

2016

Annual Report

 X5 RETAIL GROUP

MEETING DEMAND



IN EVERY STORE

DAILY

ON EVERY CORNER

EVERY DAY

FOR EVERY CUSTOMER

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All sections under Part 1 'Strategic Report' and Part 2 'Corporate Governance' are considered to be part of the Management report.

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Strategic report

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Climb Higher!

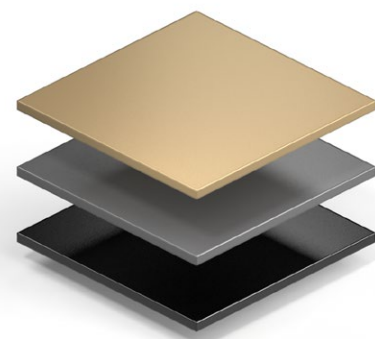
We worked very hard in 2016 to deliver yet another year of market-leading, sustainable growth while maintaining, and even improving, margins.

Key highlights



Revenue increased 27.8% year-on-year

to RUB 1,034 billion, primarily due to organic growth



Selling space grew by 29.1% year-on-year

by 968.6 thousand m², including 906.6 thousand m² of new Pyaterochka stores



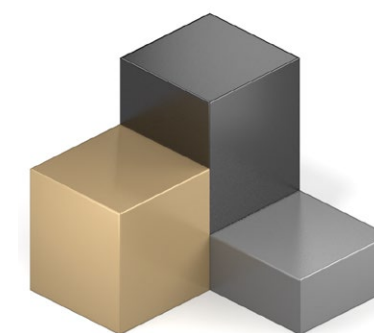
Like-for-like sales improved by 7.7% year-on-year,

increasing across all major formats



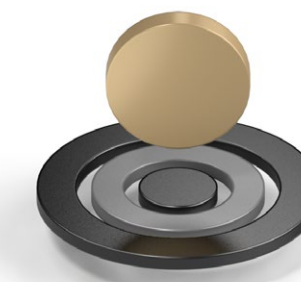
Like-for-like traffic increased by 2.5% year-on-year

up from 2.3% growth in 2015



The adjusted EBITDA margin was 7.7%

(vs. 7.3% in 2015)
X5's highest margin since 2010



Net debt/EBITDA was 1.8x

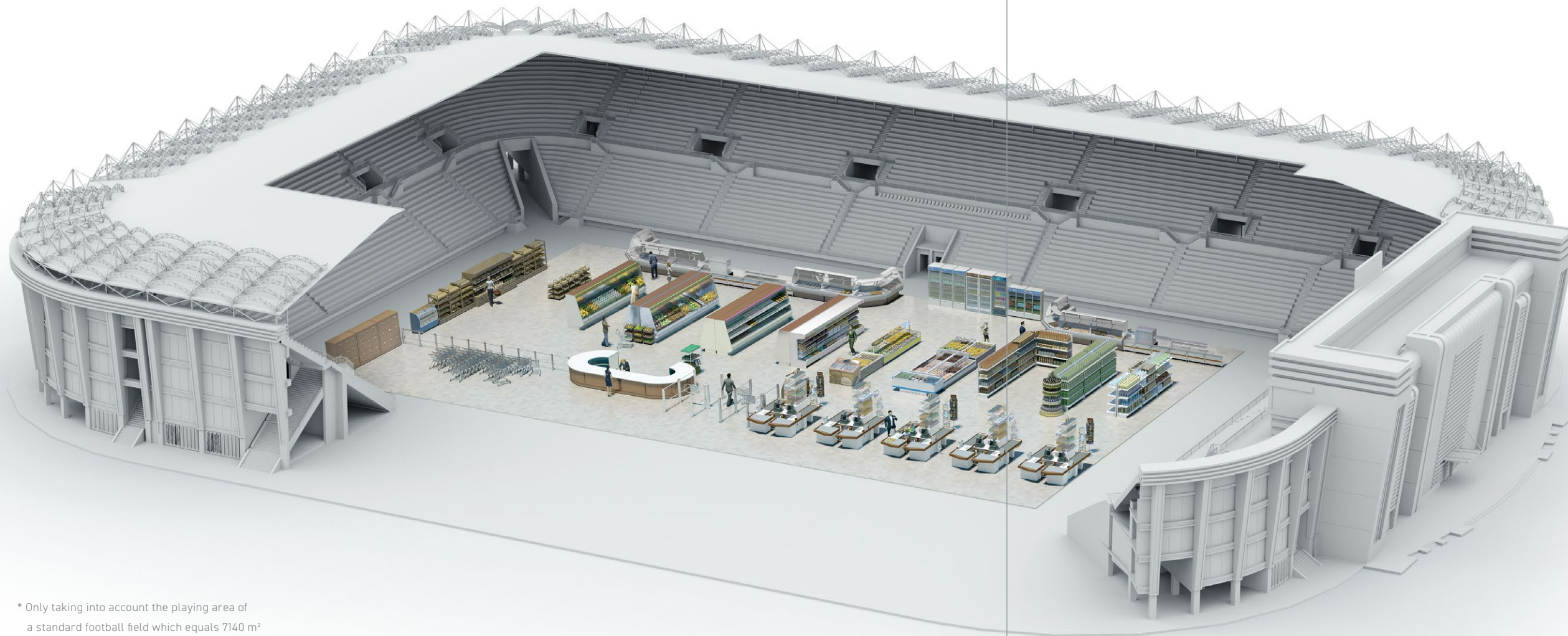
The lowest level in X5's public history

As of 31 December 2016, we were the **fastest-growing among Russian publicly traded peers for five consecutive quarters**, and we have become **Russia's #1 food retailer** — a position we intend to maintain by continuing to focus on sustainable and high-quality growth, offering customers the best value proposition at every single store we operate.

In the course of the year we opened over 2,000 stores, bringing our total number of retail outlets in Russia to 9,187 as of 31 December 2016. This rate of growth is sustained by our robust and efficient operations, our focus on quality execution, solid financial position, and successful strategy that aims to further develop our successful multi-format food retail business that puts the customer at the centre of our success.

The 968,600 m² of selling space we added in 2016 is equivalent to **135** football fields*

We delivered 29.1% selling space growth, adding 968.6 thousand square metres of retail space during 2016, with 2,167 new stores added during the year.

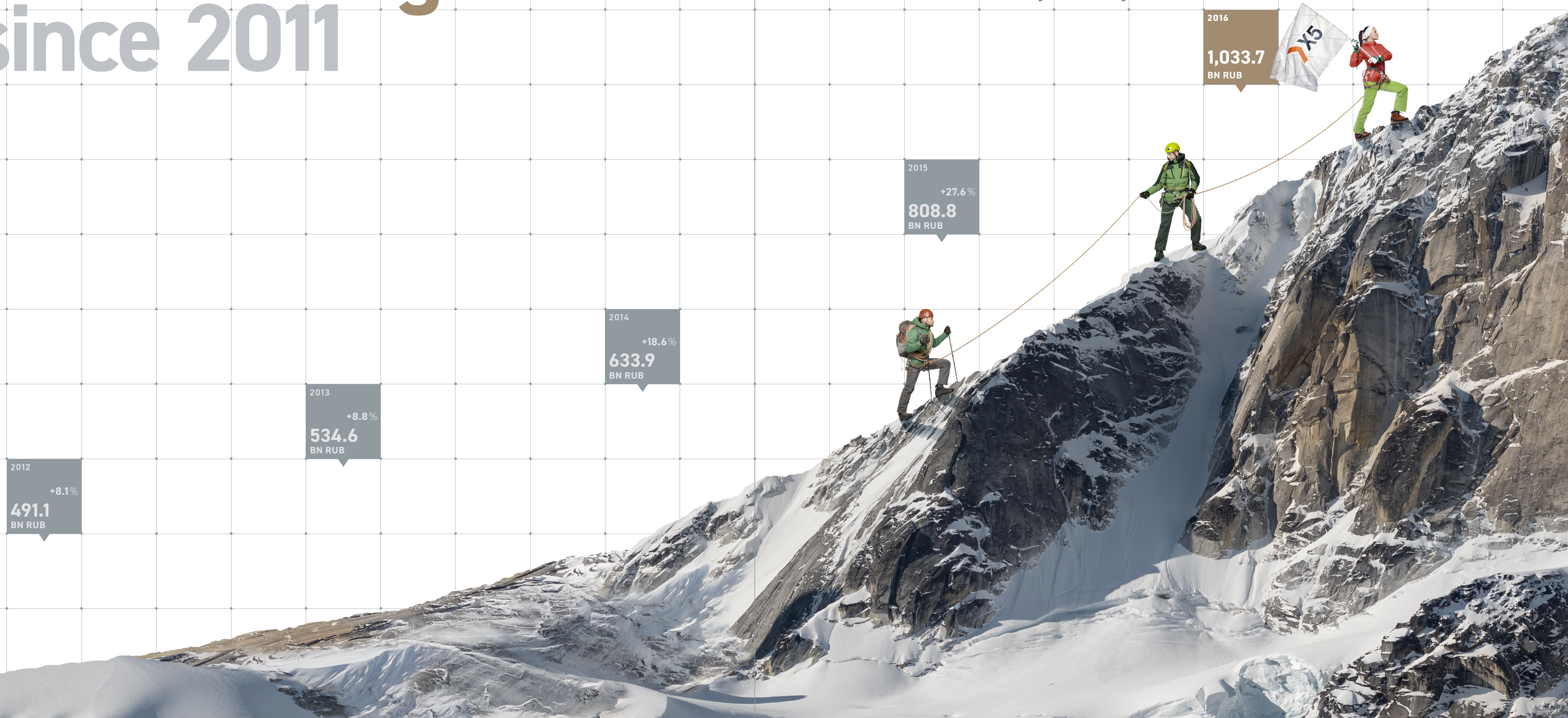


* Only taking into account the playing area of a standard football field which equals 7140 m² according to official FIFA rules

In 2016 X5 achieved its highest rate of revenue growth since 2011

+27.8%

year-on-year



Strategic highlights

Russia's #1 food retailer: 27.8% year-on-year revenue growth, above the top 10 and the sector.

Rapid expansion: 2,167 new stores added; 968.6 thousand m² of new selling space added, with stores in new regions, including the Siberian Federal District.

New store formats: 94% of Pyaterochka stores and 52% of Perekrestok stores operating under the new concepts.

Robust systems for efficient and sustainable growth: full rollout of GIS system for optimising store opening process.

Enhanced logistics: seven new DCs in Moscow, St. Petersburg, Adygea and Orenburg and the purchase of 976 new trucks, bringing our total fleet to 2,318 as of 31 December 2016.

Implementing best practices in EDI: EDI document traffic increased by 40.3% in 2016, with transition to EDI in lease, transport, non-commercial procurement and intercompany transactions.

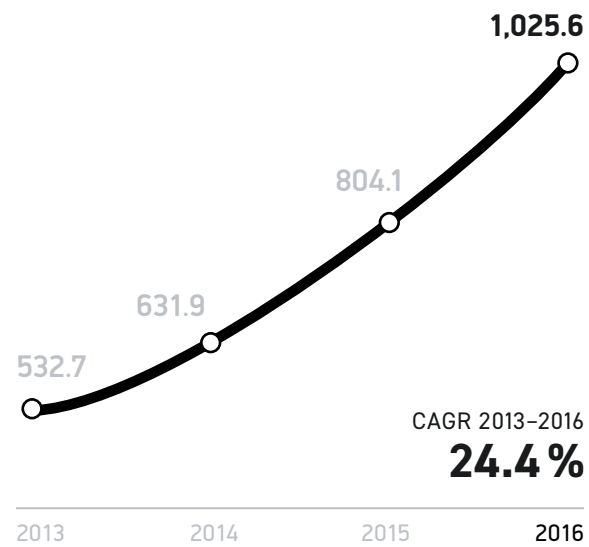
Continued improvements in customer satisfaction: Net Promoter Score (NPS) improved in Q4 2016 compared to Q3 2016: 34.4 vs. 31.7 for Pyaterochka; 15.2 vs. 9.9 for Perekrestok; 26.4 vs. 18.4 for Karusel.

Key highlights

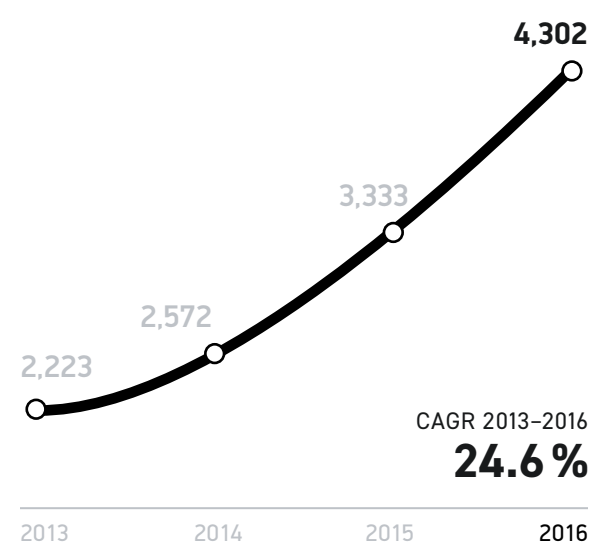
Operating highlights

Intelligent, sustainable growth: Our robust in-house systems have enabled us to continue to grow at a rapid pace while ensuring efficiency and sustainability of our expanding business and supporting operational excellence in stores.

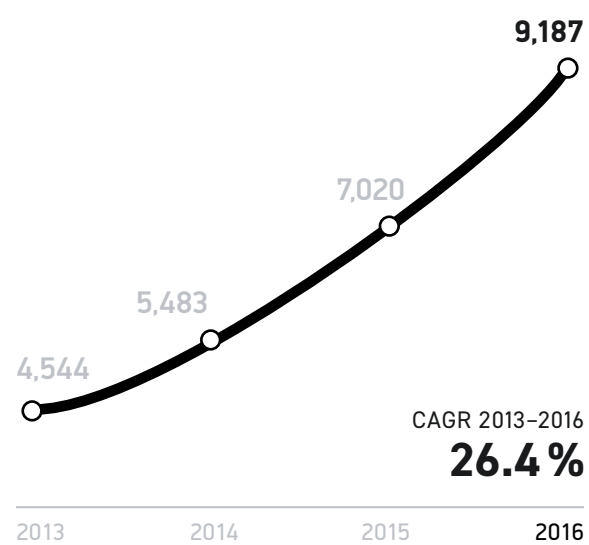
Net retail sales / bn RUB



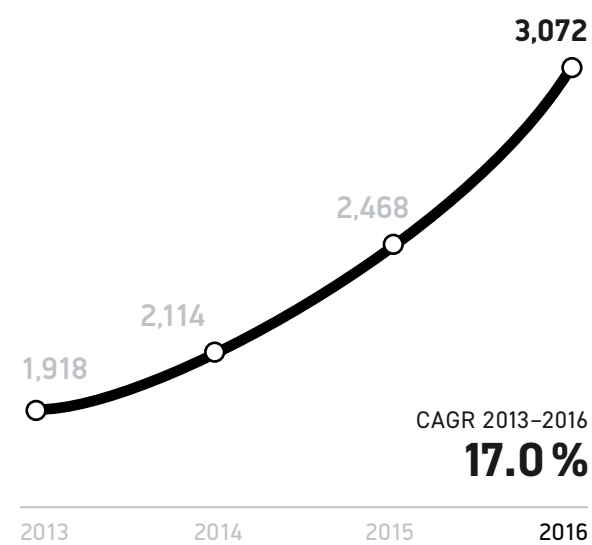
Selling space / thousand m²



Number of stores



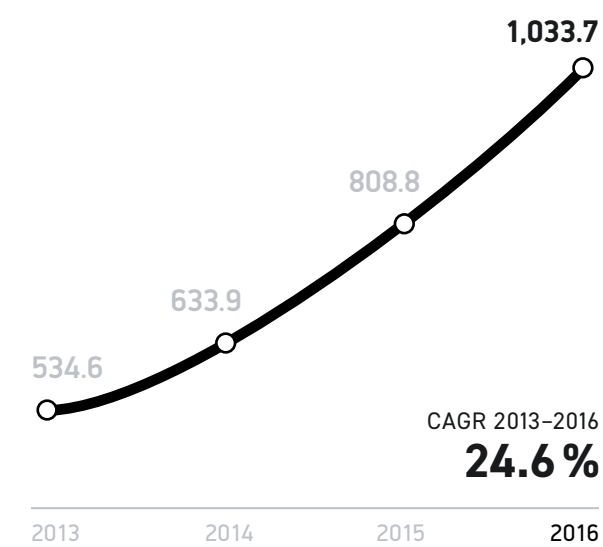
Customer visits / mln



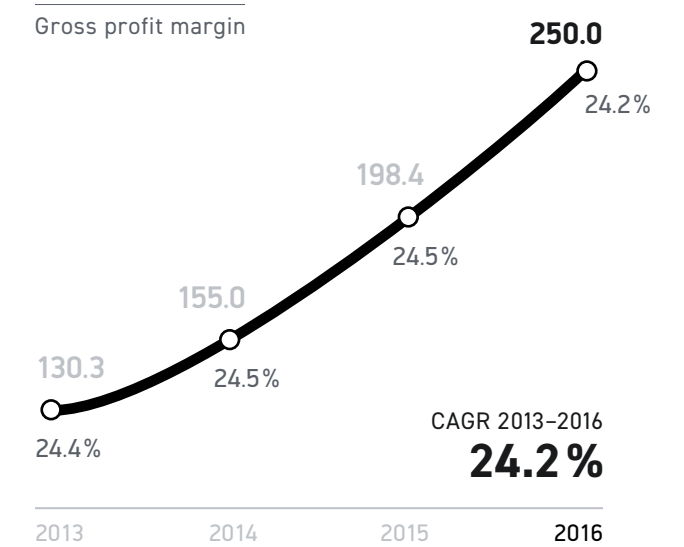
Financial highlights

Maintaining margins: X5's strategy calls for growth above the market and competition while at least maintaining margins. In 2016, we delivered even more: revenue increased 27.8% year-on-year, while our adjusted EBITDA margin expanded to 7.7%, the highest level since 2010.

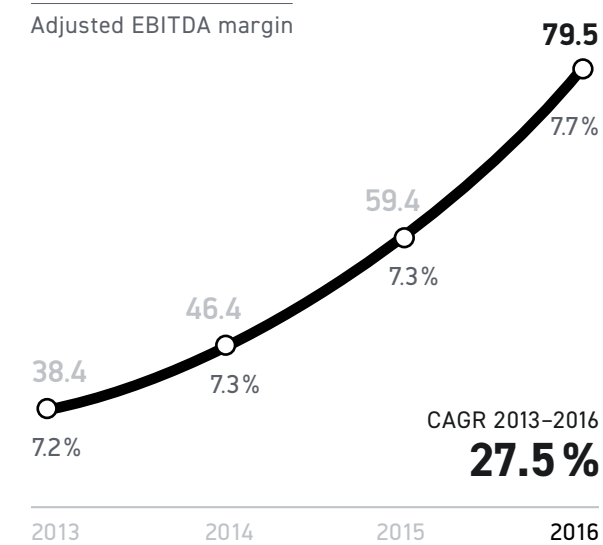
Revenue / bn RUB



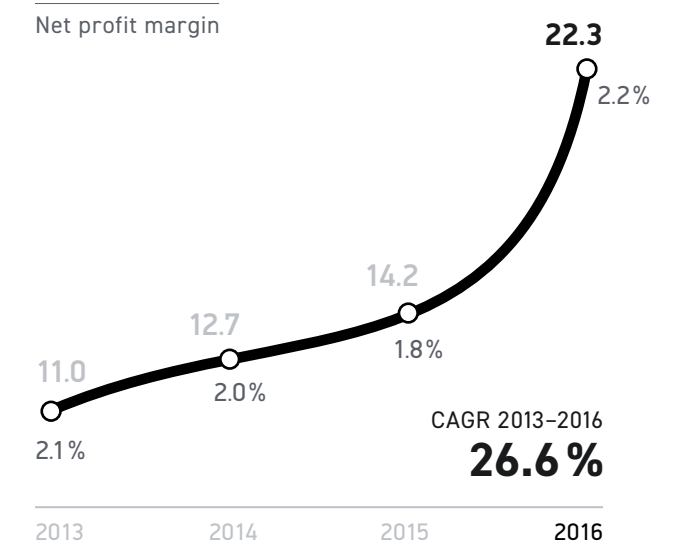
Gross profit / bn RUB



Adjusted EBITDA / bn RUB



Net profit / bn RUB



Intelligent & sustainable growth

634
bn ₺



2014

809
bn ₺



2015



2016

Revenue
totalled

1,034 billion ₺

X5 Retail Group's revenue rose at its fastest pace since 2011, increasing 27.8% year-on-year to over RUB 1 trillion. As we continue our rapid expansion, we are implementing systems that support efficient, intelligent, and sustainable growth in order to secure long-term market leadership.

Chairman's statement

1 / 2

Stephan DuCharme

Chairman of the
Supervisory Board

Dear stakeholders,

It has been just over one year since I took over as Chairman of the Supervisory Board, and I am pleased to see that the Company has continued to deliver rapid, sustainable growth. In 2016, X5 Retail Group achieved the strategic milestone of market leadership while not just maintaining, but improving margins. As a result, we have over-delivered on a goal we set in 2013, and ahead of schedule. Both the Supervisory Board and, I believe, the investment community view this performance very positively.

The achievements of X5 to date, while impressive, are just the beginning of a long journey. Market leadership is not just about being the biggest, it is also about continuing to provide our customers with the best shopping experience in every store, every day. While X5 continues its rapid growth towards the strategic goal of 15% market share by the end of 2020, the Board and I will be paying close attention to ensuring that this is sustainable, high-quality growth, and that X5's retail chains continuously strive to be #1 in the hearts, and in the wallets, of Russian consumers.

I believe that X5 is well-prepared to deliver on these goals, and the 27.8% year-on-year top-line growth in 2016 exceeded expectations, while the adjusted EBITDA margin expanded to 7.7%. While the 2016 results are impressive, the Board and I plan to ensure that management continues to focus on delivering rapid, profitable and sustainable growth in the years ahead.



Chairman statement

2/2

Achieving leadership every day, on every corner

The Board and I are impressed with the record-setting growth achieved by the X5 Retail Group during 2016, and are very pleased with the fact that the Company has recaptured the position of market leader even faster than originally planned.

This feat is made even more impressive because it has been achieved against the backdrop of a volatile economic situation with increasing competition. At the same time, I continuously emphasise to all our stakeholders, including the X5 management team and Supervisory Board, that sustainable market leadership is about providing our customers with the best value proposition and the best shopping experience in every single store. We can only retain our position by maintaining a constant focus on ensuring that every Pyaterochka, Perekrestok and Karusel store seeks to be better than the competitors next door or down the road.

This is why we have focused not only on a scalable, efficient and sustainable business model as we expand our retail chains across Russia, we have also built a structure that can respond to local needs, whether through the "cluster-based" organisational structure implemented by Pyaterochka, or by piloting a new "regional model" for Perekrestok supermarkets. We implement best practices across our chains nationwide, but we always seek to address the specific features of local retail markets in Russia's many regions.

The right model

Our results also confirm that the model we have arrived at through X5's strategic transformation

represents the best way to achieve sustainable growth over the long term. We operate in each of the three largest segments of the Russian food retail market: proximity stores, supermarkets and hypermarkets. We have implemented a decentralised model that gives autonomy to each of the chains to develop, while the Corporate Centre has enhanced efficiency and best-practice sharing across the Company. This model is key for the Corporate Centre's aim to constantly strengthen its role as a hub for food retail expertise.

Creating value for stakeholders

We are creating value for our key stakeholders while creating a virtuous circle that supports continued development; by improving customer perception and satisfaction, we create greater customer loyalty, which supports sustainable growth and profitability. Profitable growth benefits shareholders, which has a positive effect on the entire Company and its employees. Employee satisfaction helps us achieve greater loyalty and productivity, which in turn enhances customer perception, bringing us back to the beginning of the cycle.

Motivation is key

The Board and I understand that a strong team with proper motivation systems in place is one of the keys to our long-term success. The Supervisory Board regularly reviews the short-term and long-term incentive systems in place in order to ensure that X5 Retail Group's management is motivated to deliver strong and sustainable results that are aligned with the interests of shareholders and other stakeholders.

For example, the LTI programme, discussed in more detail in the Remuneration Report on page 174, aims to ensure that management continues to deliver on strategic goals even as we achieved market leadership as of the end of 2016.

Another element of our efforts to ensure that X5 has the right tools to deliver continued sustainable growth and to keep our high-quality team in place is the succession pool. In addition to ongoing work to identify candidates for the succession pool, we have tasked management with increasing the share of internal hiring for key positions, which we believe will help retain employees by giving them greater career growth opportunities within the Company.

Strategic continuity

As I said last year, one of our key priorities is maintaining strategic continuity and ensuring that the Company delivers on the goals set for it by the Board. Our core goal is for the X5 Retail Group to be the largest, most efficient, most attractive and most influential player in the Russian food retail market. This requires continued rapid growth while always keeping the store at the centre of our business.

Ensuring that every store provides its customers with the best possible shopping experience ultimately creates value for shareholders, who benefit as the business expands in a profitable and sustainable way.

Corporate responsibility

Corporate citizenship is an important element of X5's operations, and we view corporate responsibility as a key condition for sustainable market leadership. This responsibility means being a good employer, establishing partner-partner relationships with suppliers, constantly offering our customers value propositions that meet their needs, and seeking ways to improve our environmental footprint to the benefit of X5's business and society. The X5 Retail Group also supports initiatives designed to help people in need, including the Basket of Kindness programme, which we implement together with the Russian branch of the Global FoodBanking Network.

We recognise that ethics and integrity are key components in the fulfillment of X5's sustainable health and long-term success. X5's Code of Business Conduct and Ethics, revised at the end of 2015, was communicated throughout the Company during 2016. It describes the standards of conduct that support our commitment to integrity, and how all employees are expected to treat each other, our suppliers and our customers. In addition to regular monitoring and control throughout 2016, X5 continued to operate an ethics hotline for employees to share concerns or ask questions.

As a public company with a diverse group of investors from around the world, we carefully adhere to transparency and disclosure requirements. We strive to provide investors with full and timely information about the Company's performance, significant transactions, management and Board decisions, as well as strategy and business developments on an ongoing basis.



Governance and the Board

Our governance model is in line with best practice, and functions well to represent the interests of key stakeholders. I am proud to say that our Supervisory Board operates as a strong, independent team, combining a variety of skills and backgrounds in retail, strategy, finance and governance. Members of the Board provide management with valuable guidance and support as they execute X5's ambitious growth strategy. Meanwhile, the Board's profile and composition is reviewed on an annual basis, with an open eye to the evolving nature of X5's business and activities. In May, we welcomed Andrei Elinson as a new member of the Supervisory Board, succeeding Dmitry Dorofeev, who stepped down after serving as a Board member since 2012, and as Chairman since 2013. We are grateful to Dmitry for his valuable contribution during these years.

Throughout 2016, we paid special attention to continuity, both in terms of strategic goals and in terms of our management team. We had two key changes in the executive team during the year, with Dmitry Gimmelberg joining as Chief Financial Officer and Maksym Gatsuts as the General Director of Karusel. I am pleased to say that these changes took place very smoothly.

Outlook

Long-term forecasts predict RUB 3 trillion in growth in the retail market over the next four years. With a presence in all three of the major retail formats and a strong commitment to creating value for more customers by expanding our business, the X5 Retail Group will be in a position to capture a significant portion of that growth.

At the same time, we must keep the quality of our in-store operations at the centre of our attention in a market where, despite signs of stabilisation, consumers continue to search for bargains; new government regulations will require a different approach to working with suppliers; and competition will only increase. Sustainable market leadership will only be possible if we continue to attract more loyal customers by offering them the best value proposition on the market, and I would emphasise once more that the Board and I will be paying close attention to ensuring that X5's formats are consistently adapting their value propositions to the changing needs of our customers in line with market trends.

Thank you to all those who have contributed to the success of the X5 Retail Group, and for your continued support of our Company.

Stephan DuCharme

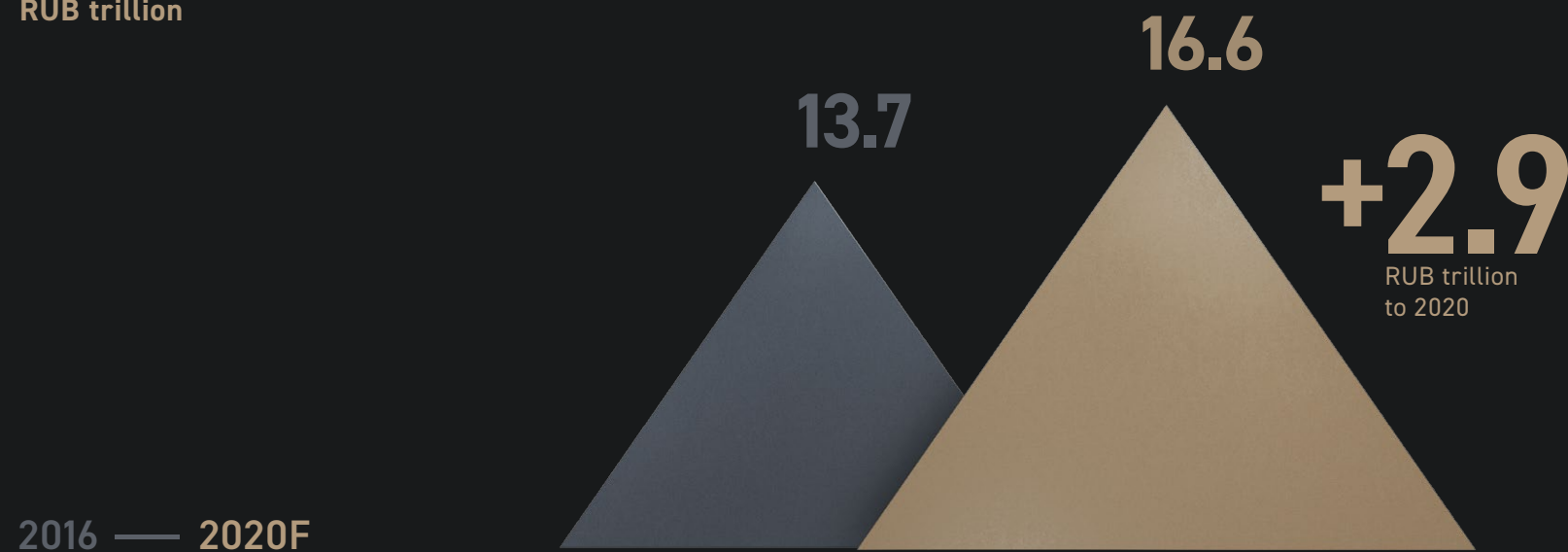
Chairman of the Supervisory Board

Our Brands

We operate in all three of the major food retail segments: proximity, supermarkets and hypermarkets. This means we are well-positioned to capture a significant part of the growth in the Russian food retail market to take place between now and 2020.

Potential total market growth

RUB trillion



SOURCE: Infoline



Pyaterochka

Pyaterochka operates conveniently located proximity stores and is Russia's leading retail brand. This chain is well-attuned to the needs of Russian consumers, offering new promotions every week and a wide assortment of fresh goods. Pyaterochka accounts for the largest part of X5's revenue.



Perekrestok

Perekrestok, Russia's largest supermarket chain, helps its customers achieve their shopping mission with a wide assortment and unique product mix, an attractive loyalty programme, and a range of goods produced in-store.



Karusel

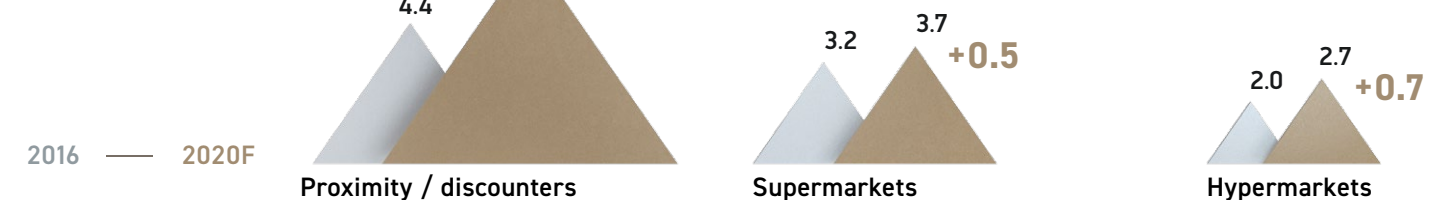
Karusel is one of the leading hypermarket chains in Russia, featuring a broad selection of food and non-food products, including household goods. Karusel primarily operates compact hypermarkets located within city limits that provide easy access with convenient parking and an attractive loyalty programme.

	Pyaterochka	Perekrestok	Karusel
Number of stores	8,363	539	91
Selling space thousand m ²	3,329	548	387
Net retail sales RUB billion	776	155	84
Percentage of X5's net retail sales	75.6%	15.2%	8.1%

AS OF 31 DEC. 2016

Potential market growth by segment

RUB trillion



SOURCE: Infoline

Our business model



The Corporate Centre focuses on Strategy, Strategic Marketing, a Centralised Commercial Function, M&A, Partnerships, Legal, IT, Talent Management, Finance, GR, IR and Corporate Communications



X5 consists of **three major retail formats** and the **Corporate Centre**.

Each of the formats is largely autonomous, running its own operations, marketing, category management, logistics, distribution¹ and expansion operations.

The Corporate Centre is responsible for providing organisational support and strategic leadership across the Company. With the main phase of the strategic transformation complete, in 2016 we were focused on reorganisation of the Corporate Centre, strengthening its role as a management company while decentralising many business functions to the formats.

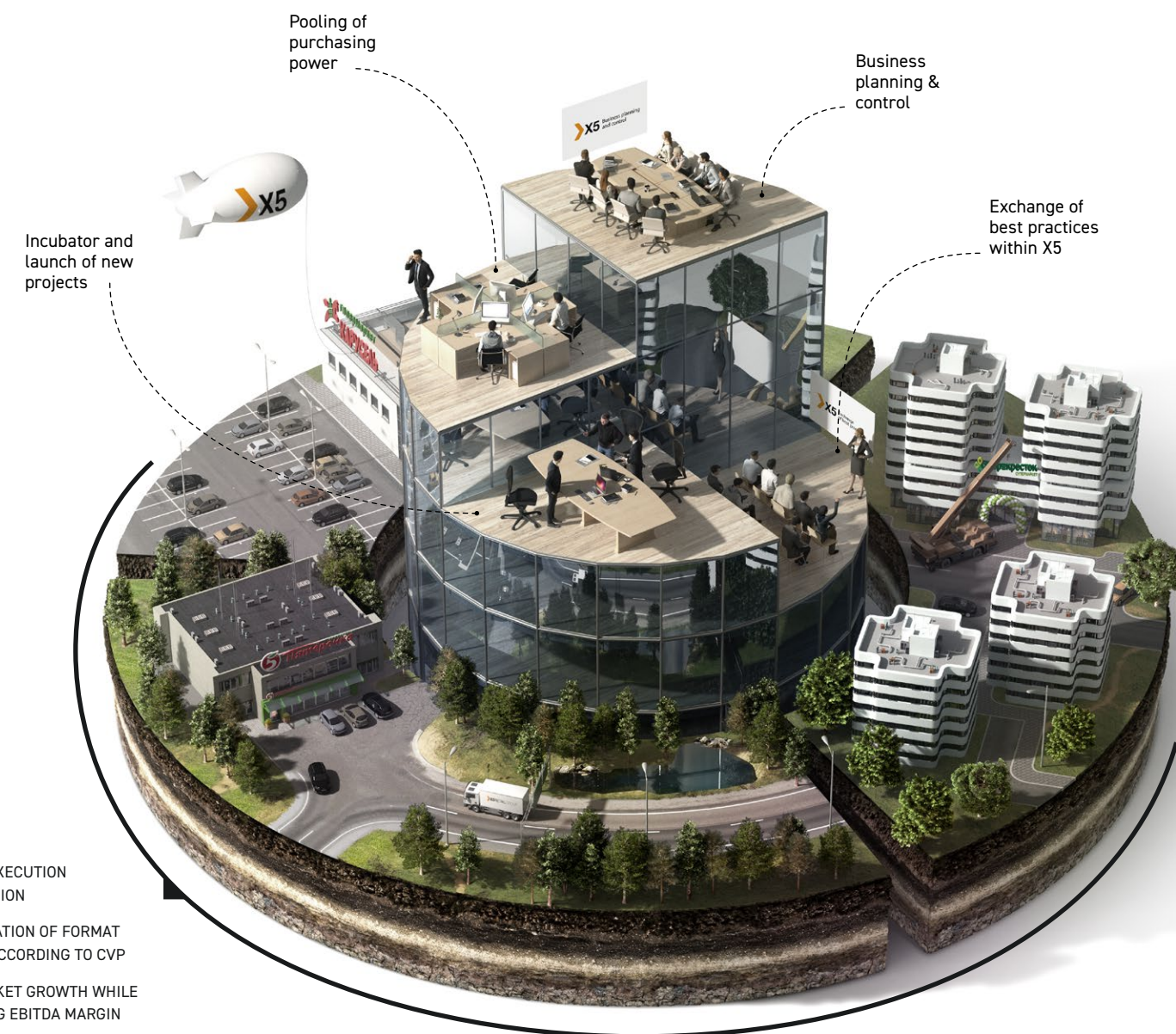
During the year we also launched a number of projects aimed at improving the quality of business processes in the Corporate Centre, and established a new commercial department to act as a shared purchasing function across formats, which helps strengthen bargaining power with suppliers.

This approach enables us to capture the maximum wallet by tailoring each format's value proposition to consumer needs in Russia's dynamic and diverse food retail market.

This business model aims to maximise shareholder value by enabling the retail formats to do what they do best: build effective and profitable businesses in each of their respective segments.

¹ Perekrestok and Karusel share distribution centre capacities in some regions.

The Corporate Centre is focused on providing support for the implementation of X5's strategy and creating synergies that support efficient, sustainable growth. The key areas of responsibility for X5's Corporate Centre include business planning and control, pooling of purchasing power, acting as an incubator and launching new projects, and supporting the exchange of best practices within X5.



- BUSINESS EXECUTION AND EXPANSION
- IMPLEMENTATION OF FORMAT STRATEGY ACCORDING TO CVP
- ABOVE-MARKET GROWTH WHILE MAINTAINING EBITDA MARGIN
- EFFECTIVE OPERATIONS

Russia's food retail market

Highlights

- The **8th-largest** grocery market globally
- Market growth forecast for 2016–2020: **RUB 3 trillion**
- CAGR 2011–2016: **9%**
- Market share of modern retail in 2016: **69%**
- Market share of top 5 in 2016: **23%**
- X5 target market share by the end of 2020: **15%**

Market overview

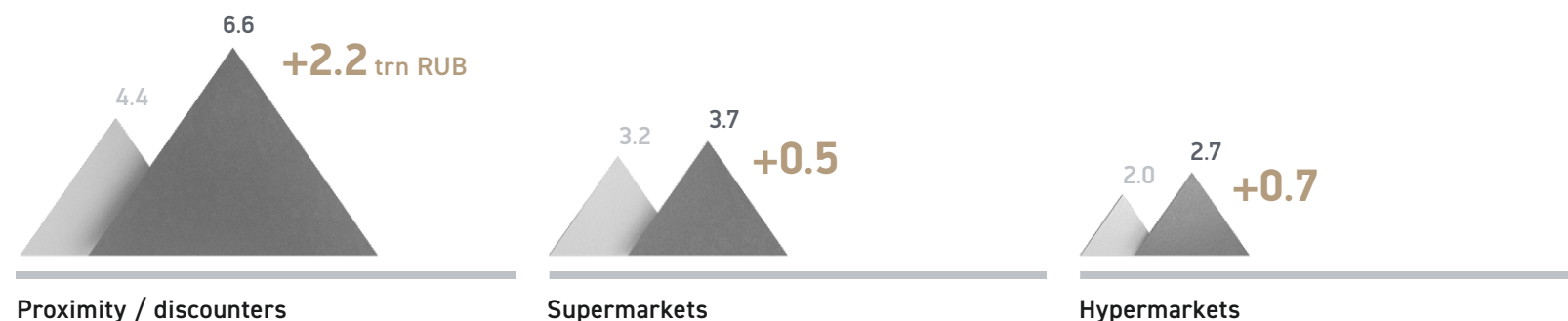
The Russian domestic market has huge potential for medium-term growth, and X5's multi-format model puts us in a position to participate in the majority of that growth.

With the strategic target of a 15% market share by the end of 2020, X5 is on a trajectory to deliver significant top-line growth while maintaining or even improving margins.

Estimated food retail market growth in major formats

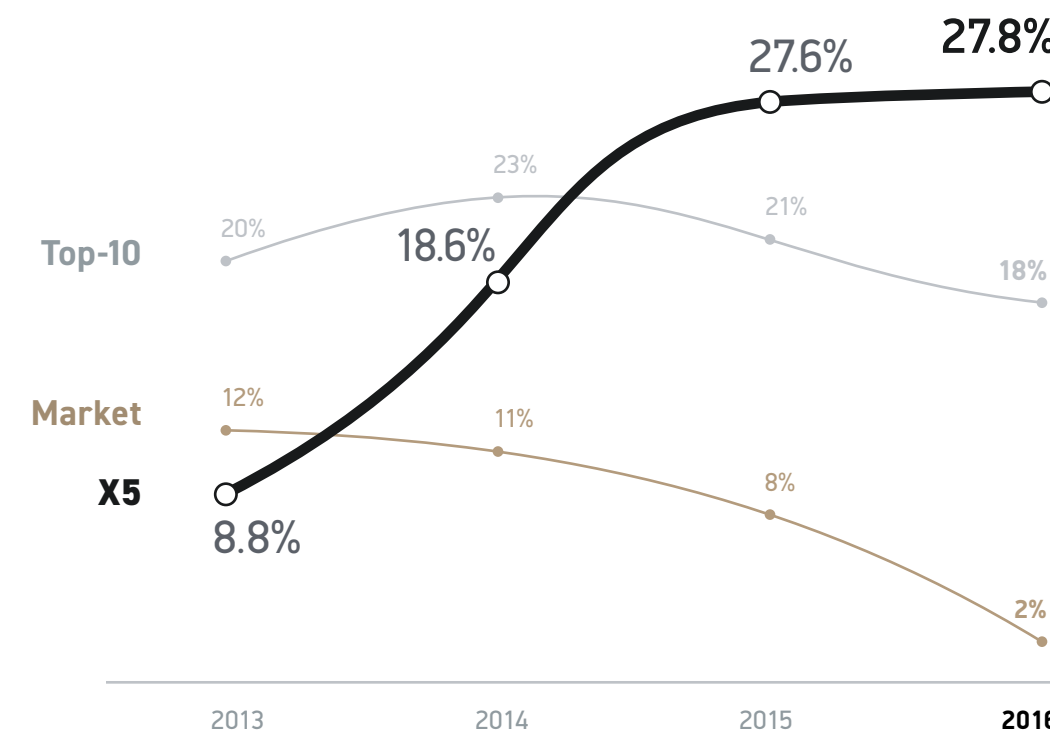
trn RUB

2016 — 2020F



NOTE: The size of Other formats is expected to decrease from 4.2 trn RUB in 2016 to 3.6 trn RUB in 2020.
SOURCE: Infoline

After several years of outgrowing the overall market and five straight quarters expanding faster than all other public food retailers, X5 achieved the strategic milestone of market leadership in Russian food retail.



NOTE: Revenue growth y-o-y
SOURCE: Infoline

Top-10 Russian Food Retailers

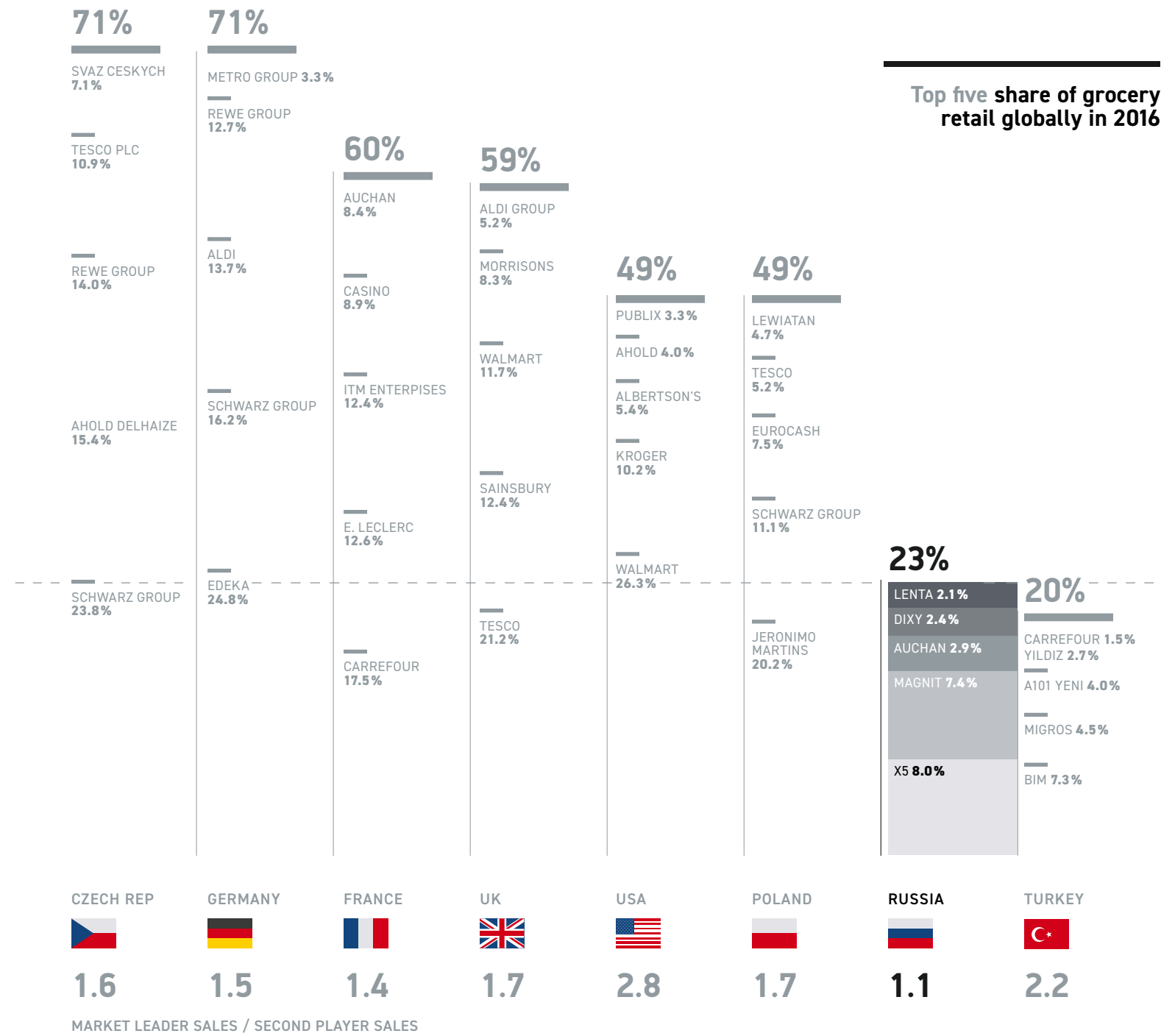
#	Company name	% of total market 2015	% of total market 2016
1	X5	6.3	8.0
2	Magnit ¹	6.8	7.4
3	Auchan	2.8	2.9
4	Dixy	2.2	2.4
5	Lenta	1.8	2.1
6	Metro	1.6	1.6
7	SPS Holding	0.7	1.2
8	O'Key	1.2	1.2
9	Monetka	0.6	0.6
10	Globus	0.5	0.6
Total Top-10		24.5	28.0

¹ Magnit retail sales exclude Magnit Cosmetic store sales.

