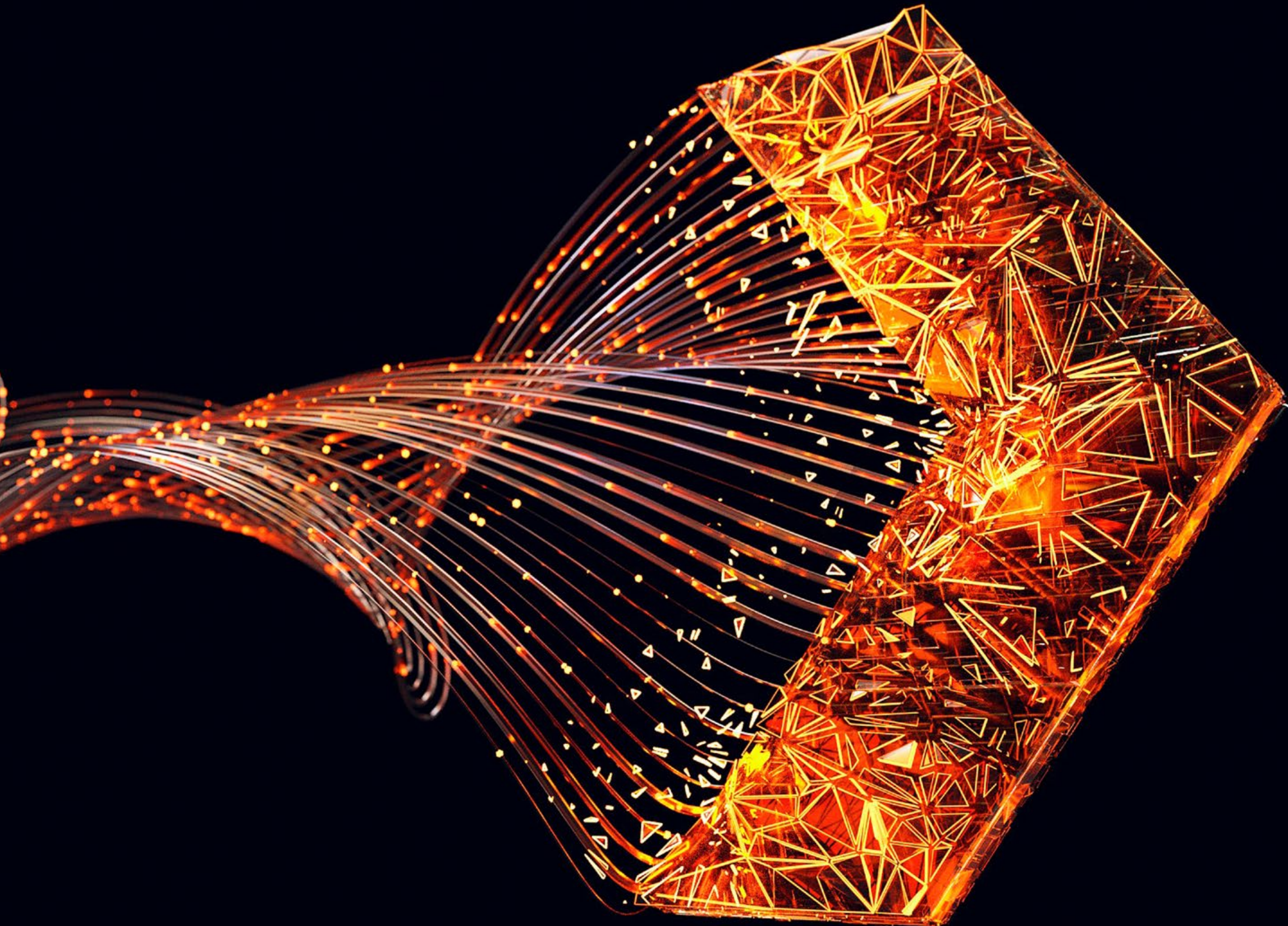




>X5 RETAIL GROUP

Sustainability Report
2018

**Leading
and evolving**



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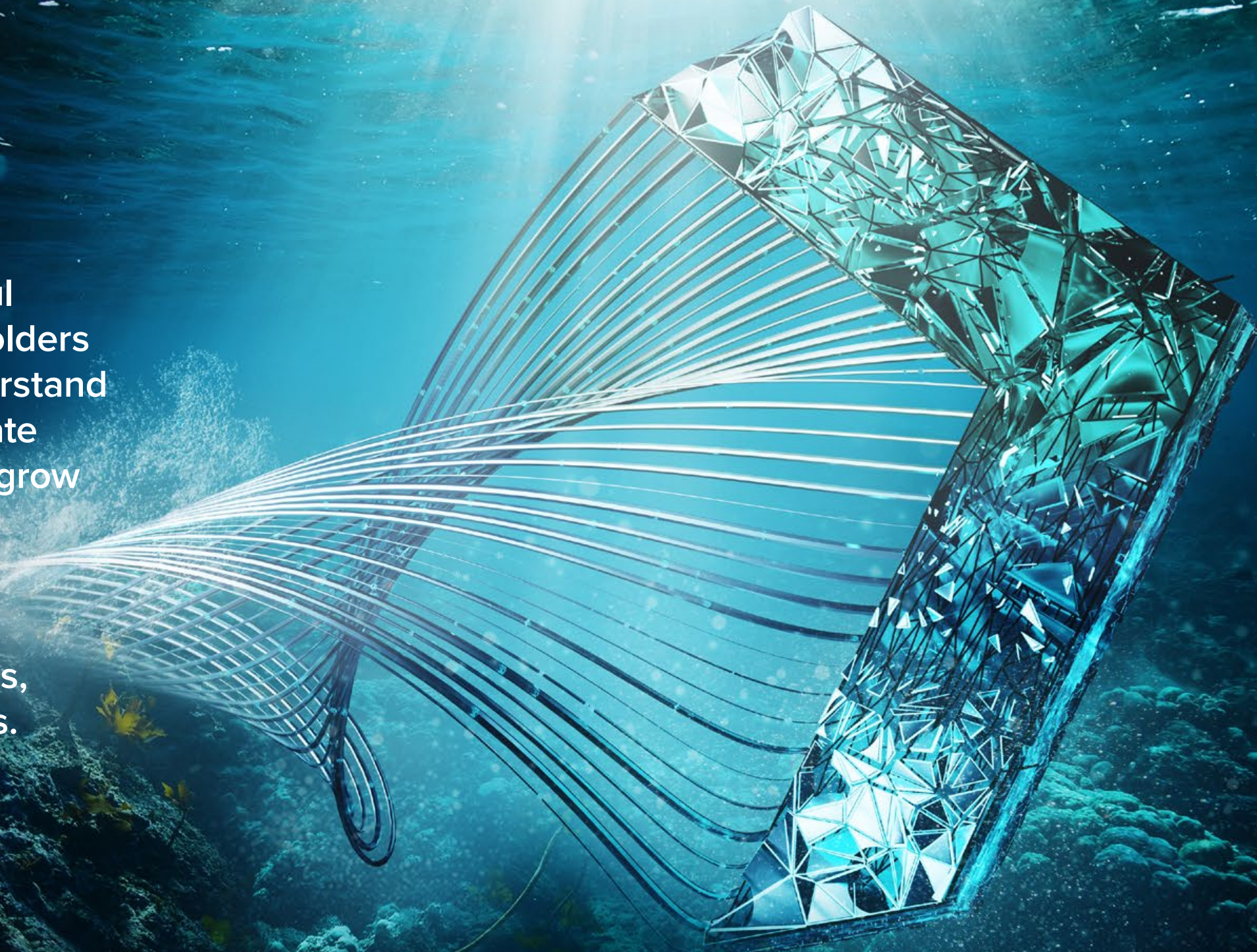
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Sustainable development

