013: RUB 58). The loan attracts 10% interest per annum and matures in August 2016.

39. Accrued expenses

The current liabilities contain accrued expenses and non-income tax payable.

40. 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 as the options granted to employees of the Group are recharged to its subsidiaries, in cases where 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 27). As at 31 December 2013 all tranches of the Stock Option Plan expired.

The following is included in the entity's accounts for the Employee Stock Option Plan:

	2014	2013
Share-based payments liability as at 31 December	–	–
Income	–	(10)

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 27).

The 2010 plan includes a funding arrangement with the subsidiaries which is recorded as an expense in the subsidiary and as 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:

	2014	2013
Equity share-based payment reserve as at 31 December	(94)	(170)
Expenses/(income)	48	(39)

41. Other income and expenses after tax

	31 December 2014	31 December 2013
Other expenses/(income) from group companies	421	(61)
Interest expenses	1,966	1,334
Interest income	(1,661)	(1,084)
General and administrative expenses	149	127
Share-based payment/RSU program	48	(49)
Currency exchange rate differences	(33)	58
Deferred income tax expenses	–	24
	890	349

42. Income tax expense

	31 December 2014	31 December 2013
Operating loss before tax	13,581	11,333
Current income tax	–	–
Deferred income tax expenses	–	24
Effective tax rate	0%	0%
Applicable tax rate	25.0%	25.0%

No deferred tax asset has been recognized in relation to the uncertainty of future taxable income to offset the current tax losses.

The Company estimates unrecognized potential deferred tax assets in respect of unused tax loss carry forwards of RUB 293 (2013: RUB 127).

Unused tax losses are available for carry forward for a period not less than eight years.

Notes to the Company Financial Statements

for the year ended 31 December 2014

(expressed in millions of Russian Roubles, unless otherwise stated)

43. Staff numbers and employment costs

Other than the Management and Supervisory Boards the Company has one employee in the Netherlands; incurred wages, salaries and related social security charges comprise RUB 2 million (2013: RUB 917 thousands).

44. Contingent rights and liabilities

Reference is made to the commitments and contingencies as disclosed in Note 33 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 2014	31 December 2013
Irrevocable offer to holders of X5 Finance bonds	**23,000**	27,731
Guarantee for Agrotorg	**21,880**	31,224
Guarantee for TH Perekrestok	**56,500**	29,303
Guarantee for Agroaspekt	**–**	7,778

45. Related party transactions

Refer to Note 8 of the Consolidated Financial Statements; all group companies are also considered related parties.

Statutory director's compensation

The Company has a Management Board and a Supervisory Board. The total remuneration of all board members as well as key management is disclosed in Notes 26 and 27 of the Consolidated Financial Statements.

Loans to group companies

For loans issued to and interest income from the group companies refer to Note 35 and Note 41.

Loan from group company

For loan received from and interest expenses to the group company refer to Note 38 and Note 41.

46. Subsequent events

In February 2015 the Group made early repayment of VTB Capital loan with floating interest rate in the total amount of RUB 9 billion.

In March 2015 Alfa-bank approved the total credit limit increase for the Group from RUB 30 billion to RUB 43 billion.

Amsterdam, 19 March 2015

Management Board:
Stephan DuCharme
Frank Lhoëst

Supervisory Board:
Dmitry Dorofeev
Mikhail Fridman
David Gould
Alexander Tynkovan
Christian Couvreux
Alexander Malis
Pawel Musial
Igor Shekhterman

Other information

Auditor's report

The auditor's report is included on page 130.

Statutory profit appropriation

In Article 28 of the Company's statutory regulations the following has been stated concerning the appropriation of result:

On the proposal of the Supervisory Board, the General Meeting shall determine how the results of the financial year shall be allocated to the reserves.

Subsequent events

For subsequent events, please refer to Note 46 of the Financial Statements.

Independent Auditor's report

To: the General Meeting and Supervisory Board of X5 Retail Group N.V.

Report on the Financial Statements 2014

Our opinion

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 2014 and of its result and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code;
- the Company Financial Statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2014 and of its result for the year then ended in accordance with Part 9 of Book 2 of the Dutch Civil Code.

What we have audited

We have audited the Financial Statements 2014 of X5 Retail Group N.V. ('the Company' or collectively with its subsidiaries 'the Group'), Amsterdam. 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 2014;
- the following statements for 2014: the consolidated statement of profit or loss and the consolidated statements of comprehensive income, cash flows and changes in equity; and
- the notes, comprising a summary of significant accounting policies and other explanatory information.