SOURCE: Infoline

Russia's food retail market

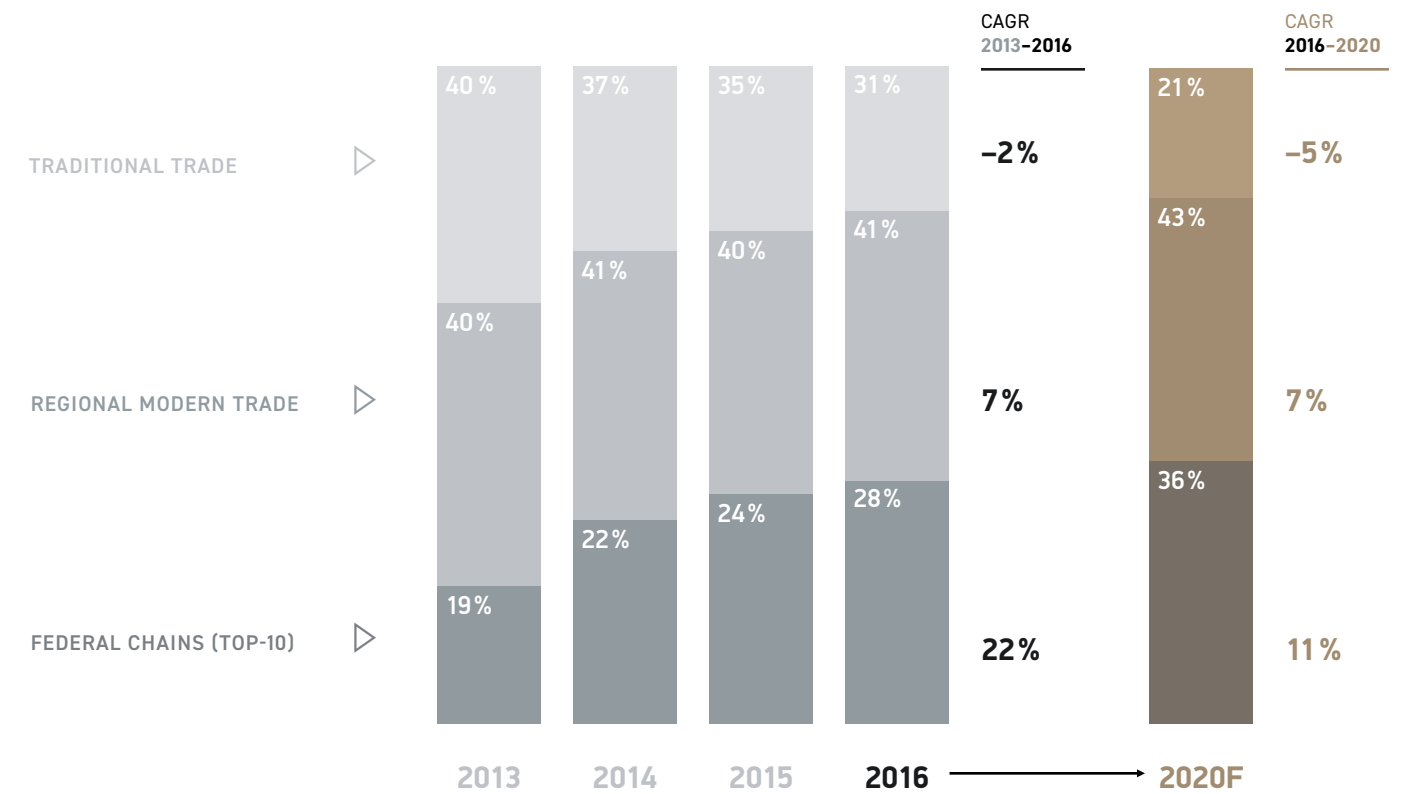
The Russian market is still highly fragmented, and we expect that the market leader in the long term will hold around an 18-22% market share, while the second-largest player will occupy 12-17%. Leading market experts expect that the proximity/discounter as well as supermarket segments will see the greatest consolidation: individual stores, small regional chains and informal trade will increasingly give way to leading players. In the hypermarkets segment, the market is already controlled primarily by large federal players.



SOURCE: Euromonitor, Infoline for Russia

Despite a substantial level of modern trade penetration in Russia, there is still potential for further growth in modern retail. The expansion of the largest players across the entire Russian Federation is expected to increase the top 10 federal players' overall share of the market from approximately 28% in 2016 to around 36% by 2020.

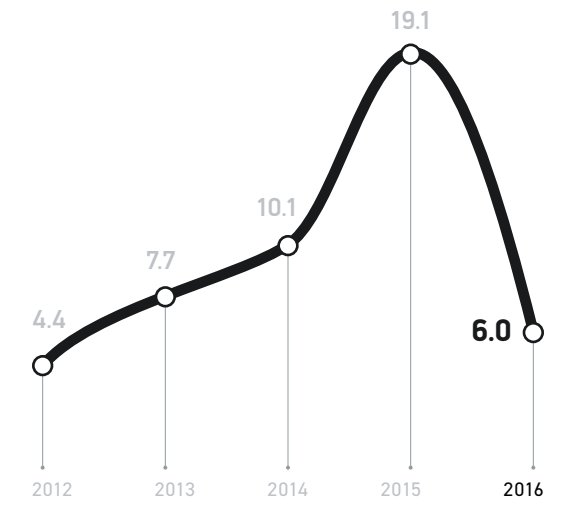
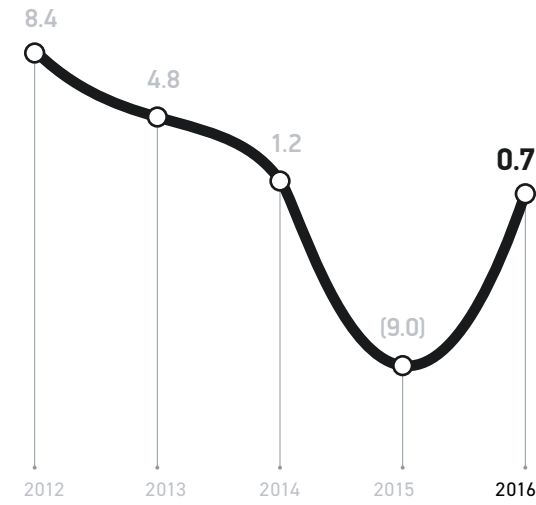
Russian food retail market development



SOURCE: Infoline

Economic & consumer trends

While the Russian economy posed challenges for doing business in 2014 and 2015, the situation in 2016 began to stabilise, with the potential to return to growth as early as 2017.



Real Wage Growth, %

Food CPI, %

SOURCE: Rosstat

X5 has proven its ability to adapt to and even prosper through the economic downturn, leveraging its scale, efficiency and flexibility to grow profitably while the growth of others slowed.

X5 has identified the key trends that will drive Russia's food retail market in the coming years, and is prepared with its own responses to these challenges and opportunities.

Trend	Description	Conclusions	X5's Response
Changing demographics	<ul style="list-style-type: none"> Growth of age 60+ population by 2-3% per annum vs. reduction of 20-29-year age group by 6% per annum 	<ul style="list-style-type: none"> Growth of price-sensitive consumer segment Growth of proximity format popularity 	<ul style="list-style-type: none"> Continued expansion of proximity segment (>75% of X5 revenues) 5-10% discounts for pensioners from 9:00 until 13:00 Focus on mothers with children
Declining population income	<ul style="list-style-type: none"> Increased price sensitivity and rational spending Growth of "cherry pickers" 	<ul style="list-style-type: none"> Growth in attractiveness of proximity/discounters Increased pressure on margins (need for opex reduction) 	<ul style="list-style-type: none"> Constant adaptation of value proposition to customer needs Best-in-class "promo engine"
Growing competition	<ul style="list-style-type: none"> Retail space saturation "Value" format development (e.g. hard discounters, dollar stores) 	<ul style="list-style-type: none"> Increasing pressure on LFL Increased pressure on margins (need for opex reduction) 	<ul style="list-style-type: none"> Strong regional expansion with effective value proposition for small cities and towns Development and rollout of new regional supermarket concept Effective GIS system to help find optimal locations
Spread of new technologies	<ul style="list-style-type: none"> Growth of online shopping and price transparency Increase in big data analytics 	<ul style="list-style-type: none"> Opportunity to improve competitiveness through service and personalisation 	<ul style="list-style-type: none"> Online retail initiative within the supermarket segment Successful development of loyalty programme and personalised promo in Perekrestok Further implementation of advanced analytics
Tightening market regulation	<ul style="list-style-type: none"> Retail trade legislation (back-margin constraints) EGAIS and other control systems International sanctions 	<ul style="list-style-type: none"> Additional costs due to new regulation Growing margin pressures Product shortages and price inflation 	<ul style="list-style-type: none"> Self-regulation approach Switch to net-net pricing Strategic partnerships with suppliers

CEO statement

1 / 2

Igor Shekhterman

Chief Executive Officer

Dear Stakeholders,

Looking back at my first full year as CEO of X5 Retail Group, I am happy to say that we have achieved all of the targets set out by the Supervisory Board and Company management. We are now Russia's largest food retailer – we finished the year larger, stronger, and growing faster than ever. We are creating value for stakeholders as the fastest-growing public player in Russia's food retail market, building a stable and sustainable business that aims to benefit consumers, employees, partners and investors over the long term.

Some of the key achievements of 2016 that I would like to highlight include:

- As of Q4 2016, X5 became Russia's #1 food retailer, increasing its market share from 6.3% in 2015 to 8.0% in 2016;
- Total revenue grew by 27.8% and exceeded RUB 1 trillion;
- Like-for-like sales were positive across all major formats despite significant deceleration of food inflation from 19.1% in 2015 to 6.0% in 2016;
- While continuing rapid growth, we improved our adjusted EBITDA margin from 7.3% in 2015 to 7.7% in 2016.

Record-setting growth in terms of square metres, 86% of which was organic, was the major contributor to top-line growth, helped by a 7.7% increase in like-for-like sales. At the same time, our continued focus on efficiency and operational excellence delivered solid profitability and a stable financial position: adjusted EBITDA rose 34% to RUB 80 billion, helping bring our net debt to EBITDA ratio down to 1.8x, the lowest level in the Company's history.



CEO Statement

2/2

Delivering on strategic targets

With the strategic transformation successfully completed, we are focused on execution against the targets that the Board of Directors has set before the Company. As promised in 2015, we maintained strategic continuity, stayed focused on execution, and delivered on our targets in 2016.

Effective multi-format operating model: X5 continues to develop each of its three major formats with the goal of capturing a significant 15% share of Russia's food retail market as it continues to grow. We delivered 29.1% selling space growth, adding 968.6 thousand square metres of retail space during 2016, with 2,167 new stores added during the year. In line with our strategy, 86% of this selling space growth was attributable to organic growth.

These results are particularly impressive given that the Russian food retail market as a whole grew by just 2.2% in 2016 and that the top 10 players grew by 17.6%, illustrating just how much faster we are expanding than the rest of the market.

In 2016, we completed the reorganisation of the Corporate Centre to strengthen its role as a management company and to decentralise many business functions by handing them over to the formats. The X5 Corporate Centre plays a key role in ensuring that the Board's strategic vision is properly implemented, in a sustainable way, across each of our formats. It focuses on establishing and enforcing standards, business planning, analysis and control functions. Other important roles played by the Corporate Centre include acting as an incubator for launching new projects and facilitating the sharing of best practices across the retail formats.

With the Corporate Centre providing overall guidance and leadership, each of the formats strives to be the best in its respective segment. This will enable X5 to maximise benefits of scale while improving efficiency across retail brands by giving them the necessary flexibility and decision-making power, as well as responsibility, to achieve goals set by the Board and the Corporate Centre.

Superior value propositions: Each of X5's major formats addresses unique shopping missions and shopping strategies of consumers in Russia. Through continuous monitoring and adaptation of their value propositions, each of the formats seeks to capture the maximum share of wallet and expand market share in its respective segment. X5's successful implementation of advanced IT systems has enabled us to analyse and gain deeper insight into market trends and to tailor our assortment, promotions, and new offerings to the shopping missions of our consumers.

We are also adapting to our customers' needs by introducing day-to-day improvements in Pyaterochka stores, piloting a promising regional supermarket model for Perekrestok, developing the loyalty programmes of Karusel and Perekrestok, and preparing to launch a new online supermarket project aimed at supporting Perekrestok's core audience.

Intelligent growth while maintaining margins: 2016 marked the completion of the full rollout of our in-house GIS system, which significantly streamlines the decision-making process for new store openings and has brought about a 4x reduction in the number of errors when choosing new locations. In order to build a sustainable market leader, we use advanced analytics to select new store locations, and X5 has built strong in-house

capabilities for land acquisition and construction. Our primary focus is on organic growth, but X5 also possesses strong internal capabilities in M&A, enabling us to rapidly enter new regions or strengthen a format's market position in an existing location.

Hand-in-hand with business growth, we managed to improve our EBITDA margin in 2016 thanks to successful cost management as a result of operational efficiency programmes, as well as the operating leverage effect.

End-to-end operational excellence: Achieving the growth we have delivered in recent years while maintaining and even expanding margins requires constant attention to operational excellence throughout the value chain. In 2016, we continued to focus on in-store operations, improving lease conditions, strengthening our transport and logistics infrastructure and enhancing our partnerships with suppliers. X5 has shown it is able to continue growing and adapting effectively and efficiently, even in Russia's rapidly changing environment. We lead the market in terms of electronic document exchange, which has significantly improved the quality of our work with suppliers. We are constantly improving our logistics operations, opening seven new state-of-the-art distribution centres while closing down the same number, as they no longer met our increasingly ambitious efficiency criteria.

Strong leadership team: Our performance in 2016 also underscored the strength of the X5 team and the fact that we have effective systems in place to retain and motivate staff, both short-term and long-term, in alignment with the interests of our shareholders. Even as we successfully completed the transition to a new CFO during the year,

X5 stayed on course for another year of excellent results. We likewise have high hopes for the new head of Karusel, Maksym Gatsuts. I am confident that the two new members of our team will make important contributions to X5's future. Going forward, our succession planning efforts should mean that we see a larger number of internal promotions to key posts.

Operating environment

We delivered strong growth despite a continuing downturn in most key economic indicators for Russia. In this challenging macroeconomic environment, we adjusted our assortment with more lower-priced goods, optimised our promotional mechanism, offered interesting new products and focused on improving customer loyalty. This is in line with our constant focus on providing the best shopping experience, the best service and the best store in every single location where X5 operates.

Our challenges range from changing demographics to declining per capita incomes, growing competition and the spread of new technologies, and stricter regulation. These factors will affect the entire retail industry, so we seek to be better-prepared to address these issues in order to continue building a successful and profitable business. We discuss X5's response to these key market trends in detail on pages 32–33.

One of the ways that we are adapting to the changing market environment is by focusing on building long-term, mutually beneficial strategic partnerships with suppliers. Relationships like this, built on trust, will help to improve purchasing conditions, create long-term relationships based on trust and help introduce cutting-edge solutions and products.

**Outlook**

While we do not expect meaningful positive macroeconomic developments in Russia in the medium term, significant growth opportunities still exist in the food retail sector thanks to consolidation among top players, increasing penetration of modern retail, the opportunity to implement modern retail features that improve customer satisfaction, and overall market growth.

Longer-term, we remain confident about X5's potential as a leading food retailer in Russia, with forecast market expansion (see page 28) and top players expected to consolidate their positions (see page 31). As we move from the goal of being the #1 food retailer in Russia to the goal of having a target market share of 15% by the end of 2020, X5 is positioned to deliver significant growth for years to come.

Our focus will remain on organic growth while maintaining margins as we develop all three of our major formats. X5 will focus on continued growth of Pyaterochka as the country's leading proximity store, expanding Perekrestok's regional model and improving Karusel's performance in the hypermarket segment.

An important element of sustainable leadership is operational efficiency and innovation. To achieve this we remain focused on implementing a logistics strategy that efficiently meets the needs of our growing business, more comprehensive coverage of our supply chain with new direct import and cross-docking facilities, and on the construction of new, efficient DCs. We also bought 976 new trucks in 2016, and plan to continue expanding our own fleet of modern, efficient trucks throughout 2017.

Putting the numbers aside, our aim is for every store to be the leader for its customers in its neighbourhood or region. With fierce competition from other federal and regional players, we are constantly looking for ways to improve our value proposition, shopping experience, and efficiency. While the increases in our key indicators tell part of the story, our goal in this report is to show how X5 Retail Group's philosophy of leadership influences everything we do, forcing us to constantly innovate to create value for our customers in every store, which will ultimately be reflected in value for shareholders.

Credit for our success in 2016 is due to the support we received during this year from our suppliers, shareholders and the Supervisory Board. Of course, we would be nothing without our customers, who are at the core of everything we do.

I give my thanks to the excellent management team and the employees of X5 Retail Group, who put our leadership mentality into practice every day, for their hard work and dedication to achieving the challenging goals that have been set before the Company as we continue to strengthen our position as Russia's #1 food retailer.

Igor Shekhterman
Chief Executive Officer

Strategic progress

In 2016, the X5 Retail Group continued to move towards achieving its key strategic goals of strong growth while at least maintaining margins. We have built a business capable of rapid, sustainable and agile growth; X5 successfully adapted to challenging market conditions while continuing to expand faster than the rest of the market in 2016.

Looking ahead, we continue to seek innovative solutions to enable us to further enhance our ability to create value for our customers, partners, employees and investors.



Anton Mironenkov

Director of Strategy



Our strategy focuses on delivering rapid, intelligent, and sustainable growth while maintaining margins. X5's multi-format business model enables us to operate in each of the largest food retail segments, capturing greater wallet share with value propositions that meet the needs of a wider range of Russian consumers.

Our long-term goal is to become the undisputed market leader, with a market share of 15% by the end of 2020.

Strategic goals

Multi-format operating model

- Act as a hub of customer value propositions/retail chains
- Build a platform that enables management of the portfolio of retail chains
- Target the largest and most profitable segments of the Russian food retail market

Constant adaptation of value propositions

- Develop distinct value propositions for each format
- Continuously adapt to evolving market conditions and customer demand
- Execute holistically from comprehensive assortment and category reviews to store refurbishments

Strong leadership team

- Maintain the right mix of skills to execute even in a tough operating environment
- Motivate based on long-term value creation

Intelligent growth

- Focus on organic growth
- Engage in tactical regional M&A as a way to quickly reach critical mass
- Improve store refurbishments and new store opening efficiencies
- Expand partnerships

Excellence in operational execution

- In-store execution
- Optimise distribution centre logistics and transportation
- Improve shelf availability

What we did in 2016

- ✓ Separated functions between the Corporate Centre and the retail formats
- ✓ Developed the responsibility matrix between the Corporate Centre and retail formats
- ✓ Enhanced the role of the central office as a service provider and a platform for sharing best practices across the retail formats
- ✓ Continued development of three major retail formats with the goal of maximising the share of the growing market

- ✓ Adapted our assortment, introducing new entry-price PLUs and developing private labels
- ✓ Optimised promotions to improve customer loyalty
- ✓ Improved customer satisfaction metrics, with NPS scores improving across all three formats in Q4 2016 compared to Q3 2016
- ✓ Introduced the "regional supermarket" model for Perekrestok expansion outside of Moscow and St. Petersburg
- ✓ Began development of an online supermarket based on the Perekrestok brand (due to launch in Moscow in 2017)
- ✓ Developed loyalty programmes for Perekrestok and Karusel

- ✓ Successfully transitioned to new CFO while accelerating growth and improving margins
- ✓ Enhanced internal talent pool
- ✓ LTI programme continued to align management and shareholder interests, with X5 rapid expansion while at least maintaining margins

- ✓ Opened the landmark 9,000th store, ending year with 9,187 stores after adding 968.6 thousand square metres of selling space (86% of which was organic growth)
- ✓ Increased food retail market share from 6.3% in 2015 to 8.0% in 2016
- ✓ Increased presence in new cities and towns, growing by 26% year-on-year
- ✓ Completed rollout of an in-house GIS system to streamline store openings
- ✓ Established presence in Siberian Federal District
- ✓ 94% of Pyaterochka and 52% of Perekrestok stores operating under the new concept

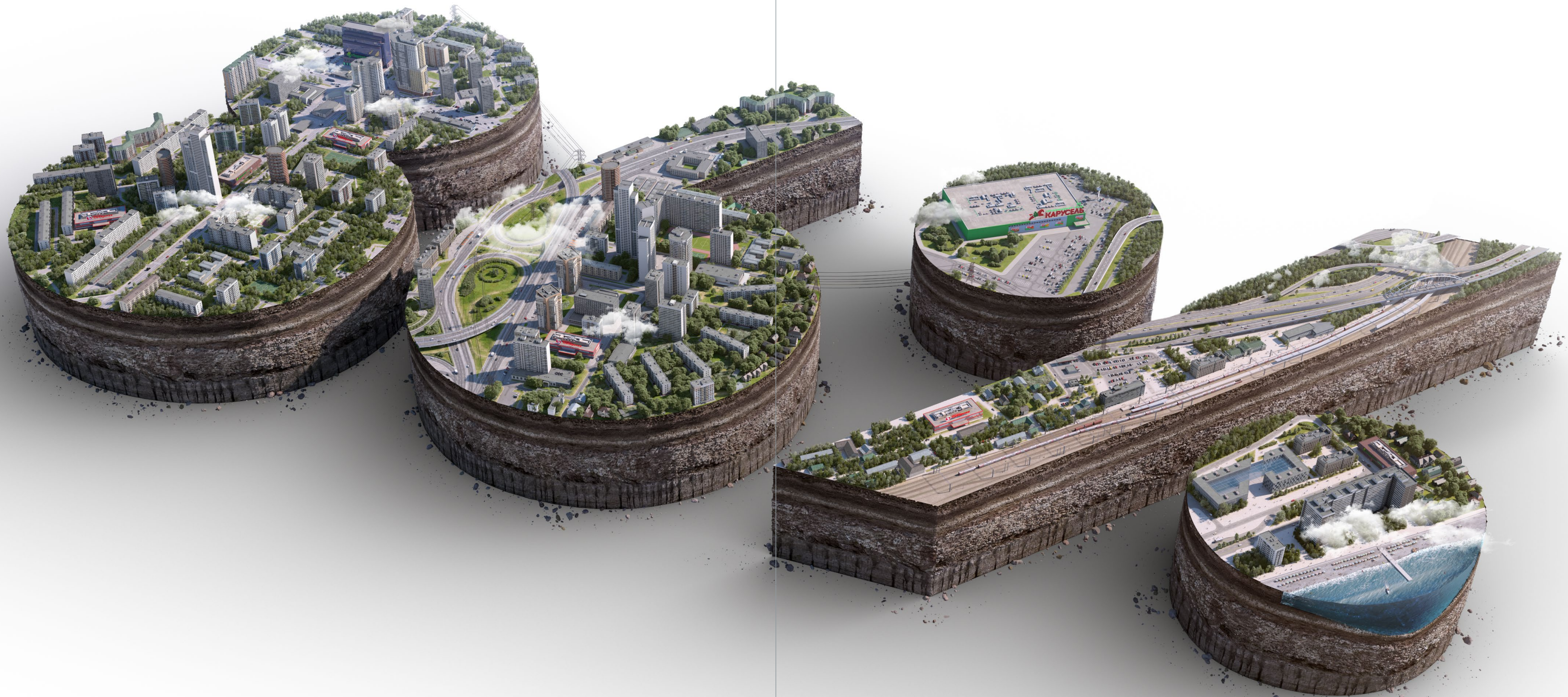
- ✓ Made day-to-day in-store improvements: new shelf layouts; introduced new "tobacco shops" at Pyaterochka, offering tobacco and premium spirits at cash registers
- ✓ Incorporated all planogram and layout designs into the JDA automated planning system
- ✓ Made improvements to SG&A, including staff costs, lease costs, and other store costs
- ✓ Improved lease conditions, reducing costs and motivating property owners to help increase traffic
- ✓ Opened seven new DCs in Moscow, St. Petersburg, Adygea and Orenburg
- ✓ Purchased 976 new trucks; increased own fleet from 1,561 as of 31 December 2015 to 2,318 as of 31 December 2016

Goals for 2020

- › Deliver strong top-line growth above the market and competition while at least maintaining margins
- › Double the size of the business within 3–4 years after 2015
- › Achieve a 15% market share by the end of 2020
- › Focus on organic expansion
- › Support a self-regulation strategy for Russian retail
- › Further optimise logistics and operating expenses
- › Reduce shrinkage costs

Focus on organic growth

We are focused on organic growth, which accounted for 86% of our selling space expansion in 2016.



Growing market share and expanding to new regions

26% increase in the number of cities and towns where we are present, to more than 2,100 at the end of 2016

Our geographic expansion aims to leverage the potential to strengthen our presence in regions where we already work, and to enter new regions or localities that are underserved by federal players offering modern retail formats:

- Defend and expand core "home" regions
- Expand in other regions and build critical mass, including with the help of tactical M&A
- Target new regions over time (X5 entered Siberia in 2016)
- Faster expansion in rural areas
- Synchronised logistics expansion

Total stores

9,187

Total number of Distribution centres

35

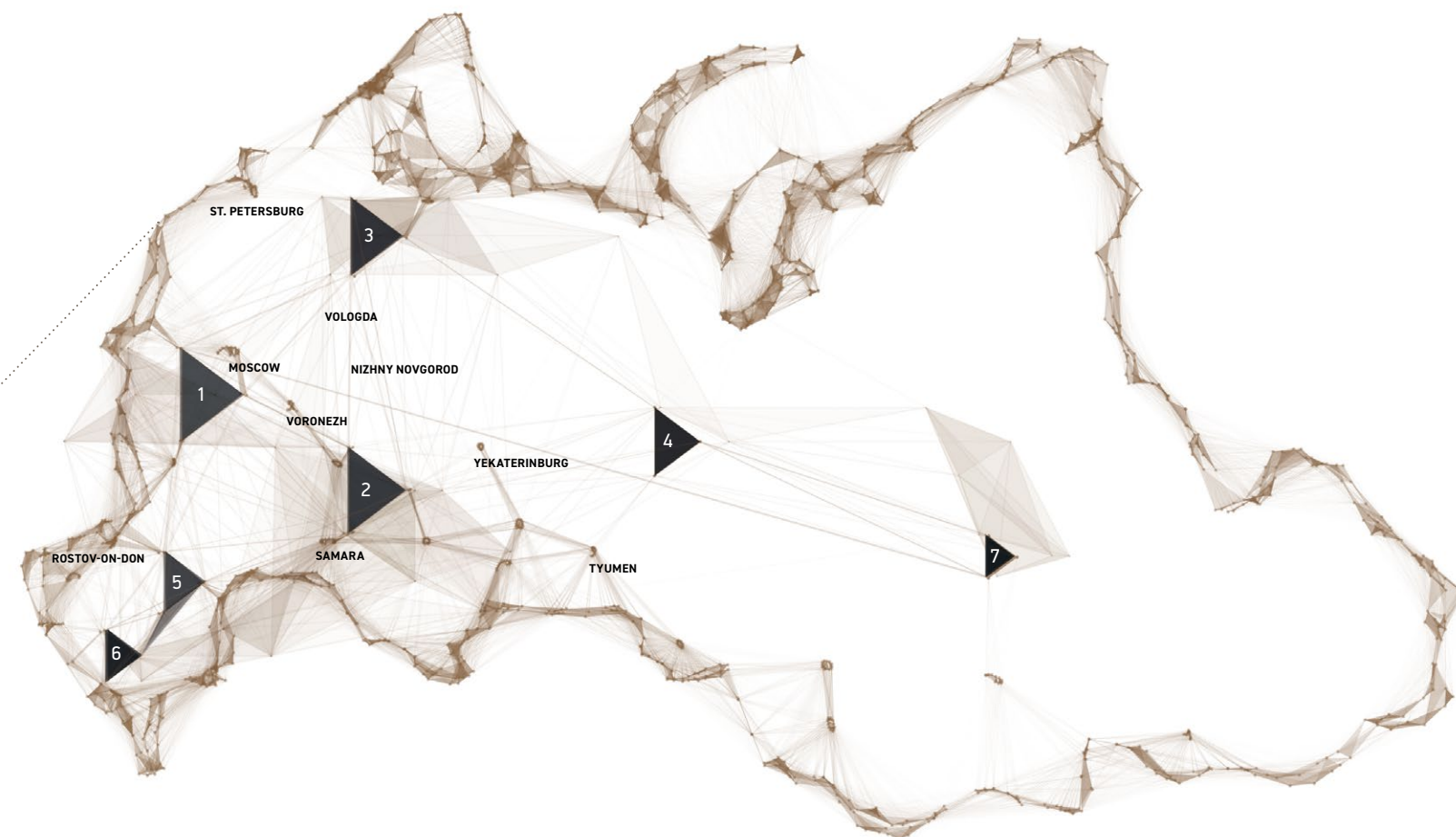


8,363	539	91	194
Pyaterochkas	Perekrestoks	Karusels	Express

31 DEC. 2016

SHARE IN X5'S NET RETAIL SALES FOR 2016

1	2	3	4	5
Central F. D.	Volga F. D.	North-Western F. D.	Ural F. D.	Southern F. D.
57.0%	17.4%	15.3%	5.6%	3.9%
Pyaterochka 3,512 (+772)	Pyaterochka 2,348 (+615)	Pyaterochka 1,028 (+247)	Pyaterochka 730 (+203)	Pyaterochka 577 (+186)
Perekrestok 336 (+35)	Perekrestok 95 (+5)	Perekrestok 50 (+3)	Perekrestok 26 (+10)	Perekrestok 24 (+2)
Karusel 35 (+1)	Karusel 25	Karusel 17	Karusel 8	Karusel 5
Distribution centres 14	Distribution centres 7	Distribution centres 5	Distribution centres 6	Distribution centres 3



A platform for sustainable growth

Regions	Number of stores				
	2012	2013	2014	2015	2016
Central	1,978	2,314	2,653	3,262	4,077
North-Western	563	644	720	845	1,095
Volga	793	1,002	1,368	1,848	2,468
Ural	252	325	405	551	764
Southern	184	201	276	418	606
North Caucasus	20	46	61	96	137
Siberian	0	0	0	0	40
Ukraine	12	12	0	0	0
TOTAL	3,802	4,544	5,483	7,020	9,187

NOTE: Based on Federal Districts (for the Russian Federation only)

Executive Committee

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Our strong leadership team combines the skills and experience needed to deliver on X5's ambitious strategic targets.



Igor Shekhterman

X5 Chief Executive Officer, Chairman and Member of the Management Board



Dmitry Gimmelberg

X5 Chief Financial Officer



Olga Naumova

General Director of Pyaterochka



Vladimir Sorokin

General Director of Perekrestok



Maksym Gatsuts

General Director of Karusel



Anton Mironenkov

Director of Strategy



Olga Kruzhkova

Organisational Development Director



Fabricio Granja

Chief Information Officer



Ekaterina Lobacheva

General Counsel



Stanislav Naumov

Government Relations Director



Elena Konnova

Corporate Communications Director



Dmitry Agureev

Head of Corporate Security



Frank Lhoëst

Company Secretary, Member of the Management Board

Executive Committee

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**Igor Shekhterman**

X5 Chief Executive Officer, Chairman and Member of the Management Board

Igor has served on X5's Supervisory Board since 2013. He was Managing Partner and CEO of RosExpert, which he co-founded in 1996 and subsequently successfully developed into the Russian alliance partner of Korn/Ferry International. Igor started his career as Finance Manager at the Russian branch of Beoluna, the Japanese jewellery producer. Igor holds a degree in economics from the Kaliningrad Technical Institute (1992), and degrees in business administration from the Institute d'Administration des Entreprises (France, 1994) and the Danish Management School (1995).

**Dmitry Gimmelberg**

X5 Chief Financial Officer

Prior to joining X5, Dmitry served as Deputy CEO for Strategic Development at Locomotive Technologies (part of the TransMashHolding Group). From 2012 to 2015, he held senior roles within the Basic Element Group operating company. In these positions he oversaw a number of strategic transformations at operating companies, established management and financial reporting systems and led a project management office. Between 2008 and 2011, Dmitry held management positions at Invest AG, a Russia- and CIS-focused investment advisory business. Prior to that, in 2002–2006, he worked for Ritzio Entertainment, where he was a member of the Board of Directors and Vice President of Finance, Legal Affairs, International Development and Property. Before that he worked in the FMCG sector, holding the position of Finance Director for Russian Standard Vodka. Education: Dmitry graduated with honours from the St. Petersburg State Polytechnic University and holds an MBA from the Maastricht School of Management.

**Olga Naumova**

General Director of Pyaterochka

Olga joined X5 in May 2013. She has over 20 years of managerial experience at the senior executive level with leading Russian and international companies, including Rimera, Severstal and IBS. During this time, Olga has effectively managed very large teams in both Russian and international environments and has a track record of success in business integration and restructuring. Education: Olga graduated from the Faculty of Social Sciences at Moscow State University in 1994.

**Vladimir Sorokin**

General Director of Perekrestok

Vladimir joined X5 in January 2013 as Deputy Purchasing Director, and in June 2013 he became the Director of Category Management for Pyaterochka. Vladimir has approximately 20 years of experience in the retail, FMCG and insurance industries and has held senior management positions at Alfa Insurance, SunInterbrew and Gillette, where he has successfully led both strategy development and business transformation projects. Education: Vladimir attended the St. Petersburg Institute of Economics and Trade, where he specialised in food production technology; and the National Research University Higher School of Economics, where he specialised in finance and credit.

**Maksym Gatsuts**

General Director of Karusel

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

**Anton Mironenkov**

Director of Strategy

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

Executive Committee

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Olga Kruzhkova
Organisational Development Director

Olga joined the X5 team in October 2015. She has a strong track record of implementing organisational change, improving governance, developing internal communications and managing HR projects. Before joining X5, Olga was a directorate head in the Organisational Development Department at ROSATOM. In 2006–2008, she ran a project management office at UC RUSAL. In 2005–2009, Olga was a senior partner and deputy CEO at AXES Management. In 1999–2005, she held various positions at ECOPSY Consulting, starting from associate and working her way up to head of the executive coaching practice. Education: Olga graduated from Moscow State University with a degree in psychology.



Fabricio Granja
Chief Information Officer

Fabricio Granja joined X5 Retail Group in October 2016. Fabricio has an impressive track record in the field of IT. Before joining X5, he worked as Vice President for IT & Projects at Eldorado LLC, and was in charge of the Company's IT strategy. Fabricio held management positions at a number of Russian and international IT consulting firms, including Ciber, ABPL Altamiro Borges Planejamento & Logistica, and FQS, focusing on projects for major companies. Education: Fabricio graduated from the Federal University of São Carlos (São Paulo, Brazil) with a master's degree in IT.



Ekaterina Lobacheva
General Counsel

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



Stanislav Naumov
Government Relations Director

Before joining X5 in March 2015, Stanislav held several high-level positions in civil service. From 1992 to 2010 he worked as Head of the Public Relations Centre in the City of Magnitogorsk Administration, as an Assistant Director of the State Tax Service of Russia, as the Assistant of the Deputy Prime Minister, as the Director of Economic Analysis and Prospective Planning of the Industry and Energy Ministry of Russia, and as Deputy Minister of Industry and Trade of the Russian Federation. From 2010 to 2012, Stanislav was Vice President for Government and Public Relations at the Skolkovo Foundation. Since December 2010, he has been acting as President of the Russian Association of Public Relations (RPRA); since 2013 he has been the Chairman of the Board of Directors of CROS Public Relations & Public Affairs Company; and he is also the Executive Director of the Eurasian Center for Integration Studies and Communications. Education: Stanislav graduated from the Faculty of Philosophy at Ural State University in 1994, where he specialised in political science. He received his PhD and an executive MBA from the Moscow Skolkovo School of Management.



Elena Konnova
Corporate Communications Director

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



Dmitry Agureev
Head of Corporate Security

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



Frank Lhoëst
Company Secretary, Member of the Management Board

Frank joined X5 in November 2007. 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. Education: Frank graduated from Leiden University with a degree in law.

Pyaterochka Proximity Stores

Pyaterochka is one of Russia's leading national brands and is currently the core source of growth for the X5 Retail Group. The brand meets the needs of Russian consumers looking for a high-quality shopping experience with a wide assortment of fresh foods, weekly promotions, reasonable prices and convenient locations.

Net retail sales
(in 2016)
+32.5% year-on-year

₽ 775.6
billion

Selling space
(as of 31 December 2016)
+37.4% year-on-year

3,329
thousand m²



The store's range consists of more than **4,000 PLUs** on average, with an average store size of **398 m²**.

Strategic highlights

- **907 thousand m² of selling space added:** the largest selling space expansion for any retail operation in proximity format anywhere in the world
- **Geographic expansion:** entered the Siberian Federal District and expanded into new cities and towns
- **Operational excellence:** store renovation programme nearly completed, with focus shifting to day-to-day in-store improvements
- **Cost optimisation:** successful ongoing negotiations to improve terms with suppliers, lease costs, and other store costs
- **Value proposition:** introduced new entry-price PLUs and developed private labels
- **Differentiation:** piloted personalisation mechanics based on advanced analytics

Performance highlights

2016

Stores in operation
(as of 31 December 2016)
+33.5% year-on-year

8,363

Customer visits
(in 2016)
+27.8% year-on-year

2.5 billion

Stores refurbished
(in 2016)
bringing the total share of stores operating under the new concept to 94%

1,185

Key operating results

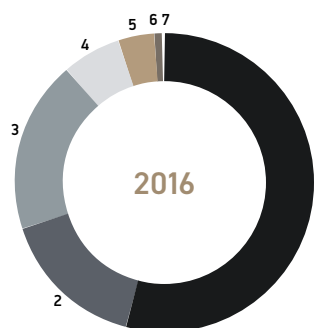
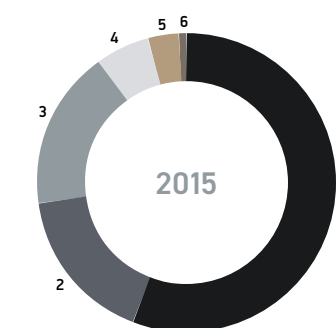
	2012	2013	2014	2015	2016
Number of stores, eop	3,220	3,882	4,789	6,265	8,363
Selling space, '000 m ² eop	1,191	1,414	1,754	2,423	3,329
Net retail sales, RUB bn	317.8	348.4	435.8	585.4	775.6
Customer visits, mln	1,353	1,450	1,645	1,990	2,543



Pyaterochka net retail sales

by region

	2015, %	2016, %
1. Central FD	56.1	54.3
2. North-Western FD	16.8	15.8
3. Volga FD	17.2	18.7
4. Ural FD	5.8	6.3
5. Southern FD	3.4	4.1
6. North Caucasus FD	0.7	0.8
7. Siberian FD	0.0	0.1





Olga Naumova

General Director
of Pyaterochka

“ We achieved another year of record-setting growth in 2016, with 907 thousand square metres of new retail space added and 2,098 stores added. We continued our geographic expansion into smaller population centres and opened our first stores in the Siberian Federal District, where we aim to achieve continued growth in the coming years. While selling space expansion was the key driver of Pyaterochka's 32.5% year-on-year growth in net retail sales, we also delivered an 9.1% year-on-year increase in like-for-like sales. Pyaterochka's impressive and sustainable growth is supported by robust and efficient systems like our in-house GIS software that enables us to quickly make intelligent decisions as we continue our rapid expansion.

Strategic priorities for 2016

Our priorities

What we did

What we plan to do

Rapid, sustainable growth

- ✓ 8,363 stores as of 31 December 2016, up 33.5% year-on-year
- ✓ 3.3 million square metres of selling space, up 37.4% year-on-year
- ✓ Completed full rollout of the GIS system for selecting optimum store opening locations
- ✓ Implemented an efficient organisational structure that enables us to adapt to local needs

Expand into new regions and cover all location types

- ✓ Entered Siberia
- ✓ Increased our presence in new cities and towns by 27% year-on-year

Preserve value proposition and introduce selective improvements

- ✓ Further adapted our assortment: introduced new entry-price PLUs and developed private labels
- ✓ Achieved average number of PLUs of more than 4,000 items
- ✓ Improved NPS from 31.7 in Q3 2016 to 34.4 in Q4 2016 ¹

Differentiate through promo and loyalty programme

- ✓ Piloted personalisation mechanics based on advanced analytics

Optimise efficiency and costs

- ✓ Negotiated improved terms from suppliers
- ✓ Made improvements to logistics: constructed new DCs, including import hubs and cross-docking, acquired trucks
- ✓ Made SG&A improvements: staff costs, lease costs, and other store costs

Maximise the share of customers, and maximise the share of these customers' wallet:

- Continue applying the current value proposition and enhance it through implementation of new initiatives
- Support rapid, sustainable growth with development in new regions (Siberia)
- Further adapt our assortment, introducing new categories and entry-price PLUs
- Implement a loyalty programme and launch customised promotions
- Further improve NPS

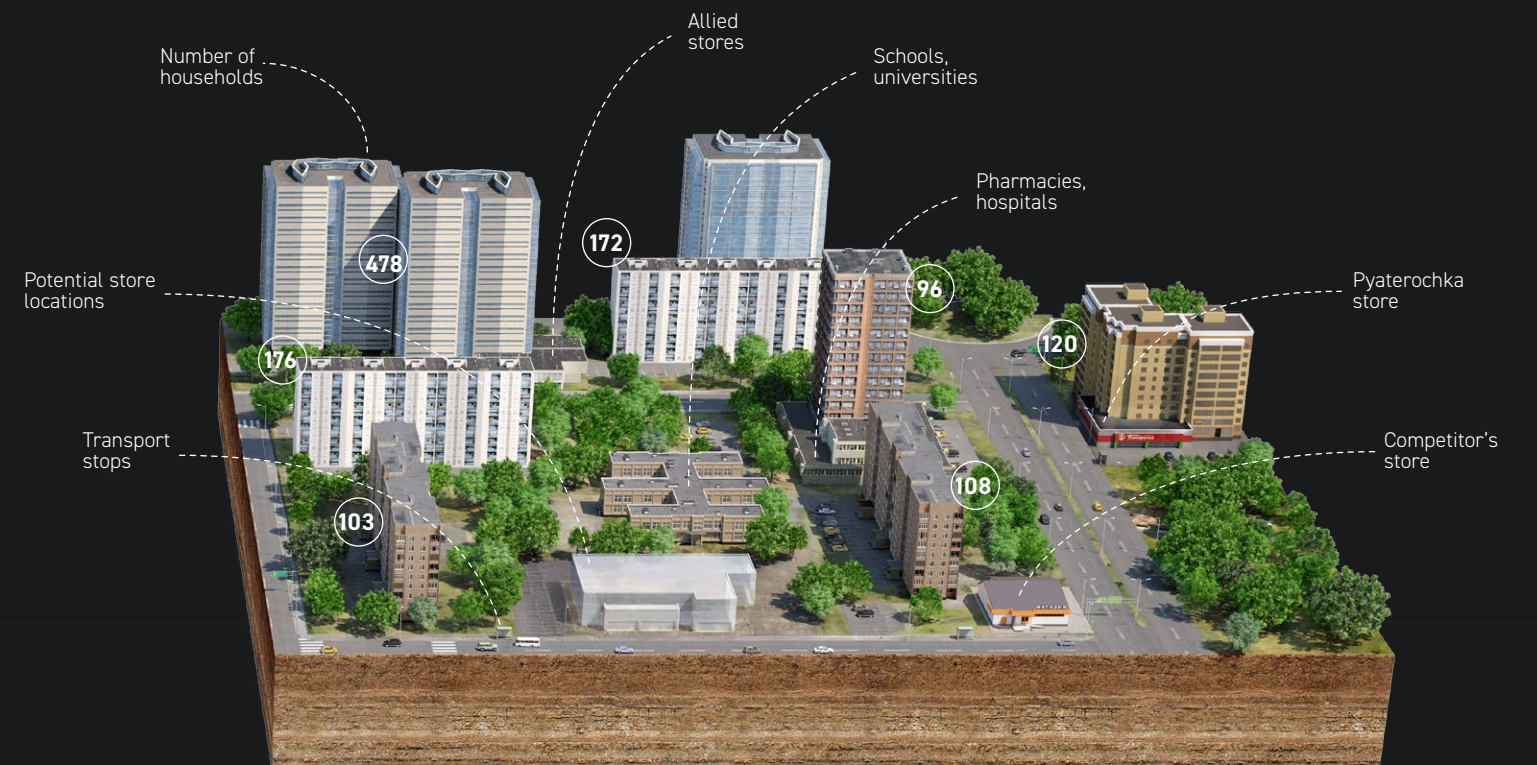
Improve efficiency and reduce costs:

- Grow the share of private label to >20% during the next 3–5 years
- Increase the share of direct import
- Rely on a lean and agile approach
- Further improve opex and purchasing terms

¹ In 1H 2016, a new methodology of NPS estimation similar for all formats across X5 was introduced.

Advanced Geographic Information System

Our proprietary GIS software has proven its ability to increase efficiency and accuracy in selecting the right locations for new stores.



Rapid & sustainable growth

With another year of record-setting growth behind us, we remain committed to building on this success and continuing to build momentum in the years ahead. Some of our key achievements of 2016 include:

Faster, more efficient openings:

Our in-house GIS software enabled us to identify the best locations for new stores in a more efficient manner. This software has cut decision-making time in half, increased the productivity of business development units by a factor of two-and-a-half, and led to a four-fold reduction in the number of mistakes.

Scalable and flexible organisational structure:

Pyaterochka's organisational structure is based on 11 divisions and 130 clusters. This decentralised approach, where clusters of up to 100 stores are the main business unit responsible for performance, gives Pyaterochka the ability to fine-tune its business to local needs, identify the best locations, respond to consumer preferences and work with local suppliers.

Building a winning team:

We continued refining our recruitment process, training staff to help them improve the service they can provide, assessing employees for potential promotions and the succession pool, and adapting our motivation systems to encourage professional achievements and teamwork by linking wages to professional achievements.