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

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



Stakeholder Engagement

	Consumers	Suppliers	Employees	Society and local communities	Shareholders/Investors
Why we interact	<ul style="list-style-type: none">• Ensure customers are aware of the value propositions of X5's retail formats• Differentiate ourselves from other food retailers• Meet customer demand, addressing their shopping needs and improving their shopping experience• Encourage customer loyalty and increase share of wallet by offering more of what they truly need• Get customer feedback that may help us improve our business• Provide customers with answers to their questions through direct engagement• Evolve our business in response to changing demand• Reduce food waste	<ul style="list-style-type: none">• Ensure the timely and reliable supply of high-quality products• Increase cooperation with local producers across the regions where we operate• Partner with suppliers to engage in effective promo and other sales activities• Ensure that our customers are getting the solutions they need or want• Maintain mutual trust and respect in our business relationships• Protect the health and safety of end consumers• Increase efficiency while reducing waste and shrinkage• Maximise the efficiency of the way we supply goods to customers	<ul style="list-style-type: none">• Facilitate the professional growth and support the social well-being of employees• Develop a corporate culture that helps us achieve our strategic goals• Engage in productive dialogues with trade unions• Ensure employees are regularly informed about health and safety procedures in the workplace• Create an atmosphere where employees are encouraged to help us identify opportunities to further improve our operations• Retain and develop a workforce of skilled and motivated employees• Improve employee motivation, help them build their professional skills• Maintain a reputation as an attractive employer for current and potential employees	<ul style="list-style-type: none">• Understand and address community needs and social or environmental concerns• Protect the health and well-being of communities where we are present• Build, maintain and protect our image and reputation• Increase recognition of our brands and offering• Keep local, federal and international media informed about our achievements and performance• Develop productive relationships with local authorities• Gain a better understanding of the business opportunities within local communities• Stay informed about government policies or regulatory changes that could impact our business	<ul style="list-style-type: none">• Keep the investment community informed about X5, our strategy, financial and operating performance, and other significant events• Constantly enhance corporate governance systems• Build sustainable long-term value as an enterprise• Seek out new ideas that may help improve the running of the business and our ability to create value• Demonstrate our commitment to openness and transparency• Support investor participation in X5's activities in capital markets• Ensure long-term growth in the Company's market capitalisation
How we interact	<ul style="list-style-type: none">• Maintain a customer hotline (each retail format has a dedicated customer hotline)• Interact via social media and messenger platforms• Use big data analytics of customer behaviour to understand how we can meet our customers' needs in the most efficient and reliable way• Develop loyalty programmes across all our formats	<ul style="list-style-type: none">• Adhere to fair and transparent business policies and practices• Implement measures to make it easier for small local producers to work with X5• Encourage the supply of locally produced goods across our formats• Hold training events to help suppliers work efficiently with X5's logistics infrastructure• Integrate nationwide transport and logistics operations with both large federal and smaller local suppliers• Focus on collaborative relationships and finding mutually beneficial solutions	<ul style="list-style-type: none">• Provide stable, fair and transparent salaries and motivation schemes to X5 Retail Group employees• Encourage career development and offer competitive compensation packages• Enact strict occupational health and safety policies across our business• Provide access to in-house and external training and development programmes• Offer social support for employees with regard to long-term illness or accidents, bereavement, or loss of property• Recognise significant contributions to X5's successful performance	<ul style="list-style-type: none">• Support charity and social initiatives that leverage X5's position as Russia's leading food retailer, including food bank initiatives like Basket of Kindness• Provide support to initiatives that are priorities for local communities• Manage our environmental footprint in a responsible way, including by reducing emissions, consumption and waste generated by our activities• Keep members of local communities informed about decisions that impact them• Maintain relationships with local authorities and community leaders	<ul style="list-style-type: none">• Execute our strategy as it evolves to address current and expected market trends• Adhere to best practice standards of transparency and disclosure• Implement corporate governance practices that are in line with recognised best practice standards• Facilitate open access to information via our investor website with annual reports, financial statements, press releases, presentations• Roadshows• Investor conferences• Conference calls• Group meetings with analysts and investors• Five independent non-executive directors on the Supervisory Board ensure that the interests of public shareholders are represented
Performance in 2018	<ul style="list-style-type: none">• Expanded omnichannel initiatives like Perekrestok Online and in-store parcel lockers for customers to pick up online purchases, making it more convenient for customers to shop with X5• Expanded loyalty programmes and the use of personalised offers that are tailored to customers' interests through big data solutions• Ongoing adaptation of the CVPs of our retail formats to meet changing demand	<ul style="list-style-type: none">• Established relationships with 1,426 new suppliers in 74 regions• Development of new exclusive private-label lines with selected suppliers, including Green Line at Perekrestok• Over 19% of assortment on average from local suppliers, with up to 30% in some regions in Pyaterochka stores	<ul style="list-style-type: none">• Invested around RUB 151 million in professional training and development• Conducted over 300 employee engagement events – sports, informational, and entertainment – attended by more than 176,000 people• Continued to implement and refined occupational health and safety policies and rules• Upheld diversity and human rights policies across all of X5's operations	<ul style="list-style-type: none">• Opened new stores and DCs, adding over 27,000 jobs in more than 60 Russian regions• Paid over RUB 49.4 billion in local, regional and federal taxes• Provided convenient, modern and reliable food retail services to people in around 2,900 cities and towns in Russia (over 4.6 billion customer visits)	<ul style="list-style-type: none">• Adhered to dividend policy adopted in 2017• Implemented award-winning investor relations practice• Held hundreds of conference calls and meetings with investors and analysts• Held two roadshows and participated in no fewer than 11 investor conferences• Held Capital Markets Day in London for the first time in October 2018• Posted around 46 RNS press releases• Significantly enhanced direct communications with investors following the introduction of MIFID II, held our first virtual roadshow

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

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

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

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

Product safety and production quality

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

2018 in numbers



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

1,240 stores audited in 2018



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

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



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

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



Policy highlights

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

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

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

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

- Ensuring food safety and social responsibility
- Understanding the current and future needs of consumers, meeting their stated and unstated goals, and aspiring to exceed their expectations
- Specifying the target quality level based on the demands of the consumer

- Establishing and developing mutually beneficial partnerships with producers and suppliers
- Creating and maintaining a corporate culture in which all employees are fully engaged and interested in using their knowledge and experience to achieve established goals
- Running all of our formats by using a process- and systems-based approach to the various stages of a product's life cycle: starting with the development and entry of goods into our product range through production and sale to the consumer
- Introducing modern quality control methods to improve efficiency and effectiveness in terms of ensuring food safety
- Continuous improvement as an ongoing requirement

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

System highlights

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

Other quality assurance practices that we use include:

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

How it works in practice

Introducing goods into our product range

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

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

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

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



Acceptance at distribution centres

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

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

In 2018, Pyaterochka implemented a project to improve the monitoring of the supply of chilled goods from the supplier to the store shelf. As part of the project, all of Pyaterochka's DCs and hubs were equipped with sensors that measure temperature and humidity data in real time. Also, all incoming deliveries of fruits and vegetables are accompanied by similar temperature

sensors, and when the goods are accepted, the quality manager has access to information on the transport conditions; in case of critical deviations, the information is recorded by the sensor, and delivery is not accepted. Another project was launched in 2018 to integrate all temperature and humidity monitoring systems into a single operational monitoring system that will make it possible to monitor storage and transportation conditions for fruits and vegetables and fresh produce supplies in one place and to take prompt corrective measures in case of violations.

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

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



Quality control in stores

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

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

Store audits

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

Audit of producers, including of private-label items

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

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

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

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

Number of supplier audits

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

Interaction with consumers

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

Interaction with public authorities and self-regulating organisations

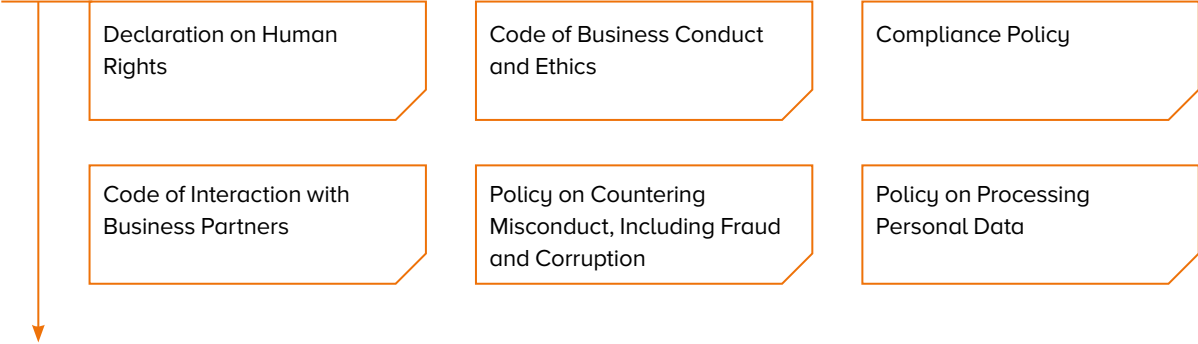
In 2018, the Company conducted a pilot project called Svetofor (traffic light), which was initiated by the Federal Service for Supervision of Consumer Rights Protection (Rospotrebnadzor). Voluntary labelling under the Svetofor system involved color-coded information on food packaging depending on the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

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

Compliance and ethics

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

Key documents



Stakeholders



Policy highlights

Code of Business Conduct and Ethics

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

Code of Interaction with Business Partners

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

Policy on Countering Misconduct, Including Fraud and Corruption

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

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

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

The system’s main objectives are:

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

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

Declaration on Human Rights

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

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

The Declaration deals with the following issues:

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

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

Compliance Policy

In order to ensure compliance with the requirements of regulators, stakeholders, established business practices, voluntarily adopted standards and rules of business conduct and ethics, X5 also adopted a **Compliance Policy** in 2017.¹ Compliance risks are assessed and reassessed on an ongoing basis.

Policy on Processing Personal Data

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

Code of Conduct on Insider Information and Operations with Securities

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

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

Key processes for ensuring ethical compliance

Ethics Committee

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

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

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

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

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

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

Hotline

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

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

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

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

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

Conflicts of interest

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

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

Insider trading

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

Training

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

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

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

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

2018 Key highlights

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

Handling of complaints submitted to X5’s ethics hotline

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

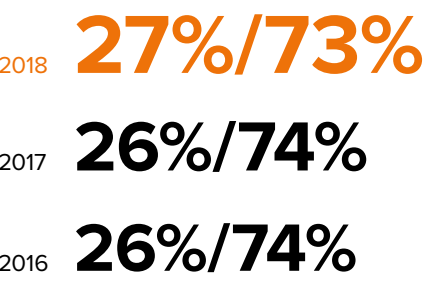
People review

Key highlights

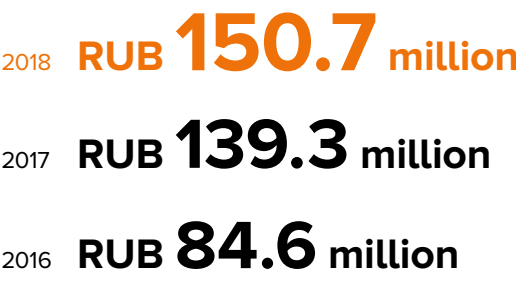
Headcount



Male/female



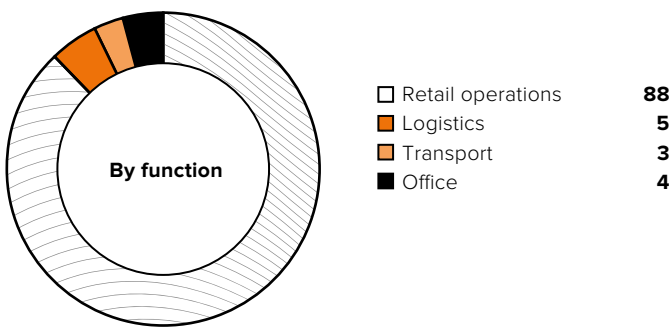
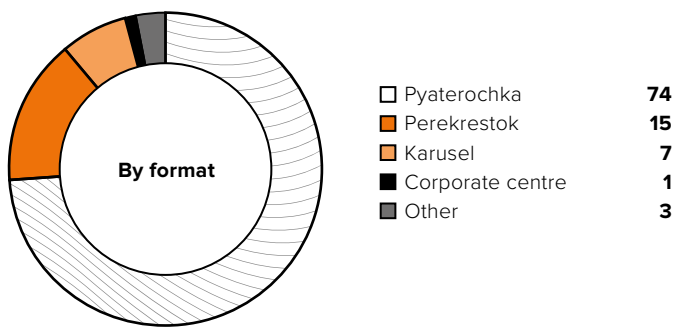
Investments in training