The Company Financial Statements comprise:

- the Company statement of financial position as at 31 December 2014;
- the Company statement of profit or loss for the year then ended; and
- the notes, comprising a summary of the accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the Financial Statements is EU-IFRS and the relevant provisions of Part 9 of Book 2 of the Dutch Civil Code for the Consolidated Financial Statements and Part 9 of Book 2 of the Dutch Civil Code for the Company Financial Statements.

The basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the 'Our responsibilities for the audit of the Financial Statements' section of our report.

We are independent of X5 Retail Group N.V. in accordance with the 'Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten' (ViO) and other relevant independence requirements in the Netherlands. Furthermore, we have complied with the 'Verordening gedrags-en beroepsregels accountants' (VGBA).

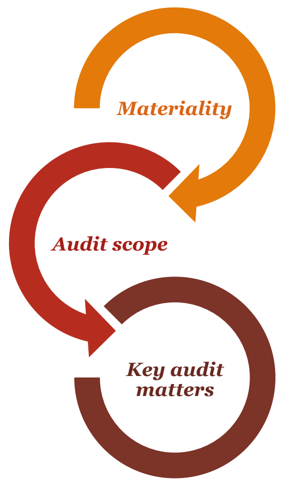
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach

Overview

We designed our audit by determining materiality and assessing the risks of material misstatement in the Financial Statements. In particular, we looked at where management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We performed procedures on the inventory and revenue process, such as attendance of physical counts in the stores and at distribution centres and reconciliation of daily revenue according to the cash registers to cash deposits made at the bank and revenue recorded in the accounting records of the Group. Apart from the key audit matters, which are explained below, other points of focus in our audit included, among others, acquisitions of businesses, the valuation of inventory and fixed asset additions in connection with new store openings and the corporate income tax position.

As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that may represent a risk of material misstatement due to fraud.



Materiality

- Overall materiality: RUB 1.1 billion which represents 2.5% of EBITDA.

Audit scope

- Our audit covered all subsidiaries within the Group that are of relevance for the Financial Statements.
- Because of the centralised structure, the entire Group has been audited by the Group engagement team.
- The Group engagement team performed its audits in both the Netherlands and Russia.

Key audit matters

- Recognition of vendor allowances
- Impairment of goodwill
- Impairment of stores and other assets
- Impact of the Russian economic crisis

Materiality

The scope of our audit is influenced by the application of materiality. Our audit opinion aims on providing reasonable assurance about whether the Financial Statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Statements.

We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of identified misstatements on our opinion.

Based on our professional judgement, we determined materiality for the Financial Statements as a whole as follows:

Overall Group materiality	RUB 1.1 billion
How we determined it	2.5% of EBITDA
Rationale for benchmark applied	We have applied this benchmark, a generally accepted auditing practice, based on our analysis of the stakeholders of X5 Retail Group N.V. On this basis we believe that EBITDA is an important metric for the financial performance of the Group.

We also take misstatements and/or possible misstatements into account that, in our judgment, are material for qualitative reasons.

We agreed with the Supervisory Board that we would report to them misstatements identified during our audit above RUB 55 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

The scope of our Group audit

X5 Retail Group N.V. is the holding company of a group of entities. The financial information of this Group is included in the Consolidated Financial Statements of X5 Retail Group N.V.

Considering our ultimate responsibility for the opinion on the Company's Consolidated Financial Statements we are responsible for the direction, supervision and performance of the Group audit. In this context, we have determined the nature and extent of the audit procedures for the Group to ensure that we performed enough work to be able to give an opinion on the Financial Statements as a whole. Determining factors are the centralised operational structure of the Group, the significance and/or risk profile of Group entities or activities, the accounting processes and controls, and the industry in which the Group operates. On this basis, we selected the processes within the Group and the financial information for which an audit or other procedures were considered necessary.

The Group includes a large number of subsidiaries, mainly located in Russia. The Group accounting function is centralized in Moscow and Nizhny Novgorod and the Group is primarily managed as a single operating unit. The Group uses centralized IT systems for its business processes and financial reporting including consolidation. Therefore all of the audit work was performed by the Group engagement team including the audit of the Group's consolidation and financial statement disclosures.

By performing the procedures above, we have obtained sufficient and appropriate audit evidence regarding the financial information of the Group as a whole to provide a basis for our opinion on the Consolidated Financial Statements.

Independent Auditor's report continued

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Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the Financial Statements. We have communicated the key audit matters to the Supervisory Board, but they are not a comprehensive reflection of all matters that were identified by our audit and that we discussed. We described the key audit matters and included a summary of the audit procedures we performed on those matters, below. On pages 50 to 53 of the 2014 Annual Report, the Company also disclosed several financial and/or operational risk factors that could have a material adverse effect on its financial position and results of operations.