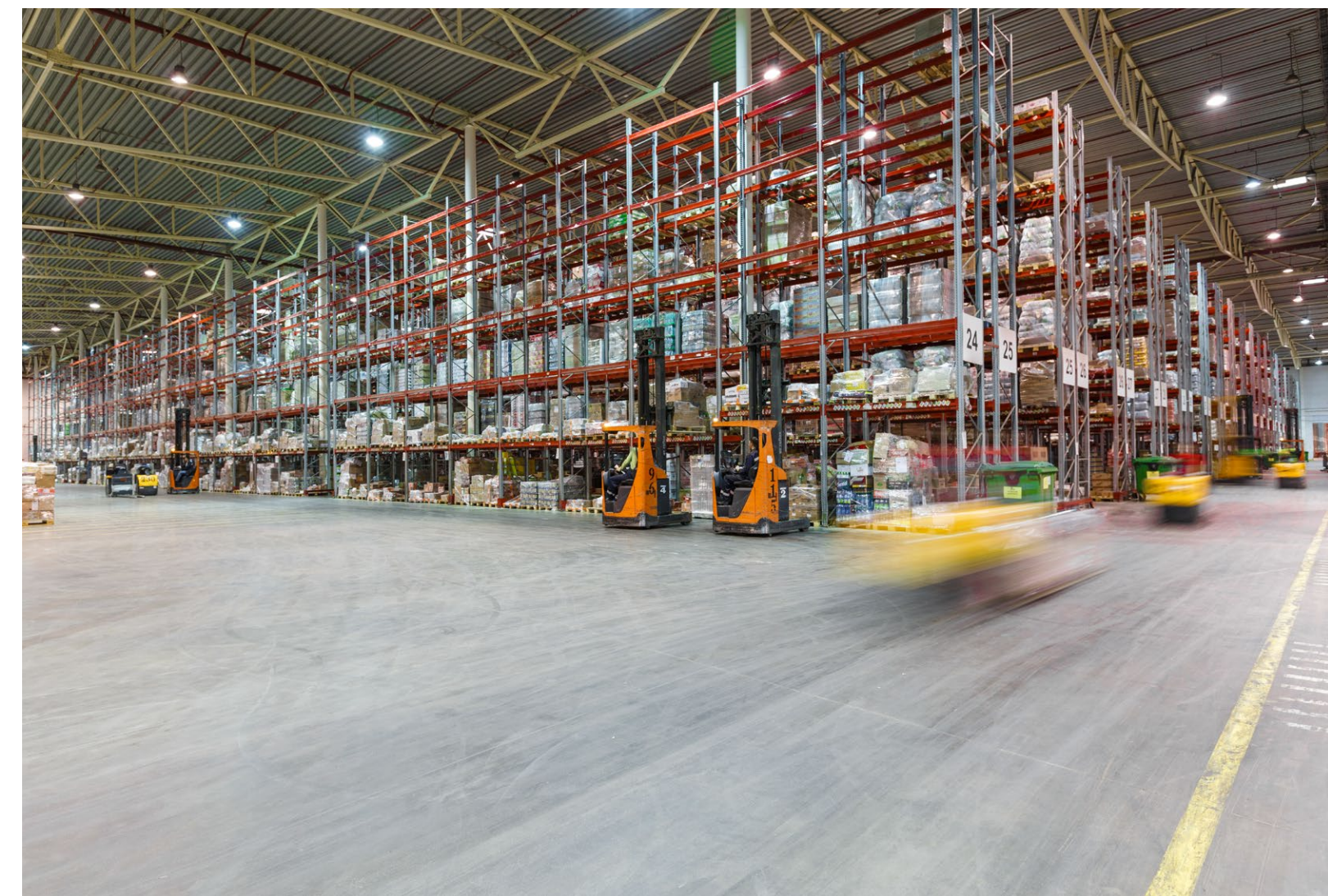


Supply chain development

For more information about X5's logistics and transport operations, see pages 82–99.

As of 31 December 2016, Pyaterochka was operating 23 distribution centres (DCs), having opened three during the year and closed two that did not meet efficiency standards. Pyaterochka's rapid expansion of selling space is supported by a comprehensive approach to logistics and supply chain management. We aim to achieve the right balance

between ensuring availability of goods on shelves and logistics costs for a fast-growing network. To achieve this, we are building a more sophisticated supply chain structure that is designed to support the growing business and improve efficiency, with a wider set of services, from direct imports to cross-docking, provided in-house.



From refurbishments to **day-to-day** improvements

As of the end of 2016, over 94% of Pyaterochka stores were operating under the new concept, marking the effective completion of this large-scale refurbishment programme to overhaul the brand, bring the entire store base in line with the new value proposition, and expand the chain's target audience.

The results of the refurbishment programme were impressive in 2016:

Average selling space increase per store **21.9%**

Average LFL sales growth **14-15%**

Average duration of store closure **11.6 days**

Average capital expenditure (excluding VAT) **₽11.9 million**



With close to 100% of Pyaterochka stores operating under the new concept, our focus has begun to shift towards day-to-day improvements of store operations.

We monitor trends and innovations, and can rapidly introduce new practices at our stores, such as optimising the produce selling space to make it more convenient and easier for customers to get a broader range of products. Another area of improvement is the addition

of in-store alcohol and tobacco shops. Customers now have a dedicated checkout lane for purchasing tobacco products and premium spirits. These checkouts offer an extensive assortment of alcohol products, and can also be used like regular lanes.



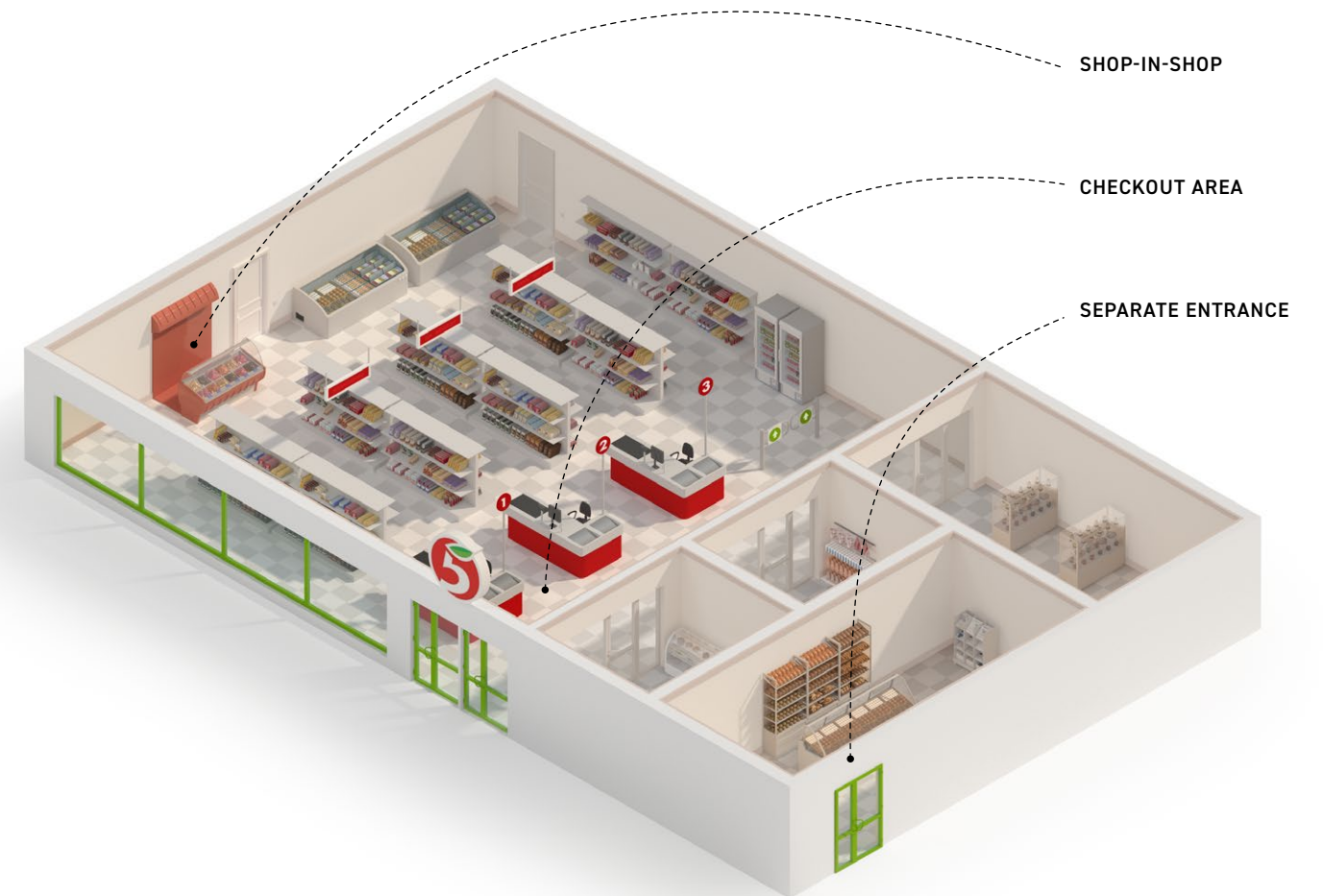
Intelligent IT solutions

We are also using intelligent IT solutions based on SAP and JDA. With 100% of Pyaterochka store planogram and layout designs incorporated into the JDA system, we can better plan unique store designs and product locations while ensuring correct automated delivery.

Sublease partnerships focused on traffic conversion

With the goal of broadening Pyaterochka's potential audience by providing a wider assortment of goods and services, we have concentrated on finding optimal sublease partners and formats. With a focus on creating long-term win-win situations and synergies that generate additional traffic for both sides, we offer lessees with high-demand services a suitable shop-in-shop, checkout area, and separate entrance locations if needed.

The in-store location affects lease rates



Priority groups for partnership

Priority	HIGH	MEDIUM	LOW
Group of services	<ul style="list-style-type: none"> • Mobile services • Pharmacy • Baby goods • Flowers • Cookery • Meat and fish 	<ul style="list-style-type: none"> • Cosmetics • Clothing • Hairdressing 	<ul style="list-style-type: none"> • Insurance services • Travel agencies • Ticket offices

Perekrestok Supermarkets

Perekrestok is Russia's #1 supermarket chain. Perekrestok's value proposition focuses on fresh selection supported by the right complementary assortment to give every customer the best products and services every time they shop. Perekrestok supermarkets have historically been located in the largest cities across the European part of Russia, but we plan to expand further afield with the regional supermarket model piloted in 2016.

Net retail sales

(in 2016)

+19.4% year-on-year

₽ 155.4
billion

Selling space

(as of 31 December 2016)

+13.3% year-on-year

548.5
thousand m²



Perekrestok stores offer an assortment of 8,000 to 15,000 PLUs, with net selling space ranging from 800 to 1,600 m² depending on the location.

Strategic highlights

- **Developing a loyalty programme:** expanded personalised promotions and launched co-branded cards with Alfa-Bank
- **Focus on Russia's most affluent regions,** with approximately 55% of new stores opened in Moscow, the Moscow region and St. Petersburg. An additional 12% of new stores were opened in cities with populations of over 1 million
- **Regional expansion:** piloted a new "regional model", with all new and refurbished stores in regions opened according to the new concept
- **Refurbishment programme:** 62 stores were refurbished in 2016, with 52% of the store base operating under the new concept as of 31 December 2016 (vs. 25% as of 31 December 2015)
- **Service and efficiency:** made across-the-board efficiency improvements in operational expenses, shrinking costs and SG&A

Performance highlights

2016

Stores in operation

(as of 31 December 2016)

+12.8 year-on-year

539

Customer visits

(in 2016)

+15.2% year-on-year

350 million

Stores refurbished

(in 2016)

bringing the total share of stores operating under the new concept to 52%

62

Key operating results

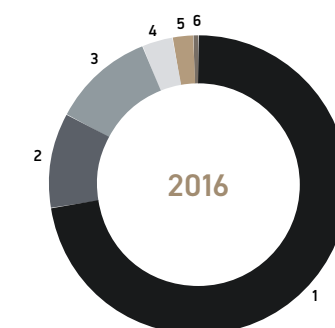
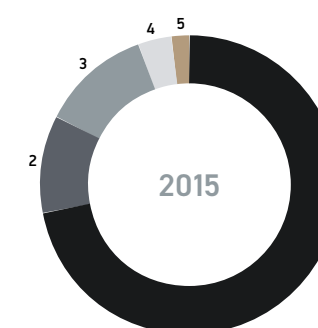
	2012	2013	2014	2015	2016
Number of stores, eop	370	390	403	478	539
Selling space, '000 m ² eop	383.5	397.8	415.8	484.0	548.5
Net retail sales, RUB bn	105.5	110.7	115.6	130.1	155.4
Customer visits, mln	297	307	302	304	350



Perekrestok net retail sales

by region

	2015, %	2016, %
1. Central FD	72.2	72.6
2. North-Western FD	10.4	10.4
3. Volga FD	11.9	10.9
4. Southern FD	3.7	3.4
5. Ural FD	1.8	2.3
6. North Caucasus FD	0.0	0.4





Vladimir Sorokin

General Director of Perekrestok

“ While we continue to strengthen Perekrestok's position in the Moscow and St. Petersburg metropolitan areas, we are successfully expanding across Russia by adapting our high-quality supermarket model to local needs, which was one of our strategic targets throughout 2016. With store openings and renovations on track, Perekrestok is working tirelessly to meet customer demands every day. We are also focused on securing Perekrestok's position as Russia's #1 supermarket for many years to come, with our priority being the introduction of a cutting-edge loyalty programme.

Strategic priorities for 2016

Our priorities	What we did	What we plan to do
Continue to develop in Moscow and St. Petersburg while reaching critical mass in cities with populations over 1 million	<ul style="list-style-type: none"> ✓ 55% of new stores were opened in Moscow, the Moscow region, St. Petersburg and the Leningrad region ✓ More than half of new stores were opened in cities with populations over 1 million 	<p>Fine-tune value proposition and adapt to customer needs:</p> <ul style="list-style-type: none"> > Maintain pace of organic growth and refurbishments > Roll out regional model to support future growth > Further adapt assortment to meet consumer needs > Increase loyalty card penetration and implement personalised promotions > Develop online supermarket > Improve NPS
Continue new store openings to preserve foothold for future growth	<ul style="list-style-type: none"> ✓ 539 stores, up 12.8% year-on-year ✓ Opened more stores than peers operating in Russia ✓ 548 thousand square metres of selling space, up 13.3% year-on-year 	
Trial regional model in 2016 and start development in 2017	<ul style="list-style-type: none"> ✓ Successfully piloted regional supermarket model ✓ All new and refurbished stores in regions were opened under the new regional supermarket concept 	
Continue to implement refurbishment programme	<ul style="list-style-type: none"> ✓ 62 stores were refurbished in FY 2016 (>52% of stores are now operating under the new concept) ✓ Decreased average refurbishment period from 45 days in 2015 to 44 days in 2016 	
Focus on further refining service and efficiency of operations	<ul style="list-style-type: none"> ✓ NPS improved from 9.9 in Q3 2016 to 15.2 in Q4 2016 ✓ Improved opex, logistics, shrinkage costs and SG&A: staff costs, lease costs, marketing, and security 	<p>Improve efficiency and reduce costs:</p> <ul style="list-style-type: none"> > Increase the share of private labels > Increase the share of direct import > Further improve logistics (forecasting, stock replenishment system) > Further improve opex and purchasing terms

A new approach to expansion

Perekrestok remained Russia's #1 supermarket brand in 2016, opening more stores than any competitor in its segment. Even in the current economic environment, which presents certain challenges for the classic supermarket model, we continue to adapt our value proposition to help our core customers achieve their shopping missions.

We have also adapted our approach to new store openings, and while we continue to focus on larger cities, our regional model uses criteria that enable Perekrestok to expand into cities with populations of less than 1 million. This opens up significant new potential for expansion of the Perekrestok chain across Russia.

We have also adopted in-house GIS software, initially developed by Pyaterochka, for selection of sites for new Perekrestok stores. This has both increased the speed of our decision-making process and helped us improve the success rates of these openings. Adoption of the GIS platform is a clear example of the advantages of X5's operating model, which enables us to retain distinct customer value propositions for each format while sharing best practices across the group.



Supply chain development

For more information about our logistics and transport operations, see pages 92–99.

Supply chain and logistics are a priority for Perekrestok as well, with a focus on optimisation and efficiency. Our key focus has been on distribution centres: Perekrestok and Karusel opened up four new DCs during 2016 and closed down five that did not meet efficiency targets during the year. As of the end of 2016, we were operating 12 DCs servicing large format stores for the Perekrestok and Karusel chains.

We have achieved better efficiency by adapting existing facilities into multi-temperature warehouses that can handle both fresh and dry goods in different zones, thus reducing administrative costs.

As we expand Perekrestok's network across Russia, all new locations we plan to open will be covered by our DC network, while more remote locations will use cross-docking.



Refurbishment: improving brand perception

Begun in 2014, the refurbishment of existing Perekrestok stores is one of our top strategic priorities. Achieving a critical mass of stores operating under the new concept is one of the keys to changing the perception of the Perekrestok brand, and our ultimate goal is to bring the entire store base in line with the new customer value proposition.

Refurbishments include installation of state-of-the-art equipment and updates to interior and exterior store design. The new concept improves the efficiency of store layouts and upgrades the lighting, giving customers more space and light in the store for a better shopping experience. Zoning and location of promotional offers are also taken into account under the refurbishment programme.

The programme has shown impressive results in terms of brand perception and LFL sales, and we have continued to refine the process in order to bring down both duration and costs.

Some of the programme's 2016 highlights include:

Number of stores refurbished in 2016 **62**

Share of stores operating under the new concept **52%**

Average duration of store closure (vs. 45 days in 2015) **44 days**

Average sales recovery period **5 months**

Average LFL sales growth (after recovery period) **14-16%**



Evolving mission and customer value proposition

With the more challenging macro environment prevailing in Russia in recent years, consumers have changed their behaviour.

Perekrestok's evolving target audience and mission:

Perekrestok has responded to this challenge by adjusting its value proposition to meet the needs of customers with less cash on hand yet who are still looking for a high-quality supermarket shopping experience.

Our mission has likewise evolved, and we have become more advanced in how we help our customers to get what they want from our stores. While customers may have less disposable income, we aim to help them maintain the same quality of life and the same basket of goods that they have grown used to.

Previous target audience

Everyone living and working within a 1.5 km radius of the store
 Individuals with average or above-average income
 Families with children
 Well-to-do males and females
 Well-off youth
 The elderly and pensioners

Current target audience

Everyone living and working within a 1.5 km radius of the store
 Individuals with average or below-average income
 Families with children with average or below-average income
 Women managing family budgets
 Men with a specific shopping list or with a limited budget
 The elderly and pensioners

Previous mission

Continued development and research into consumer tastes and preferences
 Personalised support for customers seeking tastier, more nutritious and diverse food

Current mission

Daily promotions based on customer spending potential and taste research
 Personalised, tangible offerings for customers seeking food diversity

Developing the regional supermarket model

As the Perekrestok chain has developed outside of Moscow and St. Petersburg, we have identified ways to adapt our supermarket model to successfully meet the needs of regional customers.

The regional supermarket model that we are piloting has a wider assortment of low-price and mid-price products, for example, while we have reduced the selection in the premium price segment. We have streamlined staffing and business processes in order to maintain

margins while still providing the level of service that Perekrestok shoppers expect. Based on successful pilots in 2016 and the beginning of 2017, we aim to roll out this model as part of Perekrestok's expansion into new geographical areas and smaller cities in Russia.

Key components of the regional model:

Assortment	Layout	Promotion	Location	Personnel	Design
Quantity of PLUs reduced to 8,000-10,000 per store	Maximise selling space by up to 65-70%	Attractive promotions	District centres, medium and medium+ income	Structure and headcount adjustment to store turnover and region	Simplified and welcoming to all
Focus on local PLUs	30% lower Capex per store	Flexible promotions based on category and location	Central streets, convenient access to the mall		Easy navigation outside
Clustering by price segment					



Private label

We continue to work on developing Perekrestok's private-label brands, and increased their share to around 5.8% of our turnover in Q4 2016 (vs. 5.5% in Q4 2015). In Q4 2016, we offered over 1,600 private-label PLUs.

We offer cross-category private labels in the low-price (Prosto) and the mid-price (Perekrestok-Market) categories. Perekrestok has launched several niche private labels: Bonte (confectionery), Novy Okean (seafood) and Perekrestok Chef (cookery).



Private labels by segments

Segment	Current brands
MEDIUM	• Perekrestok-Market
FIRST PRICE	• Prosto
NICHE	• Novy Ocean (seafood) • Bonte (confectionery) • Perekrestok Chef (cookery)

Loyalty programme



The **Perekrestok Club loyalty programme** has also been updated: we are seeking to leverage our significant knowledge of Perekrestok's **10.8 million customers** to ensure we offer them just the right value proposition.

We have introduced customised promotional programmes that automatically offer discounts to loyal customers on goods we know they buy regularly. With this individual approach, our customers enjoy a club system, where each loyalty cardholder feels like we are giving them individual attention.

By the end of 2016, the Perekrestok Club had 3.6 million active cardholders (who visit Perekrestok at least once every three months) compared to 3.1 million at the beginning of the year.

Our priorities for further developing the programme are to:

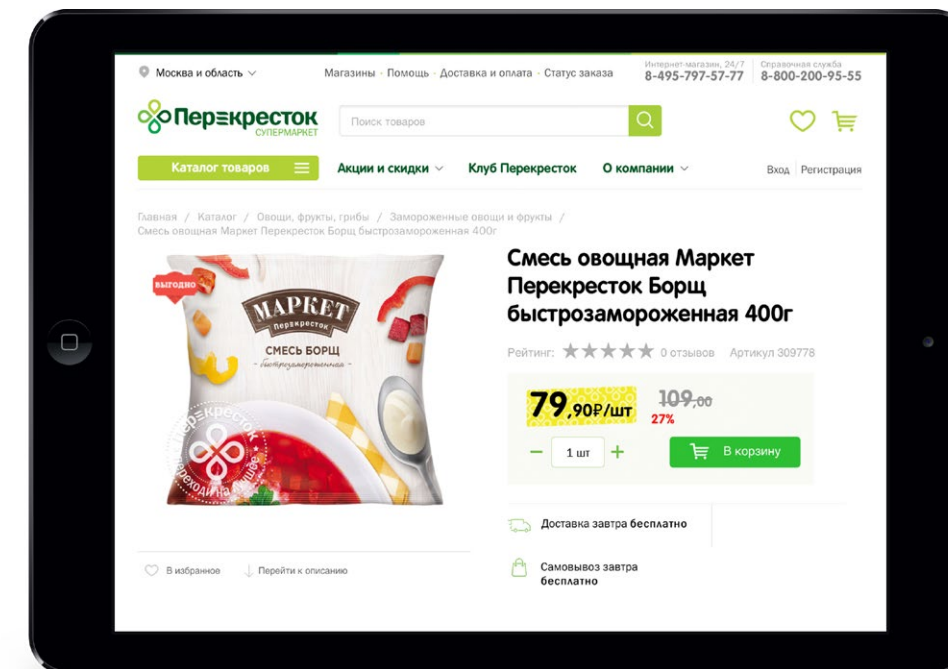
- Develop personalised offerings and personalised promotions;
- Introduce a comprehensive CRM;
- Develop new communication channels;
- Develop partnerships with other companies;
- Expand the cardholder base using internal and external sources;
- Utilise promotional mechanics to support store ramp-ups;
- Increase the share in sales of loyalty cardholders from 50% to 60%.

In addition to Perekrestok loyalty cards, we have sought to enter into strategic partnerships with such products as the **Perekrestok and Alfa-Bank co-branded MasterCard** launched in November 2016. Three types of cards are available: reloadable prepaid cards, debit cards and credit cards. Cardholders earn points on all purchases that can be redeemed against goods at Perekrestok supermarkets (10 points for each rouble spent). Purchases made at Perekrestok stores earn additional points.

Online supermarket. Investing in the future

Perekrestok's core audience includes active Internet users, who are driving the rapid growth of e-commerce across many segments of the retail industry. We aim to leverage Perekrestok's well-known brand name as we develop a modern online supermarket model that is due to launch in Moscow in 2017. Our business model is based on a careful study of successful international online supermarket businesses and adapted to the Russian market.

At the moment, Perekrestok online is being launched as a pilot project to support the loyalty of our key audience in Moscow. By launching this business and analysing its performance in Moscow, we will be able to make an informed decision as to whether we should expand to new regions or focus just on Moscow, where Perekrestok online is an important element of customer loyalty.



Perekrestok online key highlights:

Launch	<ul style="list-style-type: none"> • Planned for 2017
Product	<ul style="list-style-type: none"> • Broad, high-quality assortment matrix to replicate shopping for a family at a store (10,000-12,000 PLUs) • Home delivery
Place	<ul style="list-style-type: none"> • Full integration with Perekrestok.ru • Personalisation via loyalty programme and recommendation services
Price	<ul style="list-style-type: none"> • Same price in the online store and the Perekrestok chain
Promo	<ul style="list-style-type: none"> • Retail promotions via store website
Service	<ul style="list-style-type: none"> • Full integration with the Perekrestok chain's CRM

Karusel Hypermarkets

Karusel is our national hypermarket brand and one of the largest hypermarket chains in Russia. It offers customers convenient shopping at fair prices in convenient city locations, with a wide range of quality food and non-food products.

2016 was a year of consolidation and optimisation for Karusel, during which we appointed a new General Director of the chain, built up the management team, and sought out best practices to introduce to our commercial model. With the pilot of our "Model Hypermarkets" producing positive results, we plan to integrate its outcomes into a new operational model to be rolled out in 2017 across existing and new Karusel stores.

Net retail sales

(in 2016)

+7.9% year-on-year

₽ 84
billion

Selling space

(as of 31 December 2016)

387
thousand m²



Karusel stores offer an assortment of up to 20,000 PLUs, with an average selling space of 4,252 m².

Strategic highlights

- **Short-term improvement plan** to optimise existing hypermarket operations led to positive changes in terms of availability and quality of products, which was quickly recognised by our customers. As a result we saw Karusel's NPS improve from 18.4 in Q3 2016 to 26.4 in Q4 2016
- **Consolidation of best practices** from successful "Model Hypermarkets" pilot into the new operational model that will be tested and rolled out across all hypermarkets going forward
- **Optimised store portfolio**, closing three underperforming hypermarkets during the year, further reducing lease expenses and other costs
- **Introduced new private-label ranges**, helping to increase differentiation and customer loyalty
- **Loyalty programme** being further developed by personalisation and new communication channels helped to increase the number of active users

Performance highlights

2016

Stores in operation

(as of 31 December 2016)

91

Customer visits

(in 2016)

134 million

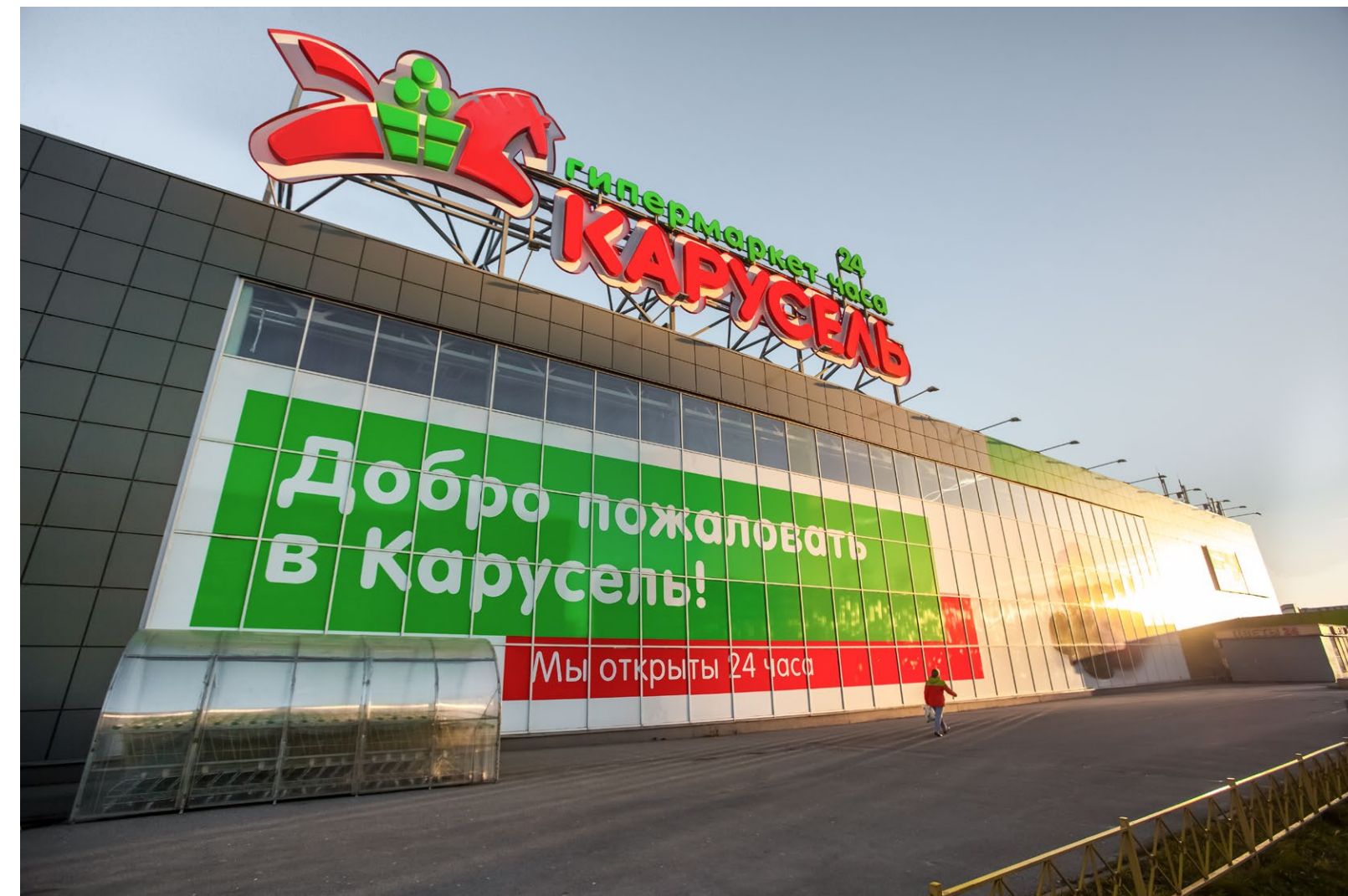
Stores refurbished

(in 2016)

7

Key operating results

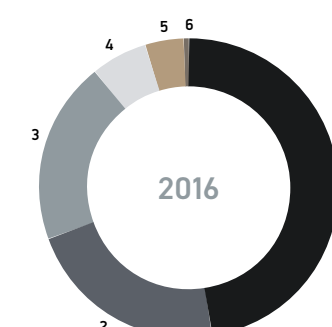
	2012	2013	2014	2015	2016
Number of stores, eop	78	83	82	90	91
Selling space, '000 m ² eop	368	376	359	390	387
Net retail sales, RUB bn	61.5	64.3	69.4	77.4	83.6
Customer visits, mln	119	122	123	129	134



Karusel net retail sales

by region

	2016, %
1. Central FD	47.6
2. North-Western FD	21.9
3. Volga FD	19.7
4. Ural FD	6.2
5. Southern FD	4.0
6. North Caucasus FD	0.5





Maksym Gatsuts

General Director
of Karusel

“ This was a year of optimisation and consolidation for Karusel, during which we focused on improving our stores' portfolio. We also started developing a new approach for X5's hypermarket business. I joined Karusel as the new General Director in 2016. I have been assembling a strong team that I am confident has the right skills to implement the best practices from the "Model Hypermarket" pilot projects. This team and I will test and roll out the new commercial model in the years ahead. The incremental changes we are already introducing at Karusel are beginning to show results, with LFL sales, traffic and basket all positive in Q4 2016, despite the challenging situation in the retail sector during that period.

Short-term improvement plan & strategy

Short-term priorities	Continuous measures	Development plan
Commerce	<ul style="list-style-type: none"> ✓ Optimise pricing; introduce new tools and mechanisms to improve price perception ✓ Continue to adapt promotions; introduce new algorithms to boost consumer loyalty ✓ Standardise selling space layout based on consumer behaviour 	<ul style="list-style-type: none"> ➢ Upgrade operating model for new hypermarkets with all best practices taken from "Model Hypermarkets" pilots ➢ Further adapt assortment and optimise pricing
Efficiency	<ul style="list-style-type: none"> ✓ Better manageability: review business processes and further develop execution culture ✓ Improve shelf availability ✓ Strict focus on product quality 	<ul style="list-style-type: none"> ➢ Increase loyalty card penetration and implement personalised promotions ➢ Increase the share of private labels ➢ Increase sales density
Store portfolio	<ul style="list-style-type: none"> ✓ Review and optimise store portfolio ✓ Further reduce lease expenses ✓ Identify and secure promising locations for future openings 	<ul style="list-style-type: none"> ➢ Improve logistics; reduce lease costs and shrinkage

Preparing to launch the new commercial model

The Karusel team has started an intensive programme to develop and launch a new commercial model, which will be better suited to the needs of the hypermarket's target audience. The new commercial model, which will focus on compact city hypermarkets, is due to be tested in 2017, after which we aim to roll it out across the whole chain. Changes at pilot stores will reflect Karusel's updated value proposition, including assortment changes, rezoning, new internal navigation, a new approach to merchandising, modified pricing instruments, and new trading equipment. We will also test new promotional mechanisms in these stores.



Own production

We continued to develop this part of the business throughout 2016, and the share of Karusel's own production in net retail sales reached 13.4% in Q4 2016. We aim to increase the share of our own production going forward, and it will remain a key element of the new operating model that we will be rolling out.



Private label

Private labels are an efficient way to diversify our assortment and price offerings. The largest private-label brand is the first-price “Krugli God” (“Year-Round”), launched in 2015. In Q4 2016, the share of this brand increased to 3.2% of net retail sales from 1.0% in Q4 2015. As of the end of 2016, our hypermarkets had approximately 700 “Year-Round” private-label PLUs.

We also introduced “Ampersand” in October 2016, which aims to compete with well-known brands in the mid-price segment.



Private labels by segments

Segment	Current brands	New brands
MEDIUM	• Ampersand	
FIRST PRICE	• Krugli God (Year-Round)	• Riviera • Pizza Pasta Vino • Marquise des Anges • Mar Adento
NON-FOOD	• Krugli God (Year-Round)	• In Progress

Loyalty programme



Karusel’s loyalty programme was relaunched in 2015 and accounted for 46% of net retail sales in 2016, with the long-term goal of reaching 80% by 2020. The new programme implements advanced analytics in order to transit personalised offerings and promotions, and will make it possible to implement special promotions for cardholders only. With new communication channels, including a mobile application that is under development as well as co-branded cards, we aim to implement a comprehensive, modern loyalty programme that will help keep customers coming back.



Retail operations infrastructure



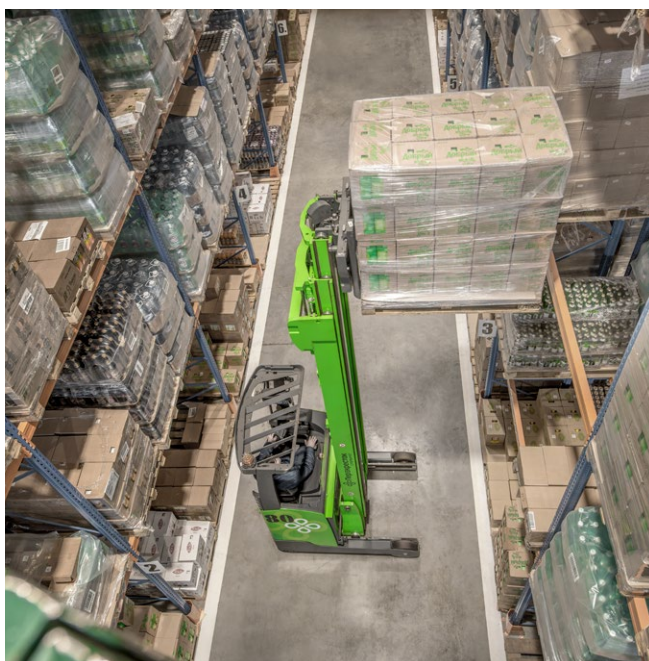
Our logistics, transport and IT systems are the backbone of our successful expansion, and help us ensure that we provide the best shopping experience to our customers every day and in every store.

Our logistics operations have become more comprehensive, covering a wider range of services from direct import to cross-docking.

In the area of transport, we have continued to grow our own fleet to keep pace with the openings of new stores and expansion into new regions.

In the area of IT, we continue to invest in systems that make our operations more efficient and improve our ability to meet demand across all of our formats.

Logistics



X5's logistics operations are divided to provide the optimal service to each of the formats.

Pyaterochka operates its own logistics, while Perekrestok and Karusel share infrastructure that is designed to serve large-format stores.

In 2016, X5 opened seven new distribution centres (DCs) with a total floor space of 212 thousand square metres, and closed seven as part of its ongoing programme to optimise DC operations.

As of 31 December 2016, we were operating 35 DCs with a total floor space of 922 thousand square metres, providing sufficient coverage for the Company's rapidly expanding operations.

Logistics strategy

Our logistics strategy aims to provide each of X5's formats with tailored services that meet their specific business needs.

Our logistics strategy focuses on:

Efficiency

We consistently raise efficiency criteria for our logistics operations, closing down those operations that are no longer able to meet expectations. We also expand the vertical integration of our logistics operations to include full-scale import hubs and cross-docking stations when we see the opportunity to reduce costs on a sustainable basis.

Quality and reliability

Logistics operations must support X5's ability to meet consumer needs every time they visit a Pyaterochka, Perekrestok or Karusel store, helping to ensure the quality and availability of goods on shelves.

Supporting expansion and regional operations

We are building out our logistics infrastructure to support continued rapid expansion, including into new regions, in order to ensure a consistent ability to deliver our value proposition to customers while also adapting to regional needs.

Centralisation

Increased centralisation helps to optimise deliveries and in-store product ranging.



How we manage logistics

At the Corporate Centre level, X5 sets and monitors standards for DC operations, helps to share best practices and technologies across formats, and assists with planning investments into new DC infrastructure given the Company's ambitious expansion plans.

Our DCs run an automated warehouse management system (WMS) featuring voice picking and weighing technology to ensure efficient monitoring of goods traffic and storage and to optimise our shipping, receiving and picking operations.

What we did in 2016

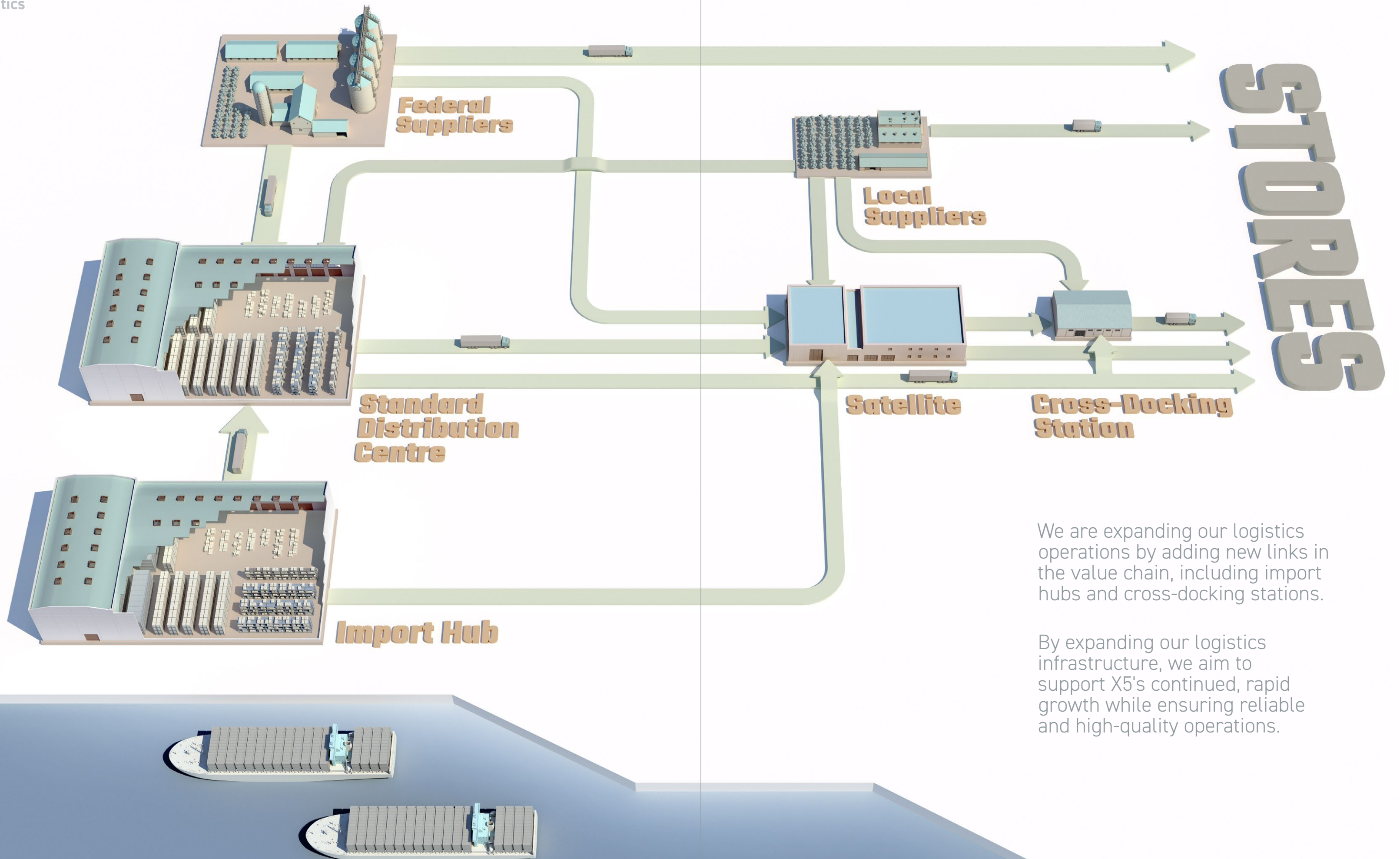
X5 Retail Group's company-wide SLT level (order processing based on timely deliveries) rose by 11 basis points to 91.6%, while centralisation increased from 85% in 2015 to 88% in 2016.

Among the seven new distribution centres we opened in 2016 was our first next-generation multi-format DC in Shushari, near St. Petersburg (serving Pyaterochka stores in North-West Russia). This new kind of DC uses the latest available technologies to help ensure the availability and freshness of products while also cutting logistics costs. With over 27,000 square metres of space, the St. Petersburg-Yug logistics facility will supply 889 Pyaterochka stores in eight regions: the city of St. Petersburg plus the Leningrad, Arkhangelsk, Vologda, Novgorod, Murmansk and Pskov regions, as well as the Republic of Karelia. Featuring five storage zones, each a distinct temperature zone, the facility is designed to accommodate all categories of goods. At its full capacity, the St. Petersburg-Yug facility will be able to process and handle products from over 200 local suppliers.

We also opened a showcase warehouse for larger formats in Sofino in March 2016. This new facility illustrates our innovative approach to optimising logistics for the Perekrestok and Karusel chains. This 65,000-square-metre DC handles over 16,000 SKUs from 680 suppliers. The advanced systems implemented at this state-of-the-art facility enable Perekrestok to increase the use of locally produced products for nearby stores while also supplying certain goods to Perekrestok stores all across Russia.

In Adygeya, we opened two new facilities with multiple storage zones and a full temperature range for different types of goods: the Yuzhny DC to serve Pyaterochka stores and the Adygeya logistics facility for Perekrestok and Karusel. In 2016, X5 also completed upgrades to existing DCs, such as the launch of stage two of our Forpost DC in Chelyabinsk, with new storage zones, including warehouses for storing dry goods and alcoholic beverages, and special fruit-ripening facilities.

With new, innovative IT solutions, we are constantly identifying ways to streamline our logistics operations, with systems that assist in identifying logistics configurations that meet demand while minimising transport and storage costs or analyse "what-if" scenarios.



We are expanding our logistics operations by adding new links in the value chain, including import hubs and cross-docking stations.

By expanding our logistics infrastructure, we aim to support X5's continued, rapid growth while ensuring reliable and high-quality operations.

Logistics

Pyaterochka

Pyaterochka opened three DCs in 2016, and closed two that did not meet efficiency standards. As of 31 December 2016, the business was operating 23 distribution centres. With Pyaterochka's rapid expansion, we are building out an increasingly comprehensive and sophisticated logistics infrastructure to support the chain's smooth and efficient operations.



Key progress in 2016 included:

- We opened fruit and vegetable import hubs in St. Petersburg and Novorossiysk, and are in the process of opening our additional facilities in St. Petersburg, Novorossiysk and Vorsino, as well as an alcohol import hub at the Podolsk DC
- Hub-satellite operations, with large regional DCs acting as hubs to store low-turnover items and constantly supply high-turnover goods to satellites and cross-docking stations
- Variable delivery chains, giving suppliers greater flexibility to deliver goods directly or via Pyaterochka DCs
- Cross-docking and cross-docking plus stations with packaging facilities to give regional DCs greater reach and keep remote stores supplied in a timely manner

Since 2015, we have been implementing lean management, or "lean logistics", by seeking to involve every employee in efforts to identify areas for improvements and develop solutions. In 2016, we deployed teams of employees at our DCs, which undertook a systematic review of inefficiencies and losses and developed solutions aimed at simplifying operations, improving working conditions, reducing costs and increasing the service life of warehouse equipment

Pyaterochka is also implementing an "ongoing improvements" project across the entire logistics chain. This project entails:

- Ongoing analysis of transport and logistics infrastructure to minimise costs while meeting demand
- Ongoing optimisation of the supply chain.
- Integrated business planning
- Optimisation of logistics personnel management with a focus on employing people who can develop and implement ideas to improve operations and efficiency

The results show that Pyaterochka's efforts are paying off. In 2016:

- Warehouse costs declined 12.5% year-on-year, from RUB 15.5 per box to RUB 13.6 per box
- Productivity increased, with OWR up 39% year-on-year in December 2016, to 62.2 boxes per hour
- Transport logistics costs were RUB 13.4 per box for 2016

Plans for 2017 include:

- Continued development of our comprehensive logistics infrastructure, expansion of cross-docking stations
- A relentless focus on optimisation and efficiency while maintaining reliability

Perekrestok & Karusel

As of the end of 2016, Perekrestok and Karusel were operating twelve DCs, having opened four and closed five during the year.



Key progress in 2016 includes:

Inventory management:

- Optimising store supplies with automated ordering and store supplies
- Increasing the share of automated ordering, which helps to release shelf space during busy seasons
- Increasing inventory turnover and purchasing accuracy
- Implementing automated ordering across all product categories in all regions
- Developing demand forecasting to improve accuracy of automated ordering
- Further integration of JDA software across supply chain and product categories
- Personnel development and training

Distribution centre improvements:

- Improving the quality and efficiency of DC packaging by establishing unified standards; using electronic forklifts with built-in scales; and automated pallet optimisation
- Adapted remuneration policies, increasing the bonus part to improve focus on quality of service, packaging and adherence to business plans
- Employee evaluation and development systems put in place, including a "DC in DC" training zone at the Sofino DC
- Piloting warehouse irrigation system at Sofino
- Increased scope of multi-temperature storage zones at DCs and in transport

Plans for 2017 include:

- Perekrestok and Karusel plan to continue expanding the reach of their DC network, including to Ekaterinburg
- Employee evaluation and development systems put in place, including a "DC in DC" training zone at the Sofino DC
- The full implementation of JDA throughout the entire supply chain and across all categories is expected to be completed by the end of the year
- Efficiency will remain a key focus, with measures to reduce the time trucks spend at DCs, further investments in training personnel, implementation of integrated business planning, and ongoing refinements to the automated ordering system

Transport

X5's in-house transport fleet is capable of handling 60–70% of our transportation needs.

With a fleet of 2,318 trucks in operation as of 31 December 2016, we have established transport operations capable of supporting X5's formats as they expand across the Russian Federation.

Transport strategy:

Our transport strategy focuses on ensuring reliable, timely and efficient supplies to our stores, helping to support our ability to deliver consistent in-store availability and quality to our customers every single day.

The key pillars of our transport strategy are:

Efficiency

From purchase of new vehicles to effective route management and driver incentives to reduce costs, we are constantly seeking ways to reduce transportation costs.

Quality and reliability

We implement monitoring systems across our fleet to help ensure food is properly stored while in transport and arrives at stores on time.

Supporting expansion and regional operations

When we expand into new regions, like Siberia, we utilise our own fleet for all transport needs due to a lack of third parties with the necessary vehicles to support X5's expansion.



How we manage transport

The Director for Transport sits in the Corporate Centre, with responsibility for implementing and monitoring performance targets and establishing strategic goals with regards to X5's transport operations.

Starting in 2016, the X5 Corporate Centre's Transport Department took over management of all of Pyaterochka's third-party transport operations in the Central division. Upon completion of this pilot project, all of the Pyaterochka's third-party transport operations are due to be transferred to the Corporate Centre during 2017.

We use modern transport management systems in order to maintain a real-time view of the location, condition and storage temperatures across the entire fleet. Thanks to GPS/GLONASS systems, store employees are able to monitor movement of shipments from DCs, helping them to plan for arrivals and be alerted to delays.

What we did in 2016

We purchased 976 new trucks in 2016, expanding our fleet by 48% year-on-year to 2,318 vehicles. These new vehicles have mileage monitoring and GPS and refrigeration unit monitoring systems installed, enabling us to maintain a detailed view of all transport operations. These systems helped reduce diversions from routes to just 4% in 2016, compared to 20% before implementation.