Number of training participants



Personnel structure in 2018, %



New HR strategy:
X5 – YOUR FIRST CHOICE

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

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

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

Values

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

Integrity

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

Engagement

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

Evolving

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

Approach to personnel management

Human rights

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

Regulatory requirements

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

Labour safety and working conditions

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

Effective motivation and fair remuneration

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

Training and development

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

Internal growth

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



Development of management potential

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

Employer brand

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

Corporate culture and values

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

Understanding the strategy and our overall goal

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

Automation and digitalisation of HR processes

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



Performance highlights

Working conditions based on best Russian and international practices

Effective motivation and fair remuneration

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

Workplace safety and working conditions

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

Automation and digitalisation of HR processes

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

X5 – a company of opportunities

Internal promotions

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

Recruitment and adaptation

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

Training and development

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

Development of management potential

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

Cultural reset

Common cultural and information space

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

Maintaining the prestige of working in retail and operations

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

Events with meaning

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



Turbo football

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



Highlights for 2018

25,000 fans

23,000
kilometres run
by football players

2,216
players

17 cities

4 months of
football matches



Occupational health and safety

Occupational Health and Safety Strategy

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

The main objectives of our OHS strategy are:

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

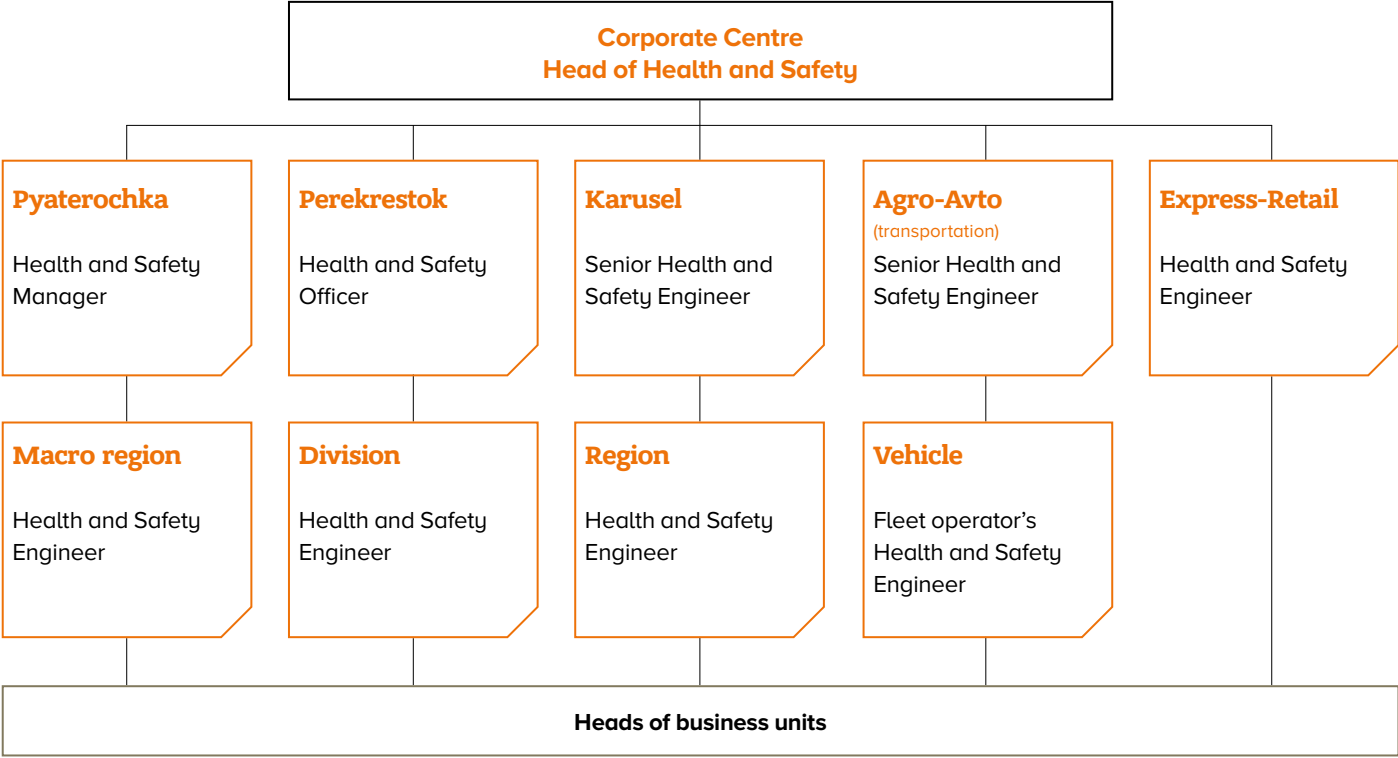
Policy highlights

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

The main aspects covered by our OHS Policy are:

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

OHS organisational chart



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

These services are mainly responsible for the following:

- Ensuring that workplaces are safe and secure
- Sharing information about workplace health and safety
- Supporting X5's Occupational Health and Safety Policy by studying and analysing occupational risks

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

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

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

System highlights

Improving OHS competencies

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

Prevention of workplace injuries

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

Protecting the health of employees and customers

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

Managing occupational risks

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



Investigating incidents and accidents at our facilities

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

Monitoring compliance with OHS legislation

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

- measures taken by the retail format in question based on the results of previous audits
- information on changes in OHS legislation
- quarterly and annual injury reports

2018 performance highlights

- The Company strictly adhered to OHS and sanitation standards, as a result of which no cases of occupational diseases were reported
- In 2018, we recorded a decrease in the severity and frequency of injuries compared to previous years, which is associated with ongoing activities that contribute to the prevention of injuries and accidents and that are aimed at compliance with the requirements of state regulations concerning the minimum conditions for safe work
- State regulatory bodies conducted 38 external inspections of compliance with OHS legislation and found 32 OHS violations, which was fewer than in 2017, and issued orders to rectify violations of labour legislation within the established period
- Special corporate training courses were developed for distance learning on occupational health and safety for all blue-collar positions. In 2018, 62,828 blue-collar workers were trained, in addition to managers and specialists
- A safety Gemba walk was carried out in the Logistics Department, and an internal OHS audit was carried out at commercial facilities using checklists approved by Russia’s Labour Ministry, which will make it possible to avoid routine on-site inspections by state regulatory bodies and to reveal and eliminate OHS violations in a more comprehensive manner

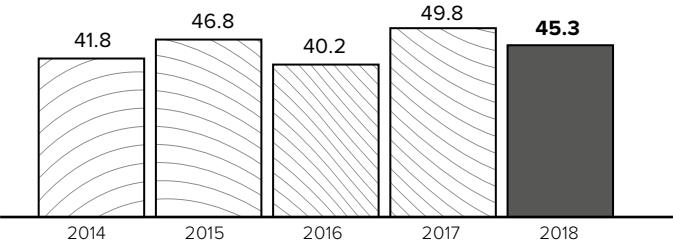
- The Automated Medical Examination project ensured that nearly 100% of employees underwent examinations, thereby minimising administrative penalties assessed by regulatory authorities
- Projects were introduced in the Logistics Department that ensured safe working conditions and increased labour productivity: this involved the mechanisation and automation of warehousing, reducing manual operations to the maximum extent possible (especially strenuous manual labour during loading and unloading operations), the installation of additional protective devices and BlueSpot warning alarms on electric vehicles, and many other projects that improved working conditions and safety of employees in warehousing operations
- Thanks to X5’s participation in a state programme that provides financial support for preventive measures to reduce workplace injuries, a special assessment of working conditions was carried out at X5 that was financed by the Social Insurance Fund of the Russian Federation, which saved the Company about RUB 16 million

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

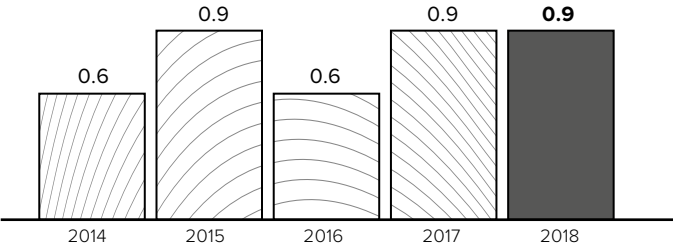
- 80% involved improper documentation for staff briefings, lack of signatures in OHS journals
- 20% of violations were technical: the lack of fencing around equipment, the lack of warning signs, etc.

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

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



Accident frequency ratio
Number of accidents per 1,000 employees



Scheduled inspections in 2018

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

X5 injury statistics

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

Environmental review

Key objective

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

Environmental strategy

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

Policy highlights

- At the Corporate Centre level, we set Group-wide strategic priorities that impact our environmental footprint.
- Our management team is responsible for setting goals and objectives in terms of our environmental performance and for carrying out regular monitoring of measures aimed at achieving those goals.
- Each of our retail formats and our logistics and transport divisions are independently responsible for implementing their environmental policy and for complying with Russian regulatory norms regarding waste disposal and emissions.