The key audit matters were addressed in the context of our audit of the Financial Statements as a whole, and in forming our opinion thereon. We do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the matter
Recognition of vendor allowances The Group receives various types of vendor allowances such as rebates and service fees as further discussed in Note 2.28 to the Financial Statements. Rebates are to a large extent dependent on volumes of products purchased and service fees are received for promotional activities that the Group undertakes for certain products. These allowances are a significant component of cost of sales and represent a reduction of the inventory cost. While the majority of the allowances are settled during the financial year, a substantial amount nevertheless remains outstanding at each year-end and is included as part of trade receivables. We focused on this area because the allowances are individually different and can be complex and recognition of vendor allowance income and receivables requires, to some extent, judgement from management - for example, concerning delivery of the service and evidence thereof. In addition, the internal controls in the process of accounting for vendor allowances are mainly manual. The allocation of the allowances to inventory cost also has some element of judgement.	Our procedures included, among others, testing internal controls around the completeness and accuracy of the allowances recognized in the accounting system. We also agreed, on a sample basis, the recorded amounts to contracts and confirmed the positions and terms with the vendors. For the service fees we reconciled the allowances received or receivable to the confirmations of the vendors that the service has been delivered. For the volume rebates we reconciled the receivables to the calculations, the contracts and the volumes purchased. In addition, we performed a margin analysis over time and we reviewed subsequent collections on prior period vendor allowance receivables and subsequent collections of the vendor allowances receivable in the current year. We have verified that the policy for the reduction in inventory cost from the vendor allowances is appropriate and has been applied correctly. We have recalculated the reduction of the inventory cost for the rebates that have been recognized.
Impairment of goodwill As a result of past acquisitions, the Group carries capitalized goodwill with a value of RUB 66 billion as at 31 December 2014. Management performs an impairment assessment on an annual basis as required by IAS 36 Impairment of Assets. The impairment assessment has been performed on the basis of the Group operating as a single segment as disclosed in Note 5 to the Financial Statements. The impairment assessment and the conclusion that there is no impairment of goodwill as at 31 December 2014, has been disclosed in Notes 3 and 12 to the Financial Statements. We have focused on this area as the impairment test on the basis of a single operating segment requires judgement from management.	We performed an evaluation of managements' conclusion that the Group is operating as a single segment based on the criteria included in IFRS 8 Operating segments. Our evaluation included discussion with management, review of the internal reporting structure, the decision making process and how resources are allocated among business units of the Group. We subsequently evaluated the impairment assessment made by management. The Company's shares are listed on the London Stock Exchange in the form of Global Depository Receipts and the goodwill assessment is performed for the Company as a whole. As a consequence, as part of our audit we have compared the book value of the Company to the total market capitalization.
Impairment of stores and other assets The Group operates in excess of 5,400 retail stores in Russia. The associated store- and other non-current assets, such as property, equipment and intangible assets, approximate RUB 169 billion and are important to our audit due to the magnitude of the carrying value as well as the judgment involved in assessing the recoverability of the invested amounts as disclosed in Note 3 to the Financial Statements. Such judgement focuses predominantly on future store performance, which is, among others, dependent on the expected revenue and the local competition and the fair value of property. The expected revenue is determined by categorizing stores by format and region and applying different growth rates for the various categories based on past years development. Management assesses the impairment annually using an internal calculation model and on the basis of internal and external property valuation reports. In 2014 management recognized net impairment losses of RUB 2.7 billion as disclosed in Notes 10 to 13 to the Financial Statements.	Among other audit procedures, we performed an evaluation of the Group's policies and procedures to identify triggering events for potential impairment of assets related to underperforming stores. These policies, for example, exclude recently opened stores from the impairment assessment as it takes from one to three years for a store to mature in terms of reaching its longer term revenue and profitability capabilities. We challenged management's key cash flow assumptions and corroborated them through comparison to management's internal forecasts and long term and strategic plans that were approved by the Board, external data and historical performance. We also involved our internal valuation experts to evaluate the applied weighted average cost of capital ('WACC') calculated by the Group and assess the (market) property valuations performed by the Group and to assist us with the audit of the impairment calculation model. An independent WACC calculation was prepared and compared to the WACC that was used by management. The competency and independence of the external property appraisers was assessed and the property valuations reviewed to assess their adequacy. The audit of the model included verification that the impairment methodology was consistently applied and that the model was mathematically accurate.