We opened 16 cross-docking stations, with a focus on regions that don't have enough stores to require a full DC, in order to ensure smooth and reliable logistics and improve the ability to cooperate with local suppliers. Three of the 16 were cross-docking "plus" stations with capacity to package goods.

We continued to refine our piece-rate wage structure for drivers, introduced in 2015, and saw further improvements in payroll per truck of 7% year-on-year in 2016. At the same time, average salaries for drivers increased by 4%.

While we still rely on third-party shippers for some of our transport needs, in 2016 we launched GoCargo, a proprietary solution for booking cargo transportation services online. The new service enables senders to place shipping orders and distributes these orders among registered private carriers based on the cargo's location and the delivery address. In 2017, we aim to roll out GoCargo to all of X5's formats and expand its use for third-party shipping orders. By the end of 2016, 40% of X5's third-party transport needs in the Central division were being handled by GoCargo.

We have developed a new form of cooperation with certain suppliers that allows them to arrange delivery of goods using X5's own transportation fleet. Currently being piloted with 10 suppliers, this form of cooperation makes it possible to improve the level of service for major partners, lower costs at cross-docking stations and increase inventory turnover.

Information technologies

Advanced analytics and information technologies are keys to our efficient operations and to successfully meeting customer demand every single day.

IT Strategy

Our IT strategy, approved by the Supervisory Board in 2015, seeks to ensure that our businesses use new technologies to improve the quality and efficiency of operations, while informing our decision-making to help us manage our growth intelligently.

Our IT strategy focuses on:

Accelerating decision-making

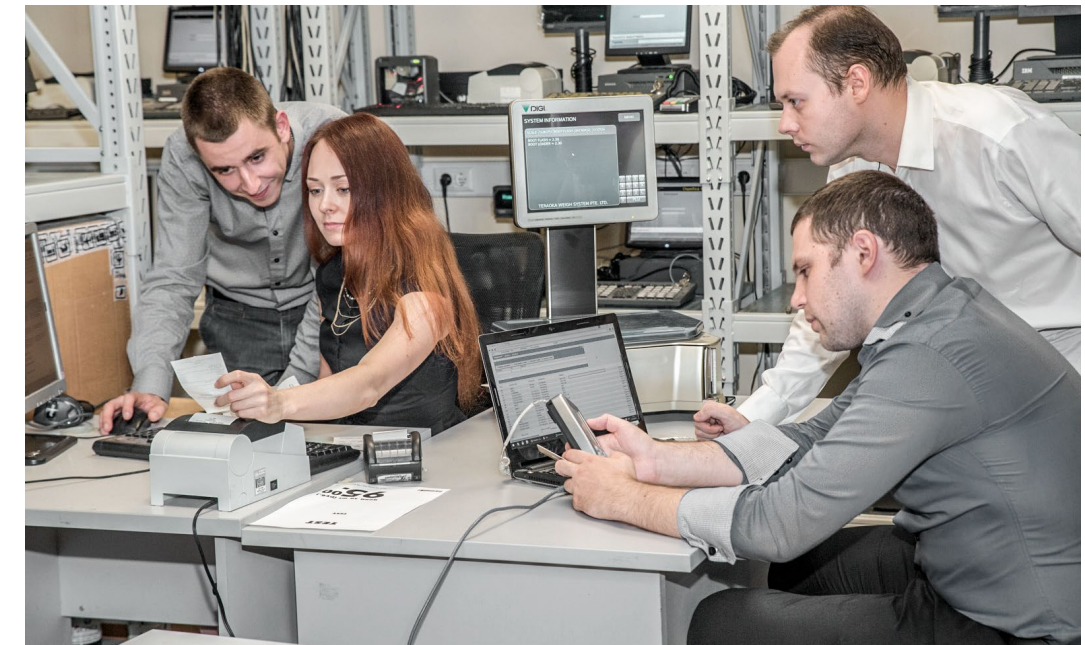
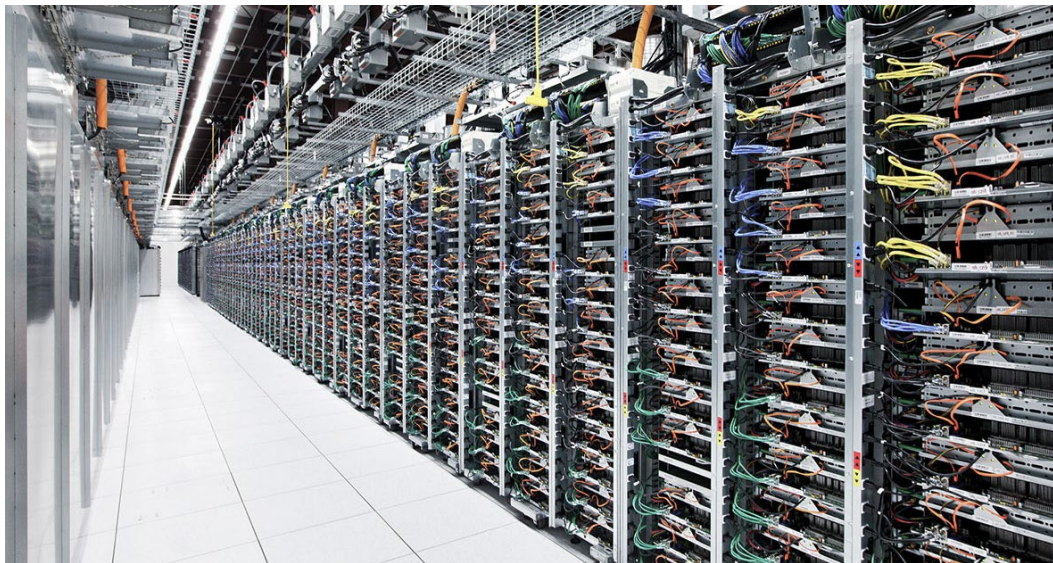
By using IT systems to effectively gather, manage and analyse data, we are able to optimise business processes like choosing locations for new stores.

Better understanding our customers

Data and analytics is one of the key elements to understanding customer behaviour and adapting our value proposition to best meet their needs.

Store management

We aim to improve store management, shelf availability, and efficiency with automated data collection, analysis, and forecasting systems.



How we manage our IT systems

Management of our IT systems and investments into IT infrastructure is handled by the Corporate Centre, while each of the formats is responsible for detailed requirements and customisation, customer loyalty programme management and other software they use to improve their business efficiency.

What we did in 2016

Our main focus was on ongoing implementation of X5's IT strategy for 2015-2017. This included two projects aimed at improving our customer-centric operations, enabling us to better analyse our customers and their behaviour, as well as develop more effective and individualised loyalty programmes.

We also invested significant funds into forecasting, supply chain management, assortment management, pricing, promo, and business planning. These systems enable us to better and more efficiently manage our business by using advanced analysis of historical data and customer behaviour to better meet demand.

The corporate data warehouse was moved over to the SAP HANA platform, which provides near-real-time sales reporting, enables us to quickly collect and analyse store-by-store receipts and performance data, with up to two years' worth of historical data. Daily reporting is accelerated by the new capabilities of the HANA platform.

X5's electronic document interchange (EDI) system is one of the most advanced in our sector, and has significantly improved both the efficiency and quality of our work with suppliers and other parties. X5 is currently implementing approximately 20 different EDI projects, and electronic document traffic increased by 40.3% year-on-year in 2016, with lease, transport, non-commercial procurement and intercompany transactions all moved to our EDI platform.

Another area of focus continues to be the "IT store" project, which puts IT Department employees in stores to work as store employees. By better understanding how employees use IT systems for day-to-day tasks, we have already generated over 300 new ideas, the implementation of which is expected to save hundreds of millions of roubles.

Product safety & production quality

All of X5's formats have clear rules and guidelines to ensure that all the products we sell consistently meet high standards of quality and safety. We have established a quality control system that covers all of our operations from supplier to shelf.

As the nation's largest retailer, we seek to improve safety and quality procedures across all our formats on an ongoing basis. As part of this, we implement recommendations on best practices from leading inspection, verification, testing and certification companies.

X5 also works closely with authorities at the federal level to draft documents, including food standards, legislative proposals, regulations and consumer rights protection proposals.

2016 in numbers



Pyaterochka

15,129

Items tested and accepted into the product matrix (40% more than in 2015)

1,956

Stores audited during 2016, almost triple the number in 2015 (702 stores)



Perekrestok

167

Suppliers audited

7,104

Random samples of stores' in-house products sent for testing



Karusel

265

Internal quality audits carried out at hypermarkets

6,830

Random samples taken from employees' hands for lab-based hygiene testing



How we manage safety and quality

X5 strives to give our customers fresh, high quality products. To do this, we have established consistent rules and regulations that cover the entire product chain from producer to end consumer. These rules and regulations comply with all Russian legislation and regulatory requirements, and also draw on global best practice in the food retail sector.

X5 deploys the principles of Hazard Analysis and Critical Control Points (HACCP) to ensure that our products are safe for consumers and the environment, and that they meet retail standards and customer needs.

Other quality assurance practices that we use include:

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

Each of our retail formats maintains its own quality assurance functions.

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

For all of our operating divisions, high product quality is a priority. Retail formats regularly engage accredited international auditors to conduct audits of their suppliers, and update quality specifications and standards for food products, private labels and packaging on an ongoing basis.

Introducing goods to our product range

All potential suppliers supply us with samples and documentation certifying the quality, safety and origin of their products before signing a supply contract with X5. The Company's quality experts then ensure that suppliers meet both X5's and regulatory requirements.

Acceptance at distribution centres

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

In 2016, Pyaterochka launched a pilot project called "remote acceptance" at one DC that reduced losses in this area by introducing a number of measures such as video monitoring and random sampling. In 2017, the Company plans to roll out this scheme at all of Pyaterochka's DCs. Pyaterochka also implemented monitoring of the cool chain from supplier to shelf during the year.

From 1 January 2018, paper veterinary certificates will be replaced by electronic documents using the Mercury national information system, which will enhance traceability of goods and reduce paperwork. In November 2016, Pyaterochka launched a pilot project to implement the Mercury system at a number of DCs, helping to reduce costs. In parallel, a centralised solution to integrate the Mercury system with Pyaterochka warehouses has been launched, with completion expected by 1 January 2018.

Implementation of the SAP QM module in all DC zones during 2016 helped increase transparency of acceptance procedures, reduce time inputs and allow statistical record-keeping at the system level.

In response to outbreaks of African swine fever, a compartmentalisation system was introduced to give DCs autonomous decision-making responsibility when accepting and transporting pig products, reducing the risks of goods losses in this category.

Quality control in stores

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

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

Store audits in 2016 were carried out as follows:

	2016	2015	Change (%)
Pyaterochka	1,956	702	179%
Perekrestok	427	305	40%
Karusel	265	212	25%

Interaction with consumers

X5 thoroughly investigates all customer complaints. This verification process may involve making control purchases and sending samples for analysis.

X5 regularly publishes the results of its quality monitoring procedures on the Quality section of our website to ensure full transparency for our customers and ensure that all of our products are genuine and high-quality. Products found to be in breach of quality and safety standards are immediately taken off the shelves and returned to the supplier.

Audit of branded and private-label products

A supplier audit is one of the criteria for selection and rating of suppliers. In 2016, the Supplier Audit Programme was adopted into X5 Policy and made available on the supplier portal along with a requirements checklist. All new suppliers undergo a mandatory audit to ensure that their production facilities are compliant with quality and food safety requirements.

During the year, all of X5's formats conducted audits of suppliers, while samples of product items were sent to independent, accredited testing facilities for analysis. The analysis was aimed at verifying the products' 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 or preserving agents not indicated on the label.

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

Audits conducted in 2016:

Producer	Pyaterochka	Perekrestok	Karusel
Number of audits	939	167	14*

*Karusel uses Pyaterochka's database.

In 2016, items were sent to independent, accredited testing facilities for analysis as follows:

Pyaterochka

2,166 items, 322 of which, or 14.8%, were found to be below quality standards

Perekrestok

1,184 finished products from suppliers

7,104 items produced in-store

Karusel

427 products from suppliers

590 private-label products

6,975 own and bakery items produced in-store

Interaction with public authorities and self-regulating organisations

In 2016, the Quality Department drafted 127 proposals on refining existing legislation and amending specific legal acts regarding technical regulation, accreditation and standardisation, food product quality and safety, veterinary control and supervision, sanitary and phytosanitary measures and consumer rights protection.

The Quality Department worked alongside 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 to develop a common industry-wide position and unify retailer efforts in key areas such as product quality guarantees, protection of consumer rights, promotion of HACCP principles among Russian manufacturers, protection of public health and strengthening of the social responsibility of food production and distribution market participants.

Russia's accession to the World Trade Organization (WTO) in 2012 required harmonisation of 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. In 2016, the department prepared 32 proposals for draft national standards, including those harmonised with international standards and those considered as part of the "Russian system of quality".

In 2016, the Retail Companies Association's quality committee was once again chaired by X5's Quality Director. The committee was created in 2014 with the goals of 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 has already earned the trust of other retailers in the association, as well as of regulatory officials. The committee held 31 meetings in 2015, including three committee meetings, 24 joint meetings with supplier industry associations and unions to address problem areas and seven meetings with regulatory officials. These meetings resulted in 42 addresses to the EEC, the Government of the Russian Federation, the Presidential Administration and federal executive authorities, reviews of 41 draft regulatory acts and the circulation of 251 memoranda, including those on legislative amendments.

Social, corporate & environmental responsibility

Corporate responsibility

At the X5 Retail Group, we recognise that long-term, sustainable market leadership requires far more than achieving rapid growth and financial performance. Our long-term success will be secured by our ability to create value for a broad range of stakeholders, including members of the communities where we operate and our employees, as well as by our responsible approach to managing our environmental impact.

X5 & Local communities



Our strategy for community investments

X5 contributes significantly to the local communities in the regions where we operate, as well as to Russian society and the economy more broadly. We have stores operating in more than two thousand cities and towns, including major metropolitan centres such as Moscow and St. Petersburg, large regional centres like Ekaterinburg and Nizhny Novgorod, as well as smaller towns with under one thousand inhabitants.

Our strategy to create value for local communities focuses on:

- Offering high-quality products at reasonable prices with a modern retail shopping experience at every store we operate
- Creating rewarding jobs with career opportunities at every store, DC, or other aspect of our operations
- Building mutually beneficial strategic relationships with suppliers, including local suppliers in the regions where our stores are located
- Identifying opportunities to cooperate with charities, and/or to make charitable contributions to provide targeted support to people or groups in need

How we manage our community investments

Our business is run responsibly, with the aim of achieving sustainable growth that will provide stable employment opportunities within each of the formats and at X5's Corporate Centre.

Decision-making for specific social partnerships and charitable giving is driven by the management of each of our retail formats, as well as by the corporate responsibility strategy established by X5's Corporate Centre.

Work with local communities

Social partnerships

We have established a partnership with the Life Line Charitable Foundation to implement a range of projects to support people in need by leveraging X5's federal reach.



Kindness Candy charity project

Since 2014, X5 and Life Line have also been conducting the Kindness Candy charity project. Under this programme, special candies 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. In 2016, we collected RUB 5.5 million through the Kindness Candy project, which helped to fund operations for seven children.



Running for Life charity marathon

Each year, the X5 team participates in Running for Life, a charity running event organised by Life Line. In 2016, more than 300 X5 employees ran the marathon. The more than RUB 4 million raised as a result of the run was donated to United Way and Life Line.



Donation boxes

We have installed dedicated collection boxes for the Life Line Charitable Foundation in our stores to help children with severe health problems. In 2016, we collected RUB 20 million for Life Line through these boxes, which helped to fund 24 surgical procedures for children in need.

Corporate Responsibility

Food aid



Food banking

In August 2015, X5, in partnership with Mars and the Rus Food Foundation (a member of the Global Foodbanking Network) launched a project called "Basket of Kindness" to collect and provide for vulnerable people across Russia. In 2016, around 20,000 customers donated more than 27.5 tonnes of food to people in need as part of the Basket of Kindness programme. The "Basket of Kindness" programme was rolled out in 200 Pyaterochka, Perekrestok and Karusel stores in 18 cities across Russia in 2016. In 2017, organisers of the project plan to double its geographic reach and to recruit more than 1,000 volunteers.



Electronic social certificates

In October 2013, the Moscow city government launched an electronic social certificates programme. Those eligible to receive these certificates include senior citizens, multi-child families, the disabled and people suffering specific hardships. The certificates have a monthly balance of RUB 1,000 that can be used to purchase food products, and can be used in a number of Pyaterochka, Perekrestok and Karusel stores. In 2016, around 130 thousand people were eligible to use these certificates.



Supporting vulnerable groups of the population

We consider it 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. For several years, we have been offering Russia's senior citizens discounts at our stores, and we plan to continue this practice going forward. Pyaterochka stores offer pensioners a 10% discount on Mondays and a 5% discount all other days of the week. Our Perekrestok and Karusel stores also offer pensioners discounts: 10% from 9:00 to 10:00 at Perekrestok, and 5% from opening until 13:00 at Karusel.

Team spirit and employee dedication are instrumental to the success of every company, especially one as big as X5. To strengthen the whole X5 team and give office-based employees a first-hand understanding of X5's core business, then-CEO Stephan DuCharme introduced the idea of X-Friday in 2013.

Held every Friday in December, X-Friday gives office-based employees the opportunity to work at select Pyaterochka, Perekrestok or Karusel stores. Anyone from senior management to interns can take part in helping store operations run smoothly – assisting customers, checking price tags and stacking shelves – during the busiest month of the food retailer's calendar.



In 2016

X-Friday has proved to be a major success among X5 employees, and participant numbers increase every year.

Employees took part

3,971

Store visits

5,196

Cities & towns participated

380

X-FRIDAY

	2013	2014	2015	2016
PARTICIPANTS	1,600	3,220	3,544	3,971
STORE VISITS		4,227	4,616	5,196

Human resources

X5 is a fast-growing business that relies on robust human resources management systems to ensure that we have the right people doing the right jobs and committed to the success of the Company. We are a diverse team with a wide range of skills, and the fast-developing nature of our business means that there are many opportunities for talented employees to advance their careers within X5.

Our strategy for our people

Our employees are our most valuable asset. Without motivated, qualified and loyal staff, we would be unable to achieve our ambitious goals of rapid, sustainable growth while maintaining margins and reaching a food retail market share of 15% by 2020.

Our human resources strategy focuses on:

High-quality recruitment

The scale and complexity of our business means that we must have systems in place to ensure we are able to hire and retain the right people in a timely manner, and that they are able to fulfil the jobs they have been hired to do.

Teamwork and orientation

We aim to ensure that all employees are properly trained from day one on key skills and knowledge required for the job, and that they are ready to work productively as part of the X5 team.

Training and education

We invest in our employees to help them advance their professional qualifications, giving them the skills they need to excel at their jobs and to advance their careers within X5.

Proper motivation

We implement a variety of bonus and incentive programmes at different levels of the business, from cashiers and warehouse workers up to senior management, aimed at aligning the motivation of our team with those of our rapidly developing business and shareholders.

How we manage human resources

With the completion of the reorganisation of the Corporate Centre in 2016, we strengthened its role as the management company that oversees each of the retail formats. Many business functions have been decentralised, enabling each of the formats to respond quickly to the demands of a fast-growing business in order to achieve our strategic goals.

While the Corporate Centre sets established strategic targets and sets and enforces standards, the formats have a significant degree of freedom to decide how to achieve these goals while adhering to Company standards and policies, including with regards to recruitment, induction, training and motivation.

X5 is an equal opportunity employer, and considers qualified candidates regardless of age, sex, social background, race, nationality or ethnicity, or physical ability. We also strive to provide a supportive and flexible work environment for employees who are students or parents.

Highlights of our human resources system

2016

Headcount employees

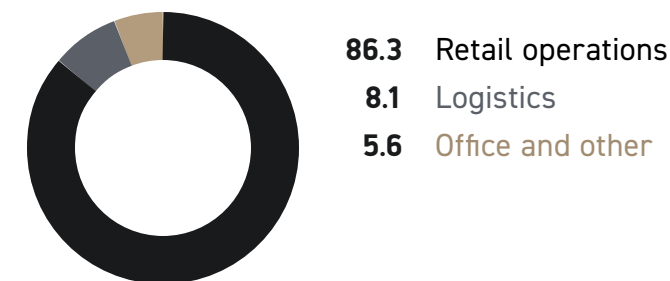
196,128

+17.1% year-on-year

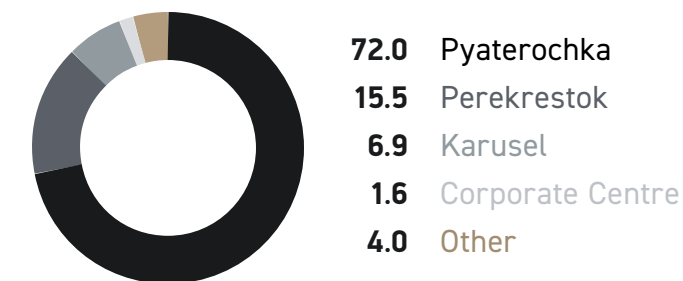
as of 31 December 2016

Personnel breakdown, %

by function

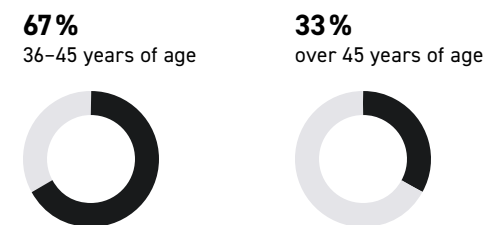


by format



Top management breakdown, %

by age



by gender



Human resources

Recruitment

With more than 2,000 stores opening every year, high-quality and rapid recruitment is key to our business.

To address this high-demand recruitment challenge, Pyaterochka has developed an HR management software solution that centralises hiring for positions requiring mass recruitment. This service gives Pyaterochka the ability to monitor the effectiveness of its recruitment processes in order to improve manageability and scalability. This new approach to recruitment has also enabled Pyaterochka to reduce the average time it takes to fill vacancies to just seven days.

Perekrestok has programmes focused on identifying talented young candidates for professional or management positions. This is achieved through partnerships with Moscow universities to recruit promising candidates for internships in the marketing, commercial and strategy departments. In 2016, 16 of our interns were hired for full-time positions as a result of this programme, seven of whom have advanced to the "specialist" level and two of whom have already been promoted to management positions.

We also focus on internal recruitment as one of the best ways to provide our employees with career opportunities while filling vacancies that require knowledge of our business. In 2016, we launched an internal selection process, which has increased the share of X5's Corporate Centre appointments from internal candidates.



Orientation and teamwork

We seek to help new employees quickly develop the knowledge and skills they need to do their jobs well.

During 2016 we focused on:

- Improvements to the "On your marks" introductory course for new Corporate Centre employees, which now includes an online course, an in-person "X5-Strategy" business game and two video sessions about working in stores and DCs.
- The introduction of a guide for new employees called "Your first steps at X5", which helps them to integrate themselves more quickly into the business and corporate culture.
- Pyaterochka completed its "Adaptation" project for store directors, supervisors, cashiers, cluster directors and office employees. Pyaterochka now has individualised plans and training materials for each group of employees.
- Karusel developed an online course for testing incoming interns. Individual plans are developed based on each individual's knowledge of specific processes and areas of the store. For newcomers, Karusel developed a two-day course that includes introductions to standards, KPIs and service.
- All employees are also required to complete online courses on information security and X5's code of ethics.



Human resources

Training and development

- Over **RUB 60 million** invested in employee training in 2016
- Over **120,000 hours** of training for office employees in 2016

Professional development for our employees is a priority, as we seek to offer fulfilling career growth opportunities and to increase the share of internal recruitment to fill vacancies.

Some of our key achievements in 2016 included:

- Introducing a planned training programme for Corporate Centre employees, including benchmarks for different categories of employees.
- Starting a programme to share best practices, where speakers from various fields share their experience and knowledge with X5 employees.
- Perekrestok's conducting three "business campus" courses for 850 key employees. The supermarket format also organises "Path to Your Dreams" training courses and master classes, as well as the "Nature of Leadership" club to help employees to develop new skills.
- Karusel's regularly organised training courses on various topics directly applicable to employees' day-to-day responsibilities, ranging from waste management to quality control to financial management.
- Launching eight new training programmes for management skills and three new programmes for communications and cross-functional cooperation.
- Initiating, at Pyaterochka, the "First League" training programme for supervisors, and the "Higher League" training programme for cluster directors and division heads.
- Launching a mentoring programme at Pyaterochka for division heads to work with cluster directors in order to share knowledge.
- Developing and launching online courses on topics that included the X5 corporate code of ethics and the Russian Trade Law.



Increasing efficiency and staff motivation

In an effort to increase operational efficiency at the Company, X5 developed a set of key performance indicators (KPIs) for staff, including a system whereby KPIs cascade down through key functions within the Company. The annual KPI system enables the Company to assess the contribution that employees make to X5's overall business goals, with bonus compensation being tied strictly to performance for all employees, irrespective of age, sex and tenure with the Company.

In 2016, changes were made to the long-term incentive programme for X5 management. The programme was aimed at aligning the interests of management and shareholders, as well as increasing overall efficiency within the Company and ensuring that it meets its financial targets.

There are also a number of non-financial incentive programmes in place for employees, including internal competitions and ratings.

Pyaterochka continued its major "Turboliada" sports competition.

Turboliada in numbers

- **10 CITIES**
- **18,500 EMPLOYEES**
- **117 TEAMS**
- **2,240 ATHLETES**
- **MORE THAN 10,000 KM OF TRACK**
- **MORE THAN 40 TONS OF EQUIPMENT**
- **15 UNIQUE TRIALS**
- **1 RUSSIAN RECORD SET**

In 2016, Pyaterochka, Perekrestok and Karusel all held competitions for cashiers — "Cashier of the Year", "Victory at the Cash Register", and "Highest Efficiency with a Smile". Pyaterochka also held a competition for warehouse operators and electric pallet stacker drivers — "Best Employee at the DC" — while Perekrestok held a competition for its "Cooking Contest" chefs.

In addition, the Company holds a number of practical and strategic conferences with the participation of management, where plans, results and key areas of focus are discussed.

Competitive wages and benefits

At X5, we want our people to receive a fair reward for their performance by offering competitive pay and benefits. In order to ensure that compensation is transparent, X5 uses a structured salary grid for each format.

We provide diverse compensation packages, which are different across formats and depend on the job level. This includes competitive fixed salaries, variable salary components, medical and accident insurance and mobile phone packages.

Ethics and compliance

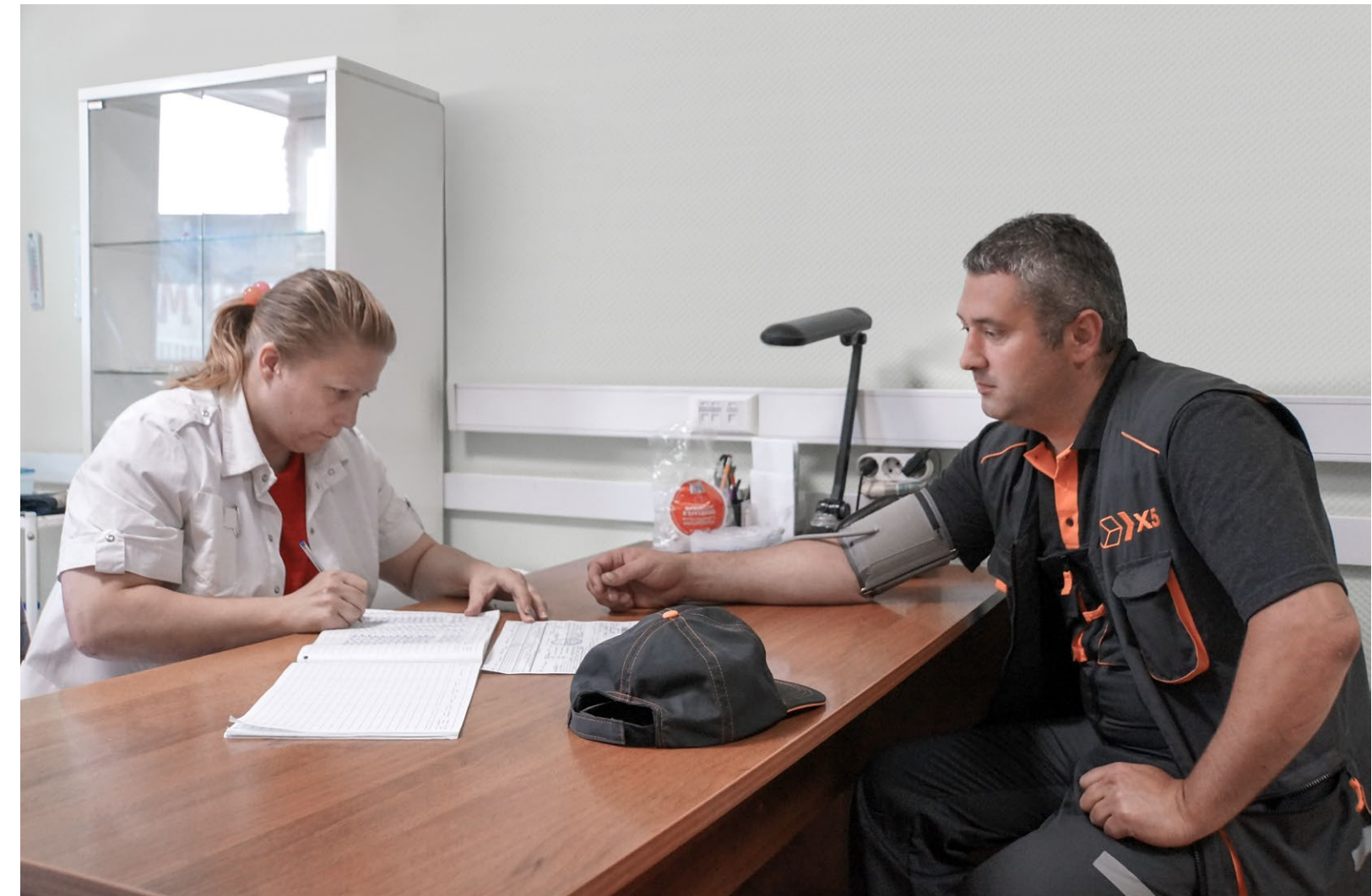
We aim to uphold high ethical standards in our relationships with employees and in upholding their statutory rights. X5's Code of Business Conduct and Ethics defines the key principles of how we take care of our employees, including providing equal opportunities, a safe and healthy workplace, and supporting an ethical working environment.

We have whistleblower hotlines in place for employees to report actual or suspected irregularities in breach of the Code of Conduct, including labour law violations. Every complaint that contains sufficient information for an investigation is dealt with appropriately. While X5's compliance department is responsible for overseeing the employee hotline, the dedicated Ethics Committee reviews actual irregularities and develops remedial and preventive measures.

Occupational health and safety

Overview

One of X5's top priorities is **ensuring the health and safety of our employees**. This helps to improve on-the-job performance and supports the Company's long-term sustainability. Management regularly monitors the performance of X5's occupational health and safety (OHS) systems.



Our OHS strategy

We are implementing an OHS strategy that aims to ensure that we adopt best practices to keep our employees healthy and safe by focusing on:

Monitoring employee health

to reduce the likelihood of work-related injuries and diseases, as well as to protect public health

Training employees

on workplace health and safety rules and procedures

Monitoring workplace conditions

, compliance with Company rules and government regulations, and analysing incidents when they do take place in order to take the necessary measures to avoid repetition

How we manage occupational health & safety

The OHS department is based in the X5 Corporate Centre, with responsibility for developing labour safety policy and standards, internal health and safety guidelines and regulations, monitoring changes in Russian Federation OHS legislation and regulations and ensuring that X5 remains compliant, and coordinating health and safety activities across the Company.

Each of the retail formats has dedicated OHS functions in charge of health and safety to manage and oversee compliance with the Company's health and safety policy and applicable Russian legislation.

Key highlights

Medical examinations

Medical examinations and screenings are an effective means of monitoring our employees' health and diagnosing occupational diseases at early stages. Our aim is to detect illnesses promptly, to prevent and contain contagious diseases and to take action to mitigate health risks and provide required treatment. X5's personnel employed in retail, logistics and transportation undergo medical examinations when joining the Company and on an annual basis thereafter. Employees who drive vehicles must undergo a medical examination prior to and following every trip.

In 2016, all eligible employees underwent medical examinations. We launched a pilot project that uses an automated monitoring system to ensure that all employees are up to date. This system, which will also reduce the costs involved in monitoring employee medical examination compliance, will be introduced at Perekrestok in 2017 and then implemented at the other formats.

Employee training

We implement a robust system of training for all of our employees, starting from the day they begin work, with regular additional instruction every six months or more. Training takes place at specialised training providers, X5's own training centres, or using online distance learning tools. This enables management across our chains to improve their professional knowledge in relation to OHS. In 2016, approximately 26,000 people completed such courses. In addition, employees working in hazardous environments (for example, electricians, forklift and truck operators) receive regular specialised training.

During 2016, we launched a new project to create an automated system that will efficiently and effectively monitor employee OHS training, helping to ensure that employees are receiving the proper training in a timely manner and in accordance with Company policy.

We also seek to ensure that employees are properly informed about OHS rules and regulations. The X5 corporate intranet has a section devoted to OHS, where employees can access internal rules and regulatory documents related to the Company's activities. Presentations explaining newly introduced standards, regulations or rules are sent to employees by email.

Oversight and monitoring

X5 implements a two-stage system of oversight and monitoring of workplaces to ensure compliance with the Company's health and safety policy and federal laws, and to identify potential areas for OHS improvements.

Managers at every site are responsible for daily monitoring of workplace conditions and identification of issues. Any instances of non-compliance must be addressed immediately if possible, or reported to relevant services if additional resources are required.

X5's OHS specialists conduct internal audits on a regularly scheduled basis. Following an audit, a report is produced identifying issues that must be addressed and recommendations for improving workplace health and safety conditions.

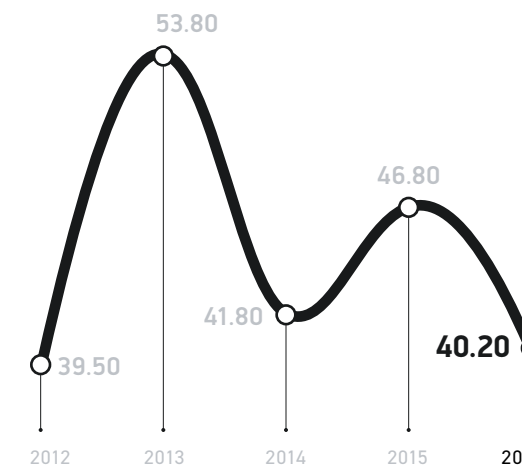
Management teams for each of the formats receive regular reports on the outcome of internal OHS audits. In 2016, the Company conducted approximately 1,000 internal audits, and 95% of violations were eliminated within five days (compared to 90 days in 2015), while the remaining 5% were addressed in 10 to 14 days.

In 2016, X5 introduced safety checklists that are used to maintain a workplace health and safety index for each of the retail formats. Any sites that are found to have substandard safety conditions are subject to additional monitoring and strict oversight until the issues are addressed.

Injury statistics

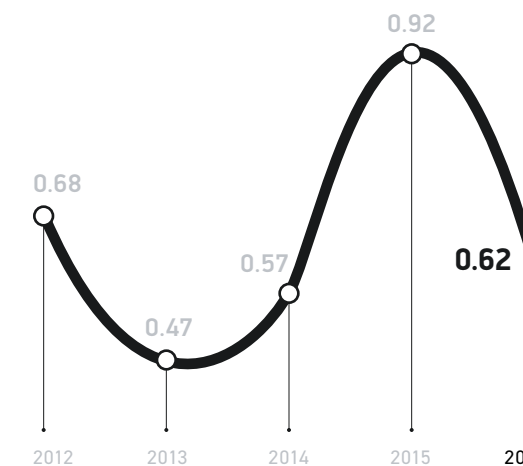
While our efforts to minimise risks and prevent accidents are ongoing, the scale of our business means that completely avoiding any occupational injuries is very challenging. When incidents do occur, we investigate them and take measures to eliminate the underlying causes and minimise the chance of repetition. Most injuries in 2016

were minor and required minimum disability leave. The severity rate, indicating the average number of work days lost per accident, decreased from 46.8 days in 2015 to 40.2 days in 2016. The accident frequency rate, indicating the number of accidents per 1,000 employees, also declined, from 0.92 in 2015 to 0.62 in 2016.



Severe accident ratio

Total number of employee work days lost per accident



Accident frequency rate

Number of accidents per 1,000 employees

SOURCE: X5's data

Compensation

To compensate for injuries caused by workplace accidents, 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 the loss of a 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.

Environmental review

Taking a responsible approach to our impact on the environment is key for X5's successful and sustainable long-term development. As our business grows and develops, so does 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.

Our environmental strategy

X5 strives to fully comply with 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 provides ample opportunities to improve business efficiency and reduce costs, and in some cases, even to generate additional income.

How we manage our environmental impact

Each of the formats is responsible for implementation of its environmental policy and compliance with the Russian Federation regulatory norms regarding waste disposal and emissions.

At the Corporate Centre level, we set group-wide strategic priorities that impact our environmental footprint, and also implement programmes aimed at minimising emissions and waste from the Corporate Centre.

Key environmental initiatives

Highlights

2016



Pyaterochka accounted for

1.4%

of total recycling volume in Russia



Perekrestok recycled

70%

of the solid waste it generated

Waste recycling and disposal

Currently, the waste generated by our stores is transferred to third parties either for use 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.

Income from the sale of recyclable waste

Format	2016	2015
Pyaterochka	RUB 913 million	RUB 682 million
Perekrestok	RUB 107 million	RUB 76 million
Karusel	RUB 126 million	RUB 82 million

Pyaterochka improved the efficiency of its recycling operations in 2016 by launching a programme to centralise collection and processing of materials at distribution centres, which made it possible to increase the volume collected as well as sale prices. Going forward, the format plans to increase the volume of recycling operations handled by distribution centres instead of stores.

Key activities in 2016

Reuse of shipping materials

To minimise supply waste and waste resulting from transportation of products from distribution centres to our stores, we use reusable containers returned to suppliers after delivery as well as wooden pallets and trays that are returned to distribution centres.

Starting in 2015, we launched a lean manufacturing initiative, under which Pyaterochka began implementing a programme to automate the tracking and return to suppliers of shipping pallets. This programme will eventually give suppliers the ability to monitor and plan pickups of their pallets from Pyaterochka DCs.

	Recycling	Reuse	Energy efficiency
PYATEROCHKA 	<ul style="list-style-type: none"> Increased collection volume and sale prices by beginning to transfer collection function from stores to DCs Entered into first direct sales contracts with recycling plants Launched a project to automatically calculate solid waste limits for each store based on revenue and assortment, which is expected to enable a 7% reduction in solid waste disposal costs 	<ul style="list-style-type: none"> Launched a programme to track inventory of grocery carts at stores, with the aim of reducing purchases of new carts while ensuring proper supplies to stores Developed an online portal for suppliers to manage inventory of reusable shipping containers at DCs (due to launch in 2017) 	<ul style="list-style-type: none"> Completed installation of energy-efficient lighting in all stores and DCs, enabling 1.2% year-on-year reduction in energy consumption Installed systems to automatically shut off all non-essential electrical systems in all stores during non-work hours, which is expected to reduce energy consumption by 2% year-on-year in 2017 Began installation of remote refrigeration unit monitoring and management equipment (due to be completed in 2017), which is expected to reduce energy consumption by 1% Launched a programme to optimise energy tariff selection based on comprehensive monitoring of energy use at each store or DC
PEREKRESTOK 	<ul style="list-style-type: none"> In Q2 2016, launched a system to track inventory of recyclable materials, which supported a 42% year-on-year increase in income from recycling and 22% year-on-year growth in recycling volume Implemented battery and paper recycling programmes at central office 	<ul style="list-style-type: none"> Continued to implement programme to return reusable shipping containers from stores to DCs 	<ul style="list-style-type: none"> Completed installation of LED lighting at all stores
KARUSEL 	<ul style="list-style-type: none"> Installed ecoboxes at 19 hypermarkets, enabling consumers to collect hazardous materials for recycling or proper disposal: collected around 2.3 tonnes of batteries and 2,700 burned-out light bulbs Continued recycling programme to reduce solid waste disposal in stores 		<ul style="list-style-type: none"> Installed LED lighting at seven stores as part of the renovation programme, and installed LED lighting at an additional three stores Replaced fluorescent lighting in signage at 20 stores with LED lighting

Environmental initiatives

Logistics

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

Distribution centres

Pyaterochka is implementing Ecodevelopment principles for its logistics network. The main goals of these principles are to reduce the consumption of energy and materials, while also increasing the quality of buildings and reducing exploitation costs. As a result of this initiative, we expect to reduce the impact of DC construction on the environment.

Transport

Our most significant environmental impact comes from our transport unit, where we use various approaches to minimise the damage caused by transport from our distribution centres to stores. Our fleet now covers 60–70% (depending on the season) of our transport needs, and is newer than the fleets of most of our external contractors. Contractors are responsible for compliance with environmental requirements, and our transport service agreements stipulate that trucks must meet all legislative requirements, including environmental requirements.

We use certified service stations to provide regular maintenance for our trucks in line with legislation and the norms established by truck manufacturers based on either the number of kilometres on the odometer or the vehicle's working life. Daily monitoring of the condition of our vehicles, including their exhaust systems, is part of our mechanics' and drivers' responsibilities. If serious failures are detected in a vehicle, it is withdrawn from use and sent for repair.

In addition, we do not purchase used or outdated vehicles, nor do we use vehicles that have reached the end of their service life in accordance with the manufacturer's recommendations. By the end of 2016, the average age of our fleet was three years, compared to an average age of four years at the end of 2015.

A full 100% of our transportation fleet meets Euro 3, Euro 4 or Euro 5 standards. Since 2014, we have been purchasing only Euro 4 or higher-class vehicles, and have been using only high-quality fuel from leading producers.

CFO overview

Dmitry Gimmelberg

X5 Retail Group
Chief Financial Officer



The X5 Retail Group continued to deliver on its strategic goal of rapid expansion while at least maintaining margins: revenue for 2016 was RUB 1,033.7 billion, up 27.8% year-on-year, and adjusted EBITDA¹ increased 33.8% year-on-year to RUB 79.5 billion, bringing the adjusted EBITDA margin up by 35 basis points to 7.7%.

Our ongoing efficiency projects produced the desired results in 2016, helping adjusted SG&A² expenses as a percentage of revenue decline by 78 basis points year-on-year to 17.2%. Operating leverage affected adjusted SG&A, and in particular staff costs, as a percentage of revenue, the latter of which declined by 29 basis points year-on-year to 7.5%.

The macro environment in 2016, while still challenging, showed some signs of stabilisation, with food inflation declining significantly compared to 2015, and real wage growth marginally positive for the year compared to a decline of 9% in 2015. Nonetheless, the Russian economy overall and the food retail sector in particular continue to face significant headwinds, and X5 Retail Group must continue to adapt as it has done successfully in recent years.

X5's already comfortable debt levels continued to improve in 2016, with net debt/EBITDA as of 31 December 2016 falling to 1.81x, the lowest level in the X5 Retail Group's history and down significantly from 2.45x at the end of 2015. We have significantly mitigated interest rate risks, with fixed interest rates on 100% of our debt.

We remain well-positioned to continue our rapid expansion in 2017, with a solid balance sheet and very strong cash flows able to support the Company's well-tuned operating model.

¹ Adjusted EBITDA is EBITDA before costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 138-141.

² Adjusted SG&A is SG&A before depreciation, amortisation and impairment costs as well as costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 138-141.



Financial review

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

The following is a review of our financial condition and results of operations as of 31 December 2016 and for the years ended 31 December 2016 and 31 December 2015. The Consolidated Financial Statements and related notes thereto are available on pages 181-240 of this document, and have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Key highlights

Revenue
RUB billion

1,034

27.8%
year-on-year increase

Adjusted SG&A
expenses

17.2%

78 basis points
year-on-year decrease

Adjusted EBITDA
margin

7.7%

35 basis points
year-on-year increase
(the highest since 2010)

Capital
expenditures
RUB billion

80.7

13.5%
year-on-year increase

Net debt/EBITDA

1.81x

The lowest level in the
Company's history

Selected macroeconomic data

Russian macroeconomic indicators, year-on-year comparison	2015					2016				
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY
RUB/USD exchange rate, weighted average for the period	62.2	52.7	63.0	65.9	61.0	74.6	65.9	64.6	63.1	67.0
CPI	16.2%	15.8%	15.7%	14.5%	15.6%	8.4%	7.4%	6.8%	5.8%	7.1%
Food inflation	22.3%	20.3%	18.0%	15.9%	19.1%	6.9%	5.7%	6.3%	5.2%	6.0%
PPI	9.9%	13.8%	13.2%	12.9%	12.5%	3.8%	3.1%	4.2%	4.9%	4.0%
Real wage growth	-9.0%	-8.5%	-9.5%	-9.8%	-9.0%	-0.6%	0.3%	1.2%	1.8%	0.7%
Unemployment rate	5.7%	5.6%	5.3%	5.7%	5.6%	5.9%	5.7%	5.3%	5.4%	5.5%
Retail turnover	8.3%	5.4%	4.5%	0.8%	4.5%	2.8%	1.5%	3.0%	1.5%	2.2%
Food retail turnover	13.2%	9.3%	7.1%	5.1%	8.4%	3.6%	1.7%	2.8%	0.8%	2.2%

Results of operations

for the year ended
31 December **2016**
compared to the year ended
31 December **2015**

The following table and discussion is a summary of our consolidated results of operations for the years ended 31 December 2016 and 31 December 2015.

Profit and loss statement highlights

Russian rouble (RUB), millions ³	2016	2015	% change y-o-y
Revenue	1,033,667	808,818	27.8
incl. net retail sales ⁴	1,025,589	804,132	27.5
Pyaterochka	775,580	585,402	32.5
Perekrestok	155,404	130,144	19.4
Karusel	83,558	77,443	7.9
Express	11,048	11,143	(0.9)
Gross profit	249,985	198,390	26.0
Gross profit margin, %	24.2	24.5	(34) b.p.
Adj. SG&A	(177,426)	(145,101)	22.3
Adj. SG&A, % of revenue	17.2	17.9	(78) b.p.
Adj. EBITDA	79,519	59,413	33.8
Adj. EBITDA margin, %	7.7	7.3	35 b.p.
Operating profit	45,631	34,449	32.5
Operating profit margin, %	4.4	4.3	16 b.p.
Net profit	22,291	14,174	57.3
Net profit margin, %	2.2	1.8	40 b.p.

³ Please note that in this and other tables and text, immaterial deviations in the calculation of % changes, subtotals and totals are explained by rounding.

⁴ Net of VAT and revenue from wholesale operations and revenue from franchise services and other services.

Revenue and net retail sales

In 2016, X5's revenue increased by 27.8% year-on-year and amounted to RUB 1,034 billion, marking the Company's highest pace of growth since 2011.

Net retail sales for 2016 grew by 27.5% year-on-year, driven by a 7.7% increase in like-for-like (LFL) sales and a 19.8% sales growth contribution from a 29.1% rise in selling space.

Net retail sales growth of RUB 221.5 billion was the highest in X5's history.

The Company's proximity store chain, Pyaterochka, was the main driver of growth in 2016: Pyaterochka's net retail sales rose by 32.5% year-on-year, driven by a 9.1% increase in LFL sales and a 23.4% contribution to sales growth from a 37.4% expansion in selling space.

Net additional selling space of 968.6 thousand square metres, driven primarily by organic expansion (86% of net selling space added), was the largest annual opening programme delivered by X5.

X5's LFL traffic growth improved to 2.5% in 2016, up from 2.3% in 2015.