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



2018 performance highlights

Goals and targets

	Pyaterochka	Perekrestok	Karusel	Logistics
Energy efficiency	<ul style="list-style-type: none">• Using LED lighting in all stores• Installing energy-efficient equipment in stores• Enhancing data collection mechanisms to minimise energy use, including through internal process automatisation• Tariff optimisation			<ul style="list-style-type: none">• Using modern energy-saving technologies to optimise energy use in DCs
Recycling	<ul style="list-style-type: none">• Collect and sell 100% of recyclable waste• Continue to launch new initiatives to enhance culture of recycling in the Company			
Waste management	<ul style="list-style-type: none">• Smart waste management• Minimising waste disposal costs• Compliance with Russian legislation in terms of waste disposal	<ul style="list-style-type: none">• Efficient storage and disposal of organic waste, including using special equipment• Compliance with veterinary rules and regulations in waste management process		<ul style="list-style-type: none">• Smart waste management• Minimising waste disposal costs• Compliance with Russian legislation in terms of waste disposal
Emissions				<ul style="list-style-type: none">• Compliance with Russian legislation in terms of emissions• Reducing emissions through truck fleet improvement and supply chain optimisation

Energy efficiency

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

Monitoring energy consumption

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

Remote operation

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

Lab store

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

LED lighting

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

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

Recyclable waste

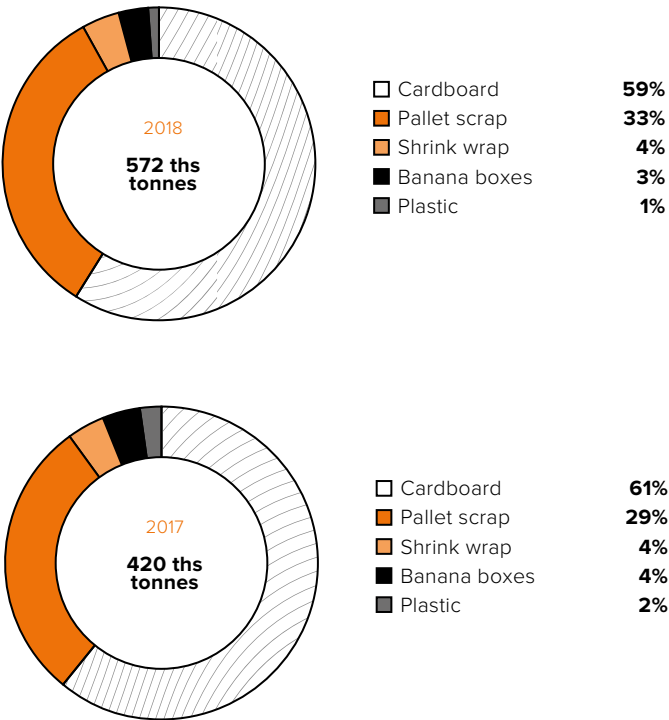
- The Pyaterochka, Perekrestok and Karusel retail formats sell 100% of their recyclable waste. Our retail formats and distribution centres do not carry out their own independent processing of secondary raw materials and waste. Our stores and distribution centres collect and compress cardboard. All secondary raw materials are then centrally collected and sold to specialised companies or suppliers for further use or recycling. All contractors are audited by the Company as part of the tender process, after which the best specialised company is chosen in terms of reliability, capacity and price.

- In addition, Pyaterochka operates a portal for returnable packaging that suppliers can use to purchase recycled materials from distribution centres.
- At Perekrestok, all the containers, pallets and plastic boxes that are to be reused are sent back to distribution centres.
- In 2018, Pyaterochka worked on developing a project to use recycling kiosks to collect PET bottles from the general population. A pilot project to install recycling kiosks in stores is scheduled to launch in 2019, which will be used to determine how much demand there is for this service among shoppers.
- The central offices of our retail formats also run separate waste collection for used batteries, plastic, polyethylene, paper and aluminium cans. Collection points are available for batteries and waste paper.

Organic waste management

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

Amount of recyclable waste sold, tonnes



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

Total income from sale of recyclable waste, RUB mln

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

Supply chain environmental strategy

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

Policy highlights

Distribution centres

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

Transport

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



2018 performance highlights

Reducing mileage

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

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

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

Improving truck fleet

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

been purchasing only Euro 5 or higher-class vehicles, and we have been using only high-quality fuel from leading producers. We purchased 916 Euro 5 standard trucks in 2018, compared to 314 in 2017. Our ongoing updates to our fleet have had a positive impact on our emissions performance:

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

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

Transportation fleet solid waste disposal

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

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

Recycling and waste management

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

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

Community investment review

Community strategy

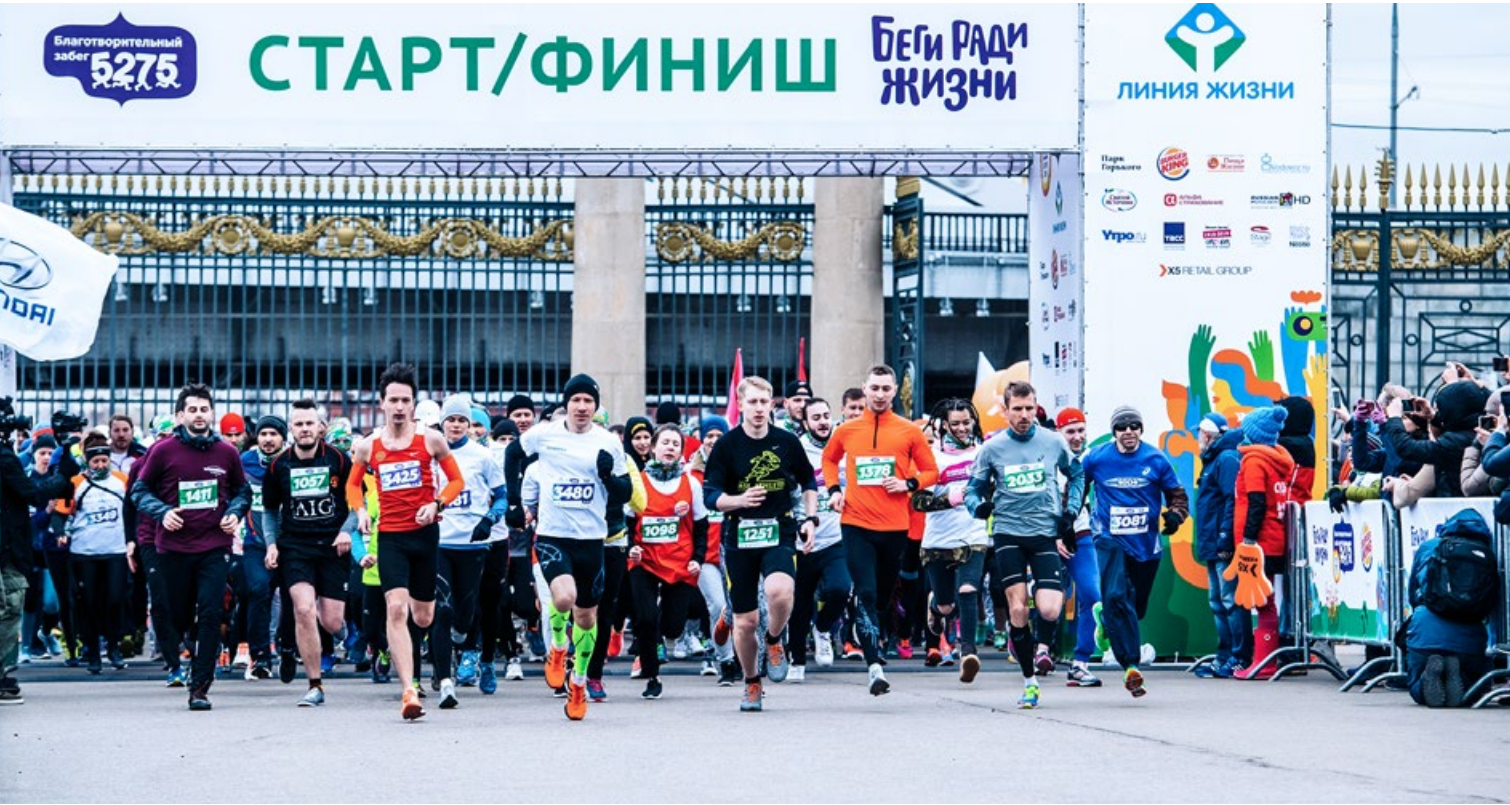
X5 is Russia's leading food retailer, and we understand that our activities have a social impact. We strive to have a meaningful and positive impact on society through both our day-to-day business activities and through targeted charity and social work. An effective dialogue with the communities and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

Policy highlights

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

System highlights

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



2018 performance highlights

Food aid

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

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

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

The first event was held in Kazan on 3 March, collecting more than 12 tonnes of groceries. On 21 April, Yekaterinburg took over

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

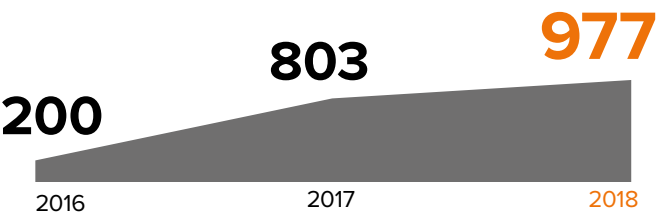
In autumn, the Basket of Kindness project launched a new programme to collect groceries and pet food in dedicated boxes at Karusel supermarkets.