Key audit matter	How our audit addressed the matter
Impact of the Russian economic crisis Towards the end of 2014 and early 2015, the RUB devaluated against most other foreign currencies resulting in an increase in inflation and interest rates and the Russian Federation's economy slowing down. As set out in the risk section of the directors report and Note 30 to the Financial Statements, management is adapting its operational strategy to these developments and is managing and monitoring its financial risk management. As there is uncertainty on the implications of the crisis for X5, management evaluated the potential impact for the 2014 Financial Statements, the most important being the liquidity assessment and the assumptions underlying the impairment assessment.	We evaluated the Group's financing facilities, which are largely in RUB and access to finance as part of our audit procedures. We confirmed the existing financing and available credit lines with contracts and providers of finance, compliance with covenants and evaluated the access to capital markets. We agreed the cash requirements for the 12 months following the date of the statement of financial position to the budget that was approved by the board. We compared the assumptions used in the 2015 budget to external information and extended the evaluation to 12 months after the date of the accounts.
At 31 December 2014, the Group has RUB 131 billion of short and long term borrowings with a remaining average maturity of 2.8 years. The total amount of available credit lines and other financing as at 31 December 2014 is RUB 84 billion. Refer to Note 19 and Note 29 to the Financial Statements. As set out in Note 19 to the Financial Statements, management has drawn on the Company's available credit lines and extending credit facilities to maintain its availability to funding and manage its cash flow and liquidity. The liquidity assessment is important for the Group and our audit as in addition to the increase in interest rates the liquidity in the Russian Federation's financial markets has decreased. Additionally the crisis could also impact the assumptions underlying the annual impairment calculation. As disclosed in Note 10 to the Financial Statements, the Company has made a sensitivity analysis focusing on those variables that are the most sensitive to the impairment calculation.	We assessed the impact of these developments on the WACC that was used for the impairment assessment and the potential impact on the revenues and EBITDA, for example through estimating the impact of inflation and the purchases of goods or services in foreign currencies. The impact on the WACC, inflation, foreign currencies and EBITDA has been included in the impairment sensitivity calculations.

Responsibilities of Management and the Supervisory Board

Management is responsible for:

- the preparation and fair presentation of the Financial Statements in accordance with EU-IFRS and with Part 9 of Book 2 of the Dutch Civil Code, and for the preparation of the Management Board report in accordance with Part 9 of Book 2 of the Dutch Civil Code, and for
- such internal control as management determines is necessary to enable the preparation of Financial Statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the Financial Statements, management is responsible for assessing the Company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, management should prepare the Financial Statements using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. Management should disclose events and circumstances that may cast significant doubt on the Company's ability to continue as a going concern in the Financial Statements.

The Supervisory Board is responsible for overseeing the Company's financial reporting process.

Our responsibilities for the audit of the Financial Statements

Our responsibility is to plan and perform an audit engagement to obtain sufficient and appropriate audit evidence to provide a basis for our opinion. Our audit has been performed with a high but not absolute level of assurance which makes it possible that we did not detect all errors and frauds.

A more detailed description of our responsibilities is set out in the appendix to our report.

Report on other legal and regulatory requirements

Our report on the Management Board report and the other information

Pursuant to the legal requirements of Part 9 of Book 2 of the Dutch Civil Code (concerning our obligation to report about the Management Board report and other information):

- 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 by Part 9 of Book 2 of the Dutch Civil Code has been annexed.
- We report that the Management Board report, to the extent we can assess, is consistent with the Financial Statements.

Our appointment

We were appointed as auditors of X5 Retail Group N.V. by the shareholders at the annual meeting held on 16 June 2006 and have been re-appointed annually by the shareholders representing a total period of uninterrupted engagement appointment of 8 years.

Amsterdam, 19 March 2015
PricewaterhouseCoopers Accountants N.V.
A.G.J. Gerritsen RA

Appendix to our auditor's report on the Financial Statements 2014 of X5 Retail Group N.V.

In addition to what is included in our auditor's report we have further set out in this appendix our responsibilities for the audit of the Financial Statements and explained what an audit involves.

The auditor's responsibilities for the audit of the Financial Statements

We have exercised professional judgment and have maintained professional scepticism throughout the audit in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our objectives are to obtain reasonable assurance about whether the Financial Statements as a whole are free from material misstatement, whether due to fraud or error. Our audit consisted of, among others:

- Identifying and assessing the risks of material misstatement of the Financial Statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Concluding on the appropriateness of management's use of the going concern basis of accounting, and based on the audit evidence obtained, concluding whether a material uncertainty exists related to events and or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report and are made in the context of our opinion on the Financial Statements as a whole. However, future events or conditions may cause the Company ceasing to continue as a going concern.
- Evaluating the overall presentation, structure and content of the Financial Statements, including the disclosures, and evaluating whether the Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards. From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the Financial Statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Notes

X5 Retail Group
Prins Bernhardplein 200
1097 JB Amsterdam
The Netherlands

X5 Retail Group Corporate Center
28 Srednyaya Kalitnikovskaya str., bld.4
Moscow, Russia, 109029
T: +7 (495) 662-88-88, 789-95-95
F: +7 (495) 662-88-88, ext. 61-145