Summary of operational results

Net 2016 RUB retail sales, y-o-y % change	Average ticket	Number of customers	Net retail sales
Pyaterochka	3.8	27.8	32.5
Perekrestok	3.8	15.2	19.4
Karusel	3.2	4.5	7.9
Express	(1.0)	(0.7)	(0.8)
X5 Retail Group	2.5	24.5	27.5

Selling space end-of-period, square metres	31 Dec. 2016	31 Dec. 2015	% change y-o-y
Pyaterochka	3,329,273	2,422,626	37.4
Perekrestok	548,473	484,008	13.3
Karusel	386,897	390,133	(0.8)
Express	37,110	36,407	1.9
X5 Retail Group	4,301,752	3,333,174	29.1

2016 LFL ⁵ results, % growth y-o-y	Sales	Traffic	Basket
Pyaterochka	9.1	3.0	5.9
Perekrestok	6.4	2.4	3.9
Karusel	0.7	(1.1)	1.9
Express	(7.9)	(10.0)	2.3
X5 Retail Group	7.7	2.5	5.0

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

Gross profit margin

The Company's gross profit margin in 2016 decreased by 34 basis points year-on-year to 24.2% due to changes in the contribution to revenue by format as the share of Pyaterochka continued to rise. The rapid expansion of the store base, with a growing number of regional stores and an increasing share of stores in ramp-up phase also affected X5's gross margin.

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

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

RUB million	2016	2015	% change y-o-y
Staff costs⁶	(77,534)	(63,052)	23.0
% of revenue	7.5	7.8	(29) b.p.
Lease expenses	(47,020)	(36,365)	29.3
% of revenue	4.5	4.5	5 b.p.
Utilities	(19,590)	(15,449)	26.8
% of revenue	1.9	1.9	(1) b.p.
Other store costs	(14,112)	(12,766)	10.5
% of revenue	1.4	1.6	(21) b.p.
Third-party services	(8,181)	(7,879)	3.8
% of revenue	0.8	1.0	(18) b.p.
Other expenses	(10,989)	(9,590)	14.6
% of revenue	1.1	1.2	(12) b.p.
Adj. SG&A	(177,426)	(145,101)	22.3
% of revenue	17.2	17.9	(78) b.p.

⁶ Staff costs excluding LTI, share-based payments and other one-off remuneration payments

In 2016, adjusted SG&A expenses, as a percentage of revenue, declined year-on-year by 78 basis points to 17.2%, primarily due to the positive impact of ongoing projects to improve operational efficiency and as a result of operating leverage.

Staff costs in 2016, as a percentage of revenue, declined year-on-year by 29 basis points to 7.5% mainly due to the positive operating leverage effect.

Lease expenses in 2016, as a percentage of revenue, increased year-on-year by only 5 basis points to 4.5%. The effect of new store openings resulting in a large number of stores in ramp-up phase and the subsequent increase in the proportion of leased space as a percentage of the total real estate portfolio was almost entirely offset by improvements in lease terms with real estate owners and by higher operating leverage. As a percentage of X5's total real estate portfolio, leased space accounted for 68% as of 31 December 2016, compared to 61% as of 31 December 2015.

Utilities expenses as a percentage of revenue changed immaterially in 2016 compared to 2015.

In 2016, other store costs as a percentage of revenue declined year-on-year by 21 basis points to 1.4%, driven by projects to optimise in-store processes and a reduction in security costs.

Third-party service expenses as a percentage of revenue declined year-on-year by 18 basis points in 2016 to 0.8% due to decreased expenses for marketing services and consulting services.

Other expenses as a percentage of revenue declined by 12 basis points year-on-year in 2016 to 1.1%, primarily due to higher provisions accrued in Q2 2015.

Long-term incentive (LTI) programme

As described in the Remuneration Report on page 174, a two-stage LTI programme is being run in the Company until 31 December 2019. The LTI programme targets have been structured to substantially align the long-term interests of shareholders and management.

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

After meeting the targets for the first stage of the LTI programme in 2015, additional performance indicators in line with the strategic objectives set by X5's Supervisory Board were met in 2016, and therefore all targets set for the deferred payout under the first stage of the LTI programme were achieved as of 31 December 2016.

Accordingly, in 2016, expenses for this stage of the LTI programme amounted to RUB 1,176 million, while expenses for all previous LTI and share-based payments programmes effective in the Company totalled RUB 178 million in 2016.

In addition, as disclosed by the Company earlier, it is management's assessment that the targets under the second stage of the programme are likely to be achieved in the near term. Therefore, an accrual of RUB 1,472 million has been made in the Consolidated Financial Statements for the year ended 31 December 2016; while in line with the programme rules, payouts under this stage are not expected to take place earlier than 2018 and, for the deferred component, not earlier than 2019.

Social taxes related to the LTI programme amounted to RUB 426 million in 2016.

EBITDA and Adjusted EBITDA analysis

EBITDA and adjusted EBITDA

RUB mln	2016	2015	% change, y-o-y
Gross profit	249,985	198,390	26.0
Gross profit margin, %	24.2	24.5	(34) b.p.
Adj. SG&A (excl. D&A&I)	(177,426)	(145,101)	22.3
% of Revenue	17.2	17.9	(78) b.p.
Lease/sublease and other income	6,960	6,124	13.7
% of Revenue	0.7	0.8	(8) b.p.
Adj. EBITDA	79,519	59,413	33.8
Adj. EBITDA margin, %	7.7	7.3	35 b.p.
LTI, share-based payments and other one-off remuneration payments expense	(2,826)	(3,729)	(24.2)
% of Revenue	0.3	0.5	(19) b.p.
SSC attributable to accrued LTI, share-based payments and other one-off remuneration payments expense	(426)	(451)	(5.6)
% of Revenue	0.04	0.06	(1) b.p.
EBITDA	76,267	55,233	38.1
EBITDA margin, %	7.4	6.8	55 b.p.

As a result of the factors discussed above, X5's adjusted EBITDA in 2016 grew year-on-year by 33.8% and totalled RUB 79,519 million, while the adjusted EBITDA margin increased by 35 basis points and comprised 7.7%.

Lease/sublease & other income

As a percentage of revenue, the Company's income from lease, sublease and other operations changed immaterially in 2016 compared to 2015, and totalled 0.7%.

Analysis by segments

Segment reporting

	RUB mln	2016	2015	% change, y-o-y
In 2016, Pyaterochka's EBITDA margin increased y-o-y by 46 b.p. to 8.3%, driven by a value proposition that is well adapted to Russian consumers' needs and to the changes in the current macro environment, and by the solid performance of mature stores.	Pyaterochka			
	Revenue	779,448	587,280	32.7
	EBITDA	64,441	45,844	40.6
	EBITDA margin, %	8.3	7.8	46 b.p.
Perekrestok's EBITDA margin decreased by 26 b.p. y-o-y in 2016 due to the evolving value proposition, including introduction of new entry-price SKUs with lower markups to better support the format's core audience.	Perekrestok			
	Revenue	157,004	131,332	19.5
	EBITDA	11,935	10,323	15.6
	EBITDA margin, %	7.6	7.9	(26) b.p.
In 2016, Karusel's EBITDA margin improved by 47 b.p. on the back of optimisation of the store portfolio, solid performance of mature stores opened in Q4 2015 and improved in-store efficiencies.	Karusel			
	Revenue	84,649	77,778	8.8
	EBITDA	4,322	3,602	20.0
	EBITDA margin, %	5.1	4.6	47 b.p.
	Other segments			
	Revenue	12,566	12,428	1.1
	EBITDA	(195)	431	-
	EBITDA margin, %	(1.6)	3.5	-
X5's Corporate Centre expenses declined due to continued elimination of duplicated functions and lower LTI accrued in 2016 compared to 2015.	Corporate centre			
	EBITDA	(4,236)	(4,967)	-

Depreciation, amortisation and impairment costs

Depreciation, amortisation and impairment costs in 2016 totalled RUB 30,636 mln (RUB 20,784 mln for 2015), increasing y-o-y as a percentage of revenue by 39 b.p. to 3.0% from 2.6% in 2015.

The Company's average gross book value of property, plant and equipment (PP&E) increased from RUB 241,246 for 2015 to RUB 296,348 for 2016, or by 23%. Moreover, the growing share of leased stores and the implementation of a large-scale refurbishment programme to bring the store base in line with new concepts led to significant changes in the structure of land and buildings, with the share of buildings (foundation and frame) and land in the gross book value (GBV) dropping from 68% in 2015 to 59% in 2016, whereas the share of fixtures and fittings attributable to reconstruction and leasehold improvements, which includes assets with a shorter useful life, in the GBV increased over the same period from 32% to 41%. On the back of these changes, the Company also decided to revise its approach to the useful life of assets. Thus, the contribution of this factor to the y-o-y increase in depreciation and amortisation costs was RUB 3,377 mln.

Impairment costs totalled RUB 3,709 mln in 2016, compared to RUB 2,832 mln in 2015. One of the main reasons for this increase was the write-off of the carrying value of obsolete equipment as a result of the refurbishment programme.

Non-operating gains and losses analysis

Non-operating gains and losses

RUB millions	2016	2015	% change, y-o-y
Operating profit	45,631	34,449	32.5
Net finance costs	(17,318)	(16,537)	4.7
Net FX result	340	18	1,788.9
Profit before tax	28,653	17,930	59.8
Income tax expenses	(6,362)	(3,756)	69.4
Net profit	22,291	14,174	57.3
Net profit margin, %	2.2	1.8	40 b.p.

Net finance costs in 2016 amounted to RUB 17,318 million, a 4.7% increase over 2015. The weighted average effective interest rate on X5's debt portfolio decreased from 12.7% for 2015 to 11.3% for 2016 due to declining interest rates in Russian capital markets and actions undertaken by X5 to minimise interest expenses.

Income tax expenses increased by 69.4% in 2016, while profit before tax increased by 59.8%. In 2016, X5's effective tax rate increased to 22.2% from 20.9% in 2015 due to the one-off effect of a tax reserve release in 2015. 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.

Cash flow analysis

Consolidated cash flow

RUB millions	2016	2015	% change year-on-year
Net cash from operating activities before changes in working capital	75,745	56,678	33.6
Change in working capital	20,056	(1,406)	n/a
Net interest and income taxes paid	(20,886)	(19,785)	5.6
Net cash flows generated from operating activities	74,915	35,487	111.1
Net cash used in investment activities	(77,279)	(59,645)	29.6
Net cash generated from financing activities	11,641	7,498	55.3
Effect of exchange rate changes on cash and cash equivalents	(45)	(5)	800.0
Net decrease/(increase) in cash and cash equivalents	9,232	(16,665)	n/a

In 2016, the Company's net cash from operating activities before changes in working capital increased by RUB 19,067 million, or 33.6% year-on-year, and totalled RUB 75,745 million. The positive change in working capital was mostly attributable to an increase in accounts payable due to strong business expansion, as well as a decrease in accounts receivable due to new contract terms with suppliers as a result of the "back-to-front margin" project and to changes in other liabilities, including for new trucks purchased in Q4 2016.

Net interest and income tax paid in 2016 increased slightly year-on-year by RUB 1,101 million, or 5.6%, and totalled RUB 20,886 million. The effect from increased gross debt as of 31 December 2016 compared to 31 December 2015 was offset by the lower weighted average effective interest rate on X5's debt for 2016. Income tax paid decreased due to advance payments of taxes in 2015 for 2016.

As a result, in 2016 net cash flows generated from operating activities totalled RUB 74,915 million, compared to RUB 35,487 million for the same period in 2015.

Net cash used in investment activities, which generally consists of payments for property, plants and equipment, totalled RUB 77,279 million in 2016, compared to RUB 59,645 million in 2015, and reflects higher expenditures for store expansion and refurbishment. X5 added 968.6 thousand square metres of selling space in 2016, a 27.3% year-on-year increase of net selling space added.

Net cash generated from financing activities totalled RUB 11,641 million in 2016, compared to RUB 7,498 million in 2015. The increase was related to the drawdown of available credit lines and bonds issued to finance the Company's investment programme.

Liquidity analysis

Liquidity update

RUB mln	31 Dec. 16	% in total	31 Dec. 15	% in total	31 Dec. 14	% in total
Total debt	156,033		144,215		130,986	
Short-term debt	45,168	28.9	42,670	29.6	15,834	12.1
Long-term debt	110,865	71.1	101,545	70.4	115,152	87.9
Net debt	137,843		135,257		105,363	
Net debt/EBITDA	1.81x		2.45x		2.30x	

As of 31 December 2016, the Company's total debt amounted to RUB 156,033 million, of which 28.9% was short-term debt and 71.1% was long-term debt. The Company's debt is 100% denominated in Russian roubles.

In 2016, the Company refinanced 100% of its loans that had interest rates linked to the CBR key rate, replacing them with loans with significantly lower fixed interest rates. As of 31 December 2016, 100% of X5's debt had fixed interest rates.

In 2016, the outlooks on two of the Company's international credit ratings improved:

- S&P upgraded its outlook on X5's BB- rating from Stable to Positive
- Moody's upgraded its outlook on X5's Ba3 rating from Stable to Positive
- Fitch confirmed without changes its rating of BB/Stable

At 31 December 2016, the Company had access to RUB 280.8 billion in undrawn credit limits with major Russian and international banks.

Information on Alternative Performance Measures

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

1. EBITDA

(including EBITDA margin)

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

RUB mln	2016	2015
Operating profit	45,631	34,449
Depreciation, amortisation and impairment	30,636	20,784
EBITDA	76,267	55,233
<hr/>		
Revenue	1,033,667	808,818
EBITDA	76,267	55,233
EBITDA margin, %	7.4	6.8

2. Adjusted EBITDA

(including adjusted EBITDA margin)

Adjusted earnings before interest, tax, depreciation and amortisation (Adjusted EBITDA) is a measure of the Company's operating performance. It is a way to evaluate a company's performance exclusive of financing, accounting and taxation factors, and also excluding the effects of the LTI programme, share-based payments and other one-off remuneration payments expense, which do not represent an ongoing cost of doing business. X5 believes that showing adjusted EBITDA and adjusted EBITDA margin performance provides readers with a more accurate understanding of the Company's ongoing performance.

RUB mln	2016	2015
EBITDA	76,267	55,233
Adjustments:		
LTI, share-based payments and other one-off remuneration payments expense	2,826	3,729
SSC attributable to accrued LTI, share-based payments and other one-off remuneration payments expense	426	451
Adj. EBITDA	79,519	59,413
<hr/>		
Revenue	1,033,667	808,818
Adj. EBITDA	79,519	59,413
Adj. EBITDA margin, %	7.7	7.3

3. Adjusted SG&A

(including adjusted SG&A as % of revenue)

Selling, general and administrative expenses (SG&A) are reported on the income statement as the sum of all direct and indirect selling expenses and all general and administrative expenses of the Company. X5 Retail Group reports adjusted SG&A, which excludes the effects of the LTI programme, share-based payments and other one-off remuneration payments expense, as well as depreciation, amortisation and impairment. The Company believes that adjusted SG&A provides additional detail to readers looking to understand the long-term SG&A costs of the business.

RUB mln	2016	2015
Selling, general and administrative expenses (SG&A)	211,314	170,065
Adjustments:		
LTI, share-based payments and other one-off remuneration payments expense	(2,826)	(3,729)
SSC attributable to accrued LTI, share-based payments and other one-off remuneration payments expense	(426)	(451)
Depreciation, amortisation and impairment	(30,636)	(20,784)
Adjusted SG&A	177,426	145,101
Revenue	1,033,667	808,818
Adjusted SG&A	177,426	145,101
Adjusted SG&A expenses as % of revenue, %	17.2	17.9

4. Net debt/EBITDA

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

RUB mln	31 Dec. 16	31 Dec. 15
Total debt, incl.:	156,033	144,215
Short-term borrowings	45,168	42,670
Long-term borrowings	110,865	101,545
Cash and cash equivalents	(18,190)	(8,958)
Net debt	137,843	135,257
EBITDA	76,267	55,233
Net debt/EBITDA	1.81x	2.45x

5. Net retail sales

Net retail sales shows the amount of sales generated by the Company after the deduction of revenue from franchise services, wholesale operations, and other services. Because food retail is X5 Retail Group's core business, net retail sales is provided for readers to more clearly understand the performance of the Company's core business activity.

RUB mln	2016	2015
Revenue	1,033,667	808,818
Adjustments to revenue:		
Revenue from franchise services	(34)	(35)
Revenue from wholesales operations and other services	(8,044)	(4,651)
Net retail sales	1,025,589	804,132

6. Like-for-like ("LFL")

LFL comparisons of retail sales between two periods are comparisons of retail sales in the local currency (including VAT) generated by relevant stores. The stores that are included in LFL comparisons are those that have operated for at least 12 full months. Their sales are included in the LFL calculation starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period. This is a commonly used indicator in the retail industry that helps readers understand the sustainability of a company's growth by focusing on the performance of stores that have already been operating for more than 12 months, by removing the effect of new stores opened during the period.

%	2016	2015
Net retail sales growth	27.5	27.3
Less contribution from an increase in selling space	(19.8)	(13.6)
LFL Sales	7.7	13.7

02

Corporate governance report

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Management Boards**
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- 173 **Remuneration**

As a public company under Dutch law and 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”).*

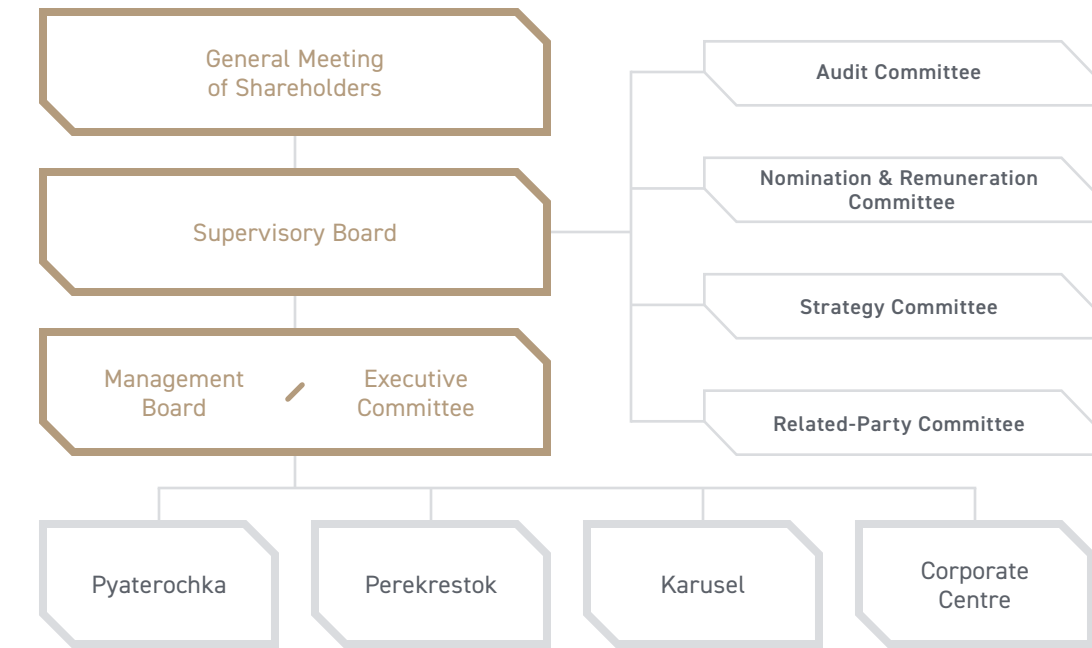
* The full text of the Code can be viewed on X5's website at www.x5.ru.

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. X5 aspires to high standards of corporate governance and is committed to a corporate governance structure that best supports its business, meets the needs of its stakeholders, and is in compliance with applicable rules and regulations.

01

Governance Structure

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 and discharging of their responsibilities.



Management Board & Executive Committee

The Management Board is responsible for the overall management of X5. It is accountable for the Company's pursuit and achievement of corporate goals, objectives, 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.

X5's Executive Committee is comprised of the Management Board as well as certain key officers, allowing both the functions and the business operations to be represented at the highest executive 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 current members of the Management Board and the Executive Committee, including their biographies, are presented on pages 46–51.

Reappointment schedule of the Management Board

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

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 oversees the structure and management of internal control systems 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 pages 164-165.

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.

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

Reappointment schedule of the Supervisory Board

Name	Year of birth	Year of first appointment	Year of possible reappointment
Stephan DuCharme (Chairman) ¹	1964	2015	2019
Mikhail Fridman ²	1964	2006	2017
Christian Couvreur	1950	2010	2018
Pawel Musial ²	1968	2013	2017
Geoff King	1965	2015	2019
Peter Demchenkov	1973	2015	2019
Mikhail Kuchment	1973	2015	2019
Andrei Elinson	1979	2016	2020

¹ Stephan DuCharme previously served on the Supervisory Board from 2008 to 2012.

² Mikhail Fridman and Pawel Musial are eligible for reappointment at the 2017 Annual General Meeting of Shareholders.

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 a minimum of 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.

Committees of the Supervisory Board

Audit Committee

The Audit Committee assists the Supervisory Board in overseeing the integrity of X5's financial statements, its system of internal business controls and risk management, its financing and finance-related strategies, its tax planning, its 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 on 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 interest and any other related-party transactions that are contemplated between X5, on the one hand, and conflicted persons or entities, including but not limited to its shareholders, members of the Supervisory Board and members of the Management Board, on the other hand.

Strategy Committee

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

Composition of the Supervisory Board Committees

Name	Audit Committee	Nomination & Remuneration Committee	Related-Party Committee	Strategy Committee
Stephan DuCharme		Chairman		
Mikhail Fridman				
Christian Couvreur	Member	Member		Chairman
Pawel Musial	Member			Member
Geoff King	Chairman		Chairman	
Peter Demchenkov		Member		
Mikhail Kuchment			Member	Member
Andrei Elinson	Member	Member		Member

Gender Diversity

X5 recognises the importance of diversity and also that the Management and Supervisory Boards do not yet reflect best practice in terms of gender composition. This is not intentional. X5 appreciates the value of diversity and aims to achieve diverse composition within its leadership. Importantly, X5 has a successful track record of developing the critical executive layer of female business leaders. In addition, X5 continues to recruit female executives. Indeed, the Executive Committee currently comprises three female members out of a total of 12, and X5 will continue in its endeavour to encourage greater diversity.

Appointment, Suspension and Dismissal

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

Supervisory Board members are appointed for a period of up to four years and may be re-elected, whereby the total term of office may not exceed 12 years. 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, Executive Committee and Supervisory Board can be found under Remuneration on page 173.

Reporting on Conflicts of Interest

Members of the Management Board or Supervisory Board are required to immediately report any actual or potential conflicts of interest that they may have with the Company and that may be of material significance to themselves or the Company, and to 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).

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 or the decision-making process on subjects or transactions relating to the conflict of interest. A decision of X5 to enter into a transaction involving a conflict of interest with a member of the Management Board or a member of the Supervisory Board that is of material significance to the member or the Company requires the approval of the Supervisory Board. The Related-Party Committee advises the Supervisory Board on the handling and resolution of actual or potential conflicts of interest and prepares resolutions of the Supervisory Board in relation thereto. An account of related-party transactions in 2016 is included in the Report of the Supervisory Board on page 171.

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 to, among other things, adopt its financial statements, decide on any proposal concerning profit allocation and discharge the members of the Management Board and Supervisory Board from their responsibility for the performance of their respective duties for the previous financial year.

Extraordinary meetings 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 authorise the Management Board or the Supervisory Board to issue shares and grant subscriptions for shares, to authorise the Management Board or the Supervisory Board to restrict or exclude pre-emptive rights of shareholders upon issuance of shares, to authorise the Management Board to repurchase outstanding shares of the Company, to adopt the remuneration policy of the Management Board, to determine the remuneration of members of the Supervisory Board, and to merge, demerge or dissolve the Company.

The notice for a General Meeting of Shareholders needs to be published no later than 42 days 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 by 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 that a matter be included on the agenda of the General Meeting of Shareholders. Such requests, if sufficiently substantiated and received by the Company at least 60 days before the date of the meeting, can only be refused on the grounds of exceptional circumstances, to be checked against the principles of reasonableness and fairness.

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

Voting Rights

Each share confers the right to cast one vote at the General Meeting of Shareholders. There are no restrictions, either under Dutch law or in the Articles of Association, on the right of non-residents of the Netherlands or foreign owners to hold shares or to vote, other than those also imposed on residents of the Netherlands. Resolutions of the General Meeting of Shareholders are passed by a simple majority of the votes cast at 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 shall be convened no later than four weeks after the first meeting. At this 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 will allocate the remaining profits.

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

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

Significant Ownership of Voting Shares

According to the Dutch Financial Markets Supervision Act (Wet op het financieel toezicht), any person or legal entity who, directly or indirectly, acquires or disposes of an interest in X5's capital and/or voting rights must immediately give written notice to the Netherlands Authority for 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 as of 28 February 2017 in the AFM's public register who hold an interest of 3% or more in the share capital of the Company:

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

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

Securities Owned by Board Members

The members of the Management Board and Supervisory Board and X5's other senior management are subject to the Company's Inside Information and Dealing Code, as amended in accordance with the EU Market Abuse Regulation, which entered into force on 1 July 2016. This code contains rules of conduct to prevent trading in X5's global depository receipts of shares or other financial instruments when holding inside information, or during blackout periods when trading is not permitted (for instance prior to the publication of quarterly financial results). The Inside Information and Dealing Code can be viewed on the Company's website.

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

Repurchase by the Company of Its Own Shares

The Company may acquire fully paid shares, or GDRs thereof, in its capital for a consideration only following authorisation 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 2016, the Management Board was authorised to acquire up to 10% of the shares or GDRs thereof. This authorisation is valid through 10 November 2017. In addition, the Supervisory Board has resolved that in case a purchase of shares or depository 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.

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

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

Issue of New Shares and Preemptive 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 duration not exceeding five years. In 2016, the General Meeting of Shareholders approved delegation of this authority to the Supervisory Board, relating to the issuance and/or granting of rights to acquire up to 6,789,322 shares (10% of the issued share capital) through 10 November 2017.

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 duration not exceeding five years. The General Meeting of Shareholders

has delegated the authority to restrict or exclude the pre-emptive rights of shareholders upon the issue of shares and/or the granting of rights to subscribe for shares to the Supervisory Board through 10 November 2017.

Articles of Association

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

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

The current text of the Articles of Association is available on the Company's website.

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. The Audit Committee makes a recommendation to the Supervisory Board with respect to the external auditor to be proposed for appointment or reappointment by the General Meeting of Shareholders. In addition, the Audit Committee evaluates and, as 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. Specific rules relating to non-audit work performed by the external auditor are included in X5's "Rules on External Auditor Independence and Selection." This document is available on the corporate website.

In accordance with mandatory audit firm rotation rules, Ernst & Young was appointed by the General Meeting of Shareholders on 12 November 2015 as the new external auditor for X5 as of 2016, for an initial period of three years.

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

Provision 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 this conflicts with the law, or if the confidential, share-price-sensitive or competition-sensitive nature of the transaction prevents publication or could damage X5's competitive position.

Provision III.2

Independence of members of the Supervisory Board

Both Mikhail Fridman and Andrei Elinson are related to companies that are owned or controlled by companies that ultimately hold 10% or more of the shares or GDRs in X5. Stephan DuCharme was a member of the Management Board immediately prior to his appointment to the Supervisory Board in November 2015. These members of the Supervisory Board are, therefore, not considered to be independent within the meaning of the Code.

X5 believes that the non-independent members of the Supervisory Board have in-depth knowledge of the geographical market, of business in general and of retail specifically, as well as a relevant track record in the markets in which X5 operates. This is of particular advantage to X5 and its shareholders. Meanwhile, with five independent members, the Supervisory Board has a majority of independent board members and remains committed to improving the ratio between independent and non-independent board members.

Provision III.3.5

A person may be appointed to the Supervisory Board for a maximum of three four-year terms

Mikhail Fridman was appointed as a member of the Supervisory Board in 2006. In 2017, he will be eligible for reappointment for a fourth term, thus exceeding the maximum of 12 years set out by the Code.

Mikhail Fridman is the founder and chairman of the Alfa Group Consortium, which is currently the largest shareholder in X5 with a holding interest of 47.86%. X5 is committed to long-term value creation for all shareholders. The Company believes that it benefits from the long-term commitment of its large shareholders, and also that the interests of Supervisory Board members who hold more than 10% of the shares are substantially aligned with those of X5 and the broad shareholder base. These Supervisory Board members are generally involved with the Company over a longer period and this in turn contributes to long-term value creation for X5 and all its shareholders.

Provision III.4.2**The Chairman of the Supervisory Board may not be a former member of the Company's Management Board**

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

Provision III.5**If the Supervisory Board comprises more than four members, it should designate [...] a Remuneration Committee and a Selection and Appointment Committee**

As it is felt that issues related to selection, appointment and remuneration are interlinked, the Supervisory Board has decided that all these activities should be dealt with by one committee: the Nomination and Remuneration Committee.

Provision III.5.11**The Remuneration Committee may not be chaired by the Chairman of the Supervisory Board or by a former member of the Management Board**

When Stephan DuCharme stepped down as CEO and was appointed as Chairman of the Supervisory Board in 2015, he also took over as the Chair of the Nomination and Remuneration Committee to ensure continuity in succession planning, recruitment and retention of senior management. Now that the transition to the new management team has been successfully completed, and mindful of corporate governance best practices, the Supervisory Board has resolved that Peter Demchenkov will take over Stephan DuCharme's position as Chairman of the Nomination and Remuneration Committee as of 1 April 2017.

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

As determined by the General Meeting of Shareholders, members of the Supervisory Board may participate in the Company's restricted stock unit plan. X5 acknowledges that the awarding 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.

How we manage risk

The Management Board of X5, supported by the Executive Committee and the central Risk Management Team, is responsible for designing, implementing, and operating an adequately functioning risk management system for the Company. The aim of this system is to ensure that the extent to which the Company's strategic and operational objectives are being achieved is understood, that the Company's reporting is reliable and that the Company complies with relevant laws and regulations.

Risk Management and Internal Control

Risk management

During 2016, the Management Board of X5, supported by the Executive Committee, paid special attention to strengthening the design and effectiveness of the risk management and internal control system, ensuring that:

- A comprehensive review of both internal and external risks is carried out at least annually;
- Risks of both strategic and short-term objectives of X5 are assessed;
- Desired risk responses and risk mitigating activities are put in place;
- The Company's reporting is accurate and reliable; and
- The Company complies with relevant laws and regulations.

X5's new risk management policy was developed and approved in 2016, providing an integrated approach to risk classification and assessment, risk mitigation and allocation of risk management responsibilities.

Under the authority delegated by the Management Board, management teams at all levels of the organisation are responsible for identifying, managing and monitoring relevant risks.

The central Risk Management Team facilitates a company-wide view of risk-relevant issues, helps to develop risk management activities in both retail chains and the corporate centre and ensures that the Executive Committee is continuously and promptly informed of important risk management developments.

An important precursor to risk assessments is the Company's overall risk appetite, which is defined by the Management Board. This requires adequate understanding of risks, as well as awareness and insight into the magnitude of risks the Company faces. The willingness to accept risks, as well as other factors, determines the Company's risk appetite, namely the level of risk required to achieve X5's strategic goals. In order to fully utilise the opportunities existing in the food retail market in Russia, management recognises and accepts a certain degree of economically justifiable risk to achieve X5's business expansion and growth. With the implementation of the decentralised business model, the Company has been establishing a new set of risk appetite and risk tolerance parameters, taking into account the individual risk appetite of each of its businesses. The updated overall risk appetite will be addressed in more detail in the Annual Report for 2017.

Risk assessment and risk response

In the framework of its annual risk management approach, the Company continues to identify, measure and prioritise business risks with the help of risk maps. In order to perform risk assessment, X5 utilises its own "risk universe", which covers risks for both functions and businesses in all risk categories.

For the major strategic risks that are identified, the management team ensures that mitigating actions are quickly designed and properly provided for through the corporate budget process.

Based on the results of the annual risk assessment, risk management initiatives have been planned to mitigate risks and keep risks at an acceptable level. Results of risk management initiatives based on the risk assessment for the previous year are regularly monitored and are reported to the Audit Committee quarterly.

Internal control

The X5 control framework is based on the COSO Internal Control Integrated Framework (2014).

To ensure the effectiveness and completeness of the Company's internal control system, X5 employs a three-tier model to exert control:

- The first tier of control requires each business unit to own and manage the necessary controls for each of their specific business processes;
- The second tier of control is reliant on central functions that are responsible for the design and development of X5's internal control system, ensuring compliance with controls through monitoring and testing;
- The third tier of control is the Internal Audit function reporting directly to X5's Management Board, with direct access to the Audit Committee. The Internal Audit function's role is to regularly assess, and recommend improvements to, the first and second control tiers of the Company.

In 2016, an organisational change strengthened the distinction between the second-tier functions of Risk Management and Compliance and the third-tier Internal Audit function. In addition, a new dedicated function was defined, responsible for the development of the Company's internal control system. The first task was to train key finance department employees, both at the corporate centre and in business units, in ways to integrate control activities into business processes.

Promoting a control and compliance culture

Values and business principles are important elements of the internal environment for risk management. In order to develop a clear culture, X5's Code of Business Conduct and Ethics outlines our guiding principles of ethical behaviour.

The full Code is available on the corporate governance section of X5's public website at www.x5.ru.

The principles of the Code apply to all X5 employees. The Compliance Department plays an important role in enhancing awareness of and compliance with the Code. New employees are trained in the Code and acknowledge compliance with the Code upon hiring. In 2016, the Company developed an e-learning course on the Code, compulsory for all employees, specifically addressing integrity and transparency in dealings and relations with external parties.

The Code also aims to help employees understand when and where to ask for advice or report a breach of the Code, if necessary through the ethics hotline. All cases reported through the ethics hotline are thoroughly reviewed by the Compliance Department, and investigations are performed by a forensic team of the Security function as needed.

The Compliance Department periodically reviews and updates the Company's internal policies in line with new or amended legislation. For instance, in 2016 the Company adopted a new version of X5's Inside Information and Dealing Code, and Information Policy in line with the EU Market Abuse Regulation (MAR), which came into effect on 1 July 2016. Both policies are available on the Company's official website.

Employees are regularly made aware of new policies through newsletters published on the corporate intranet, and through additional communications highlighting key provisions of these documents in corporate videos and the standard Business Ethics section of the corporate news digest.

The central Compliance Department is strongly embedded in the Company's businesses, monitors ongoing business processes and takes part in key projects to align business activities with applicable laws.

The Compliance Department also monitors X5 employees' conflicts of interest. All potential conflicts of interest are reviewed by the Ethics Committee, a sub-committee of the Executive Committee, and are regularly reported to the Audit Committee.

Monitoring and assurance

The Risk Management function ensures that the Company maintains and improves the integrity and effectiveness of the risk management system. The Compliance function ensures that the Company's activities maintain compliance with all external laws and internal policies. The newly established Internal Control function will ensure business compliance with operational procedures and controls.

In addition, Internal Audit provides independent and objective assurance of the impact of the above-mentioned control activities. Systematic and disciplined evaluations of the operational, financial and information systems regarding risk management, internal control and governance processes are aimed at improving their effectiveness.

Following a risk-based audit planning approach, Internal Audit performs tests of controls on key business processes and provides recommendations for improvement of respective internal controls to the respective management. Implementation of such recommendations is carefully monitored by and controlled through follow-up audits. Progress on implementation of management action plans for resolving internal control issues is regularly reported to the Executive Committee and the Audit Committee.

The Company's Principal Risks

The principal risks that may impede the achievement of X5's objectives with respect to strategy, operations, compliance and financial matters are described below. It should be noted that there are additional risks that management believes are immaterial or otherwise common to most companies, or that we are currently not aware of. Our principal risks remain substantially unchanged from 2015. No significant incident, that impacted the business or its results substantially occurred in 2016. The Company is in the process of reviewing its methodology with respect to risk impact evaluation, and will disclose this in next year's Annual Report.

Strategic risks

Risk	Description	Mitigation
<p>Business Strategy</p> <p>If the business strategy follows a sub-optimal direction or is not sufficiently clear or is not effectively communicated or implemented, the business may suffer from slowdown of expansion and revenue growth.</p>	<p>X5 has a multi-year strategy that includes both plans for growth and financial targets. We need to understand and properly manage strategic risks in order to deliver sustainable long-term financial success.</p> <p>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 on how well we communicate and execute the right strategic direction.</p>	<p>To ensure that the Company's strategy is successfully delivered, the strategy is broken down into plans that form the core objectives of the management. In addition, progress is reviewed regularly by the Executive Team and quarterly by the Strategy Committee of the Supervisory Board.</p> <p>The strategic direction is refreshed annually to ensure that all changing factors are taken into account.</p>
<p>Economic & Market Conditions</p> <p>Significant changes to the economic environment may challenge the existing business strategy and materially impact financial performance. Not adapting quickly to new situations may lead to a competitive disadvantage.</p>	<p>The Russian economy is vulnerable to fluctuations in the price of oil and natural gas in the world market. A decline in the price of oil and/or natural gas can significantly slow or disrupt the Russian economy.</p> <p>Consumer demand depends largely on a range of external factors outside of X5's control. These factors include demographic changes, employment levels, discretionary consumer spending and changing consumer preferences.</p> <p>In periods of economic uncertainty, customers may quickly change their buying patterns, seeking greater value for money or alternative products as they are forced to manage a tighter household budget.</p>	<p>X5's multi-format business model enables it to be responsive to changes in consumer preferences and to cater to a diverse range of lifestyles and family budgets.</p> <p>We aim to have a broad appeal in product price and range in a way that allows us to compete successfully both during improving and worsening economic climates.</p> <p>Importantly, product range, pricing policy, merchandising and marketing concepts are also adapted continually to account for changing consumer behaviour.</p> <p>The fundamentals of X5's trading strategy remain sound given the latent consumer demand for better choice, higher quality and better value for money.</p>
<p>Expansion</p> <p>Our expansion plans for the future are significantly influenced by: (1) the ability to find and effectively manage retail locations and negotiate appropriate purchase and lease terms; (2) effective development and implementation of plans and procedures to support organic growth; and (3) finding solutions to manage an expanding logistical footprint across the country.</p>	<p>To deliver sustainable long-term market leadership, X5 must expand at a rate that equals or exceeds that of its competitors. The failure of X5 to open new stores will directly impact its growth and profitability.</p> <p>Our strategy requires us to be able to avail of emerging opportunities to grow market share through both acquisition and organic expansion.</p>	<p>X5's management both at the corporate level and at the retail chain level pays particular attention and allocates significant resources to optimising its organic expansion strategy and support processes.</p> <p>Our investment decisions are supported by robust financial and non-financial assessments that provide reasonable assurance that we are obtaining, at attractive prices, facilities that will be attractive for the long term.</p> <p>The Company has made a significant shift in its growth strategy, from reliance on acquisitions to increased focus on opening new stores organically. However, our capability to identify and quickly integrate regional acquisitions has been retained.</p>

Operational Risks

Risk	Description	Mitigation
<p>Retail Operations</p> <p>Effective and consistent management of our multi-site operations is key to earning the continued loyalty of our customers. In addition, we must stay in touch with changing customer needs to ensure we remain a destination favoured over the competition.</p>	<p>The key risks related to these activities are: (1) our ability to define a product range that is in line with customer needs; (2) our ability to provide our customers with an attractive shopping experience; and (3) our ability to maintain a competitive price position.</p>	<p>Our customers are our main focus. In order to consistently provide high-quality goods and services at a reasonable price, we constantly analyse and improve our operational processes related to, for instance, assortment management, pricing, supplier relationships, merchandising, sales and customer relations.</p> <p>We regularly use trading and research data to assess our performance in meeting customer priorities regarding prices, product range, availability and service.</p> <p>To be more responsive to meeting customer needs, we have switched to an operating model that provides more autonomy to retail chain directors. Every year we increase our regional management teams to ensure our stores are well supported across our chains in all locations.</p>
<p>Human Resources</p> <p>Our success in achieving the Company's strategic objectives relies heavily on the dedication of our employees and the effectiveness of our organisation.</p>	<p>Our ability to succeed can be limited by a failure to recruit, train and retain the optimal number and quality of staff at both managerial and operational levels and by a failure to create a balanced organisational structure that enables and motivates personnel to achieve key objectives.</p>	<p>In order to be an employer of choice, we recruit, develop and reward employees according to leading human resource (HR) practices:</p> <ul style="list-style-type: none"> We are developing X5's corporate culture with a focus on shared business values, personal initiative and accountability at all levels. A competitive compensation package is provided to our executives 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 against the competition, enabling us to attract and keep talent. Our Talent Development Programme meets the succession and capability needs of our businesses and enables career development across the Company, helping employees realise their full potential.

Operational Risks

Risk	Description	Mitigation
<p>IT Systems & Infrastructure</p> <p>We rely on our IT systems and infrastructure in order to trade efficiently. Failure of key systems could have a significant impact on our business or could restrict growth potential.</p>	<p>If investment in the IT infrastructure and business support systems does not keep in pace with business growth, there is a material risk of failures in customer service, business continuity and expansion support.</p>	<p>The Company recognises the importance of IT to sustain growth, and invests accordingly.</p> <p>The Company has extensive controls in place to maintain the integrity and efficiency of its IT systems, including detailed recovery and contingency plans in the event of a significant failure.</p> <p>Data protection is safeguarded with regular testing and upgrading of our system defences.</p>
<p>Real Estate</p> <p>Our ability to open new stores is heavily dependent on identifying and leasing and/or purchasing properties, on commercially reasonable terms, that are suitable for the Company's needs.</p>	<p>The acquisition, development and management of property sites carry inherent risk. Challenges may arise in relation to (1) obtaining planning or other consents; (2) compliance with varying country safety, design and construction standards; (3) tenant management; and (4) developing cost-effective real estate with the right balance of freehold and leasehold sites and maintaining those sites to an acceptable standard.</p>	<p>When identifying, leasing, purchasing or refurbishing suitable properties, our real estate divisions monitor and address regulatory and other risks related to construction work.</p> <p>The performance of real estate is monitored and reviewed on an ongoing basis and a refurbishment programme for stores is in place to maintain and optimise real estate.</p>
<p>Supply Chain</p> <p>Sound transport and warehouse infrastructure and management systems are vital to ensure efficient distribution across the entire supply chain.</p>	<p>A key trading risk is our ability to maintain (1) effective inventory management, ensuring an adequate flow of goods to our customers while minimising shrinkage and excessive stock; and (2) relationships with suppliers and producers of private-label goods to ensure supply while meeting our quality standards.</p>	<p>X5 stores are part of a complex supply chain with logistics functions decentralised from retail chains and with distribution centres dedicated to particular retail chains as well. This organisational design allows retail chains to effectively manage inventory across the supply chain.</p> <p>The Company works in partnership with its suppliers to manage the risk of any delays or interruptions in this supply that might affect its retail operations.</p>
<p>Performance Risk</p> <p>Our operational plans are derived from trading and research data and are targeted at maintaining high operational standards and delivering noticeable performance improvements each year.</p>	<p>There is a risk that the Company will not deliver the operational improvements the strategy demands either because of external factors or for reasons of internal performance.</p>	<p>All managers of our retail chains and business units have stretched targets and improvement goals in line with the overall strategy. Key improvement goals are monitored regularly and reported monthly to the Executive Committee and the Supervisory Board. Personal motivation rewards are aligned with business performance targets.</p>
<p>Reputational Risk</p> <p>As X5's success depends to a significant extent upon brand recognition, the brand names Pyaterochka, Perekrestok and Karusel and their associated reputations are key assets of X5's business.</p>	<p>X5 has brand risk through either (1) leakage of intellectual property to competitors; (2) carrying out activities that attract negative CSR reactions; or (3) demonstrating unethical or non-customer-focused behaviour.</p>	<p>X5 is committed to being a responsible corporate citizen that strives to meet international standards and best practices in the operation of its business and in its relationships with shareholders, partners and society.</p> <p>The Company has ensured that it has set itself high ethical standards that are well-communicated through our Code of Ethics; activities are regularly monitored to ensure compliance.</p> <p>The Company believes it has taken appropriate steps to protect its trademarks and other intellectual property rights.</p>

Compliance Risks

Risk	Description	Mitigation
<p>Regulatory Environment</p> <p>Successful operation depends on: (1) the ability to identify, quickly respond to and attempt to modify unfavourable proposed changes to applicable laws and regulations stemming from changes in political and economic conditions; and (2) the ability to quickly establish compliance with new standards.</p>	<p>X5's operations are 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 the licences and permits required by X5's operations with respect to various quality, health and safety, packaging, labelling and distribution standards are subject to supervision and regulation by various government authorities and agencies.</p>	<p>By permanently monitoring regulatory developments we strive to ensure that all existing and forthcoming regulations are complied with.</p> <p>We also engage with public and governmental organisations to ensure that the interests of our customers are represented.</p> <p>In addition, X5 is consulted with and invited to contribute to shaping government regulations concerning the retail industry.</p> <p>We regularly monitor our compliance with existing regulations and take necessary steps to maintain adequate adherence.</p>
<p>Legal and Litigation</p> <p>This includes risks such as entering into contracts that are unfavourable for the Company and the failure to comply with or monitor contract terms to protect the Company from financial losses.</p>	<p>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 supplier contracts, real estate and M&A transactions.</p>	<p>Our legal team participates in every stage of important business negotiations and analyses contract terms to minimise risks.</p> <p>Contracts are largely standardised to ensure that our rights are uniformly protected.</p> <p>We are strongly committed to complying with all applicable laws and regulations, and to enforcing our rights in litigation if necessary by using all means provided by law.</p>
<p>Food Product Safety</p> <p>The packaging, marketing, distribution and sale of food products entail an inherent risk of contamination or deterioration, which could potentially lead to product liability, product recall and, as a result, negative publicity.</p>	<p>X5 is potentially exposed to the risk of being unable to establish strict food safety and quality control policies and procedures and to ensure full adherence to these at all times.</p>	<p>The quality and safety of our products is of the highest importance. We have strict product safety procedures for ensuring product integrity at all times.</p> <p>We partner with suppliers to ensure mutual understanding of the required standards.</p> <p>The Company also monitors changes in the regulations regarding food safety and regularly reviews its respective policies and procedures to ensure compliance.</p>
<p>Health and Safety</p> <p>With many customers and employees across many locations, effective controls to ensure employee and customer safety are of paramount importance.</p>	<p>Prevention of 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.</p>	<p>The Company has a health and safety policy in place to cover workplaces across its various functions. We are committed to promoting the highest health and safety standards by implementing advanced safety technologies and techniques and through ongoing risk monitoring, analysis and mitigation.</p> <p>We have occupational health and safety teams (OHS) in each retail chain to oversee compliance with the Company's health and safety policies.</p>

Compliance Risks

Risk	Description	Mitigation
<p>Taxation</p> <p>Compliance with taxation regulations is often complex, open to differing interpretations, and dependent on the Company's risk appetite.</p>	<p>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 activities of X5 may be challenged by the relevant regional and federal tax authorities. The values involved in tax and penalties are often very large.</p> <p>In recent years, tax authorities in the Russian Federation have taken a more assertive approach in their enforcement of tax legislation, and it is possible that transactions and activities that have not been challenged in the past may now be challenged.</p>	<p>Management regularly reviews the Company's taxation compliance with applicable legislation, laws and decrees and current interpretations published by the authorities. It also thoroughly reviews the judicial precedents that come out of tax disputes involving other companies operating in Russia.</p> <p>The Company further protects itself against tax risks by establishing provisions in its IFRS consolidated financial statements for items in dispute.</p> <p>Note 33 "Commitments and Contingencies" to the IFRS consolidated financial statements in this Annual Report contains a description of the main tax uncertainties and an estimate of the related liability.</p>
<p>Fraud</p> <p>An 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.</p>	<p>The Company places much trust in its employees to carry out their duties in an ethical way and in accordance with Company policies and the laws of the country.</p> <p>While we persistently strive to high standards of integrity among our staff, there remains the potential for fraud and other dishonest activity at all levels of the business, from store level to senior management.</p>	<p>X5 gives clear guidance on behaviour to employees through the Code of Business Conduct and Ethics.</p> <p>The Company constantly emphasises its whistle-blower policy and the ethics hotline through which employees can anonymously report suspected violations of the Code.</p> <p>Allegations of fraud are investigated, discussed by the Ethics Committee and regularly reported to the Management Board and the Audit Committee of the Supervisory Board.</p> <p>The Company also regularly carries out forensic reviews in sensitive areas to detect any early signs of wrongdoing.</p>

Financial Risks

Risk	Description	Mitigation
<p>Funding and Liquidity Risk</p> <p>Our ability to generate and access sufficient funds is critical in order to satisfy our business and expansion needs.</p>	<p>This entails the risk of failing to ensure continuity of funding on the best available market terms, with a diverse credit portfolio; to arrange funding ahead of requirements and to maintain sufficient undrawn credit lines; and to maintain a strong credit rating so that maturing debt may be refinanced as it falls due.</p>	<p>We finance our operations through a combination of internal cash flows, short-term treasury lines, exchange-traded rouble bonds and long-term bank loans. We are reducing gearing, reflecting our ability to rely more on internally generated funds to finance Company expansion.</p> <p>Available credit limits have recently been increased with major Russian and international banks. X5 also has proven access to the rouble bond market.</p>

Financial Risks

Risk	Description	Mitigation
<p>Interest Rate Risk</p> <p>If the cost of borrowing increases, an unfavourable price paid per unit of funds borrowed per year may limit the Company's expansion ambition.</p>	<p>The objective is to limit our exposure to increases in interest rates while retaining the opportunity to benefit from interest rate reductions.</p>	<p>The Company seeks to lower the cost of funding by reacting to market trends and through renegotiation.</p> <p>The Company has also been able to improve its credit rating, which assists in lowering borrowing costs.</p> <p>In 2016, the Company refinanced 100% of its loans that had interest rates linked to the CBR key rate with fixed-rate loans at significantly lower rates. 100% of X5's debt has fixed interest rates.</p>
<p>Foreign Currency Risk</p> <p>X5 may be exposed to unfavourable fluctuations in hard currencies (e.g. euros and US dollars) that are used to carry out direct import of goods for resale or that impact transactions denominated in a hard currency.</p>	<p>Foreign currency fluctuations bring instability in the prices of imported goods and services and certain rental obligations, which may impact profitability if not compensated by adjustments in selling prices.</p>	<p>The direct import of goods for resale is not significant as a proportion of total goods sold. Most imported products we buy locally, and thus share the risk of currency fluctuations with suppliers.</p> <p>In the case of long-term rental agreements, the majority are denominated in roubles, with the remaining part denominated in hard currency with an upward cap. Recently we have been trying to renegotiate foreign currency rental agreements into roubles following similar judicial precedents in Russia.</p>

Statement of the Management Board

The Management Board reviewed and analysed the strategic, operational, compliance and financial 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 2016. The outcome of this review and analysis has been shared with the Audit Committee and the Supervisory Board and has been discussed with X5's external auditors.