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

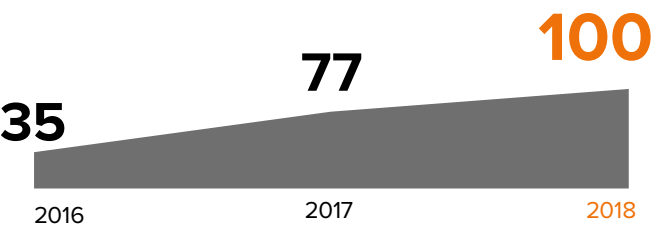


Basket of Kindness results

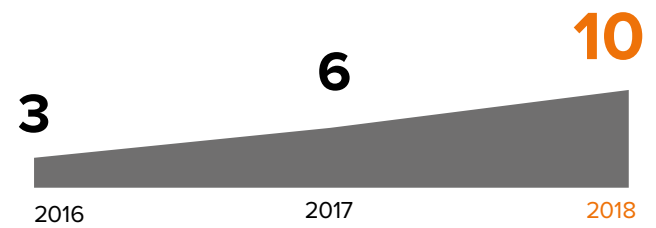
Number of participating stores



Amount of collected groceries, tonnes



Number of families, who received support, ths



Support for children’s causes

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

- Donation boxes placed in stores to help children with serious illnesses. In 2018, these boxes raised RUB 12.5 million compared to RUB 14 million in 2017.
- Shoppers at Pyaterochka stores can purchase so-called Candies of Kindness at checkout counters in order to donate RUB 5 to the Life Line Foundation. In 2018, this initiative collected RUB 8.5 million to help children with serious illnesses compared to RUB 7.8 million in 2017.
- Members of the Perekrestok Club loyalty programme can now help children with serious medical conditions by donating points accumulated on their bonus card to charity. Through this initiative, RUB 2.2 million was donated to the Life Line Foundation in 2018 compared to RUB 1.1 million in 2017.

- Since 2016, RUB 1 from the sale of every package of Bonte waffles at Perekrestok supermarkets has been donated to the Life Line Foundation. In 2018, this initiative raised more than RUB 1 million compared to around RUB 800,000 in 2017.
- Company employees regularly take part in the charity fairs that X5 organises together with its partners. In 2018, these fairs raised RUB 107,500 for the Life Line Foundation compared to RUB 300,000 in 2017.

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

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

Support for vulnerable social groups

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

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

Since the end of 2017, as part of the Children’s Club programme, Pyaterochka stores have been offering additional bonus

points on Pyaterochka loyalty cards to families with children for children’s goods. The programme has more than 1.4 million members.

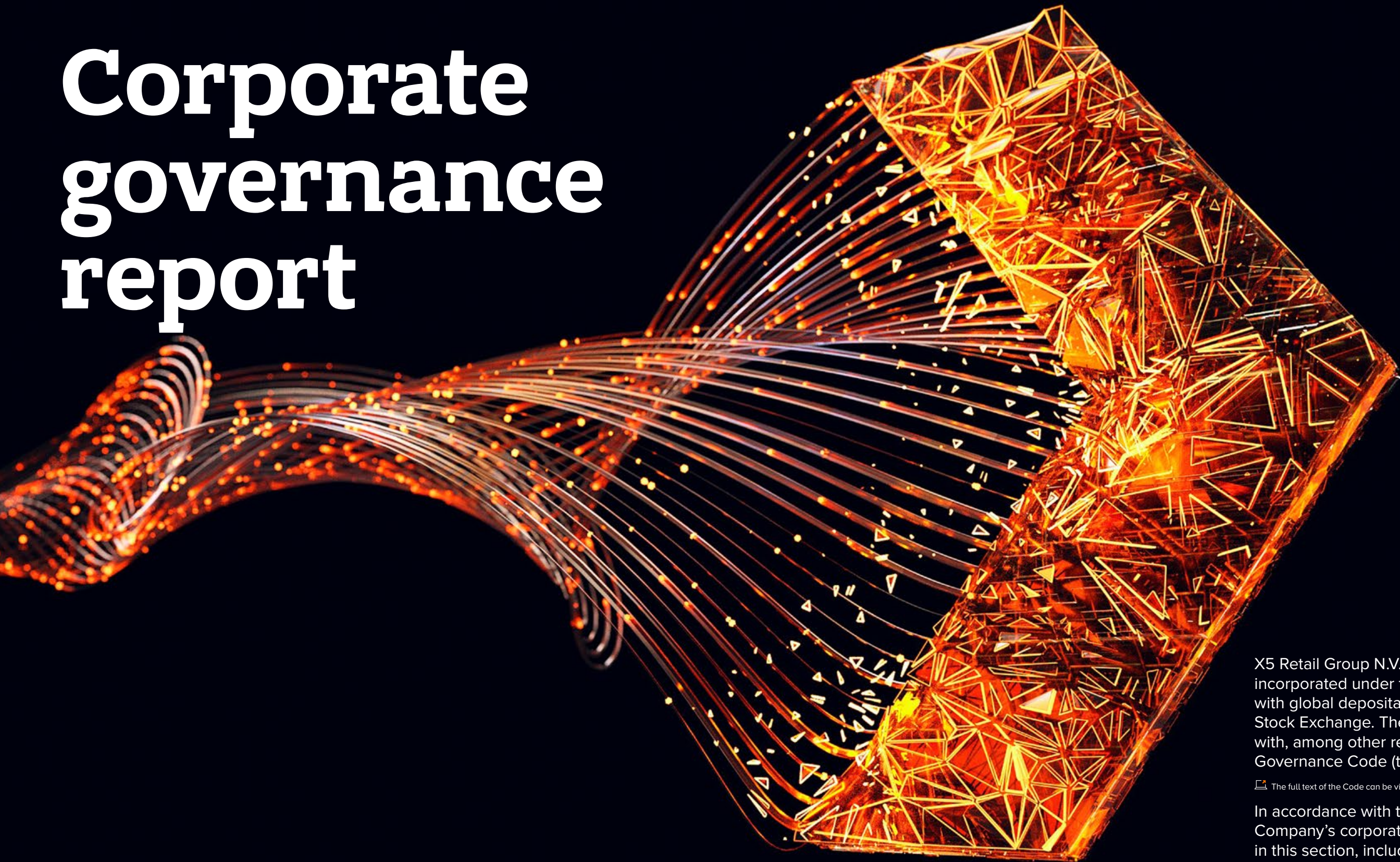
In August 2018, Perekrestok supermarkets launched a club for shoppers with children and parents-to-be. Members receive discounts of up to 40% on items produced by partner brands and special benefits on purchases in all categories of children’s goods. On weekends, members also receive a discount on large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

Volunteering


X5 encourages its employees to take part in socially beneficial projects. In 2018, 340 Company employees and their children took part in the Run for Life charity marathon organised by the Life Line Foundation, which raised RUB 2.8 million for charity projects. 60 X5 employees took part in a charitable Nordic walk event organised by Life Line Foundation, which raised over RUB 475,000.



Corporate governance report



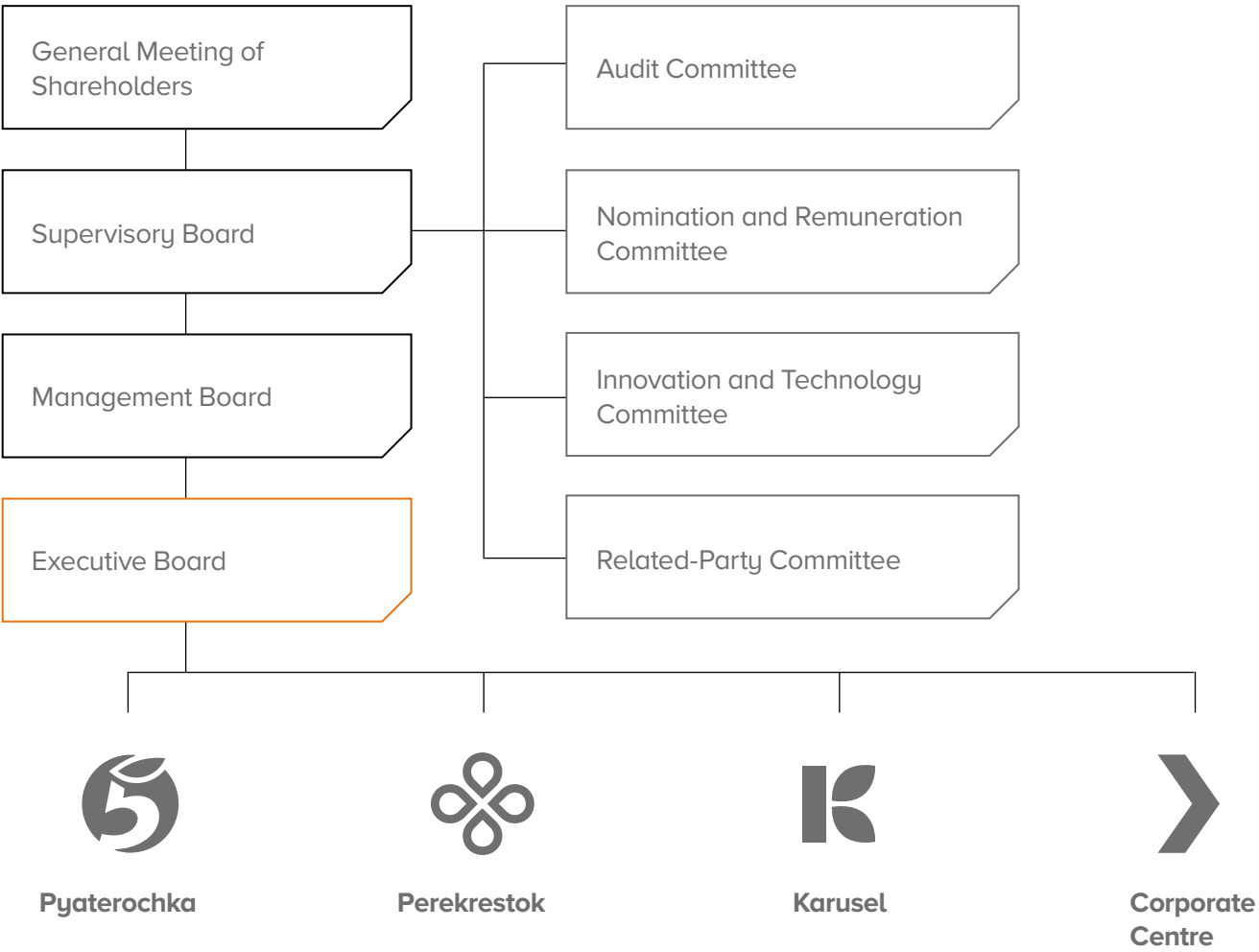
X5 Retail Group N.V. is a public limited-liability company incorporated under the laws of the Netherlands, with global depositary receipts listed on the London Stock Exchange. The Company is required to comply with, among other regulations, the Dutch Corporate Governance Code (the “Code”).