On the basis of the above and in accordance with best practice provision II.1.5 of the Dutch Corporate Governance Code, and Article 5.25c of the Dutch Financial Supervision Act, the Management Board confirms that internal controls over financial reporting provide a reasonable level of assurance that the financial reporting does not contain any material inaccuracies, and confirms that these controls functioned properly in the year under review and that there are no indications that they will not continue to do so. The financial statements fairly represent the Company's financial condition and the results of the Company's operations and provide the required disclosures.

It should be noted that the above does not imply that these systems and procedures provide absolute assurance as to the realisation of operational and strategic business objectives, or that they can prevent all misstatements, inaccuracies, errors, fraud and non-compliance with legislation, rules and regulations.

In view of all of the above, the Management Board confirms that, to the best of its knowledge, these financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and its consolidated subsidiaries, and that the management report includes a fair review of the position on the balance sheet date and of the development and performance of the business during the financial year, together with a description of the above-mentioned principal risks and uncertainties that the Company faces.

The Management Board

24 March 2017

03

Supervisory Board

**1. Stephan DuCharme**

Chairman of the Supervisory Board,
Chairman of the Nomination and
Remuneration Committee

Mr. DuCharme, a dual US/German citizen, served as CEO and Chairman of the X5 Management Board from July 2012 until November 2015, after having previously served on X5's Supervisory Board beginning in 2008. Prior to X5, he held senior management positions with SUN Group and Alfa Group, preceded by senior banking positions with 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 Ltd and JSC SUEK. He graduated with distinction from the University of California at Berkeley and received an MBA from INSEAD.

2. Mikhail Fridman

Member of the Supervisory Board

Mr. Fridman, one of the original founders of Alfa Group Consortium, is Chairman of the Supervisory Board of Alfa Group Consortium, one of Russia's largest privately owned financial-industrial conglomerates. Mr. Fridman is also a member of the Supervisory Board of VimpelCom Ltd, a member of the Board of Directors of Alfa-Bank, and a member of the Board of Directors at ABH Holdings. Mr. Fridman is a member of the Board of the Russian Union of Industrialists and Entrepreneurs and of the International Advisory Board of the Council on Foreign Relations (USA). He graduated from the Moscow Institute of Steel and Alloys in 1986. Mr. Fridman was born in Lvov, Ukraine, in 1964.

3. Peter Demchenkov

Member of the Supervisory Board

Mr. Demchenkov, a Russian citizen, is CEO of ALIDI, a leading provider of distribution and logistics services in Russia. From 2004 to 2005 he was Development Director at the investment bank CIT Finance, and from 1997 to 2004 Peter worked in Procter & Gamble's Business Development Department for Eastern Europe. Peter graduated from the St. Petersburg Polytechnic University with a degree in Technical Cybernetics.

4. Andrei Elinson

Member of the Supervisory Board

Mr. Elinson is the Director of Asset Management at CTF Holdings, where he has worked since December 2015. Currently, Mr. Elinson is a member of the Board of Directors of ABH Holdings S.A., a member of the Board of Directors of Alfa-Bank, and a member of the Board of Directors of AlfaStrakhovanie Group. Prior to joining CTF, Mr. Elinson was Deputy CEO of Basic Element, where he worked from August 2007, with responsibility for managing companies in the aviation, construction, automotive, financial and other industries. From 1997 to 2007, Mr. Elinson worked at Deloitte CIS, and later became a Partner in 2005. Mr. Elinson graduated with honours from the Accounting & Auditing Faculty at the Russian State Finance Academy. Mr. Elinson is a US Certified Public Accountant and a US Certified Fraud Examiner. He holds a Certificate in Company Direction (UK). Mr. Elinson was born in Moscow, Russia, in 1979.

5. Geoff King

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

Mr. King is a British national, and is a director of GNC Group Consulting, a retail-focussed advisory practice in SE Asia. Between 1988 and 2009 Geoff held many leadership roles in his career with Tesco PLC including CFO for Ireland, Poland and Regional CFO for Asia and Central Europe. Between 2010 and 2013 he was the Group CFO of Maxis, a major telecoms operator in Malaysia and India. Geoff graduated from Exeter University with a degree in Pure Mathematics and is a qualified CIMA Accountant.

6. Christian Couvreur

Chairman of the Strategy Committee

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

7. Michael Kuchment

Member of the Supervisory Board

Michael Kuchment, a Russian citizen, is the co-founder and Vice President of Hoff, one of the leading home furnishing retailers in Russia. Currently, Michael is also Chairman of the Supervisory Board of Sovcombank, one of the leading Russian consumer banks. From 2008 until 2015 Michael was a board member of M.Video, the largest consumer electronics chain in Russia and the country's first public non-food retailer. Previously, from 2002 until 2008, Michael worked as the Commercial Director at M.Video. Michael graduated from the Moscow Institute of Physics and Technology as a physics researcher, and holds an Executive MBA from the Skolkovo Moscow School of Management.

8. Pawel Musial

Member of the Supervisory Board

Pawel Musial, a Polish citizen, is Chairman of Profi Rom Food, one of the largest supermarket chains in Romania, following his position as CEO of the chain from 2010 until 2015. In 2008 and 2009 he was Chairman of the Ukrainian supermarket chain EKO Market. From 2006 to 2007 Pawel was Chief Commercial Officer and member of the Management Board of X5, having previously been General Director and Chief Operating Officer of the Perekrestok chain from 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. Pawel graduated from the Warsaw University of Life Sciences (SGGW) with an engineering degree in Nutrition Technology.

Management Board

9. Igor Shekhterman

X5 Chief Executive Officer,
Chairman and Member
of the Management Board

Igor Shekhterman has served on X5's Supervisory Board since 2013. He was previously the Managing Partner and CEO at RosExpert, which he co-founded in 1996, and subsequently successfully developed into the Russian partner of Korn/Ferry International. Igor started his career as Finance Manager at the Russian branch of Beoluna, the Japanese jewellery producer. Igor holds a degree in Economics from the Kaliningrad Technical Institute (1992) and degrees in Business Administration from the Institute d'Administration des Entreprises (France, 1994) and the Danish Management School (1995).

10. Frank Lhoëst

Company Secretary,
Member of the Management Board

Mr. Lhoëst joined X5 in November 2007, having previously 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 Intertrust's Intellectual Property Group in the Netherlands. Frank graduated from Leiden University with a degree in Law.

04

Report of the Supervisory Board

The Supervisory Board is responsible for supervising and advising the Management Board and overseeing the general course of affairs and strategy of the Company. 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. In X5's two-tier corporate structure under Dutch law, the Supervisory Board is a separate body operating completely independently of the Management Board.

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, with a majority of five independent members. The Supervisory Board annually reviews the profile of its size and composition, taking into account the evolving nature of X5's business and activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board profile is published on X5's corporate website.

At the Annual General Meeting of Shareholders on 10 May 2016, Andrei Elinson was appointed as a new member of the Supervisory Board, succeeding Dmitry Dorofeev, who stepped down from the Board on the same date, having served on the Board since 2012, and as Chairman since 2013. The Supervisory Board expresses its gratitude for Mr. Dorofeev's valuable contribution to the development of X5 during those years.

In accordance with the retirement and reappointment schedule of the Supervisory Board, Mikhail Fridman and Pawel Musial's terms will expire in 2017. Both Board members are eligible for reappointment.

An overview of the current composition of the Supervisory Board, and a short biography of each member, is presented in the Corporate Governance Report on pages 164-165.

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.

When Stephan DuCharme was appointed as Chairman of the Supervisory Board in 2015, he also took over the Chair of the Nomination and Remuneration Committee to ensure continuity in succession planning, recruitment and retention of senior management. Now that the transition to the new management team has been successfully completed, and mindful of corporate governance best practices, the Supervisory Board has resolved that Peter Demchenkov will take over Stephan DuCharme's position as Chairman of the Nomination and Remuneration Committee as of 1 April 2017, with Stephan DuCharme remaining a member of this committee.

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 centres, to gain greater familiarity with senior management and to develop deeper knowledge of local operations, opportunities and challenges.

Meetings of the Supervisory Board

In 2016, the Supervisory Board held four regular meetings. Further resolutions in writing were taken when necessary during the year. For each of the four meetings in 2016, the Supervisory Board meeting was preceded by meetings of the Audit Committee, the Strategy Committee and the Nomination and Remuneration Committee. The Related-Party Committee convened throughout the year when necessary. In 2016, 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 four times for two consecutive days, thus ensuring sufficient time for 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 November, which was not attended by Mikhail Fridman. The CEO and CFO attended the meetings, and other members of senior management were regularly invited to present. In 2016, the Supervisory Board held regular private sessions without members of the Management Board present to independently discuss matters related to the performance, functioning and development of members of the Executive Committee. The external auditor attended the meeting in March, at which the 2015 Annual Report and financial statements were recommended for adoption by the Annual General Meeting of Shareholders. In between the Supervisory Board meetings, several informal meetings and telephone calls took place among Supervisory Board members and members of the Management Board and other Company management to consult with each other on various topics and to ensure that the Supervisory Board remained well informed about the Company's operations.

In September 2016, the Supervisory Board discussed the recommendations of the Board assessment performed by an external party during the summer of 2016. The assessment took the form of a routine update on progress made with regard to the 2015 Board review, preparing the ground for the triennial in-depth evaluation in 2017. The assessment particularly focused on board effectiveness following the transition in the roles of Chairman and CEO in 2015, and a review of the required level of skills and expertise of the Supervisory Board, especially taking into account digital transformation challenges in the retail industry. The Supervisory Board attaches great value to these evaluations. They ensure continuous focus on the quality of the activities, composition and functioning of the Supervisory Board and its committees and its relationship with the Executive Committee.

During 2016, the Supervisory Board reviewed various matters related to all significant aspects of the Company: its activities and operational results, its strategy going forward and the management team and its development. Throughout the year, the Board continued to monitor the implementation of the Company's accelerated growth and expansion strategy with a focus on operational discipline and sustainable margin optimisation, always against the background of the challenging economic situation in Russia. As part of the ongoing performance review of the various functions and business divisions of the Company, the main topics reviewed and discussed by the Supervisory Board included:

- The sustainable leadership strategy for the Pyaterochka retail chain, with a focus on disciplined growth, operational efficiencies and cost control;
- The development and implementation of a strengthened strategy for Perekrestok supermarkets in the regions;
- The further development and testing of the Karusel value proposition, with a focus on operational improvements and top-line growth as reflected by LFL traffic and sales;
- Organisational changes, including in the role and size of the Corporate Centre in support of the new operating model;
- Stock management and loss reduction across all formats;
- X5's "Strategic Vision 2020", serving as a framework for the medium-term plan, and the Annual Budget approved for 2017.

In addition, throughout the year, the Supervisory Board discussed the following regular topics:

- The financial reporting process and, in particular, the approval of the 2015 Annual Report and review of the 2016 half-yearly and quarterly financial reports;
- Reports by internal and external auditors;
- The regular assessment of the members of the Executive Committee, including talent management and succession planning;
- Selection, appointment and remuneration of new members of the Executive Committee (including Dmitry Gimmelberg and Maksym Gatsuts, appointed in 2016 as, respectively, CFO and General Director Hypermarkets) and other senior managers of the Company;
- The annual review of the profile and composition of the Supervisory Board, as well as the composition of the committees of the Supervisory Board;
- Remuneration of the Supervisory Board;
- Compliance with relevant rules and legislation, with a particular focus on the Trade Law amendments in Russia that entered into force during the year;
- The revised financing strategy for the next three years, ensuring that sufficient funding is available to meet the Company's investment plans;
- The IT strategy, including the systems development roadmap and team capability assessment;
- The major business risks and the management activities to mitigate those risks.

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 2016, the Audit Committee consisted of Geoff King (Chairman), Christian Couvreur, Pawel Musial and Andrei Elinson. In 2016, the Audit Committee held four in-person meetings, with all committee members attending each meeting. Additional meetings were held by conference call when necessary, for instance to review the publication of quarterly results. As a rule, all meetings were attended by the CFO, the external auditor and the internal audit director. Other members of the Supervisory Board and senior management were invited when necessary and appropriate. The Audit Committee met once with the external auditor without the presence of management.

The Audit Committee assists the Supervisory Board in its responsibility to oversee X5's financing, financial statements, financial reporting process, and system of internal business controls, risk management and audit.

To ensure the robustness and fair representation of X5's financial statements, the Audit Committee specifically reviewed the level of financial provisions, the key movements in the balance sheet, working capital changes and any contingent liability movements.

The Audit Committee discussed various items related to the Company's risk profile and reviewed quarterly reports on risk status and mitigation plans. The Audit Committee dedicated specific attention to X5's new risk management policy, with an integrated approach to risk classification and assessment, risk mitigation, and allocation of risk management responsibilities.

Each quarter, the agenda included a discussion on current control topics, including internal audit findings and the external auditor's reflections on the control framework. These discussions guided management and Internal Audit to focus on the right priorities throughout the year and to build a relevant audit plan for 2017. Specific attention was given to an audit of internal controls in accounting and financial reporting, performed by internal audits in cooperation with the external auditor, with follow-up actions to be addressed and monitored by the Audit Committee during 2017.

In the context of the quarterly ethics and compliance updates and whistle-blower reports, the Audit Committee dedicated specific attention to detection and prevention of fraud, corruption and illegal practices, and risk-mitigating measures to protect the Company in these areas.

Throughout the year, the Audit Committee continued to review the operational control framework with particular attention to stock and fixed assets. Management processes regarding stock-holding and loss levels were examined across all formats. The Audit Committee also closely monitored the effectiveness of the capital investment process, appraisal methodology, and safeguarding of core assets. Twice during the year, the Audit Committee reviewed an assessment of the level of returns from recent investments, as well as management actions addressing underperforming stores and assets whose carrying value was impaired.

The Audit Committee also discussed other items, including:

- The 2015 Annual Report, including the financial statements;
- The external audit report with respect to accounting and audit issues and internal control recommendations in respect of the audit of the 2015 consolidated financial statements;
- Quarterly interim financial reports and trading updates;
- X5's financing strategy;
- X5's tax management and residual tax risks, with specific attention to the Group's corporate tax structure both in Russia and abroad;
- Material legal cases;
- Regulatory compliance and changes in legislation, with specific attention in 2016 to the Russian Trade Law amendments which entered into force in July, imposing extra obligations and requirements when entering into contracts with suppliers, impacting the Group's working capital and product margin structures as a result of tighter payment-related provisions in such contracts;
- Review and update of the Code of Business Conduct and Ethics and other internal policies, including the Inside Information and Dealing Code and Information Policy, both amended in line with the EU Market Abuse Regulation, which entered into force on 1 July 2016;
- Cybersecurity and data protection, indicating a need for enhanced data protection measures and controls.

With regard to the external audit, the Audit Committee reviewed the proposed audit plan related to the audit scope, approach and transition plan. This was the first year that Ernst & Young acted as external auditor, replacing PricewaterhouseCoopers. Therefore, a more thorough and in-depth assessment of X5's procedures and controls was performed by the external auditor to familiarise itself with the Company.

The Audit Committee assured itself of the independence of the external auditor and reviewed requests for non-audit services provided by the external auditor, in line with the Company's Rules on External Auditor Independence and Selection.

With respect to the external auditor's management letter for the financial year 2016, the Audit Committee confirms that the management letter contained no significant items that need to be mentioned in this report.

During the third quarter of 2016, the Audit Committee discussed the reorganisation of the Group's Internal Audit, Risk and Compliance function in order to strengthen the Company's "second line of defence" activity by separating Risk and Compliance from Internal Audit. The Internal Audit function remains as the "third line of defence" in the Company's risk management and internal control system, reporting to the Management Board and with direct access to the Audit Committee.

Nomination and Remuneration Committee

The role of the Nomination and Remuneration Committee is described in its charter, which is available on the Company's website. On 31 December 2016, the Nomination and Remuneration Committee consisted of Stephan DuCharme (Chairman), Christian Couvreur, Peter Demchenkov and Andrei Elinson. The Nomination and Remuneration Committee held four meetings in 2016, with all committee members attending each meeting. The CEO was invited to attend each meeting, and other members of the Supervisory Board and senior management were invited when necessary and appropriate.

In 2016, discussions focused on succession planning and human resource needs in relation to the Company's multi-format operating model and growth objectives. The Nomination and Remuneration Committee further reviewed and prepared the following items to recommend or report to the full Supervisory Board, as part of its ongoing responsibilities:

- Proposals regarding variable pay of the Executive Committee: realisation of annual bonus targets, targets for next year's annual bonus, and realisation of the targets outlined in the long-term incentive plan;
- The annual assessment of the Executive Committee and its individual members;
- The proposals to appoint new members of the Executive Committee, including Dmitry Gimmelberg and Maksym Gatsuts;
- Proposals to appoint Andrei Elinson as a member of the Supervisory Board;
- Profile, self-assessment, and remuneration of the Supervisory Board;
- The organisational structure and role of the Corporate Centre in support of the decentralised operating model;
- The outcomes and conclusions of the annual talent review and succession planning.

For information on the remuneration policy, see Remuneration on pages 173-177. Details of actual remuneration in 2016 can be found in notes 26 and 27 of the Consolidated Financial Statements.

Related-Party Committee

The role of the Related Party Committee is described in its charter, which is available on the Company's website. On 31 December 2016, the Related-Party Committee consisted of Geoff King (Chairman) and Mikhail Kuchment. During the year, the Related-Party Committee considered a number of transactions that gave rise to the appearance of a conflict of interest within the Company. More specifically, the Related-Party Committee discussed the following transactions:

- Insurance contracts with AlfaStrakhovanie;
- Foreign exchange agreements, bond issues, revolving credit facilities and other bank products with Alfa-Bank;
- Service agreements with Alfa Services Limited;
- Agreements with RosExpert for executive search services;
- A bonds issue with, inter alia, Sovcombank as arranger;
- A lease agreement with Hoff for real estate in St. Petersburg;
- The appointment of Stephan DuCharme as CEO and managing partner of L1 Retail (UK) LLP;
- A cooperation agreement between Pyaterochka and OJSC VimpelCom;
- A co-branded loyalty card agreement between Perekrestok, MasterCard and Alfa-Bank.

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 (Conflicts of Interest) of the Rules Governing the Principles and Practices of the Supervisory Board, which rules are available on the Company's website. The Supervisory Board assessed that, to the extent that any of the listed transactions constitute a conflict of interest for certain members of the Supervisory Board, such conflict does not undermine the independent judgement of these Board members while performing their duties for X5.

Recognising the importance of robust internal procedures and transparency with respect to (potential) related-party transactions, the Supervisory Board, upon recommendation of the Related-Party Committee, approved the Company's new Related-Party Transaction Policy in November.

Strategy Committee

The role of the Strategy Committee is described in its charter, which is available on the Company's website. On 31 December 2016, the Strategy Committee consisted of Christian Couvreur (Chairman), Pawel Musial, Mikhail Kuchment and Andrei Elinson. The responsibilities of the Strategy Committee include reviewing 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 four meetings in 2016. All meetings were attended by all members of the Supervisory Board as well as the CEO, the CFO and the general director of each of the retail formats. In 2016, the Strategy Committee reviewed and affirmed its multi-format strategy, with a distinct value proposition for each of the core formats within the Russian retail landscape. The Strategy Committee particularly focused on leadership in operating efficiencies, enhanced regional expansion and further development and testing of the Karusel value proposition, and explored further opportunities for growth in new segments and business models, including convenience and online grocery shopping. The outcomes and conclusions of these discussions were reflected in the "Strategic Vision 2020" discussed in June, and the subsequent preparation of the medium-term plan that was approved in September. In December, the Strategy Committee discussed the Company's budget for 2017.

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 2016 consolidated financial statements, audited by Ernst & Young Accountants LLP, were presented to the Supervisory Board in the presence of the Management Board and the external auditor. Ernst & Young's report can be found on page 250.

The Supervisory Board recommends that the Annual General Meeting of Shareholders adopt the 2016 Consolidated Financial Statements, and requests that the Annual General Meeting of Shareholders grants discharge to the members of the Management Board for their management and to the members of the Supervisory Board for their supervision in 2016.

The Supervisory Board wishes to express its sincere appreciation for the results achieved and would like to thank the Executive Committee and all X5 employees for their continued dedication and efforts in 2016.

The Supervisory Board

24 March 2017

Remuneration

This chapter outlines the remuneration policy for the Management Board and the Supervisory Board, as approved by the General Meeting of Shareholders. Details of actual remuneration in 2016 can be found in notes 26 and 27 to the consolidated financial statements.

Since members of the Management Board are also members of the Executive Committee, and the Supervisory Board resolved that the remuneration policy shall apply equally to all members of the Executive Committee, this section will refer to the Executive Committee unless specific provisions apply to members of the Management Board only, in which case that will be indicated.

The objective of X5's 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 on a sustainable basis in achieving its strategic objectives; and
- to balance short-term operational performance with the long-term objectives of the Company and sustainable value creation for its shareholders and stakeholders, with due regard for the risks to which variable remuneration may expose the Company.

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

Benchmarking with industry peers

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

Total direct compensation

Total direct compensation consists of the following components: base salary, performance-related short-term incentives (STI) and performance-related long-term incentives (LTI).

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

Base salary

Base salaries are specified in the individual contracts with members of the Executive Committee and reflect their respective qualifications, experience, expertise and responsibilities. The levels of base salaries are determined by (1) benchmarking with industry peers, as described above; and (2) the specific responsibilities of the individual member of the Executive Committee. The annual review date for base salaries is 1 April.

Based on the salary benchmarking review conducted in 2015, no adjustments were made to the 2016 base salaries of Executive Committee members.

Short-term incentive (STI)

The annual incentive for members of the Executive Committee is predicated upon both quantitative financial indicators and individual targets. The on-target pay out as a percentage of base salary is 100%, contingent on full achievement of the objectives, with a cap at 140% in case of exceptional performance.

The Supervisory Board sets the annual incentive targets at the beginning of each financial year, as well as performance ranges, i.e. the value below which no payout will be made (the threshold), the on-target value and the maximum payout level. The financial targets consist of elements related to the Company's operational performance, including net sales, with an EBITDA threshold as a condition for STI payout. Individual targets include targets related to divisional performance, mission-related or key project-related targets, as well as qualitative cultural and behavioural targets.

Both financial and individual performance measures contribute to the Company's success in the short term, while also securing the long-term objectives of the Company. X5 does not disclose targets for the STI programme, which represent commercially sensitive information.

Long-term incentive (LTI)

The LTI programme is divided into two stages, and runs until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management on a sustainable basis. The targets represent the Group's long-term ambitions, with a specific focus on net revenue and market share relative to the competition without sacrificing EBITDA margin or incurring undue risk. The total available fund for all payouts under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved.

Each stage of the programme includes a deferred component of conditional payouts in order to maintain the focus on long-term goals throughout the programme and to provide for an effective retention mechanism. The size of each individual cash award is based on a predetermined score reflecting the participant's role and contribution to meeting the LTI targets, at both the individual and team levels. For each LTI participant, the total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

After meeting the targets for the first stage of the LTI programme in 2015, the targets set for the deferred payout under the first stage of the LTI were achieved as of 31 December 2016, as specific performance indicators were met in line with the strategic objectives set by the Supervisory Board, and (additionally) EBITDA exceeded the target threshold.

Other remuneration components

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

Contractual arrangements

Management Board members appointed prior to 1 January 2013 are engaged on the basis of an employment agreement for an indefinite period of time. Russia-based members of the Management Board are engaged on the basis of a Management Services Agreement with a four-year term, to be extended upon reappointment by the Annual General Meeting of Shareholders, and a contract of employment with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract reflect the relevant responsibilities of each member of the Management Board in the Netherlands and in Russia.

Claw-back change of control

New claw-back legislation introduced in the Netherlands on 1 January 2014 strengthens the Company's ability to revise and claw back a director's variable pay components if they are excessive or wrongly awarded. Under the new rules, the Supervisory Board may recover from Management Board members all or part of a paid bonus if such bonus is based on the basis of incorrect information regarding the targets or the conditions of the bonus. Furthermore, the Supervisory Board has the discretionary authority to adjust an unpaid bonus to an appropriate amount if payment of the bonus is considered unreasonable or unfair. In addition, in the case of a change-of-control event, a related increase in the value of the securities that have been granted to a board member as part of his or her remuneration will be deducted from the remuneration to be paid to the board member at the time of selling these securities or when his or her board membership ends.

Severance arrangement

The severance payment is, in principle, limited to a maximum of one year's base salary for members of the Management Board and six months' base salary for Executive Committee members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances.

Loans

X5 does not provide any loans or guarantees to members of the Executive Committee.

Insurance and indemnity arrangements

Members of the Management Board and the Supervisory Board, as well as certain senior management members, are insured under X5's Directors and Officers Insurance Policy.

Although the insurance policy provides wide coverage, X5's directors and officers may incur uninsured liabilities. Members of the Management Board may be indemnified by the Company against any claims arising out of or in connection with the general performance of their duties, provided that such claim is not attributable to gross negligence, wilful

misconduct or intentional misrepresentation by such director or officer. Similar indemnities granted by the Company to members of the Supervisory Board were approved by the 2016 Annual General Meeting of Shareholders.

Supervisory Board Remuneration

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

Any non-independent member of the Supervisory Board who is, either directly or indirectly, affiliated with, engaged or employed by a legal entity or person holding at least 30% of the voting rights in the Company shall waive his or her entitlement to remuneration for acting as a member of the Supervisory Board.

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. Therefore, members of the Supervisory Board are entitled to an annual award of Restricted Stock Units (RSUs). The number of RSUs awarded in each given year is based on 100% of the board member's fixed annual remuneration divided by the average market value¹ of a GDR on the relevant award date.

RSU awards are subject to a three-year vesting period. Provided that the Supervisory Board member still holds office when the RSUs vest, the RSUs will be converted into an equal number of GDRs, which cannot be traded during a further two-year lock-in period. RSU awards to members of the Supervisory Board are not subject to performance criteria, as determined by the General Meeting of Shareholders.

Adjustments to remuneration policy in 2016

The Annual General Meeting of Shareholders of 10 May 2016 approved two amendments to the remuneration policy for members of the Supervisory Board.

Under the adjusted remuneration principles, Board members are entitled to additional compensation for time and expertise dedicated to specific strategic projects for X5, provided that such compensation (1) relates to work of a temporary, one-off nature, performed as an extension of the statutory non-executive duties of the relevant Board member; and (2) is approved in advance by the Supervisory Board – upon recommendation of the Nomination and Remuneration Committee, which will ensure, on a case-by-case basis, that any such engagement shall under no circumstances compromise the independence of the relevant Board member or the Board collectively.

Secondly, effective May 2016, the General Meeting approved a simplified award mechanism for RSUs under the Restricted Stock Unit Plan, while safeguarding the existing terms and conditions for vesting and lock-up under the plan. As such, the "conditional grant" under the plan was substituted by an award, followed by a three-year vesting period and a subsequent two-year lock-up period.

¹ The average market value is defined as "on any particular day the volume weighted average price of a GDR over the thirty immediately preceding calendar days. The volume weighted average price is calculated using the closing price of a GDR taken from the Official List of the London Stock Exchange."

Remuneration Policy in 2017 and beyond

In 2016, the Remuneration Policy as described in this report was applied. It is the intention that the current policy, with its focus on aligning the interests of shareholders and management on a sustainable basis, will be continued in the next financial year and beyond.

Under the Company's long-term incentive programme (LTI), targets have been structured to ensure that the long-term interests of shareholders and management are aligned and to achieve the strategic objectives of the Company. The targets represent the Group's long-term ambitions for sustainable and profitable growth with a specific focus on net revenue and market share relative to the competition without sacrificing EBITDA margin or incurring undue risk.

In 2015 and 2016, X5 made significant progress in achieving the long-term strategic goals set by the Supervisory Board, including becoming the largest food retailer in Russia by revenue as of 31 December 2016. Accordingly, and underpinning this progress, the targets under the first stage of the LTI were achieved in 2015 and 2016 consecutively.

Building on this achievement, and subject to meeting the sustainability criteria set out in the LTI programme, management expects that the targets under the second stage of the LTI programme are likely to be met in 2017. Pay-outs will take place in subsequent years. Similar to the first stage, the second stage of the programme includes a deferred component of conditional payouts, the purpose of which is to maintain the focus on long-term, sustainable goals throughout the life of the programme, and also to create an effective mechanism for motivating and retaining members of management who are critical to the ongoing success of the Company.

The Supervisory Board

24 March 2017

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Consolidated financial statements

X5 Retail Group N.V.

31 December 2016

X5 RETAIL GROUP N.V.

Consolidated Statement of Financial Position at 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	Note	31 Dec. 2016	31 Dec. 2015
ASSETS			
Non-current assets			
Property, plant and equipment	10	232,316	189,000
Investment property	11	4,590	4,828
Goodwill	12	80,369	75,313
Other intangible assets	13	16,380	15,101
Other non-current assets	16	4,448	3,751
Deferred tax assets	28	5,306	5,417
		343,409	293,410
Current assets			
Inventories	14	73,801	57,887
Indemnification asset	33	182	1,261
Trade, other accounts receivable and prepayments	16	28,027	25,008
Current income tax receivable		954	1,729
VAT and other taxes receivable	17	8,922	13,862
Cash and cash equivalents	9	18,190	8,958
		130,076	108,705
TOTAL ASSETS		473,485	402,115
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	20	2,458	2,458
Share premium		46,251	46,253
Retained earnings		78,261	55,970
Share-based payment reserve	27	70	37
		127,040	104,718
Total equity		127,040	104,718
Non-current liabilities			
Long-term borrowings	19	110,865	101,545
Deferred tax liabilities	28	6,505	4,961
Long-term deferred revenue		8	11
Other non-current liabilities		1,697	-
		119,075	106,517
Current liabilities			
Trade accounts payable		131,180	103,773
Short-term borrowings	19	45,168	42,670
Interest accrued		1,177	1,390
Short-term deferred revenue		282	243
Current income tax payable		821	1,684
Provisions and other liabilities	18	48,742	41,120
		227,370	190,880
Total liabilities		346,445	297,397
TOTAL EQUITY AND LIABILITIES		473,485	402,115

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated Statement of Profit or Loss for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	Note	2016	2015
Revenue	22	1,033,667	808,818
Cost of sales	23	(783,682)	(610,428)
Gross profit		249,985	198,390
Selling, general and administrative expenses	23	(211,314)	(170,065)
Lease/sublease and other income	24	6,960	6,124
Operating profit		45,631	34,449
Finance costs	25	(17,372)	(17,131)
Finance income	25	54	594
Net foreign exchange gain		340	18
Profit before tax		28,653	17,930
Income tax expense	28	(6,362)	(3,756)
Profit for the period		22,291	14,174
Profit for the period attributable to:			
Equity holders of the parent		22,291	14,174
Basic earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	328.37	208.82
Diluted earnings per share for profit attributable to the equity holders of the parent (expressed in RUB per share)	21	328.36	208.82

X5 RETAIL GROUP N.V.

Consolidated Statement of Comprehensive Income for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	2016	2015
Profit for the period	22,291	14,174
Other comprehensive income/(loss)		
Items that may be reclassified subsequently to profit and loss		
Reclassification of changes in fair value attributable to disposed available-for-sale investments	-	7
Total items that may be reclassified subsequently to profit and loss, net of tax	-	7
Other comprehensive income, net of tax	-	7
Total comprehensive income for the period, net of tax	22,291	14,181
Total comprehensive income for the period attributable to:		
Equity holders of the parent	22,291	14,181

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated Statement of Cash Flows for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	Note	2016	2015
Profit before tax		28,653	17,930
Adjustments for:			
Depreciation, amortisation and impairment of property, plant and equipment, investment property and intangible assets	23	30,636	20,784
Loss on disposal of property, plant and equipment, investment property and intangible assets		47	77
Finance costs, net	25	17,318	16,537
Impairment of trade, other accounts receivable and prepayments	23	247	1,260
Share-based compensation expense	27	48	18
Net foreign exchange gain		(340)	(18)
Other non-cash items		(864)	90
Net cash from operating activities before changes in working capital		75,745	56,678
Decrease/(increase) in trade, other accounts receivable and prepayments		350	(6,228)
Increase in inventories		(15,914)	(10,152)
Increase in trade payable		27,471	9,339
Increase in other accounts payable		8,149	5,635
Net cash flows generated from operations		95,801	55,272
Interest paid		(17,236)	(15,924)
Interest received		40	387
Income tax paid		(3,690)	(4,248)
Net cash flows from operating activities		74,915	35,487
Cash flows from investing activities			
Purchase of property, plant and equipment		(68,694)	(51,605)
Acquisition of businesses, net of cash acquired	7	(6,658)	(5,884)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		589	288
Purchase of other intangible assets		(2,516)	(2,685)
Proceeds from disposal of available-for-sale investments		-	210
Proceeds from associate		-	31
Net cash flows used in investing activities		(77,279)	(59,645)
Cash flows from financing activities			
Proceeds from loans		131,563	66,320
Repayment of loans		(119,922)	(58,822)
Net cash flows generated from financing activities		11,641	7,498
Effect of exchange rate changes on cash and cash equivalents		(45)	(5)
Net increase/(decrease) in cash and cash equivalents		9,232	(16,665)
Movements in cash and cash equivalents			
Cash and cash equivalents at the beginning of the year	9	8,958	25,623
Net increase/(decrease) in cash and cash equivalents		9,232	(16,665)
Cash and cash equivalents at the end of the year	9	18,190	8,958

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Consolidated Statement of Changes in Equity for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	Attributable to equity holders of the parent						Total
	Number of shares	Share capital	Share premium	Share-based payment reserve	Retained earnings	Total shareholders' equity	
BALANCE AS AT 1 JANUARY 2015	67,867,743	2,457	46,218	94	41,789	90,558	90,558
Other comprehensive income for the period	-	-	-	-	7	7	7
Profit for the period	-	-	-	-	14,174	14,174	14,174
Total comprehensive income for the period	-	-	-	-	14,181	14,181	14,181
Share-based payment compensation (Note 27)	-	-	-	(21)	-	(21)	(21)
Transfer and waiving of vested equity rights	14,678	1	35	(36)	-	-	-
BALANCE AS AT 31 DECEMBER 2015	67,882,421	2,458	46,253	37	55,970	104,718	104,718
BALANCE AS AT 1 JANUARY 2016	67,882,421	2,458	46,253	37	55,970	104,718	104,718
Other comprehensive income for the period	-	-	-	-	-	-	-
Profit for the period	-	-	-	-	22,291	22,291	22,291
Total comprehensive income for the period	-	-	-	-	22,291	22,291	22,291
Share-based payment compensation (Note 27)	-	-	-	31	-	31	31
Transfer and waiving of vested equity rights	1,919	-	(2)	2	-	-	-
BALANCE AS AT 31 DECEMBER 2016	67,884,340	2,458	46,251	70	78,261	127,040	127,040

The accompanying notes are the integral part of these consolidated financial statements.

X5 RETAIL GROUP N.V.

Notes to the Consolidated Financial Statements for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated




01

Principal activities and the Group structure

These consolidated financial statements are for the economic entity comprising X5 Retail Group N.V. (the "Company") and its subsidiaries, as set out in Note 6 (the "Group").

X5 Retail Group N.V. is a joint stock limited liability company established in August 1975 under the laws of the Netherlands. The principal activity of the Company is to act as a holding company for a group of companies that operate retail grocery stores. The Company's address and tax domicile is 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 2016 the Group operated a retail chain of 9,187 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express" (each representing separate format) in major population centres in Russia, including but not limited to Moscow, St. Petersburg, Nizhny Novgorod, Rostov-on-Don, Kazan, Samara, Lipetsk, Chelyabinsk, Perm, Ekaterinburg (31 December 2015: 7,020 proximity stores, supermarket, hypermarket and express stores under the brand names "Pyaterochka", "Perekrestok", "Karusel" and "Perekrestok Express"), with the following number of stores:

		31 Dec. 2016	31 Dec. 2015
	Perekrestok		
	Supermarket		
	Central FD	336	301
	North-Western FD	50	47
	Southern FD	24	22
	Northern Caucasus	8	2
	Volga FD	95	90
	Ural FD	26	16
	Total	539	478
	Pyaterochka		
	Proximity stores		
	Central FD	3,512	2,740
	North-Western FD	1,028	781
	Southern FD	577	391
	Northern Caucasus	128	93
	Volga FD	2,348	1,733
	Ural FD	730	527
	Siberian FD	40	-
	Total	8,363	6,265
	Karusel		
	Hypermarket		
	Central FD	35	34
	North-Western FD	17	17
	Southern FD	5	5
	Northern Caucasus	1	1
	Volga FD	25	25
	Ural FD	8	8
	Total	91	90
	Perekrestok Express (Express)	194	187
	TOTAL STORES	9,187	7,020

As at 31 December 2016 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 is 100% ultimately beneficially owned by three individuals: Mr. Fridman, Mr. Khan and Mr. Kuzmichev (the "Shareholders"). None of the Shareholders individually controls and/or ultimately beneficially owns 50% or more of CTF. Until 31 December 2016, CTF was the controlling parent company of the Company. CTF has since determined that it no longer exercises control over the Company given the cumulative effect of several factors and developments that occurred in the course of 2016, including changes in the composition of the Company's Supervisory Board, although the formal governance structure and CTF's shareholding have not changed. Following CTF's determination, CTF retains significant influence over the Company as at 31 December 2016.

As at 31 December 2016 the Company's shares were 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).

02

Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

2.1 Basis of preparation

These consolidated financial statements for the year ended 31 December 2016 have been prepared in accordance with, and comply with International Financial Reporting Standards as adopted by the European Union and with Part 9 Book 2 of the Dutch Civil Code.

The consolidated financial statements have been prepared under the historical cost convention, 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 majority of voting power in an investee. In such a case, the Group assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of investee's activities or apply only in exceptional circumstances, do not prevent the Group from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of businesses other than those acquired from parties under common control. The consideration transferred is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, including fair value of assets or liabilities from contingent consideration arrangements but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs related to the acquisition and incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt as part of the business combination are deducted from the carrying amount of the debt and all other transaction costs associated with the acquisition are expensed. The date of exchange is the acquisition date where a business combination is achieved in a single transaction. However, when a business combination is achieved in stages by successive share purchases, the date of exchange is the date of each exchange transaction; whereas the acquisition date is the date on which acquirer obtains control of the subsidiary.

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

Goodwill is measured by deducting the fair value of 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 (bargain purchase gain) is recognised in 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 appropriateness of their measurement.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interest method (also referred as "the predecessor values method"). Under this method the consolidated financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented or, if later, the date when the combining entities were first brought under common control. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts.

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

2.3 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 recognised at cost. Dividends received from associates reduce the carrying value of the investment in associates. Other post-acquisition changes in Group's share of net assets of an associate are recognised 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 recognised 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 recognised 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 recognise 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

The functional currency of the Group's entities is the national currency of the Russian Federation, the Russian Rouble ("RUB"). The presentation currency of the Group is the Russian Rouble ("RUB"), which management believes is the most useful currency to adopt for users of these consolidated financial statements.

b) Transactions and balances

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

2.5 Segment reporting

Operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker has been identified as the Management Board. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments. The Group identifies retail chains of each format (see Note 1) as separate operating segments in accordance with the criteria set forth in IFRS 8. Reportable segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

2.6 Property, plant and equipment

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

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

Leasehold improvements are capitalised when it is probable that future economic benefits associated with the improvements will flow to the Company and the cost can be measured reliably.

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment including construction in progress. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs of disposal and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the consolidated statement of profit or loss. An impairment loss recognised for an asset in prior years is reversed if there has been a favourable change in circumstances affecting estimates used to determine the asset's value in use or fair value less costs of disposal.

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

Land 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. In 2016 the Group revised the useful lives for certain parts of buildings. Buildings are divided into foundation and frame with a depreciation period of 40-50 years and other parts of 7-8 years. Other parts mainly include fixtures and fitting. The retrospective application of this revision would not result in any material effect on the prior period consolidated financial statements.

02 Summary of significant accounting policies

The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are as follows:

Buildings (foundation and frame)	40-50 years
Buildings (other parts)	7-8 years
Machinery and equipment	5-10 years
Refrigerating equipment	7-10 years
Vehicles	5-7 years
Other	3-5 years

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

2.7 Investment property

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

Investment properties are stated at cost less accumulated depreciation and provision for impairment, where required. If any indication exists that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs of disposal. Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. 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 40–50 years.

Fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. 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.

2.8 Intangible assets

a) Goodwill

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

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

b) Lease rights

Lease rights represent:

- Rights for favourable operating leases acquired in business combinations. Lease rights acquired in a business combination are recognised initially at fair value;
- Key money payments due to incumbent tenants and other directly attributable costs for entering into lease contracts (refer to Note 2.32).

Lease rights are amortised using the straight-line method over the lease term of the respective lease contracts – ranging from 5 to 50 years.

c) Brand and private labels

Brand and private labels acquired in a business combination are recognised initially at fair value. Brand and private labels are amortised 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 recognised initially at fair value. Franchise agreements are amortised using the straight-line method over their useful lives.

e) Software and other intangible assets

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

f) Impairment of intangible assets

Where an indication of impairment exists, the recoverable amount of any intangible asset, including goodwill, is assessed and, when impaired, the asset is written down immediately to its recoverable amount. Goodwill and intangible assets not yet available for use are tested for impairment at least annually and whenever impairment indicators exist.

2.9 Operating leases

Leases of assets under which substantially all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease except preopening rentals, which are directly attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management, capitalised as a part of retail store or distribution centre construction costs.

The Group leases retail outlets and distribution centres under terms of fixed and variable lease payments. The variable lease payments depend on revenue earned by the respective retail outlets. The Group classifies variable lease payments as contingent rents.

Initial direct costs incurred by the Group in negotiating and arranging an operating lease including key money paid to previous tenants for entering into lease contracts are recognised as lease rights.

2.10 Inventories

Inventories at distribution centres and retail outlets are stated at the lower of cost and net realisable value. Cost comprises direct costs of goods, transportation and handling costs. Cost is determined by the weighted average method. Net realisable value is the estimate of the selling price in the ordinary course of business, less selling expenses.

The Group provides for estimated inventory losses (shrinkage) between physical inventory counts on the basis of a percentage of cost of sales. The provision is adjusted to actual shrinkage based on regular inventory counts. The provision is recorded as a component of cost of sales. The Group also provides for slow moving inventory where the expected selling price is below cost.

2.11 Financial assets and liabilities

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 are initially recorded at fair value plus transaction costs. Financial liabilities are initially recorded at fair value minus 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 derecognises 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 recognised in the consolidated statement of profit or loss in the period in which they arise. Other financial liabilities are carried at amortised cost.

2.12 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 amortised cost using the effective interest rate method. Trade receivables are initially recognised at their fair values and are

subsequently carried at amortised 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 recognised 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.

2.13 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 recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised 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 derecognised or impaired at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognised 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 purchase consideration and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss and subsequent gains are recognised 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 recognised in profit or loss, the impairment loss is reversed through the current period's profit or loss.

2.14 Cash and cash equivalents

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

2.15 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are measured as the best estimate of the expenditure required to settle the present obligation at the reporting date.

2.16 Value added tax

Output VAT related to sales is payable to tax authorities on the earliest of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice and fulfilment of other conditions in compliance with Russian tax legislation.

The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability, except for VAT, presented within other non-current assets. Where a provision has been made for the impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

2.17 Employee benefits

Wages, salaries, bonuses, paid annual leave and sick leave are accrued in the period in which the associated services are rendered by the employees of the Group. The Group's entities contribute to the Russian Federation's state pension and social insurance funds in respect of their employees. These contributions are accrued when incurred. The Group's commitment ends with the payment of these contributions.

2.18 Share-based payments

Employee stock plan

The Group receives services from employees as consideration for conditional rights to receive GDRs after vesting period of 3 years and fulfilment of certain predetermined performance conditions.

Share-based payment transactions under the employee stock plan are accounted for as equity-settled transactions.

The fair value of the employee services received in exchange for the grant of the conditional rights is recognised as an expense over the vesting period and measured by reference to the market price of the GDRs which is determined at grant date.

2.19 Borrowings

Borrowings are initially recognised at their fair value, net of transaction costs, and are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the consolidated statement of profit or loss over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial period of time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

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

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

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

2.20 Trade and other payables

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

2.21 Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as share premium.

2.22 Dividends

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

2.23 Treasury shares

Where any group company purchases the Company's equity share capital, the paid consideration, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any received consideration, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.24 Earnings per share

Earnings per share are determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting period. Diluted earnings per share are calculated by adjusting the earnings and the number of shares for the effects of dilutive options.

2.25 Taxes

Current 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 consolidated financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Current income tax liabilities (assets) are measured in accordance with IAS 12 Income Taxes, based on legislation that is enacted or substantively enacted at the reporting date, taking into consideration applicable tax rates and tax exemptions.