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

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

Governance Structure

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



Management Board

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

In managing X5’s general affairs and its day-to-day operations, the Management Board is supported by the Executive Board, which was established to provide for a leadership team at

the level of the Company’s operating subsidiaries in Russia in order to best support X5’s strategy and businesses at the local operating level. The Management Board is ultimately responsible for the actions and decisions of the Executive Board.

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

Composition and reappointment schedule of the Management Board

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

Supervisory Board

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

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

The Supervisory Board has prepared a profile of its size and composition, taking account of the nature of the Company’s business and its activities and the desired expertise and background of the members of the Supervisory Board. The

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

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

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

Composition and reappointment schedule of the Supervisory Board

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

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

Committees of the Supervisory Board

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

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

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

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

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

Composition of the Supervisory Board Committees

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

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

Diversity

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

Each year, the Supervisory Board conducts an evaluation of its functioning and the functioning of the Management Board. In this context, the Supervisory Board gives careful

consideration to the diversity of its own composition, as well as that of the Management Board, so as to be effective in performing its role.

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

Appointment, suspension and dismissal

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

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

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

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

Remuneration

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

Reporting on conflicts of interest

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

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

Shareholders and their rights

General Meeting of Shareholders

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

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

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

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

One or more shareholders or holders of GDRs representing at least 3% of X5’s issued share capital are entitled to request that a matter be included on the agenda of the General Meeting of Shareholders. Such requests, if sufficiently substantiated and received by the Company at least 60 days before the

date of the meeting, can only be refused on the grounds of exceptional circumstances, to be checked against the principles of reasonableness and fairness.

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

Voting rights

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

Dividend rights

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

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

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

Significant ownership of voting shares

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

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

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

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

Securities owned by board members

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

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

Repurchase by the Company of its own shares

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

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

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

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

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

Issue of new shares and pre-emptive rights

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

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

Articles of Association

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

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

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

Anti-takeover measures and change-of-control provisions

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

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

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

Auditor

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

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

Compliance with the Dutch Corporate Governance Code

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

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

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

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

2.1.9: Independence of the Chairman of the Supervisory Board

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

2.2.2: Appointment and reappointment periods of Supervisory Board members

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

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

2.3.2: Supervisory Board Committees

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

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

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

How we manage risk

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

Risk management and internal control

Risk management

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

- **Strengthen the design.** Significant progress has been made in applying risk models to be able to better quantify risk. Efforts in this area will continue in 2019 to apply a cost-benefit analysis of risk mitigation activities in the financial budgeting and risk monitoring processes; and
- **Increase effectiveness.** The reporting lines of the Compliance, Internal Control and Risk Assessment Teams were changed in 2018. In the revised structure, the Risk Assessment Team and Internal Control Team now report to the Chief Financial Officer, the Compliance Team reports to the General Counsel, and the Forensic Team reports to the Head of Corporate Security.

To constantly strengthen the risk management system:

- a comprehensive review of both internal and external risks is carried out at least annually;

- risk appetite is reviewed and reconfirmed;
- annual quantitative risk impact assessments complement a qualitative risk appetite;
- risks of X5’s strategic and short-term objectives are assessed;
- risk-mitigating activities are put in place.

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

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



Risk appetite

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

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

		Cautious means that only limited potential losses can be taken otherwise managers will prefer to avoid actions leading to risks: The maximum potential impact from these risks should be lower or equal to the minimal return. The necessary mitigation actions and controls should prevent losses.		Opportunistic – highest priority or willingness to take risk: The risk impact is inferior to the importance placed on reaching desired targets.	
Risk Category				Opportunistic	
Strategy		Cautious		Open	
Operations		Minimal			
Compliance		Averse			
Reporting					
		Averse means total avoidance of actions leading to unacceptable risks: Risks are unacceptable in any case despite mitigating factors and considerable potential reward.		Minimal means extremely conservative appetite to risk taking Potential losses from these risks should be calculated and planned in advance, provisions should be created or insurance contracts should be in place, and necessary controls should be in effect.	
				Open – willingness to consider potential losses and taking risks only under the right conditions: The risk impact may exceed the potential return; compensating factors may partly mitigate this impact.	

Internal control


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

1. The first tier of control requires each business unit to establish, operate and monitor the necessary controls for each of their specific business processes.
2. The second tier of control oversees the development and improvement in first-tier controls as the business evolves. This work is co-ordinated by the Risk Assessment and Internal Control Teams across various central functions that design and develop changes to X5’s internal control system.
3. The third tier of control is the Internal Audit function. The role of Internal Audit is to regularly assess, and recommend improvements to, the Company’s first and second control tiers. Internal Audit reports directly to the Management Board and has direct access to the Audit Committee.

Ethics and compliance culture

Values and business principles are crucial elements of the internal environment for risk management. X5 is committed to practices that contribute to a culture of integrity and long-term value creation. X5 has established and internally communicated rules and policies that outline these values and principles, including X5’s:

- Code of Conduct and Ethics
- Policy on Countering Misconduct, Including Fraud and Corruption
- Declaration on Human Rights

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

Monitoring and assurance

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

Internal Audit is periodically subject to independent and external evaluation to maintain and improve audit standards. In 2018, Internal Audit identified two areas for development:

- a more agile approach to audit projects (allowing for a wider scope but shorter duration of audit projects);
- enhanced auditing of controls in the area of IT, IT infrastructure and data security.

The Company’s principal risks

Risk profile

Strategy

Group risk	Risk appetite	Influenced indicator	Mitigation
Market and our customer value propositions (CVP) If the customer value propositions of X5’s retail formats fail to meet customer needs and preferences, this can lead to low sales densities, slower revenue growth, lower profits and returns. The risk can be caused by: <ul style="list-style-type: none">Failure to promptly respond to changes in customer preferences or behaviour patterns and lifestyleFailure to promptly respond to new business models, services and technologies used by competitors in retail and related marketsFailure to properly understand local consumption and regional economic potentialOver-investment in unproven retail formats and new business streams	Minimalist to Cautious	Net Sales, Gross Profit	<ul style="list-style-type: none">Constantly monitor retail and consumer trends in Russia and internationally to spot changes in behaviours and needsRegularly monitor trends in operating performance indicators and Net Promoter ScoresContinually invest in improving the format CVPs while at the same time improving operating cost-efficienciesRevise the target CVP on an annual basis and embed business improvement plans into the heart of the annual operating plan reviewed by the Supervisory BoardExplore, test and roll out new retail technologies and expand range in emerging category areas <div>Also see “Our brands” on pages 24-25 and “Our strategy in action” on pages 44-51, as well as the section on each retail format</div>
Economic and market conditions Major changes in the economic environment may challenge the existing business strategy, have a material impact on financial performance and lead to a competitive disadvantage. Such changes include: <ul style="list-style-type: none">A sharp drop in consumer demand (structural changes and shrinking consumer demand in money and absolute terms), depending on real income, consumer confidence and the unemployment levelSocial and demographic developmentsExcessively low or high product inflationUnexpected decline in national or regional economic activity leading to suppressed growth, higher unemployment and lower personal incomesPolitical events with a negative impact on trade practices or consumer demand	Cautious to Open	Gross Profit	<ul style="list-style-type: none">Rely on a multi-format model that enables the Company to respond to changes in customer demand and meet the needs of customers with various lifestyles and income levels (all groups of customers in Russia)Monitor the economic environment, manage the product mix and pricing policy and identify geographies for further expansion based on local customer demandDevelop direct imports, partner with direct suppliers and develop private labels to drive expansion of the product mix and bring purchase prices downWork to ensure the robust growth of retail formats in regions that demonstrate the strongest potential <div>Also see “Economic and consumer trends” on pages 34-35</div>

The principal risks that may impede the achievement of X5’s objectives with respect to strategy, operations, compliance and reporting matters are described below. It should be noted that there are additional risks that management believes are less material or otherwise common to most companies.

Group risk	Risk appetite	Influenced indicator	Mitigation
Growth and expansion The Company is committed to a sensible expansion strategy and the upkeep of existing stores. The Company’s expansion is associated with the following risks: <ul style="list-style-type: none">Lack of cost-efficient locations for new openingsHigher costs of opening and refurbishment projects can erode return on investmentsLack of logistics capacity to support expansion can cause higher logistics costs and, consequently, lower marginsSuboptimal geographical plan for expansion and overly optimistic expectations for project economics in certain locationsInefficient synergies from M&A deals to acquire local playersReaching market share caps in certain trading regions	Cautious to Open	Selling Space, Number of Stores, Net Sales	<ul style="list-style-type: none">Have a valuation methodology in place for stores of each formatEnsure that investment and post-investment valuation is carried outProject the Company’s future need for logistics capacities and open new distribution centres to keep pace with the rollout of new space in each formatImprove store opening and refurbishment processes and reduce bureaucracy and time delaysOptimise the performance of stores with negative margins <div>Also see “Geography of operations” on pages 52-53, as well as the section on each retail format</div>

Risks heat map see on page 210

Operations

Group risk	Risk appetite	Influenced indicator	Mitigation
Retail operations The operational efficiency of the logistics network, stores and back office units determine the operating performance of existing and new stores and the Company's overall profit margins. Operating activities are subject to the following risks: <ul style="list-style-type: none">Operational disruptions and delays in implementing the CVPLower productivity of the logistics networkLower efficiency of inventory management at the DCs and stores (reduced availability of goods, increase in inventories and write-offs)Lower productivity in stores resulting in either staff cost overspends or poor operating standardsLower productivity in the back office resulting in higher operating costs or reduced service standards	Minimalist to Cautious	Gross Profit, Operation Cost	<ul style="list-style-type: none">Ensure an optimal level of management on key business processesOngoing management of the product mix across the retail formatsDevelop the logistics capability in line with expansion strategy and closely manage supply chains within the existing logistics networkImprove and automate processes in the back office, DCs and storesMonitor the operating performance of stores and DCs based on defined KPIs and performance standardsMonitor the operations of national and regional competitors on an ongoing basis and ensure a prompt and appropriate response <div>Also see "Retail infrastructure" on pages 126-145, as well as the section on each retail format</div>
Human resources The Company's strategic goals are heavily dependent on the competencies and performance of its officers and employees. Risks related to HR management include: <ul style="list-style-type: none">Poor recruitment and vetting leading to inappropriate staff for rolesInsufficient attention to employee welfare, training and rewardsPoor morale leading to high turnover rates, high rates of morbidity and low productivityShortage of qualified professionals and employees in key skill areasCompetitor demand for our top talentInadequate succession planning	Cautious to Open	Operation Cost	<ul style="list-style-type: none">Monitor the labour market and provide employee benefits in line with market normsInvest in a professional recruitment process, use various employee recruitment and vetting tools to ensure the right candidates are chosenHave a system for employee onboarding, training and development in place, along with a talent pool management processEnsure rewards are kept in line with market norms through salary benchmarking and incentive schemesDevelop and reinforce the Company cultureMonitor staff morale through employee feedback processes <div>Also see "People review" on pages 160-167</div>
IT performance, continuity The Company's operating model and scale of business depends on the capabilities and reliability of its IT systems. The inability to harness IT to improve productivity can limit expansion and decrease profitability. IT management is subject to the following risks: <ul style="list-style-type: none">Failure to match IT capabilities, scalability and reliability in relation to business requirementsDisruptions of business continuity due to IT failures	Minimalist to Cautious	Revenue Operation Cost	<ul style="list-style-type: none">Ensure the IT development roadmap is integrated within the overall business operating planEmploy a mix of external and internal expertise to ensure an agile response to business opportunitiesEnsure IT change projects are sponsored by business owners and professionally managed to keep within scope and budgetEnsure good governance of IT architecture and the integration of IT systemsEnsure sufficiently close monitoring and speedy fault rectification of IT infrastructureImplement policies and procedures to ensure cybersecurity protection is maximised <div>Also see "Information technologies" on pages 138-139</div>

Group risk	Risk appetite	Influenced indicator	Mitigation
Cybersecurity The Company understands the rising trend of external threats to information security. Cybersecurity risks include: <ul style="list-style-type: none">Cyberattacks, spread of viruses and other malicious actions to disrupt our operationAttempts to steal or corrupt our dataAttempts to circumnavigate our control systems in order to cause fraud	Minimalist to Cautious	Revenue Operation Cost	<ul style="list-style-type: none">Implement policies and procedures to protect our systems and dataOur Information Security department was set up to monitor and action issues related to cyber-risksUse of specialised hardware and software to protect against malicious software, spam, external and internal cyberattacks, and data leaksUse of information systems to detect atypical behaviours in the X5 network and alert trained personnel for action <div>Also see "Information technologies" on pages 138-139</div>
Real estate, rent and maintenance Maintaining our existing stores in a fit state of repair is an important factor in continuing to serve our customers well. Optimal service costs also affect the Company's margins. In pursuing these objectives, the following risks can arise: <ul style="list-style-type: none">High incidences of equipment failures and emergency repairsHigher utility ratesHigher vacancy rates and a resulting decrease in revenues from subleased areasUnplanned increases in lease rates or termination of lease agreements by the lessor in favour of another tenant	Minimalist to Cautious	Operation Cost	<ul style="list-style-type: none">Have store refurbishment projects planned into our budgetsInvest in preventative maintenance programmesStandardise and monitor the utility and technical maintenance of stores and automate store monitoring processesSign long-term lease agreements, specify rules for their termination, and manage rental rates and landlord relationshipsManage relations with lessors and sub-lessees
Financing risks Financing risks are driven by both internal and external factors. They can have an adverse impact on X5's liquidity, profitability and growth. The most common financing risks include: <ul style="list-style-type: none">Significant volatility of foreign exchange ratesVolatility in country and sector economic fortunes and thus increases in interest rates and banking feesPricing and availability of new credit	Averse to Minimalist	See Financial Statements	<ul style="list-style-type: none">Raise financing in Russian roubles, avoid FX-denominated agreements in operating activitiesRestrict banking activity to a pool of partner banks whose stability has been assessed and verifiedEnsure continuity of funding on the best available market terms, with a diverse credit portfolio of lending arrangementsArrange funding ahead of requirements and maintain sufficient undrawn credit limits in banksMonitor working capital and have internal policies on credit terms, stock levels and payment termsClosely monitor the performance against budget and introduce changes needed to achieve financial targets in a timely manner <div>Also see "Financial review" on pages 112-121</div>

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
Reputation and social responsibility As X5's success depends to a significant extent on brand recognition, the brand names Pyaterochka, Perekrestok, Karusel and X5 and their associated reputations are key long-term assets of X5's business. As a market leader, X5 is fully aware of its social responsibility and is committed to managing social aspects involved in its operations, thus building a foundation for sustainable development. In terms of reputation and social responsibility, the following risks can arise: <ul style="list-style-type: none">• Unethical conduct, unscrupulous practices by X5 management and employees in their relations with customers, counterparties, government authorities, non-profit associations, investors and other stakeholders• A mismatch between the Company's social responsibility standards and the expectations of communities, market players and stakeholders based on X5's role, scale of business and growth potential• Abuse by third parties using X5's trademarks and brands• Misleading information about X5 in social and mass media that may damage the reputation of the Company and its retail formats• Leakage of critical (sensitive) information onto the Internet or to competitors	Averse to Minimalist	N/A	<ul style="list-style-type: none">• Use X5's Code of Business Conduct and Ethics; X5's Policy on Countering Misconduct, Including Fraud and Corruption; X5's Charity Policy• Raise awareness, train employees and develop the corporate culture to make sure unethical behaviour is seen as unacceptable and that there is zero tolerance for any fraudulent activities• Use the X5 Retail Group Code of Interaction with Business Partners, review complaints filed by counterparties and engage the Conciliation Commission to look into any incidents that take place• Take disciplinary action in cases of unethical behaviour• Record, arrange and process reports received from the Company's employees via the hotline• Use the Customer Service Standards and the hotline for customers, and work with reports and complaints• Engage in external and in-house social and charity projects• In emergencies, use dedicated channels of communication and rely on the Crisis Response Team to mitigate financial and non-financial damage to X5• Ensure accessibility for special-needs customers and employees <div>Also see "Community investment review" on pages 180-185</div>
Environment X5 is committed to preserving and protecting the environment and making sustainable use of natural resources. Risks regarding environmental management include: <ul style="list-style-type: none">• Reputational damage for being perceived as an environmentally uncaring organisation• Financial penalties imposed for non-compliance with environmental regulations	Averse to Minimalist	N/A	<ul style="list-style-type: none">• Implement energy-efficient technologies and equipment• Make wider use of paperless document flows• Set environmental expectations for contractors in their work for X5• Ensure our vehicles meet emission standards• Collect and dispose of waste appropriately, and promote recycling wherever possible <div>Also see "Environmental review" on pages 174-177</div>

Group risk	Risk appetite	Influenced indicator	Mitigation
Human rights While most human rights laws concern relationships between the state and individuals, non-state organisations also impact individuals' human rights, and they have a responsibility to respect them. In its operations, X5 addresses the following human rights violations: <ul style="list-style-type: none">• Discrimination against employees, customers and representatives of the Company's partners on the grounds of age, gender, sexual orientation, social status, nationality or ethnicity, cultural or political beliefs, etc.• Unethical employee behaviour in violation of human rights (e.g., forced or unpaid labour, workplace bullying, harassment, use of offensive language or humiliation)• X5's involvement in human rights violations by third parties	Averse to Minimalist	N/A	<ul style="list-style-type: none">• X5's Declaration on Human Rights (available on the Company's website)• Use the X5 Code of Business Conduct and Ethics, provide training to employees and develop the corporate culture• Use the Internal Labour Rules and the Compensation and Benefits Policy and communicate them to employees• Receive complaints from the Company's employees via the hotline and investigate and take necessary disciplinary actions• Improve the Company's business processes to eliminate the root causes of complaints received through the hotline• Use the Customer Service Standards and the hotline for customers, and investigate and remedy complaints• Ensure accessibility for special-needs customers and employees <div>Also see "People review" section on pages 160-167</div>
Health and safety The health and safety of our employees and customers is our primary responsibility. Injuries or fatalities would have a negative impact on the trust and loyalty of our customers and X5's business reputation. The Company addresses the following risks: <ul style="list-style-type: none">• Accidents causing injuries, including fatal injuries, to employees or individuals at X5 facilities and in adjacent areas• Injuries to employees due to an unsafe and uncomfortable working environment• Failure to provide the necessary first aid on a timely basis	Averse to Minimalist	N/A	<ul style="list-style-type: none">• Provide a safe working environment (premises, equipment, uniforms) at the Company's offices, DCs and stores, and carry out regular workplace assessments• Ensure compliance with employees' working hours and holiday schedule (work and rest schedule)• Provide employees with life and health insurance programmes and seasonal vaccinations• Arrange regular medical examinations for employees and health screening assessments to confirm that they are fit to work <div>Also see "Occupational health and safety" on pages 168-173</div>
Product safety and quality Product safety and quality are important criteria for our customers. Products of poor quality and with little shelf life remaining can lead to high wastage and potentially damaged customer relationships. This risk may be triggered by: <ul style="list-style-type: none">• Selling products that fail to meet safety standards and representations about quality• Violations of operational process rules that may lead to spoilage and contamination• Accepting from suppliers products that fail to meet safety standards, representations about quality or that have insufficient shelf-life	Averse to Minimalist	N/A	<ul style="list-style-type: none">• Audit suppliers by carrying out laboratory tests of product samples before adding the products to the assortment. Remove suppliers from our assortment who fail to meet our standards.• Ensure inspection of incoming products at DCs and stores• Comply with all rules for product transportation, storage and sale• Comply with sanitation and personal-hygiene rules• Provide training for employees on quality assurance• Handle complaints and requests from customers and investigate root causes <div>Also see "Product safety and production quality" on pages 150-155</div>