Deferred income tax is provided using the reporting liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. In accordance with the initial recognition exception, deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and

02 Summary of significant accounting policies

subsequently for goodwill which is not deductible for tax purposes. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period in which the asset is realised or the liability is settled, based on tax rates which are enacted or substantially enacted at the reporting date.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted within the consolidated group of taxpayers (CGT) and within individual companies of the Group for the entities that are not members of the CGT.

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

2.26 Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 32.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1** quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2** valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3** valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

2.27 Income and expense recognition

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

a) Revenue

Revenue from the sale of goods through retail outlets is recognised at the point of sale. Revenue from franchisee fees is recognised based on contractual agreements over the term of the contracts. The up-front non-refundable franchisee fees received by the Group are deferred and recognised over the contractual term. Revenue from advertising services is recognised based on contractual agreements. Revenues are measured at the fair value of the consideration received or receivable. Revenues are recognised 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 includes the purchase price of the products sold and other costs incurred in bringing the inventories to the location and condition ready for sale, i.e. retail outlets. These costs include costs of purchasing, storing, rent, salaries and transporting the products to the extent it relates to bringing the inventories to the location and condition ready for sale.

The Group receives various types of allowances from suppliers in the form of volume discounts and other forms of payment. In accounting for supplier bonuses received by the Group, the Group determined that these bonuses are a reduction in prices paid for the product and are reported as part of the cost of sales as the related inventory is sold. Bonuses receivable from suppliers in cash are presented as trade receivables.

c) Interest income and expense

Interest income and expense are recognised on an effective yield basis.

d) Selling, general and administrative expenses

Selling expenses consist of salaries and wages of stores employees, store expenses, rent or depreciation of stores, utilities, advertising costs and other selling expenses. General and administrative expenses include costs of salaries and wages of support office employees, rent and depreciation of support offices, impairment and amortisation charges of non-current assets and other general and administrative expenses. Selling, general and administrative expenses are recognised on an accrual basis as incurred.

2.28 Impairment of non-current assets other than goodwill

The Group periodically assesses whether there is any indication that non-current assets may be impaired. If any such indicators exist, the Group estimates the recoverable amount of the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash generating unit to which it belongs. Individual stores are considered separate cash-generating units for impairment testing purposes. Impairment loss is recognised whenever the carrying amount of an asset or the related cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the consolidated statement of profit or loss. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.29 Fair value of assets and liabilities at the acquisition date

A primary valuation of assets and liabilities of acquired companies was performed on a provisional basis. Once the valuation is finalised, any adjustments arising are recognised retrospectively.

2.30 Indemnification asset

The indemnification asset equivalent to the fair value of the indemnified liabilities is included in net assets acquired in the business combination if the selling shareholders of the acquiree agreed to compensate possible claims or contingencies. Subsequent measurement of the indemnification asset and contingent liability does not have any impact on future earnings, unless the indemnification asset becomes impaired.

2.31 Offsetting of financial assets and financial liabilities

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

2.32 Reclassification

The Group has made reclassification of prepaid leases into lease rights within other intangible assets, as they both have the same characteristics except for the measurement at initial recognition.

Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities include:

Impairment of goodwill

The Group tests goodwill for impairment at least annually. The recoverable amount of a cash-generating unit is determined based on the higher of fair value less costs of disposal or value-in-use calculations. These calculations require the use of estimates as further detailed in Note 12.

Identifying a business combination

The Group enters into transactions to acquire integrated set of assets and operations of retail stores. The Group determines whether such transactions represent a business combination or assets acquisitions. The Group treats such transactions as business combinations when the integrated set of activities and assets acquired is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to the Group. In making this judgment the Group considers whether it acquired inputs and processes applied to the inputs that have ability to create output. All acquisitions of assets and operations of retail stores occurred in 2016 and 2015 were treated by the Group as business combinations.

Provisional fair values of net assets of acquired businesses

During the reporting period the Group made 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 increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that property, plant and equipment may be impaired. The Group performs assets impairment testing (Note 10). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is

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Critical accounting estimates and judgements in applying accounting policies

recognised in the consolidated statement of profit or loss. For the year ended 31 December 2016 the Group recognised a net impairment loss in the amount of RUB 3,132 (year ended 31 December 2015: a net impairment loss in the amount of RUB 2,266).

Investment property

The Group's management determines the estimated useful lives and related depreciation charges for its investment properties (Note 11). Management increases the depreciation charge where useful lives are less than previously estimated lives or it writes-off or writes-down technically obsolete or non-strategic assets that have been abandoned or reclassified as held for sale.

The Group periodically assesses whether there is any indication that investment property may be impaired. The Group performs assets impairment testing (Note 11). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2016 the Group recognised a net impairment loss in the amount of RUB 257 (year ended 31 December 2015: a net impairment gain in the amount of RUB 2).

Lease rights

The Group's management determines the fair value of lease rights acquired in business combinations. The assessment of the fair value of such lease rights is based on the estimate of the market rates of the lease (Note 13). The Group periodically assesses whether there is any indication that lease rights may be impaired. The Group performs assets impairment testing (Note 13). The Group estimates the recoverable amount of the asset or cash generating unit and if it is less than the carrying amount of an asset or cash generating unit an impairment loss is recognised in the consolidated statement of profit or loss. For the year ended 31 December 2016 the Group recognised a net impairment loss in the amount of RUB 66 (year ended 31 December 2015: a net impairment loss in the amount of RUB 530).

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.

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 recognised in the consolidated statement of profit or loss. For the year ended 31 December 2016 the Group recognised an impairment loss in the amount of RUB 68 (year ended 31 December 2015: an impairment loss in the amount of RUB 38).

04

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

All new standards, interpretations and amendments to IFRSs adopted by the EU and effective for the financial year beginning 1 January 2016 were applied by the Group in these consolidated financial statements and did not have a material impact on the financial position or performance of the Group.

The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective:

Standards issued but not yet effective in the European Union	Effective for annual periods beginning on or after
IFRS 9 "Financial Instruments"	1 January 2018
IFRS 15 "Revenue from Contracts with Customers"	1 January 2018
IFRS 16 "Leases"*	Not yet adopted by the EU
Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued on 11 September 2014)*	Postponed
IAS 7 Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016)*	Not yet adopted by the EU
IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12 (issued on 19 January 2016)*	Not yet adopted by the EU
IFRS 2 Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2 (issued on 20 June 2016)*	Not yet adopted by the EU
IFRS 14 Regulatory Deferral Accounts (issued on 30 January 2014)	Not to be endorsed by the EU till the final standard is issued
Clarifications to IFRS 15 Revenue from Contracts with Customers (issued on 12 April 2016)*	Not yet adopted by the EU
Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (issued on 12 September 2016)*	Not yet adopted by the EU
Annual Improvements to IFRS Standards 2014-2016 cycle (issued on 8 December 2016)*	Not yet adopted by the EU
IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016)*	Not yet adopted by the EU
Amendments to IAS 40: Transfers of Investment Property (issued on 8 December 2016)*	Not yet adopted by the EU

* Subject to EU endorsement

The Group expects that the adoption of the pronouncements listed above will not have a significant impact on the Group's results of operations and financial positions in the period of initial application except for IFRS 16 Leases described below:

IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU). The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the

04

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

lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

The Group is currently assessing the potential effect of IFRS 16 on its consolidated financial statements.

05

Segment reporting

The Group identifies retail chains of each format (see Note 1) as separate operating segments in accordance with the criteria set forth in IFRS 8.

The following significant operating functions are decentralised by formats:

- Category management, including purchasing, pricing, assortment management, promotion management;
- Distribution centres logistics;
- Development function.

The formats' general managers are determined as segment managers in accordance with IFRS 8. The chief operating decision-maker has been determined as the Management Board. The Management Board reviews each format's internal reporting in order to assess performance and allocate resources.

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

The accounting policies used for segments are the same as accounting policies applied for these consolidated financial statements. In 2016 a new methodology of overhead expenses allocation was used for more accurate measurements of segments' performance. The comparative figures for earlier periods have been adjusted in order to provide meaningful comparative information.

The segment information for the year ended 31 December 2016, comparative figures for earlier periods and reconciliation of EBITDA to profit for the period is provided as follows:

Year ended 31 December 2016	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	779,448	157,004	84,649	12,566	-	1,033,667
EBITDA	64,441	11,935	4,322	(195)	(4,236)	76,267
Depreciation, amortisation and impairment						(30,636)
Operating profit						45,631
Finance cost, net						(17,318)
Net foreign exchange result						340
Profit before income tax						28,653
Income tax expense						(6,362)
Profit for the year						22,291
Capital expenditure	62,971	11,881	5,213	501	112	80,678
31 December 2016						
Inventories	52,022	12,050	8,951	778	-	73,801

Year ended 31 December 2015	Pyaterochka	Perekrestok	Karusel	Other segments	Corporate centre	Total
Revenue	587,280	131,332	77,778	12,428	-	808,818
EBITDA	45,844	10,323	3,602	431	(4,967)	55,233
Depreciation, amortisation and impairment						(20,784)
Operating profit						34,449
Finance cost, net						(16,537)
Net foreign exchange result						18
Profit before income tax						17,930
Income tax expense						(3,756)
Profit for the year						14,174
Capital expenditure	50,658	13,657	6,305	347	95	71,062
31 December 2015						
Inventories	42,069	8,443	6,641	734	-	57,887

06

Subsidiaries

Details of the Company's significant subsidiaries at 31 December 2016 and 31 December 2015 are as follows:

Company	Country	Nature of operations	Ownership (%)	
			31 Dec. 2016	31 Dec. 2015
Agroaspekt LLC	Russia	Retailing	100	100
Agrotorg LLC	Russia	Retailing	100	100
Alpegru Retail Properties Ltd.	Cyprus	Real estate	100	100
Beta Estate LLC	Russia	Real estate	100	100
GSWL Finance Ltd.	Cyprus	Financing	100	100
Kopeyka-Moscow LLC	Russia	Retailing	100	100
Krasnoborskoye LLC	Russia	Real estate	100	100
Perekrestok Holdings Ltd.	Gibraltar	Holding company	100	100
Perekrestok 2000 LLC	Russia	Real estate	100	100
Sladkaya Zhizn N.N. LLC	Russia	Retailing	100	100
Speak Global Ltd.	Cyprus	Holding company	100	100
Torgovy Dom PEREKRESTOK CJSC	Russia	Retailing	100	100
X5 Finance LLC	Russia	Bond issuer	100	100
X5 Nedvizhimost CJSC	Russia	Real estate	100	100
TD Kopeyka OJSC	Russia	Holding Company	100	100

07

Acquisition of businesses

Acquisitions in 2016

In 2016 the Group acquired 100% of several businesses of other retail chains in Russian regions. The acquisitions were individually immaterial.

In the year ended 31 December 2016 the acquired businesses contributed revenue of RUB 11,509 from the date of acquisition. The businesses did not prepare relevant financial information immediately before the acquisition, therefore, it is impracticable to disclose revenue and net profit of the Group for the year ended 31 December 2016 as though the acquisition date had been the beginning of that period.

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

	Provisional fair values at the acquisition date
Property, plant and equipment (Note 10)	965
Other intangible assets (Note 13)	322
Deferred tax assets (Note 28)	627
Trade and other accounts receivable	1
Deferred tax liabilities (Note 28)	(18)
Net assets acquired	1,897
Goodwill (Note 12)	4,802
Purchase consideration	6,699
Net cash outflow arising from the acquisition	6,654

The Group assigned provisional fair values to net assets acquired, in estimating provisional values of intangible assets and property, plant and equipment direct references to observable prices in an active market and estimates of the independent appraisal are used (market approach). The Group will finalise the purchase price allocation within 12 months from the acquisition date.

The purchase consideration for the reporting period comprises the transfer of cash and cash equivalents of RUB 6,654, accounts receivable with fair value of RUB 44 and RUB 1 as deferred consideration. During 12 months ended 31 December 2016 the Group transferred RUB 4 as deferred payments for prior period's acquisitions.

The goodwill recognised is attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers.

Acquisitions in 2015

In 2015 the Group acquired 100% of several businesses of other retail chains in Russian regions.

At 31 December 2015 the Group assigned provisional fair values to net assets acquired, in estimating provisional fair values of acquired assets. In 2016 the Group completed the purchase price allocation, which resulted in the following changes in fair values at the acquisition date:

	Provisional fair values at the acquisition date	Finalised fair values at the acquisition date	Effect of change in purchase price allocation on the consolidated statement of financial position as at 31 December 2016
Property, plant and equipment (Note 10)	3,681	3,681	-
Other intangible assets (Note 13)	1,181	1,181	-
Other non-current assets	67	67	-
Deferred tax assets (Note 28)	550	570	20
Inventories	651	609	(42)
Indemnification asset	1,607	1,607	-
Trade, other accounts receivable and prepayments	437	321	(116)
VAT and other taxes receivable	16	40	24
Cash and cash equivalents	59	59	-
Long-term borrowings	(2,727)	(2,727)	-
Deferred tax liabilities (Note 28)	(169)	(245)	(76)
Trade accounts payable	(2,527)	(2,527)	-
Short-term borrowings	(2,696)	(2,696)	-
Interest accrued	(52)	(52)	-
Current income tax payable	(933)	(933)	-
Provisions and other liabilities	(2,703)	(2,767)	(64)
Net assets acquired	(3,558)	(3,812)	(254)
Goodwill (Note 12)	9,506	9,760	254
Purchase consideration	5,948	5,948	-
Net cash outflow arising from the acquisition	5,884	5,884	-

The purchase consideration for the prior period comprised the transfer of cash and cash equivalents of RUB 5,943 and RUB 5 as deferred consideration.

Not all businesses prepared 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 2015 as though the acquisition date had been the beginning of that period.

The goodwill recognised was attributable to: i) the business concentration in the Russian regions; ii) expected cost synergies from the business combination and iii) acquired traffic from existing customers.

08

Related party transactions

In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the relationships for those related parties with which the Group entered into significant transactions or had significant balances outstanding at 31 December 2016 are provided below. The ownership structure is disclosed in Note 1.

The following transactions were carried out with related parties:

	Relationship	2016	2015
CTF Holdings Ltd.	Entity with significant influence over the Company (Ultimate parent company before 31 December 2016)		
Management services received		90	65
Other	Under control by the entity with significant influence over the Company (Under common control before 31 December 2016)		
Purchases from related parties		1,517	1,190
Insurance expenses		223	161
Other operating expenses		2	155
Bonuses from related parties		226	301
Other	Other		
Other operating expenses		42	52

The consolidated financial statements include the following balances with the related parties:

	Relationship	31 Dec. 2016	31 Dec. 2015
Other	Under control by the entity with significant influence over the Company (Under common control before 31 December 2016)		
Trade accounts payable		278	236
Other accounts payable		3	4
Trade accounts receivable		29	38
Other receivables and prepayments from related parties		11	7
Other	Other		
Other accounts payable		12	9
Other accounts receivable		-	3

Key management personnel compensation

Key management personnel compensation is disclosed in Note 26.

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the year-end are unsecured and interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. For the year ended 31 December 2016, the Group has not recorded any impairment of receivables relating to amounts owed by related parties (2015: Nil).

09

Cash and cash equivalents

	31 Dec. 2016	31 Dec. 2015
Cash in hand – Roubles	2,599	2,118
Bank current account – Roubles	5,799	1,143
Bank current accounts and deposits – other currencies	6	5
Cash in transit – Roubles	9,105	4,954
Short-term deposits – Roubles	681	738
Total	18,190	8,958

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

The Group assessed credit quality of outstanding cash and cash equivalents balances as high and considered that there was no significant individual exposure. The maximum exposure to credit risk at the reporting date was the carrying value of cash and bank balances.

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

Bank	Moody's	Fitch	S&P	31 Dec. 2016	31 Dec. 2015
Alfa-Bank	Ba2	BB+	BB	1,088	621
Sberbank	Ba1	BBB-	-	3,510	246
Raiffeisenbank	Ba2	BBB-	-	-	5
HSBC	Aa2	AA-	AA-	5	3
MCB	B1/NP	BB	BB-	1,866	912
VTB	Ba2	-	BB+	3	91
Other banks				14	8
Cash in transit and in hand				11,704	7,072
Total				18,190	8,958

10

Property, plant and equipment

Costs:	Land and buildings	Machinery & equipment	Refrigerating equipment	Vehicles	Other	Construction in progress	Total
AT 1 JANUARY 2015	141,382	18,748	20,457	6,859	16,620	12,043	216,109
Additions	-	-	-	-	-	53,887	53,887
Transfers	29,535	7,208	9,218	1,415	6,173	(53,549)	-
Transfers to investment property (Note 11)	(1,530)	-	-	-	-	-	(1,530)
Assets from acquisitions (Note 7)	2,994	91	211	38	37	310	3,681
Disposals	(400)	(1,638)	(1,833)	(945)	(871)	(78)	(5,765)
AT 31 DECEMBER 2015	171,981	24,409	28,053	7,367	21,959	12,613	266,382
Additions	-	-	-	-	-	70,492	70,492
Transfers	36,816	10,874	12,964	5,273	6,873	(72,800)	-
Transfers to investment property (Note 11)	(473)	-	-	-	-	(312)	(785)
Assets from acquisitions (Note 7)	-	-	-	-	-	965	965
Disposals	(363)	(4,041)	(2,780)	(710)	(2,843)	(3)	(10,740)
AT 31 DECEMBER 2016	207,961	31,242	38,237	11,930	25,989	10,955	326,314

Accumulated depreciation and impairment:

AT 1 JANUARY 2015	(33,540)	(9,750)	(8,189)	(3,755)	(9,987)	(560)	(65,781)
Depreciation charge	(5,716)	(2,488)	(2,834)	(947)	(2,952)	-	(14,937)
Impairment charge	(3,131)	(366)	(468)	(69)	(128)	(452)	(4,614)
Reversal of impairment	2,334	-	-	-	-	14	2,348
Transfers	(75)	48	-	-	2	25	-
Transfers to investment property (Note 11)	221	-	-	-	-	-	221
Disposals	320	1,572	1,741	823	849	76	5,381
AT 31 DECEMBER 2015	(39,587)	(10,984)	(9,750)	(3,948)	(12,216)	(897)	(77,382)
Depreciation charge	(10,677)	(3,907)	(3,929)	(1,133)	(4,470)	-	(24,116)
Impairment charge	(4,883)	(835)	(685)	(2)	(157)	(643)	(7,205)
Reversal of impairment	3,671	-	-	-	-	402	4,073
Transfers	(1,454)	(30)	(24)	-	1,416	92	-
Transfers to investment property (Note 11)	141	-	-	-	-	238	379
Disposals	166	3,909	2,717	642	2,819	-	10,253
AT 31 DECEMBER 2016	(52,623)	(11,847)	(11,671)	(4,441)	(12,608)	(808)	(93,998)
Net book value at 31 December 2016	155,338	19,395	26,566	7,489	13,381	10,147	232,316
Net book value at 31 December 2015	132,394	13,425	18,303	3,419	9,743	11,716	189,000
Net book value at 1 January 2015	107,842	8,998	12,268	3,104	6,633	11,483	150,328

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 2016 and 31 December 2015.

Construction in progress predominantly related to the development of stores through the use of sub-contractors.

The buildings are mostly located on leased land. Land leases with periodic lease payments are disclosed as part of commitments under operating leases (Note 33). No loans were collateralised by land and buildings including investment property as of 31 December 2016.

Impairment test

At the end of 2016 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 (cash generating unit – CGU). The variability of these factors depends on a number of conditions, including uncertainty about future events and changes in demand.

The impairment review has been carried out by comparing recoverable amount of the individual store/unit with their carrying values. The recoverable amount of store/unit is determined as the higher of fair value less cost of disposal or value in use.

The resulting impairment charge arose primarily from underperforming stores. At the same time the Group recognised the reversal of previously recorded impairment charges due to improved performance of certain stores. Due to the great number of CGUs being tested for impairment it is considered impracticable to disclose detailed information for each individual CGU.

Fair value less costs of disposal

Fair value of land and buildings and construction in progress is determined by an independent appraiser by reference to current observable prices on an active market subsequently adjusted for specific characteristics of respective assets. The fair value measurement of these assets is classified at level 3 of the fair value hierarchy.

Value in use

For items of land, buildings and construction in progress the discounted future cash flow approach is applied and covers a 10 year period from 2017 onwards. The future 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. One of the main assumptions used for the subsequent years is revenue growth being in the range from 3.5% to 6% in accordance with the strategic plan and consumer price index projections (31 December 2015: 0% to 12.25%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 15.9% (31 December 2015: for the first two years – 18.29%, for subsequent years – 16.69%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions. If the revised estimated discount rate consistently applied to the discounted cash flows had been 200 b.p. higher than management's estimates, the Group would need to reduce the carrying value of property, plant and equipment, investment property and intangible assets by RUB 1,005 (31 December 2015: RUB 840), if 200 b.p. lower – increase by RUB 1,643 (31 December 2015: RUB 1,152). If the annual revenue growth rate used in calculations of value in use had been 200 b.p. higher, the Group would need to increase the carrying value of property, plant and equipment, investment property and intangible assets by RUB 2,592 (31 December 2015: RUB 1,374), lower – decrease by RUB 2,473 (31 December 2015: RUB 1,374).

11

Investment property

The Group held the following investment properties at 31 December 2016 and 31 December 2015:

	2016	2015
Cost		
Cost at 1 January	8,040	6,510
Transfer from fixed assets	785	1,530
Disposals	(141)	-
Cost at 31 December	8,684	8,040
Accumulated depreciation and impairment		
Accumulated depreciation and impairment at 1 January	(3,212)	(2,792)
Depreciation charge	(246)	(201)
Impairment charge	(446)	-
Reversal of impairment	189	2
Transfer from fixed assets	(379)	(221)
Accumulated depreciation and impairment at 31 December	(4,094)	(3,212)
Net book value at 31 December	4,590	4,828
Net book value at 1 January	4,828	3,718

Depreciation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2016 and 31 December 2015.

Rental income from investment property amounted to RUB 1,243 (2015: RUB 1,186). Direct operating expenses incurred by the Group in relation to investment property amounted to RUB 546 (2015: RUB 409). 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 2016 amounted to RUB 7,839 (31 December 2015: RUB 8,494). The fair value was estimated using the joint income and comparative approach with key inputs being rent income rates and market value of comparable assets.

Impairment test

At the end of 2016 management performed an impairment test of investment property. The evaluation performed and reasons for it are consistent with the approach for impairment testing of Property, Plant and Equipment (Note 10).

12

Goodwill

Movements in goodwill arising on the acquisition of businesses at 31 December 2016 and 31 December 2015 are:

	2016	2015
Cost		
Gross book value at 1 January	141,625	131,996
Acquisition of businesses (Note 7)	4,802	9,506
Effect of change in purchase price allocation (Note 7)	254	123
Gross book value at 31 December	146,681	141,625
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	75,313	65,684
Carrying amount at 31 December	80,369	75,313

Goodwill impairment test

For the purposes of impairment testing, goodwill is allocated to groups of cash-generating units (groups of CGUs) being store chains of each format. This represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

The group of CGUs to which goodwill has been allocated is tested for impairment annually or more frequently if there are indications that the particular group of CGUs might be impaired. Goodwill is tested for impairment at the group of CGUs level by comparing carrying values of particular group of CGU assets including allocated goodwill to their value in use.

The allocation of carrying amounts of goodwill to each group of CGUs is as follows:

Year ended 31 December 2016	Pyaterochka	Perekrestok	Karusel	Other	Total
Goodwill	65,189	10,344	4,550	286	80,369
Year ended 31 December 2015	Pyaterochka	Perekrestok	Karusel	Other	Total
Goodwill	60,133	10,344	4,550	286	75,313

Value in use

For items of land, buildings and construction in progress the discounted future cash flow approach is applied and covers a 10 year period from 2017 onwards. The future 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. One of the main assumptions used for the subsequent years is revenue growth being in the range from 3.5% to 6% in accordance with the strategic plan and consumer price index projections (31 December 2015: 0% to 12.25%). The projections are made in the functional currency of the Group's entities, being Russian Rouble, on a pre-tax basis and discounted at the Group pre-tax weighted average cost of capital which is then adjusted to reflect the risks specific to the respective assets (cash-generating units (CGUs)) – 15.90% (31 December 2015: for the first two years – 18.29%, for subsequent years – 16.69%). Inflation rates are in line with the consumer price index forecast published by the Ministry of Economic Development of Russian Federation. The Group's management believes that all of its estimates are reasonable and consistent with the internal reporting and reflect management's best knowledge.

The changes in assumptions applied in the model used for impairment testing don't indicate any trigger for impairment because the fair value less cost of disposal and the value in use are significantly higher than the carrying values of the cash generating unit assets.

The result of applying discounted cash flows model reflects expectations about possible variations in the amount and timing of future cash flows and is based on reasonable and supportable assumptions that represent management's best estimate of the range of uncertain economic conditions.

Impairment test

The recoverable amount of the groups of CGUs calculated exceeds their carrying amounts. Therefore no impairment is recognised.

Other intangible assets

Other intangible assets comprise the following:

	Brand and private labels	Franchise agreements	Software and other	Lease rights	Total
Cost:					
AT 1 JANUARY 2015	17,136	2,130	6,155	9,563	34,984
Additions	-	-	1,407	1,277	2,684
Acquisitions of businesses (Note 7)	-	-	-	1,181	1,181
Disposals	-	(2,118)	(61)	(36)	(2,215)
AT 31 DECEMBER 2015	17,136	12	7,501	11,985	36,634
Additions	-	-	3,294	549	3,843
Acquisition of businesses (Note 7)	-	-	-	322	322
Disposals	-	(12)	(20)	(91)	(123)
AT 31 DECEMBER 2016	17,136	-	10,775	12,765	40,676
Accumulated amortisation and impairment:					
AT 1 JANUARY 2015	(10,174)	(2,100)	(2,483)	(5,609)	(20,366)
Amortisation charge	(784)	(18)	(607)	(1,405)	(2,814)
Impairment charge	(38)	-	-	(723)	(761)
Reversal of impairment	-	-	-	193	193
Disposals	-	2,118	61	36	2,215
AT 31 DECEMBER 2015	(10,996)	-	(3,029)	(7,508)	(21,533)
Amortisation charge	(726)	(7)	(1,096)	(736)	(2,565)
Impairment charge	(68)	(5)	(181)	(442)	(696)
Reversal of impairment	-	-	-	376	376
Disposals	-	12	20	90	122
AT 31 DECEMBER 2016	(11,790)	-	(4,286)	(8,220)	(24,296)
Net book value at 31 December 2016	5,346	-	6,489	4,545	16,380
Net book value at 31 December 2015	6,140	12	4,472	4,477	15,101
Net book value at 1 January 2015	6,962	30	3,672	3,954	14,618

Brand and private labels includes brand "Pyaterochka" with the carrying amount of RUB 4,029 (31 December 2015: RUB 4,466) and brand "Karusel" with the carrying amount of RUB 1,258 (31 December 2015: RUB 1,456).

Amortisation charge, impairment charge and reversal of impairment are included in selling, general and administrative expenses in the consolidated statement of profit or loss for the years ended 31 December 2016 and 31 December 2015.

Impairment test

At the end of 2016 management performed an impairment test of lease rights 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 and private labels which were no longer used.

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Inventories

At 31 December 2016 inventories in the amount of RUB 73,801 were accounted at the lower of cost and net realisable value (31 December 2015: RUB 57,887). Inventory shrinkage and slow moving stock provisions recognised as cost of sales in the consolidated statement of profit or loss amounted to RUB 36,467 (2015: RUB 26,248).

15

Financial instruments by category

Loans and receivables

31 DECEMBER 2016	Assets as per consolidated statement of financial position	
	Trade and other receivables excluding prepayments	25,021
	Cash and cash equivalents	18,190
	Total	43,211

Financial liabilities at amortised cost

31 DECEMBER 2016	Liabilities as per consolidated statement of financial position	
	Borrowings	156,033
	Interest accrued	1,177
	Trade, other current and non-current payables excluding statutory liabilities and advances	172,396
	Total	329,606

Loans and receivables

31 DECEMBER 2015	Assets as per consolidated statement of financial position	
	Trade and other receivables excluding prepayments	22,411
	Cash and cash equivalents	8,958
	Total	31,369

Financial liabilities at amortised cost

31 DECEMBER 2015	Liabilities as per consolidated statement of financial position	
	Borrowings	144,215
	Interest accrued	1,390
	Trade and other payables excluding statutory liabilities and advances	133,224
	Total	278,829

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Trade, other accounts receivable and prepayments

	31 Dec. 2016	31 Dec. 2015
Trade accounts receivable	24,606	22,316
Other receivables	2,206	2,209
Accounts receivable for franchise services	15	23
Provision for impairment of trade and other receivables	(1,806)	(2,137)
Total trade and other accounts receivable	25,021	22,411
Prepayments	2,956	2,490
Advances made to trade suppliers	733	975
Provision for impairment of prepayments and advances	(683)	(868)
Total prepayments	3,006	2,597
TOTAL	28,027	25,008

All classes of receivables except prepayments are categorised as loans and receivables under IAS 39 classification. The carrying amounts of the Group's trade and other receivables were primarily denominated in Russian Roubles. Other non-current assets were mainly represented by long-term prepayments for rent in the amount of RUB 4,221 (31 December 2015: RUB 3,548).

Trade receivables

There were balances of RUB 715 that in accordance with accounting policies were past due but not impaired as at 31 December 2016 (31 December 2015: RUB 708).

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

	31 Dec. 2016	31 Dec. 2015
2-12 months	715	708
Total	715	708

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

	2016	2015
AT 1 JANUARY	(1,190)	(260)
Addition of provision for receivables impairment	(666)	(1,048)
Release of provision for receivables impairment	645	93
Receivables written off as uncollectable	299	25
AT 31 DECEMBER	(912)	(1,190)

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 related to debtors that expect financial difficulties or where there was likelihood of the debtor's insolvency. It was assessed that a portion of the receivables was expected to be recovered.

16 Trade, other accounts receivable and prepayments

The ageing of amounts receivable (gross) that were individually impaired based on days outstanding was as follows:

	31 Dec. 2016	31 Dec. 2015
3-6 months	107	270
Over 6 months	1,161	1,037
Total	1,268	1,307

For those receivables that were neither past due nor impaired the Group considered the credit quality as high. Trade receivables are mainly bonuses from suppliers of goods for resale receivable on quarterly basis with a low historic default rate. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

Other receivables and receivables for franchise services

There were balances of RUB 189 that in accordance with accounting policies were past due but not impaired as at 31 December 2016 (31 December 2015: RUB 428).

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

	31 Dec. 2016	31 Dec. 2015
2-12 months	189	428
Total	189	428

Movements on the provision for impairment of other receivables and receivables for franchise services were as follows:

	2016	2015
AT 1 JANUARY	(947)	(762)
Addition of provision for receivables impairment	(399)	(511)
Release of provision for receivables impairment	289	247
Receivables written off as uncollectable	163	79
AT 31 DECEMBER	(894)	(947)

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 related to debtors that expected financial difficulties or there was likelihood of the debtor's insolvency. It was assessed that a portion of the receivables was expected to be recovered.

The ageing of amounts receivable (gross) that were individually impaired based on days outstanding was as follows:

	31 Dec. 2016	31 Dec. 2015
3-6 months	119	110
Over 6 months	1,038	1,084
Total	1,157	1,194

For those receivables that were neither past due nor impaired the Group considered the credit quality as high. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

Prepayments and advances made to trade suppliers

There were balances of RUB 876 that in accordance with accounting policies were past due but not impaired as at 31 December 2016 (31 December 2015: RUB 854).

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

	31 Dec. 2016	31 Dec. 2015
2-12 months	876	664
Over 1 year	-	190
Total	876	854

Movements on the provision for impairment of prepayments and advances made to trade suppliers were as follows:

	2016	2015
AT 1 JANUARY	(868)	(875)
Addition of provision for receivables impairment	(417)	(456)
Release of provision for receivables impairment	297	267
Receivables written off as uncollectable	305	196
AT 31 DECEMBER	(683)	(868)

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 related to debtors that expected financial difficulties or there was likelihood of the debtor's insolvency. It was assessed that a portion of the receivables was expected to be recovered.

The ageing of amounts receivable (gross) that were individually impaired based on days outstanding was as follows:

	31 Dec. 2016	31 Dec. 2015
3-6 months	-	119
Over 1 year	754	1,028
Total	754	1,147

For those receivables that were neither past due nor impaired the Group considered the credit quality as high. The maximum exposure to credit risk at the reporting date was the carrying amount of each class of receivable mentioned above. The Group did not hold any collateral as security.

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VAT and other taxes receivable

	31 Dec. 2016	31 Dec. 2015
VAT receivable	8,698	13,680
Other taxes receivable	224	182
Total	8,922	13,862

VAT receivable related to property, plant and equipment of RUB 446 (31 December 2015: RUB 492) was recorded within current assets because management expected it will be recovered within 12 months after the reporting 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 fulfillment of other conditions in compliance with Russian tax legislation, therefore there are risks that recovering the balance may take longer than 12 months.

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Provisions and other liabilities

	31 Dec. 2016	31 Dec. 2015
Other accounts payable and accruals	14,232	9,861
Accrued salaries and bonuses	12,412	10,238
Accounts payable for property, plant and equipment	11,890	8,441
Taxes other than income tax	7,037	7,806
Advances received	1,462	1,471
Payables to landlords	1,210	911
Provisions and liabilities for tax uncertainties (Note 33)	499	2,392
Total	48,742	41,120

There were no significant amounts of other payables to foreign counterparties as at 31 December 2016 and 31 December 2015.

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Borrowings

The Group had the following borrowings at 31 December 2016 and 31 December 2015:

Current	Final maturity year*	Fair value		Carrying value	
		2016	2015	2016	2015
RUB Bonds X5 Finance series 04	-	-	7,992	-	8,000
RUB Bonds X5 Finance series B0-02	-	-	4,950	-	4,997
RUB Bonds X5 Finance series B0-03	-	-	4,914	-	4,999
RUB Bonds X5 Finance series B0-06	2017	5,045	-	4,993	-
RUB Bilateral Loans	2017	40,175	24,674	40,175	24,674
Total current borrowings		45,220	42,530	45,168	42,670

Non-current	Final maturity year*	Fair value		Carrying value	
		2016	2015	2016	2015
RUB Bonds X5 Finance series B0-04	2019	5,219	5,000	4,993	4,991
RUB Bonds X5 Finance series B0-05	2018	5,089	-	4,995	-
RUB Bonds X5 Finance series B0-07	2019	5,008	-	4,991	-
RUB Bonds X5 Finance series 001P-01	2019	14,970	-	14,997	-
RUB Bilateral Loans	2019	81,919	98,018	80,889	96,554
Total non-current borrowings		112,205	103,018	110,865	101,545
Total borrowings		157,425	145,548	156,033	144,215

* In case of the Group's Bonds – the next oferta (put option) date.

In February 2016 the Group made several drawdowns out of Sberbank long-term credit line in the total amount of RUB 8.9 billion with fixed interest rate.

In 2016 the Group issued following exchange corporate bonds:

- In March 2016 series B0-05 with 10.90% coupon rate and 2.5-year oferta (put option) in the total amount of RUB 5 bn.
- In May 2016 series B0-06 with 10.50% coupon rate and 1.5-year oferta (put-option) in the total amount of RUB 5 bn.
- In August 2016 series B0-07 with 9.75% coupon rate and 2.5-year oferta (put option) in the total amount of RUB 5 bn.
- In September 2016 series 001P-01 with 9.45% coupon rate and 3-year oferta (put option) in the total amount of RUB 15 bn.

The Group made several drawdowns with fixed interest rate out of Alfa-Bank long-term credit line in the total amount of:

- RUB 14.7 bn. in June 2016;
- RUB 12.5 bn. in August 2016.

In December 2016 the Group made several drawdowns out of Sberbank long-term credit lines in the total amount of RUB 45.4 bn. with fixed interest rates.

The weighted average effective interest rate on X5's total borrowings for 2016 comprised 11.30% per annum (2015: 12.67%).

19 Borrowings

All borrowings at 31 December 2016 are shown net of related transaction costs of RUB 267 which are amortised over the term of the loans using the effective interest method (31 December 2015: RUB 207). Borrowing costs capitalised for the year ended 31 December 2016 amounted to RUB 285 (2015: RUB 272). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation is 11.20% (2015: 12.41%).

In accordance with loan agreements the Group maintains an optimal capital structure by tracking certain covenants, such as the maximum level of Net Debt/EBITDA (4.00/4.25 during 2 quarters after acquisition). At 31 December 2016 the Group complied with this covenant and Net Debt/EBITDA was equal to 1.81 (31 December 2015: 2.45).

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Share capital

As at 31 December 2016 the Group had 190,000,000 authorised ordinary shares (31 December 2015: 190,000,000) of which 67,884,340 ordinary shares are outstanding (31 December 2015: 67,882,421) and 8,878 ordinary shares are held as treasury stock (31 December 2015: 10,797). The nominal par value of each ordinary share is EUR 1.

No dividends were paid or declared during the year ended 31 December 2016 and the year ended 31 December 2015.

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Earnings per share

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

Earnings per share were calculated as follows:

	2016	2015
Profit attributable to equity holders of the parent	22,291	14,174
Weighted average number of ordinary shares in issue	67,883,606	67,876,926
Effect of share options granted to employees, number of shares	2,366	-
Weighted average number of ordinary shares for the purposes of diluted earnings per share	67,885,972	67,876,926
Basic earnings per share for profit from continuing operations (expressed in RUB per share)	328.37	208.82
Diluted earnings per share for profit from continuing operations (expressed in RUB per share)	328.36	208.82

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Revenue

	2016	2015
Revenue from sale of goods	1,033,320	808,497
Revenue from franchise services	34	35
Revenue from other services	313	286
Total	1,033,667	808,818

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Expenses by nature

	2016	2015
Cost of goods sold	751,763	583,970
Staff costs (Note 26)	92,947	78,343
Operating lease expenses	51,202	39,773
Depreciation, amortisation	26,927	17,952
Impairment of non-current assets	3,709	2,832
Other store costs	17,773	15,795
Utilities	20,445	16,086
Other	30,230	25,742
Total	994,996	780,493

Operating lease expenses included RUB 49,626 (2015: RUB 38,901) of minimum lease payments and contingent rents of RUB 1,576 (2015: 872 RUB).

Impairment of trade and other receivables amounted to RUB 247 for the year ended 31 December 2016 (2015: RUB 1,260).

The fees listed below related 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):

	2016	2015
Financial statement audit	55	75
Tax services	14	14
Other non-audit services	8	8
Total	77	97

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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 were as follows:

	31 Dec. 2016	31 Dec. 2015
Not later than 1 year	2,325	2,166
Later than 1 year and no later than 5 years	1,474	970
Later than 5 years	615	427
Total	4,414	3,563

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Operating lease / sublease income

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

	31 Dec. 2016	31 Dec. 2015
Not later than 1 year	676	624
Later than 1 year and no later than 5 years	127	117
Later than 5 years	61	88
Total	864	829

The rental income from operating leases recognised in the consolidated statement of profit or loss for the year ended 31 December 2016 amounted to RUB 6,142 (2015: RUB 5,519).

The contingent rents recognised in the consolidated statement of profit or loss in the year ended 31 December 2016 amounted to RUB 170 (2015: 142).

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Finance income and costs

	2016	2015
Interest expense	17,044	16,570
Interest income	(47)	(387)
Other finance costs, net	321	354
Total	17,318	16,537

Other finance costs included transaction costs of RUB 177 written-off to the consolidated statement of profit or loss (2015: RUB 309) (Note 19).

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Staff costs

	2016	2015
Wages and salaries	73,435	61,510
Social security costs	19,464	16,815
Share-based payments expense	48	18
Total	92,947	78,343

Wages and salaries in 2016 included expenses of RUB 2,778 related to the long-term incentive programme (LTI) for key employees, including members of the Management Board, other key management and other key employees.

For the year ended 31 December 2016 statutory pension contributions amounted to RUB 13,065 (2015: RUB 10,894).

Key management personnel

The Group 'key management personnel' consists of members of the Supervisory Board, Management Board and certain other members of the Executive Committee, having authority and responsibility for planning, directing and controlling the activities of the Group as a whole. The total direct compensation for members of the Executive Committee including the

members of the Management Board consists of a base salary, a performance related short-term incentive and a performance related long-term incentive; members of the Supervisory Board receive an annual base compensation in cash and share-based payments.

Management Board

The remuneration of the members of the Management Board, which comprises the CEO and the Company Secretary, is determined by the Supervisory Board within the framework of the remuneration policy as approved by the General Meeting of Shareholders. More details about the remuneration policy are included in the "Remuneration" section on page 173 onwards.

Base salaries in 2016

Base salaries of each member of the Management Board are determined in line with compensation levels in peer companies. For the CEO, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr. DuCharme when in office as CEO, thereby securing continuity. As such, Mr. Shekhterman's reward package does not include a severance entitlement and instead, he shall be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman shall be entitled to the difference upon completion of his full term as CEO.

Short-term incentive (STI) for 2016

For 2016 the Supervisory Board has determined that 100% of the total on-target bonus opportunity for the CEO depends on achieving financial and quantitative group targets. Group targets consist of elements related to the Company's operational performance, including net sales and return on invested capital (ROIC), with a profitability threshold as a condition for STI payout. For the Company Secretary the STI is based on achievement of individual targets, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO, and 40% for the Company Secretary. With regard to financial targets, the Group achieved EBITDA above the target threshold, while other group targets, including the net sales target, were fully met. The achievement of individual performance targets was assessed and determined by the Supervisory Board for each Management Board member individually, as reflected in the table below.

Long-term incentive (LTI)

The LTI programme comprises two stages which run until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management. The targets represent the Group's long-term ambitions, with a specific focus on net revenue and market share relative to the competition, without sacrificing EBITDA or incurring undue risk. The total available fund for all payouts under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. Each stage of the programme includes a deferred component of conditional payouts in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

As at 31 December 2016 the targets set for the deferred payout under the first stage of the LTI were achieved, as specific comparative performance indicators were met, and EBITDA also exceeded the target threshold. Consequently, Mr. Shekhterman was eligible for a payout, details of which are provided in the table below.

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Expenses recognized for remuneration of the members of the Management Board:

Name	Year	Base salary ¹	Short-term incentive ²	Long-term incentive ³	Exit payment ⁴	Share based compensation ⁵	Social security cost	Total
I. Shekhterman	2016	47	52	296	-	1	59	455
	2015	13	16	143	-	-	26	198
F. Lhoëst	2016	20	6	10	-	-	-	36
	2015	19	5	20	-	1	-	45
S. DuCharme	2015	41	33	399	440	3	138	1,054
Total	2016	67	58	306	-	1	59	491
	2015	73	54	562	440	4	164	1,297

¹ Mr. Shekhterman succeeded Mr. DuCharme as member of the Management Board and CEO on 12 November 2015. Mr. Shekhterman's annual base salary is RUB 42 million, for 2015 reflected in the table on a pro rata basis from 8 September 2015, the day that Mr. Shekhterman started a transition period following his nomination as CEO. The table reflects actual base salary amounts, including adjustments based on number of days spent on vacation and business trips, in accordance with Russian labour law.

² Short-term incentives are based on results achieved in 2016 and payable in 2017. The short-term incentive levels are based on full achievement of both group and individual targets with additional reward for outperformance of group targets, resulting in payouts of 123% of base salary for Mr. Shekhterman, and 32% of base salary for Mr. Lhoëst.

³ For Mr. Shekhterman the expense recognized for the long-term incentive reward is composed of two elements: (i) accrual for the period 2016 with respect to the deferred payout under the first stage of the LTI programme, and (ii) an accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 March 2017, as described in the Remuneration Report on page 173. For Mr. Lhoëst the long-term incentive is composed of the deferred component of the cash incentive awarded for performance in the year 2014 under the Deferred Cash Incentive Plan.

⁴ Mr. DuCharme stepped down as CEO and member of the Management Board on 12 November 2015, to become Chairman of the Supervisory Board as per the same date. In accordance with a settlement agreement dated 21 September 2015 Mr. DuCharme was entitled to deferred parts of bonuses awarded in 2014 and 2015 under the Deferred Cash Incentive Plan (USD 1,540,773) and a discretionary transformation bonus approved by the Supervisory Board (USD 5,000,000).

⁵ Since 2013 members of the Management Board no longer participate in the Company's Restricted Stock Unit Plan. The share based compensation reflects the accrued amounts related to previous awards under the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

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

Name	Tranche	RSUs awarded in 2011	RSUs awarded in 2012	RSUs awarded in 2013	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016	Year of vesting	RSUs vested	Value on vesting date ¹	GDRs locked-up as per 31 Dec. 2016 ²	End of lock-up period	RSUs outstanding as per 31 Dec. 2016	RSUs outstanding as per 31 Dec. 2015
I. Shekhterman	4	-	-	-	7,384	-	-	2016	7,384	9	7,384	2018	-	7,384
	5	-	-	-	-	15,793	-	2017	-	-	-	2019	15,793	15,793
	6	-	-	-	-	-	11,396	2018	-	-	-	2020	11,396	-
F. Lhoëst	1	9,024	-	-	-	-	-	2013	9,024	5	-	2015	-	-
	2	-	13,645	-	-	-	-	2014	13,645	8	-	2016	-	-
	3	-	-	7,192	-	-	-	2015	7,192	7	4,068	2017	-	-

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

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

Supervisory Board

As described in the Corporate Governance Report on page 166, the composition of the Supervisory Board changed in 2016. At the Annual General Meeting of Shareholders in May, Dmitry Dorofeev stepped down, to be succeeded by Andrei Elinson.

The Annual General Meeting of Shareholders also approved the adjustment of the remuneration principles for the Supervisory Board so that Board members are entitled to additional compensation for time and expertise dedicated to specific strategic projects for X5, provided that such compensation (i) relates to work of a temporary, one-off nature, performed as an extension of the statutory non-executive duties of the relevant Board member and (ii) is approved in advance by the Supervisory Board, upon recommendation of the Nomination and Remuneration Committee, which will ensure, on a case-by-case basis, that any such engagement shall under no circumstance compromise the independence of the relevant Board member or the Board collectively.

Furthermore, with effect from May 2016, the Annual General Meeting of Shareholders approved the simplification of the award mechanism for Restricted Stock Units (RSUs) under the Restricted Stock Unit Plan while safeguarding the existing terms and conditions for vesting and lock-up under the Plan.

In accordance with the remuneration principles for the Supervisory Board, the non-independent Board members Mr. Fridman and Mr. Elinson are not remunerated by the Group.

In 2016 the remaining Supervisory Board members received remuneration in cash and an annual award of Restricted Stock Units (RSUs). In addition, Messrs. Couvreur, Musial and King received additional cash remuneration for time and expertise dedicated to specific strategic projects for X5, under the framework approved by the General Meeting of Shareholders.

Restricted Stock Units

In 2016 the Annual General Meeting of Shareholders approved that the Supervisory Board members Stephan DuCharme, Christian Couvreur, Pawel Musial, Geoff King, Peter Demchenkov and Mikhail Kuchment be awarded a number of RSUs with award date 19 May 2016, equal to 100% of the fixed remuneration in 2016 of the relevant Board member, divided by the average market value of one GDR as of 19 May 2016. Under the rules of the RSU Plan, the average market value is defined as the volume weighted average price of a GDR over the thirty calendar days immediately preceding 19 May 2016. The volume weighted average price is calculated using the closing price of a GDR taken from the Official List of the London Stock Exchange. The RSUs awarded under tranche 6 will vest on 19 May 2018, followed by a lock-in period ending on 19 May 2020. The RSUs awarded under tranche 7 will vest on 19 May 2019, followed by a lock-in period ending on 19 May 2021.

The number of RSUs awarded and outstanding to the members of the Supervisory Board is shown below. For the calculation of the intrinsic value and further details refer to Note 27.

Expenses recognized for remuneration of the members of the Supervisory Board:

	Base remuneration ¹		Additional remuneration ²		Share-based compensation ³	
	2016	2015	2016	2015	2016	2015
Current members:						
S. DuCharme (appointed 12 November 2015)	32	11	-	-	10	-
A. Elinson	-	-	-	-	-	-
M. Fridman	-	-	-	-	-	-
C. Couvreur	14	14	8	2	10	7
P. Musial	7	7	35	-	4	3
G. King (appointed 7 May 2015)	18	16	8	2	10	3
P. Demchenkov (appointed 7 May 2015)	7	7	-	-	4	1
M. Kuchment (appointed 12 November 2015)	7	3	-	-	2	-
Former members:						
D. Dorofeev (stepped down 10 May 2016)	-	-	-	-	-	-
D. Gould (stepped down 7 May 2015)	-	-	-	-	-	-
A. Tynkovan (stepped down 7 May 2015)	-	4	-	-	-	13
A. Malis (stepped down 7 May 2015)	-	2	-	-	-	(2)
I. Shekhterman (stepped down 12 November 2015)	-	9	-	-	-	6
TOTAL	85	73	51	4	40	31

¹ The annual membership allowance for independent Supervisory Board members is determined and paid in Euro, as follows: chairman EUR 250,000; members chairing a committee EUR 200,000; other members EUR 100,000. For former Board members and Board members appointed during the year, the pro-rata amounts are reflected. In accordance with the remuneration principles for the Supervisory Board, non-independent Board members Messrs. Dorofeev, Fridman, Gould and Elinson were not remunerated.

² Additional cash remuneration for time and expertise dedicated to key strategic projects in 2016.

³ The share-based compensation reflects the accrued amounts related to the Restricted Stock Unit Plan (see table below) and includes benefits resulting from the reduction in the value of the cash settled share-based payment compensation.

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

Name	Tranche	RSUs awarded in 2012	RSUs awarded in 2013	RSUs awarded in 2014	RSUs awarded in 2015	RSUs awarded in 2016 ¹	Year of vesting	RSUs vested	Value on vesting date ²	GDRs locked-up as per 31 Dec. 2016 ³	End of lock-up period	RSUs outstanding as per 31 Dec. 2016	RSUs outstanding as per 31 Dec. 2015
S. DuCharme ³	7	-	-	-	-	25,703	2019	-	-	-	2021	25,703	-
C. Couvreur	1	-	-	-	-	-	2013	7,219	4	-	2015	-	-
	2	7,939	-	-	-	-	2014	7,939	5	-	2016	-	-
	3	-	10,461	-	-	-	2015	10,461	11	6,904	2017	-	-
	4	-	-	14,768	-	-	2016	14,768	19	9,747	2018	-	14,768
	5	-	-	-	15,793	-	2017	-	-	-	2019	15,793	15,793
	6	-	-	-	-	11,396	2018	-	-	-	2020	11,396	-
	7	-	-	-	-	11,424	2019	-	-	-	2021	11,424	-
P. Musial	4	-	-	2,461	-	-	2016	2,461	3	2,461	2018	-	2,461
	5	-	-	-	7,897	-	2017	-	-	-	2019	7,897	7,897
	6	-	-	-	-	5,698	2018	-	-	-	2020	5,698	-
	7	-	-	-	-	5,712	2019	-	-	-	2021	5,712	-
G. King	6	-	-	-	-	13,250	2018	-	-	-	2020	13,250	-
	7	-	-	-	-	14,280	2019	-	-	-	2021	14,280	-
P. Demchenkov	6	-	-	-	-	5,698	2018	-	-	-	2020	5,698	-
	7	-	-	-	-	5,712	2019	-	-	-	2021	5,712	-
M. Kuchment	7	-	-	-	-	5,712	2019	-	-	-	2021	5,712	-

¹ In 2016 the RSUs awarded under tranche 7 were awarded in accordance with the amended award schedule, observing the 3 year vesting period prescribed by the RSU Plan.

² Vesting date is 19 May of each respective year of vesting.

³ Number of GDRs held during lock-up period equal the number of vested RSUs minus GDRs sold to cover taxes, if any.

Other key management personnel

Other key management personnel comprise certain members of the Executive Committee. In accordance with the Remuneration Policy, the total direct compensation of other key management personnel consists of a base salary, a short-term incentive and a long-term incentive.

Base salaries in 2016

Base salaries of members of the Executive Committee are determined in line with compensation levels in peer companies as set out in the remuneration policy.

Short-term Incentive

For 2016, the Supervisory Board had determined that 100% of the total on-target bonus opportunity for leaders of the formats would be based on achieving financial and quantitative group targets at both company and format level, with a profitability threshold as a condition for STI payout. For functional leaders 20% of the total on-target bonus opportunity depends on achieving financial group targets, while 80% depends on achieving personal targets; a profitability threshold is also a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100%. In terms of financial targets, average achievement levels exceeded the targets that had been set, including the net sales targets; EBITDA exceeded the target threshold. With regard to the individual performance

26 Staff costs

targets the cash incentive is approved by the Supervisory Board for each executive individually. For other key management personnel this results in an average 100% cash payout as a percentage of base salary.

Long-term incentive

As indicated above under "Management Board", the targets set for the deferred payout under the first stage of the LTI were achieved, as specific comparative performance indicators were met, with EBITDA exceeding the required threshold. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

Expenses recognized for remuneration of other key management personnel:

	Year	Base salary ¹	Short-term incentive ²	Long-term incentive ³	Exit payment	Social security cost	Total
Other key management	2016	155	141	650	31	144	1,121
personnel	2015	148	121	891	8	179	1,347

¹ Base salary remuneration reflects the increase in salary for some key management personnel, as well as fluctuation in base salary due to the number of days spent on vacation and business trips, in accordance with Russian labor law.

² Short-term incentive for performance in the year 2016 (2015) paid in cash in 2017 (2016).

³ The expense recognized for the long-term incentive rewards is composed of two elements: (i) accrual for the period 2016 with respect to the deferred payout under the first stage of the LTI programme, and (ii) an accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 March 2017, as described in the Remuneration Report on page 173. In 2015 and 2016 the long-term incentive includes deferred components of the cash incentives awarded for, respectively, the performance years 2013 and 2014 to participants under the Deferred Cash Incentive Plan.

27 Share-based payments

Restricted Stock Unit plan

Members of the Supervisory Board are entitled to annual awards of restricted stock units (RSUs) under the Company's Restricted Stock Unit Plan (RSU Plan) approved at the AGM in 2010. RSU awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

During the year ended 31 December 2016, a total number of 115,981 RSUs were awarded under tranches 6 and 7 of the RSU Plan, of which 47,438 RSUs awarded under tranche 6 will vest in 2018 and 68,543 RSUs awarded under tranche 7 will vest in 2019. In 2016, 25,843 RSUs awarded in 2014 under tranche 4 vested. Upon vesting these RSUs were converted into GDRs registered in the participant's name, and kept in custody during a two-year lock-in period during which the GDRs cannot be traded.

In total, during the year ended 31 December 2016 the Group recognised expense related to the RSU Plan in the amount of RUB 48 (expense during the year ended 31 December 2015: RUB 18). At 31 December 2016 the equity component was RUB 70 (31 December 2015: RUB 37). The fair value of services received in return for the conditional RSUs granted to employees is measured by reference to the market price of the GDRs which is determined at grant date.

Details of the conditional rights outstanding were as follows:

	2016		2015	
	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	123,123	765.23	235,425	659.61
Granted during the period	68,543	1,272.00	47,438	1,033.57
Vested during the period	(25,843)	577.63	(58,713)	606.52
Waived of previously vested	18,168	890.28	-	-
Forfeited during the period	(28,527)	785.35	(101,027)	737.34
Outstanding at the end of the period	155,464	1,030.77	123,123	765.23

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Income tax

	2016	2015
Current income tax charge	4,154	4,214
Deferred income tax charge/(benefit)	2,208	(458)
Income tax charge for the year	6,362	3,756

The theoretical and effective tax rates are reconciled as follows:

	2016	2015
Profit before taxation	28,653	17,930
Theoretical tax at the effective statutory rate *	5,731	3,586
Tax effect of items which are not deductible or assessable for taxation purposes:		
Effect of income taxable at rates different from standard statutory rates	(1,512)	(1,206)
Expenses on inventory shrinkage	2,082	1,479
Unrecognised tax loss carry forwards for the year	181	465
Deferred tax (income) arising from recovery of deferred tax assets written down in previous periods/ deferred tax expenses arising from the write-down of the deferred tax asset	(312)	(454)
Other non-deductible expense/(non-taxable income)	192	(114)
Income tax charge for the year	6,362	3,756

* Profit before taxation on Russian operations is assessed based on the statutory rate of 20%.

As at 31 December 2016 37 Russian subsidiaries of the Group were the members of the CGT (consolidated group of taxpayers) with Torgovy Dom PEREKRESTOK CJSC acting as a responsible CGT member.

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2016:

	31 Dec. 2015	Credited/ (debited) to profit and loss	Deferred tax on business combinations (Note 7)	31 Dec. 2016
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	4,661	183	-	4,844
Property, plant and equipment and Investment property	637	(43)	28	622
Other intangible assets	18	(596)	599	21
Inventories	2,394	(790)	-	1,604
Accounts receivable	193	33	17	243
Accounts payable	5,145	(66)	27	5,106
Other	190	(17)	-	173
Gross deferred tax asset	13,238	(1,296)	671	12,613
Less offsetting with deferred tax liabilities	(7,821)	538	(24)	(7,307)
Recognised deferred tax asset	5,417	(758)	647	5,306
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(6,730)	(2,197)	(6)	(8,933)
Other intangible assets	(2,178)	669	(12)	(1,521)
Accounts receivable	(3,629)	818	(100)	(2,911)
Accounts payable	(45)	43	-	(2)
Other	(200)	(245)	-	(445)
Gross deferred tax liability	(12,782)	(912)	(118)	(13,812)
Less offsetting with deferred tax assets	7,821	(538)	24	7,307
Recognised deferred tax liability	(4,961)	(1,450)	(94)	(6,505)

28 Income tax

Deferred income tax

Deferred tax assets and liabilities and the deferred tax charge in the consolidated statement of profit or loss were attributable to the following items for the year ended 31 December 2015:

	31 Dec. 2014	Credited/ (debited) to profit and loss	Deferred tax on business combinations	31 Dec. 2015
Tax effects of deductible temporary differences and tax loss carry forwards				
Tax losses available for carry forward	3,589	1,050	22	4,661
Property, plant and equipment and Investment property	205	141	291	637
Other intangible assets	5	(152)	165	18
Inventories	2,476	(82)	-	2,394
Accounts receivable	128	(41)	106	193
Accounts payable	3,514	1,501	130	5,145
Other	221	(39)	8	190
Gross deferred tax asset	10,138	2,378	722	13,238
Less offsetting with deferred tax liabilities	(6,570)	(1,079)	(172)	(7,821)
Recognised deferred tax asset	3,568	1,299	550	5,417
Tax effects of taxable temporary differences				
Property, plant and equipment and Investment property	(5,558)	(892)	(280)	(6,730)
Other Intangible assets	(2,253)	163	(88)	(2,178)
Accounts receivable	(2,464)	(1,165)	-	(3,629)
Accounts payable	(1)	(44)	-	(45)
Other	(218)	18	-	(200)
Gross deferred tax liability	(10,494)	(1,920)	(368)	(12,782)
Less offsetting with deferred tax assets	6,570	1,079	172	7,821
Recognised deferred tax liability	(3,924)	(841)	(196)	(4,961)

Temporary differences on unremitted earnings of certain subsidiaries amounted to RUB 35,929 (2015: RUB 26,294) for which the deferred tax liability was not recognised as such amounts are being reinvested for the foreseeable future.

The current portion of the gross deferred tax liability amounted to RUB 4,170 (31 December 2015: RUB 4,204), the current portion of the gross deferred tax asset amounted to RUB 7,269 (31 December 2015: RUB 7,243).

Management believes that the future taxable profits in tax jurisdictions that suffered a loss in the current or preceding years will be available to utilise the deferred tax asset of RUB 4,844 recognised at 31 December 2016 for the carry forward of unused tax losses (31 December 2015: RUB 4,661).

The Group estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of RUB 2,759 (2015: RUB 2,613).

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

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Financial risk management

Financial risk management is a part of integrated risk management and internal control framework described in "Corporate Governance" section of this Annual Report. The primary objectives of the financial risk management are to establish risk limits, and then ensure that exposure to risks stays within these limits.

Financial risk management is carried out by Corporate Finance Department. Corporate Finance Department monitors and measures financial risks and undertakes steps to limit their influence on the Group's performance.

(a) Market risk

Currency risk

The Group is exposed to foreign exchange risk arising from foreign currency denominated assets and liabilities with respect to import purchases. As at 31 December 2016 the Group had trade accounts payable denominated in foreign currency in the amount of RUB 2,409 (31 December 2015: RUB 1,731). As at 31 December 2016 the Group did not have any other significant assets and liabilities denominated in foreign currency and the exposure for the Group was estimated as not significant.

Interest rates risk

As at 31 December 2016 the Group had no significant floating interest-bearing assets and liabilities, the Group's income, expenses and operating cash inflows and outflows were substantially independent of changes in market interest rates.

(b) Credit risk

Financial assets, which are potentially subject to credit risk, consisted principally of cash and cash equivalents held in banks, trade and other receivables (Note 9 and Note 16). Due to the nature of its main activities (retail sales to individual customers) the Group had no significant concentration of credit risk. Cash was placed in financial institutions which were considered at the time of deposit to have 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 was 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 were continually monitored and no individual exposure was considered significant.

(c) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Liquidity risk is managed by the Group Treasury.

The Group finances its operations by a combination of cash flows from operating activities and long and short-term debt. The objective is to ensure continuity of funding on the best available market terms. The policy is to keep the Group's credit portfolio diversified structure, continue to improve the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn available bank facilities, and a strong credit rating so that maturing debt may be refinanced as it falls due.

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities as at the reporting date at spot foreign exchange rates:

29 Financial risk management

Year ended 31 December 2016

	During 1 year	In 1 to 3 years
Borrowings	58,621	123,058
Trade payables	131,180	-
Other finance liabilities	39,744	1,472
Total	229,545	124,530

Year ended 31 December 2015

	During 1 year	In 1 to 4 years
Borrowings	58,041	114,225
Trade payables	103,773	-
Other finance liabilities	29,451	-
Total	191,265	114,225

At 31 December 2016 the Group had net current liabilities of RUB 97,294 (31 December 2015: RUB 82,175) including short-term borrowings of RUB 45,168 (31 December 2015: RUB 42,670). At 31 December 2016 the Group had available bank credit lines of RUB 280,808 (31 December 2015: RUB 140,176). At 31 December 2016 the Group had RUB bonds available for issue on MICEX of RUB 35,000 (31 December 2015: RUB 15,000).

Management regularly monitors the Group's operating cash flows and available credit lines to ensure that these are adequate to meet the Group's ongoing obligations and its expansion programmes. Part of the short term liquidity risk is seasonal, with the highest peak in 1st quarter and strong cash generation in 4th quarter, therefore the Group negotiates the maturity of credit lines for the 4th quarter, when the future cash flow allows for the repayment of debts. Part of the existing lines in the local currency (RUB) are provided on rolling basis which is closely monitored by detailed cash flow forecasts and are managed by the Group Treasury.

The Group's capital expenditure programme is highly discretionary. The Group optimises its cash outflows by managing the speed of execution of current capex projects and by delaying future capital extensive programmes, if required.

The Group is carefully monitoring its liquidity profile by optimizing the cost of funding and the drawdown periods within revolving credit facilities as well as extending existing credit facilities or obtaining new credit lines. The Group manages liquidity requirements by the use of both short-term and long-term projections and maintaining the availability of funding. Based on the review of the current liquidity position of the Group management considers that the available credit lines and expected cash flows are more than sufficient to finance the Group's current operations.

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Operating environment of the Group

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 2016 the Russian economy was negatively impacted by low oil prices, ongoing political tension in the region and continuing international sanctions against certain Russian companies and individuals, all of which contributed to the country's economic recession characterised by a decline in gross domestic product. The financial markets continue to be volatile and are characterised by frequent significant price movements and increased trading spreads. Russia's credit rating was downgraded to below investment grade. This operating environment has a significant impact on the Group's operations and financial position. Management is taking necessary measures to ensure sustainability of the Group's operations. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

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.

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Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages total equity attributable to equity holders recognised under IFRS requirements. The Group is in compliance with externally imposed capital requirements.

In accordance with loan facilities the Group maintains an optimal capital structure by tracking certain requirements: the maximum level of Net Debt/EBITDA (4.00/4.25 after acquisition). Net debt is calculated as the sum of short-term and long-term borrowings less cash and cash equivalents. Reconciliation of EBITDA to operating profit is performed in Note 5. This ratio is included as covenants into loan agreements (Note 19). At 31 December 2016 the Group complied with the requirements under the loan facilities.

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Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value.

Financial assets carried at amortised cost

The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty.

The carrying amount of cash and cash equivalents and trade and other financial receivables approximates their fair value.

Liabilities carried at amortised cost

The fair value of bonds is based on quoted market prices. Fair values of other liabilities are determined using valuation techniques.

The fair value of bonds traded on the MICEX is determined based on active market quotations and amounted to RUB 35,331 at 31 December 2016 (31 December 2015: RUB 22,856). The measurement is classified in level 1 of the fair value hierarchy. The carrying value of these bonds amounted to RUB 34,969 at 31 December 2016 (31 December 2015: RUB 22,987) (Note 19). The fair value of long-term borrowings amounted to RUB 81,919 at 31 December 2016 (31 December 2015: RUB 98,018). The measurement is classified in level 3 of the fair value hierarchy and is determined based on expected cash flows discounted using interest rate of similar instruments available on the market. The sensitivity analysis shows that the increase/decrease of the effective interest rate by 10% leads to the decrease/increase of fair value of long-term borrowings by RUB 1,292 at 31 December 2016. The fair value of short-term borrowings was not materially different from their carrying amounts.

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Commitments and contingencies

Commitments under operating leases

At 31 December 2016, the Group operated 7,380 stores through rented premises (31 December 2015: 5,270 stores). There are two types of fees in respect of operating leases payable by the Group: fixed and variable (contingent rent). For each store fixed rent payments are defined in the lease contracts. The variable part of rent payments is predominantly denominated in RUB and normally calculated as a percentage of 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 28,904 (net of VAT) (31 December 2015: RUB 26,211).

Capital expenditure commitments

At 31 December 2016 the Group contracted for capital expenditure for the acquisition of property, plant and equipment of RUB 10,987 (net of VAT) (31 December 2015: RUB 7,271).

Law regulating the trade of the food products

In 2016 there were amendments in the law regulating the trade of the food products in the Russian Federation ("trade law"). These amendments established certain strict limitations on volume of back margin received from suppliers. At the same time these amendments also established stricter limitations on payments terms to suppliers.

The amendments are effective starting 15 July 2016 for newly concluded contracts and starting 1 January 2017 for the existed contracts and are obligatory for all market participants. The Group may be charged with the fine of from 1 mln RUB to 5 mln RUB for each violation in case of failure or improper application of the provisions of this law. Currently the official position of government authorities is continually being reconsidered.

The Group has performed all required procedures in order to amend existing and new contracts in compliance with the new provisions of the law by 1 January 2017 as well as the Group periodically evaluates its obligations under these regulations. As obligations are determined to be probable, they are recognized immediately as liabilities. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant probable liabilities related to compliance with the trade law.

Legal contingencies

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time. Management believes that there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued at 31 December 2016.

33 Commitments and contingencies

Taxation environment

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of these legislative areas as applied to the transactions and activities of the Group may be challenged by the relevant regional and federal authorities. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian authorities decide to issue a claim and prove successful in court, they would be entitled to recover the tax amount claimed, together with fines amounting to 20% of such amount and late payment interest at the rate of 1/300 of the rate of the Central Bank of the Russian Federation (CBRF rate) for each day of the delay during the first 30 days, 1/150 of CBRF rate for each day of the delay if the latter is for more than 30 days to be calculated from the amount of underpaid tax. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Russia has transfer pricing rules generally aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD). The transfer pricing legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of controlled transactions (transactions with related parties and some types of transactions with unrelated parties), provided that the transaction price is not arm's length. Given that the concept of the Russian transfer pricing rules is rather new and the practice is 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 is not expected to be significant 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. Management believes that its pricing policy is arm's length and it has implemented internal controls to be in compliance with the transfer pricing legislation.

Starting 2015 the "de-offshorisation law" came into force introducing the following rules and concepts which may have an impact on the Group's operations:

The concept of beneficial ownership

The possibility to apply the reduced tax rates to the income paid to foreign companies of the Group allowed under double tax treaties (DTTs) will depend on whether the company receiving such income is its beneficial owner. When determining the beneficial owner status of a foreign company the functions it performs and the risks it undertakes should be tested. It will be also considered whether such income was transferred (fully or in part) to another company. Given that the concept of beneficial ownership is rather new and the practice is not yet developed, the impact of any challenge of application of the reduced tax rates to the income paid to foreign Group companies cannot be reliably estimated, however, it may be significant to the financial conditions and/or the overall operations of the Group.

Management believes that the Group's foreign companies receiving income from Russia are beneficial owners of that income and the reduced tax rates are correctly applied in accordance with the relevant DTTs.

Broader rules for determining the tax residency of legal entities

Starting 2015, more specific and detailed rules were put in place establishing when foreign entities can be viewed as managed from Russia and consequently can be deemed Russian tax residents. Russian tax residency means that such legal entities' worldwide income will be taxed in Russia. The Group comprises companies incorporated outside of Russia. The

tax liabilities of the Group were determined on the assumption that these companies were not subject to Russian profits tax, because they did not have a permanent establishment in Russia and were not Russian tax residents by way of application of the new tax residency rules. This interpretation of relevant legislation in regard to the Group companies incorporated outside of Russia may be challenged. Given that the concept of the Russian broader rules for determining the tax residency of legal entities is rather new and the practice is not yet developed, the impact of any such challenge cannot be reliably estimated currently; however, it may be significant to the financial position and/or the overall operations of the Group.

Tax contingencies, commitments and risks

Russian tax legislation does not provide definitive guidance in many areas. 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 past may be challenged as not having been in compliance with Russian tax laws applicable at the relevant time. In particular, the Supreme Court issued guidance to lower courts on reviewing tax cases providing a systematic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed.

From time to time, the Group adopts interpretations of such uncertain areas that reduce the overall tax rate of the Group. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices; the impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial condition and operations of the entity.

Management regularly reviews the Group's taxation compliance with applicable legislation, laws and decrees and current interpretations published by the authorities in the jurisdictions in which the Group has operations. Furthermore, management regularly assesses the potential financial exposure relating to tax contingencies for which the three years tax inspection right has expired but which, under certain circumstances, may be challenged by the regulatory bodies. From time to time potential exposures and contingencies are identified and at any point in time a number of open matters may exist.

Management estimates that possible exposure in relation to the aforementioned risks, as well as other profits tax and non-profits tax risks (e.g. imposition of additional VAT liabilities), that are more than remote, but for which no liability is required to be recognised 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.

In 2016 the Group released provisions and liabilities for tax uncertainties attributable to profit tax and non-profits tax risks in amount of RUB 3,242 including net release of non-income tax provision of RUB 1,732, income tax provision of RUB 522 with simultaneous release of respective indemnification asset of RUB 988. In 2016 indemnification asset of RUB 91 was impaired.

In 2015 the Group released provisions and liabilities for tax uncertainties attributable to profit and non-profits tax risks in amount of RUB 1,783 including non-income tax net release of RUB 196, income tax net release of RUB 990 and net release of RUB 597 indemnified by previous shareholders of acquired companies.

33 Commitments and contingencies

At the same time management has recorded liabilities for income taxes in the amount of RUB 399 (31 December 2015: RUB 1,348) and provisions for taxes other than income taxes in the amount of RUB 499 at 31 December 2016 (31 December 2015: RUB 2,392) in these consolidated financial statements as their best estimate of the Group's liability related to tax uncertainties as follows:

BALANCE AT 1 JANUARY 2015	2,595
Increases due to acquisitions during the year recorded as part of the purchase price allocation	2,791
Release of provision	(4,058)
Accrual of provision	2,275
Offset of provision	137
BALANCE AT 31 DECEMBER 2015	3,740
Release of provision	(3,772)
Accrual of provision	530
Offset of provision	400
BALANCE AT 31 DECEMBER 2016	898

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Subsequent events for the Group

There were no significant events after the reporting date.

Company financial statements

X5 Retail Group N.V.

31 December 2016

X5 RETAIL GROUP N.V.

Company Statement of Financial Position at 31 December 2016 Before appropriation of profit

Expressed in millions of Russian Roubles, unless otherwise stated

	Note	31 Dec. 2016	31 Dec. 2015
Assets			
Non-current assets			
Financial fixed assets	36	145,462	111,233
		145,462	111,233
Current assets			
Financial assets	36	1	11,188
Amounts due from subsidiaries		6,047	793
Prepaid expenses		2	4
Other receivables		75	98
		6,125	12,083
TOTAL ASSETS		151,587	123,316
Equity and liabilities			
Paid up and called up share capital	37	4,332	5,410
Share premium account	37	46,251	46,253
Share-based payment reserve	39	70	37
Other reserves		54,096	38,844
Result for the year		22,291	14,174
Total equity		127,040	104,718
Non-current liabilities			
Loan from group company	38	17,036	-
		17,036	-
Current liabilities			
Loan from group company	38	-	17,242
Amounts due to group companies		7,451	1,286
Accrued expenses and other liabilities		43	48
VAT and other taxes payable		17	22
		7,511	18,598
		24,547	18,598
TOTAL EQUITY AND LIABILITIES		151,587	123,316

X5 RETAIL GROUP N.V.

Company Statement of Profit or Loss for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

	Note	2016	2015
General and administrative expenses	40	(298)	(302)
Other income (expenses)		(254)	(75)
Operating loss		(552)	(377)
Finance costs		(1,705)	(2,557)
Finance income		1,517	1,967
Net foreign exchange gain/(loss)		234	(162)
Loss before tax		(506)	(1,129)
Income tax	41	-	-
Income on participating interest after tax		22,797	15,303
Profit for the period		22,291	14,174

The accompanying notes are the integral part of these company financial statements.

X5 RETAIL GROUP N.V.

Notes to the Company Financial Statements for the year ended 31 December 2016

Expressed in millions of Russian Roubles, unless otherwise stated

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Accounting principles

General

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

Basis of presentation

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

Accounting principles

Unless stated otherwise below, the accounting principles applied for the Company accounts are similar to those used in the IFRS Consolidated Financial Statements (refer to Note 2.1 to the Consolidated Financial Statements). The consolidated accounts of companies publicly listed in the European Union must be prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and adopted by the European Commission.

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

Investments in group companies

Investments in group companies are entities (including intermediate subsidiaries and special purpose entities) over which the Company has control, because the Company (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns. Group companies are recognised from the date on which control is transferred to the Company or its intermediate holding entities. They are derecognised from the date that control ceases.

The Company applies the acquisition method to account for acquiring group companies, consistent with the approach identified in the consolidated financial statements. Investments in group companies are presented in accordance with the net asset value method. When an acquisition of an investment in a group company is achieved in stages, any previously held equity interest is remeasured to fair value on the date of acquisition. The measurement against the book value is accounted for in the statement of profit and loss.

When the Company ceases to have control over a group company, any retained interest is remeasured to its fair value, with the change in carrying amount to be accounted for in the statement of profit or loss. When parts of investments in group companies are bought or sold, and such transaction does not result in the loss of control, the difference between the consideration paid or received and the carrying amount of the net assets acquired or sold, is directly recognised in equity.

When the Company's share of losses in an investment in a group company equals or exceeds its interest in the investment (including separately presented goodwill or any other unsecured non-current receivables being part of the net investment), the Company does not recognise any further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the investment. In such case the Company will recognise a provision.

Amounts due from group companies

Amounts due from group companies are stated initially at fair value and subsequently at amortised cost. Amortised cost is determined using the effective interest rate.

Shareholders' Equity

Issued and paid up share capital, which is denominated in Euro, is restated into Russian Rouble ("RUB") at the official exchange rate of the Central Bank of the Russian Federation as at reporting date in accordance with section 373 sub 5 of book 2 of the Dutch Civil Code. The difference is settled in the other reserves.

Financial fixed assets

	31 Dec. 2016	31 Dec. 2015
a. Movements in the interests in group companies have been as follows:		
Opening balance	111,227	94,778
Acquisitions/capital contribution	4,126	1,162
Divestment of group companies/ capital repayments	-	(16)
Profit from group companies for the year	22,797	15,303
Closing balance	138,150	111,227
A complete list of group companies has been disclosed in the consolidated financial statements (refer to Note 6 of the consolidated financial statements).		
b. Movements in the loans to group companies have been as follows:		
Opening balance	11,194	11,035
Settlement/repayment	(8,638)	(111)
Additions	4,761	269
Foreign exchange differences	(4)	1
Closing balance	7,313	11,194
Non-current financial assets	145,462	111,233
Current financial assets	1	11,188
TOTAL FINANCIAL FIXED ASSETS	145,463	122,421

31 December 2016

Borrowing group company	Loan currency	Carrying value	Interest rate, % p.a.	Maturity date
GSWL Finance Ltd	RUB	4,598	Mosprime1m + 3.6%	December 2021
GSWL Finance Ltd.	RUB	2,569	11%	December 2022
Perekrestok Holdings Ltd.	USD	140	11%	December 2022
X5 Capital S.A.R.L	EUR	5	4.5%	December 2018
X5 Capital S.A.R.L	EUR	1	4%	December 2017
Total loans to group companies		7,313		

31 December 2015

Borrowing group company	Loan currency	Carrying value	Interest rate, % p.a.	Maturity Date
GSWL Finance Ltd	RUB	2,557	Mosprime1m + 3.6% (Libor1m + Mosprime1m)*	August 2016
Perekrestok Holdings Ltd.	RUB	8,631	½ +4.5%	December 2016
X5 Capital S.A.R.L	EUR	6	4%-4.5%	December 2017
Total loans to group companies		11,194		

The total amount of the loans provided to group companies was RUB 7,313 (2015: RUB 11,194) and it approximated the fair value. The loans have not been secured.

Shareholders' equity

	Share capital ¹	Share premium	Other reserves	Profit/(loss)	Share-based payment (equity)	Total
BALANCE AS AT 1 JANUARY 2015	4,638	46,218	26,917	12,691	94	90,558
Share-based payment compensation (Note 27)	-	-	-	-	(21)	(21)
Transfer	-	-	12,691	(12,691)	-	-
Currency translation	771	-	(771)	-	-	-
Transfer of vested equity rights	1	35	-	-	(36)	-
Result for the period	-	-	-	14,174	-	14,174
Disposed available-for-sale investments	-	-	7	-	-	7
BALANCE AS AT 1 JANUARY 2016	5,410	46,253	38,844	14,174	37	104,718
Share-based payment compensation (Note 27)	-	-	-	-	31	31
Transfer	-	-	14,174	(14,174)	-	-
Currency translation	(1,078)	-	1,078	-	-	-
Transfer of vested equity rights	-	(2)	-	-	2	-
Result for the period	-	-	-	22,291	-	22,291
BALANCE AS AT 31 DECEMBER 2016	4,332	46,251	54,096	22,291	70	127,040

¹ Share capital translated at the year end exchange rate EUR/RUB of 63.8111 (2015: 79.6972).

37 Shareholders' equity

Share capital issued

As at 31 December 2016 the Group had 190,000,000 authorised ordinary shares (31 December 2015: 190,000,000) of which 67,884,340 ordinary shares were outstanding (31 December 2015: 67,882,421) and 8,878 ordinary shares held as treasury stock (31 December 2015: 10,797). The nominal par value of each ordinary share is EUR 1.

The acquisition price of the shares purchased was charged against other reserves. Other reserves as at 31 December 2016 included RUB Nil (2015: RUB Nil) translation reserve.

No dividends were paid or declared during the years ended 31 December 2016 and 2015.

Statutory profit appropriation

Supervisory Board propose to General Meeting to recapitalise full amount of the profits earned for the year.

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Loan from group company

	Loan currency	31 Dec. 2016	Interest rate, % p.a.	Final maturity date
Torgovy Dom PEREKRESTOK CJSC	RUB	15,629	10%	December 2020
Torgovy Dom PEREKRESTOK CJSC	USD	1,300	10%	December 2020
Torgovy Dom PEREKRESTOK CJSC	EUR	107	10%	December 2020
Total		17,036		

	Loan currency	31 Dec. 2015	Interest rate, % p.a.	Final maturity date
Torgovy Dom PEREKRESTOK CJSC	RUB	15,629	10%	April 2016
Torgovy Dom PEREKRESTOK CJSC	USD	1,566	10%	April 2016
Torgovy Dom PEREKRESTOK CJSC	EUR	47	10%	April 2016
Total		17,242		

The loan payable to Torgovy Dom PEREKRESTOK CJSC denominated in RUB/USD/EUR. RUB facility amounted to 15,629 (2015: RUB 15,629), USD 21.4 million (2015: USD 21.5 million) and EUR 1.7 million (2015: EUR 0.6 million).

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Share-based payments

X5 Retail Group N.V. operates both cash and equity settled share based compensation plans in the form of its Restricted Stock Unit Plan.

The Restricted Stock Unit Plan consists of performance based awards and awards subject to the employment condition only. For employees of the Company an expense is recorded in the profit and loss account.

The receivable or expense is accounted for at the fair value determined in accordance with the policy on share-based payments as included in the consolidated financial statements, including the related liability for cash settled plans or as equity increase for equity settled plans (Note 27).

The following is included in the entity's accounts for the Restricted Stock Unit Plan:

	2016	2015
Equity share-based payment reserve as at 31 December	70	37
Expenses for the year ended 31 December	48	18

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Selling, general and administrative expenses

	2016	2015
Other expenses	248	257
Audit expenses	12	10
RSU + LTI programme	38	35
Total	298	302

In accordance with the Dutch legislation article 2:382a the total audit fees related to the accounting organisation Ernst & Young Accountants LLP amounted to RUB 12 (the total audit fees related to the accounting organisation PricewaterhouseCoopers Accountants N.V. in 2015: RUB 10).

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Income tax expense

	2016	2015
Operating loss before tax	(506)	(1,129)
Income on participating interest after tax	22,797	15,303
Current income tax	-	-
Deferred income tax	-	-
Effective tax rate	0%	0%
Applicable tax rate	25.0%	25.0%

No deferred tax asset has been recognised due to uncertainty of future taxable income to offset the current tax losses.

The Company estimated unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of RUB 675 (2015: RUB 565). Unused tax losses are available for carry forward for a period not less than six years (for 2015: seven years).

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Staff numbers and employment costs

Other than Management and Supervisory Board the Company has 2 employees in the Netherlands, incurred wages, salaries and related social security charges comprise RUB 1,4 (2015: RUB 1,8).

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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 Company had the following guarantees issued under obligations of its group companies:

	31 Dec. 2016	31 Dec. 2015
Irrevocable offer to holders of X5 Finance LLC bonds	35,000	23,000
Suretyship for Agrotorg LLC	-	11,000
Suretyship for Torgovy Dom PEREKRESTOK CJSC	23,500	67,500

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Related party transactions

Refer to Note 8 of the consolidated financial statements; all group companies are also considered related parties.

Statutory director's compensation

The Company has a Management Board and a Supervisory Board. The total remuneration of all board members as well as key management is disclosed in Note 26 and Note 27 of the consolidated financial statements.

Loans to group companies

For loans issued to and interest income from the group companies refer to Note 36.

Loan from group company

For loan received from and interest expenses to the group company refer to Note 38.

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Subsequent events for the Company

In February 2017 the Company provided suretyship for Torgovy Dom PEREKRESTOK CJSC in the amount of 45,400.

Amsterdam, 24 March 2017

Management Board:

Frank Lhoëst
Igor Shekhterman

Supervisory Board:

Stephan DuCharme
Mikhail Fridman
Andrei Elinson
Christian Couvreur
Pawel Musial
Geoff King
Peter Demchenkov
Mikhail Kuchment

Other information

Auditor's report

The auditor's report is included on page 250.

Statutory profit appropriation

In Article 28 of the Company's statutory regulations the following has been stated concerning the appropriation of result:

On proposal of the Supervisory Board, the General Meeting shall determine which part of the profits earned in a financial year shall be added to the reserves and the allocation of the remaining profits.

Subsequent events

For subsequent events, please refer to note 45 of the financial statements.

Independent auditor's report

To: The General Meeting
and Supervisory Board
of X5 Retail Group N.V.



Report on the audit of the financial statements 2016

Our opinion

We have audited the financial statements 2016 of X5 Retail Group N.V., based in Amsterdam, the Netherlands. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

- > the accompanying consolidated financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2016, and of its result and its cash flows for 2016 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- > the accompanying company financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2016, and of its result for 2016 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

- > the consolidated statement of financial position as at 31 December 2016;
- > the following statements for 2016: the consolidated statement of profit or loss, the consolidated statements of comprehensive income, cash flows and changes in equity;
- > the notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

- > the company statement of financial position as at 31 December 2016;
- > the company statement of profit or loss for 2016;
- > the notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of X5 Retail Group N.V. in accordance with the Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore we have complied with the Verordening gedrags- en beroepsregels accountants (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Materiality

Materiality RUB 1.9 billion

Benchmark applied 2.5% of EBITDA

Explanation We have applied this benchmark, a generally accepted auditing practice, based on our analysis of the stakeholders' needs and main KPI's set for management. On this basis we believe that EBITDA is an important metric for the financial performance of the Group.

We have also taken misstatements into account and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of RUB 90 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

X5 Retail Group N.V. is established in the Netherlands and is head of a group of subsidiaries operating food retail stores in Russia ("the Group"). The financial information of all these entities is included in the consolidated financial statements of X5 Retail Group N.V.

We are responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out. The Group accounting function is centralized in Moscow and Nizhny Novgorod and the Group is primarily managed as a single operating unit with multiple operating segments. We have used the work of EY Moscow to perform full-scope audit procedures to obtain sufficient coverage for financial statement line items from a consolidated financial statement perspective. We executed a program of regular communication that has been designed to ensure that the audit progress and findings were discussed between us and the audit team of EY Moscow. We have visited EY Moscow during planning and execution phases, as well as held meetings with Company's management, internal audit and finance and reporting representatives.

By performing the procedures mentioned above, we have been able to obtain sufficient and appropriate audit evidence of the Group's financial information to provide an opinion on the consolidated financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Risk

Our audit approach

Impairment of goodwill

Note 12 to the financial statements

As a result of past acquisitions, the Group carries capitalized goodwill with a value of RUB 80 billion as at 31 December 2016. In accordance with the requirements of IAS 36 Impairment of Assets, management performs an impairment assessment on an annual basis.

The Group identifies separate operating segments for each of its retail formats. The goodwill impairment assessment is performed at the level of the operating segments.

The impairment assessment includes the assessment of the recoverable amount based on expected cash flows. These cash flows are based on current budgets and forecasts approved by management and are extrapolated for subsequent years based on consumer price index.

Key assumptions used are revenue growth, projected EBITDA margin and the discount rate.

We consider this to be a key audit matter as the goodwill amount is significant and the current economic environment in Russia specifically requires management to exercise judgment in performing the impairment assessment.

We obtained an in-depth understanding of the Group's methodology used for performing the goodwill impairment test and ensured it is in accordance with EU-IFRS. We challenged management's key assumptions used in the goodwill impairment test and compared the assumptions used with industry trends and forecasts developed by independent analysts. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias.

Regarding the key assumptions used and methodology applied, we involved internal valuation experts, who compared assumptions used in the model with observable market data and verified the methodology applied is compliant with EU-IFRS.

We tested mathematical accuracy of the impairment testing model, reconciled internal inputs in the model with audited accounting records and ensured consistency of data used for goodwill impairment testing with other information obtained during the audit.

Risk

Impairment of stores and other non-current assets

Notes 10, 11 and 13 to the financial statements

The Group operates more than 9,000 retail stores in Russia. The associated valuation of stores and other non-current assets, such as property, equipment and intangible assets, approximated RUB 241 billion as at 31 December 2016 and is considered a key audit matter due to the magnitude of the carrying value as well as the judgment involved in assessing the recoverability of the invested amounts.

Management assesses annually the existence of triggering events for potential impairment of assets, or reversals thereof, related to underperforming stores. For the impairment assessment that is performed in accordance with Group policies and procedures, management first determines the value in use for each store and compares this to the carrying value. Where the carrying value is higher than the value in use, the fair value less cost of disposal is determined.

The judgment involved focuses predominantly on the discount rate and future store performance, which is, among others, dependent on the expected revenue and the local competition. The expected revenue is determined based on strategic growth plan prepared with reference to macroeconomic forecasts. Management assesses the impairment and impairment reversal on an annual basis using an internal calculation model.

Judgment is also involved in determination of the fair value of property undertaken on the basis of internal and external property valuation reports.

We consider this to be a key audit matter as total amount of other non-current assets, such as property, equipment and intangible assets, is significant. Furthermore, the uncertain economic environment in Russia impacts the level of judgment exercised by management in performing the impairment assessment.

Our audit approach

Among other audit procedures, we assessed appropriateness of the Group's policies and procedures to identify triggering events for potential (reversal of) impairment of assets related to underperforming stores.

We challenged management's key assumptions used in the cash flow forecast such as revenue growth and corroborated these assumptions through comparison to management's internal forecasts, external data and historical performance. We assessed accuracy of management's forecasts used in prior year to identify potential bias.

We involved our internal valuation experts to evaluate the methodology, inputs and assumptions used in the model for consistency with general practice and market observable data.

The audit of the model also included verification that the impairment methodology is consistently applied and that the model is mathematically accurate.

We involved our internal real estate valuation experts to assess the (market) property valuations performed by the Group. We also assessed objectivity and competency of external appraisers engaged by the Group.

Risk

Recognition of vendor allowances

Note 2.27 to the financial statements

The Group receives various types of vendor allowances such as rebates and service fees. Rebates largely depend on volumes of products purchased and service fees are received for promotional activities that the Group undertakes with respect to certain products. These allowances represent a significant component of cost of sales and are recognized as a reduction of the inventory cost value. While the majority of the allowances are settled during the financial year, a substantial amount remains outstanding at each year-end and is recognized as part of trade receivables.

We consider this to be a key audit matter because allowances are individually different, can be complex and recognition of vendor allowance income and receivables requires a certain level of judgment by management, for example, timing of delivery of the service and evidence thereof.

Moreover, the allocation of the allowances to inventory cost value also has an element of judgment.

The Group evaluates all required disclosures for vendor allowances and determines that they are appropriately included in the financial statements.

Our audit approach

Our procedures included testing of internal controls related to occurrence, completeness and measurement of the allowances recognized in the accounting system and covered both, IT application and manual controls, including controls related to periodic reconciliations with vendors.

We selected a sample of vendors and obtained direct confirmations from vendors of their settlements with the Group.

We tested on a sample basis documents supporting journal entries regarding the recognition of vendor rebates and services fees.

In addition, we performed margin analysis and we reviewed subsequent collections on prior period vendor allowance receivables and subsequent collections of the vendor allowances receivable in the current year.

We verified that the policy for the reduction of inventory cost related to vendor allowances is appropriate and has been applied correctly.

Risk

Our audit approach

Depreciation of buildings

Note 2.6 to the financial statements

The Group's buildings category of property, plant and equipment includes own real estate objects and improvements of leased ones. In 2016 the Group revised the useful lives for certain parts of buildings. Buildings were categorized into foundation and frame, with a depreciation period of 40-50 years and other assets with a depreciation period of 7-8 years. The Group has evaluated the impact of retrospective application of this approach on the prior period consolidated financial statements noting it would not result in a material change.

We consider this to be a key audit matter because the carrying amount of buildings is significant and determination of appropriate components and their useful lives requires management to exercise significant judgment.

We analysed composition of the Group's buildings category of property, plant and equipment and challenged reasonableness of the revised approach for depreciation of buildings (foundation and frame) and buildings (other parts) as well as revised useful lives assigned.

We involved our internal real estate experts to evaluate reasonableness of the Group's revised useful lives for buildings (foundation and frame). For buildings (other parts) component we compared assigned revised useful lives with historical pattern of their replacement.

We also tested mathematical accuracy of application of the revised approach for depreciation of buildings (foundation and frame) and buildings (other parts) components.

Risk

Our audit approach

Long-term incentive programme (LTI)

Note 26 to the financial statements

The Group has a long term incentive plan in place. The long-term incentive programme (LTI) is a programme in several stages which runs until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management. The targets represent the Group's long-term ambitions, with a specific focus on revenue and market share growth relative to the competition, without sacrificing EBITDA margin.

The total available fund for all pay-outs under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. Each stage of the programme includes a deferred component of conditional pay-outs in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI pay-out may be adjusted downwards based on individual performance during the period of the programme.

We consider this to be a key audit matter due to significant judgment involved in determination of appropriate accounting policies and estimates used in LTI calculations.

We obtained an in-depth understanding of the Group's LTI program and methodology used for recognition of LTI expense.

We challenged management's key assumptions used in the LTI expense calculations.

We tested accuracy of prior year estimates and assumptions used by management to identify possible bias.

We tested mathematical accuracy of LTI expense calculations, reconciled internal inputs in the calculations with audited accounting records and ensured consistency of data used for LTI calculations with other information obtained during the audit.

Risk

Impact of the Russian economic crisis

Note 30 to the financial statements

During 2016, the Russian economy continued to be negatively impacted by a significant drop in crude oil prices and a significant devaluation of the Russian Ruble, as well as sanctions imposed on Russia by several countries in 2014.

The Ruble interest rates remained high after the Central Bank of Russia raised its key rate in December 2014, with subsequent gradual decreases in 2015 and 2016. These developments led to reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

For 2017, it is expected that the total volume of the retail market will grow by 4% in nominal terms. GDP is expected to grow by 0-1%.

At 31 December 2016, the Group had RUB 156 billion of short and long term borrowings with a remaining average maturity of 2 years. The total amount of available credit lines as at 31 December 2016 is RUB 281 billion.

The liquidity assessment is important due to reduced access to capital by Russian entities and increased interest rates. In addition, the economic crisis creates additional uncertainty for certain assumptions used for impairment tests as well as for sensitivity of the Group to other market and non-market risks.

Our audit approach

We carried out a detailed analysis of the Group's liquidity position as well as the Group's potential sensitivity to the reasonably possible changes in external factors.

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 has been approved by the Board.

We compared the assumptions used in the 2017 budget to external information and extended the evaluation to 12 months after the date of the financial statements.

We ensured that the effect of current economic situation was correctly reflected in the assumptions used for impairment tests.

We ensured that risks associated with Russian economic crisis are correctly disclosed in the consolidated financial statements.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- > The management board's report;
- > The corporate governance report;
- > The strategic report;
- > Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code;

Based on the following procedures performed, we conclude that the other information:

- > is consistent with the financial statements and does not contain material misstatements;
- > contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.

Management is responsible for the preparation of the other information, including the management board's report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

We were appointed as auditors of X5 Retail Group N.V. by the shareholders at the extraordinary general meeting held on 12 November 2015, as of the audit for the year 2016 and have operated as statutory auditor since that date.

Description of responsibilities for the financial statements

Responsibilities of management and the Supervisory Board for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, management is responsible for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, 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 objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included e.g.:

- 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, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit.

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.

Amsterdam, 24 March 2017

Ernst & Young Accountants LLP
Signed by G.A. Arnold.

The logo for X5 Retail Group, featuring an orange chevron symbol pointing right, followed by the text "X5 RETAIL GROUP" in white, uppercase, sans-serif font.

X5 RETAIL GROUP

ANNUAL REPORT 2016