Compliance

Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Legislation and litigation</p> <p>X5's activities are governed by a wide range of laws and regulations. By complying with these, the Company maintains its reputation and manages operating expenses. Unfavourable legislative developments may affect X5's strategy and margins. Contractual terms that are unfavourable for X5, failure of counterparties to fulfil their obligations and court action against X5 due to contract violations may have a negative impact on the Company's performance and reputation.</p> <p>Risks related to legislation and protection of X5's interests can include:</p> <ul style="list-style-type: none">• Non-compliance with applicable laws, including failure to change or adjust the Company's activities on a timely basis in line with new developments• Unfavourable changes in retail laws (e.g., market share limitation, sales restrictions introduced for certain types of products) and obsolete requirements• Unfavourable changes in legislation that result in higher operating expenses for the Company• Risk of legal action against X5 initiated by regulators and counterparties• Counterparties taking advantage of laws and contractual provisions that fail to properly protect X5's interests• Issues related to violations of data protection compliance	Averse to Minimalist	N/A	<ul style="list-style-type: none">• Interaction with government agencies as prescribed by applicable laws, participation in public organisations, representation of interests• Monitoring of draft laws, timely initiation of internal projects to alter and adjust X5's activities to legislative developments• Implementation of X5's Compliance Policy:• Assessment of compliance risks, rollout and improvement of compliance procedures to integrate them into the Company's processes, consistent efforts to identify violations and non-compliance with laws, and disciplinary action• Personnel training to ensure compliance with laws• Legal support, audit of contracts, development and use of contract templates

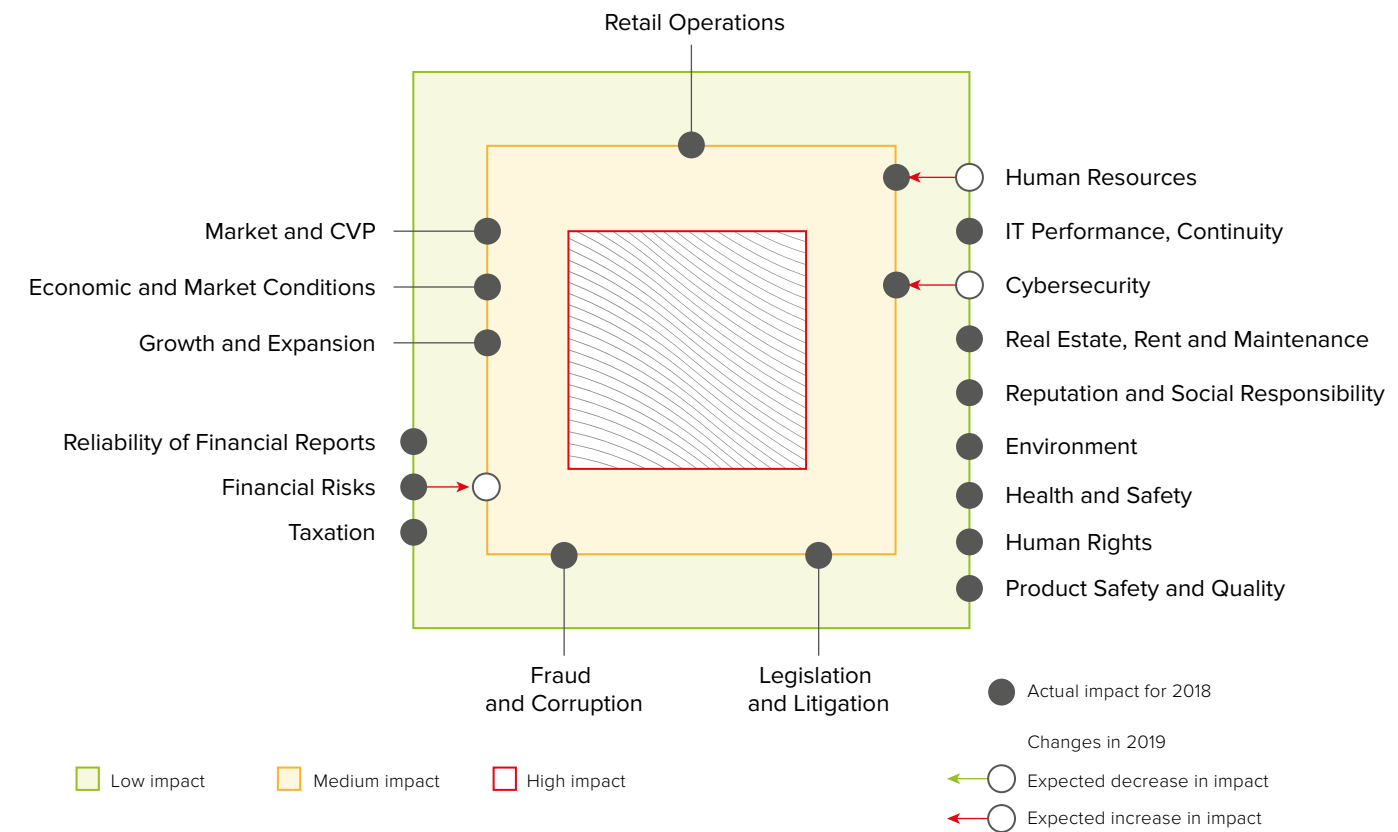
Group risk	Risk appetite	Influenced indicator	Mitigation
<p>Fraud and corruption</p> <p>Like many other industries, the retail sector is exposed to risks of fraud and corruption. The scale of X5's activities and the diversity of its business operations can result in fraud risks and potential for corruption.</p> <p>These risks include:</p> <ul style="list-style-type: none">• Theft, fraud, acts of corruption and abuse on the part of X5 employees• Hidden conflicts of interest• Fraud, commercial bribery and theft by third parties (customers, counterparties)	Averse to Minimalist	Operation Cost	<ul style="list-style-type: none">• Use the Code of Business Conduct and Ethics and X5's Policy on Countering Misconduct, Including Fraud and Corruption• Promote among employers zero tolerance of abuse, and provide personnel training and information about our codes and policies• Implement segregation of duties of sensitive roles to reduce risk, and closely manage access rights to our systems• Conduct background checks on counterparties and employees• Identify abuses, fraud and theft by internal departments (Security, Audit, Finance and IT). Carry out internal checks, take disciplinary action, initiate administrative or criminal proceedings against employees, counterparties or customers• Record, arrange and process reports received from the Company's employees via the hotline, from counterparties in the Conciliation Commission and from the Security Department• Require declaration of conflicts of interest for all employees
<p>Taxation</p> <p>Compliance with taxation regulations is often complex, open to differing interpretations and depends on the Company's risk appetite.</p> <p>Tax risks may be related to:</p> <ul style="list-style-type: none">• Unfavourable changes in tax calculation rules, introduction of new taxes and fees• Federal and regional authorities interpreting tax laws in a way that is adverse for X5• Developments in case law involving tax disputes• Attempts to challenge previous transactions and amounts of associated tax payments	Averse to Minimalist	See Financial Statements	<ul style="list-style-type: none">• Monitoring of taxation-related legislative initiatives and case law, changes to business processes• Tax planning with preliminary reviews and advisory sessions• Tax risk assessment before executing transactions and signing contracts• Tax budgeting, provisioning for tax risks• Tax control during transactions

Reporting

Group risk	Risk appetite	Influenced indicator	Mitigation
Reliability of financial reports The reliability and completeness of financial reports is a critical element when it comes to maintaining the trust of shareholders and other stakeholders. The integrity of financial reporting is exposed to the following risks: <ul style="list-style-type: none">Non-compliance with statutory requirements on financial reportingMisrepresentation of management accounts and financial statementsAmbiguity of management accounts and financial statementsDisclosure levels not in line with shareholder, lender or market expectations	Averse to Minimalist	N/A	<ul style="list-style-type: none">Annual audit by professional external auditorsMonitoring and prompt adoption of legislative initiatives regarding financial statements and changes in reporting methodologiesManagement controls over the methodologies adopted and consistent application in preparing management reportingInternal controls for the preparation of financial statementsInternal audit to assess the effectiveness of the internal controls used for the preparation of financial statements

Expected risk tendency

For the designated risk groups, X5 analysed the actual risk impact in 2018 and made predictions about the expected future impact, taking external conditions and trends into consideration.



Statement of the Management Board

The Management Board reviewed and analysed the strategic, operational, compliance and reporting risks to which the Company was exposed, as well as the effectiveness of the Company's internal risk management and control systems over the course of 2018. The outcome of this review and analysis has been shared with the Audit Committee and the Supervisory Board and has been discussed with X5's external auditors.

- The Management Board reviewed the effectiveness of X5's internal risk management and control systems based on:
- internal audit reports on reviews performed throughout the year; observations and measures to address issues were discussed with management and the Audit Committee;
 - a systematic review of scoping, control execution and control assessments in the context of an internal control strategy for 2017-2020;
 - periodic risk reports reported by the management of corporate functions and the three main business segments (retail formats);
 - ongoing monitoring of key risk-management initiatives aimed at mitigating risks and keeping risks at an acceptable level;
 - the external auditor's ongoing reflections on the control framework, and the management letter from the external auditor with observations and remarks regarding internal controls.

For more information on X5's risk management activities, internal control, risk management systems and key risks, see the section "How we manage risk" above. The purpose of X5's internal risk management and control systems is to adequately

and effectively manage the significant risks to which the Company is exposed. Such systems can never provide absolute assurance as to the realisation of operational and strategic business objectives, nor can they prevent all misstatements, inaccuracies, errors, fraud and non-compliance with legislation, rules and regulations. These systems do not provide certainty that the Company will achieve its objectives. Based on the annual evaluation and discussion of X5's internal control and risk management systems and identified risk factors, the Management Board confirms that, according to the current state of affairs and to the best of its knowledge:

- X5's internal risk management and control systems provide reasonable assurance that the Company's financial reporting does not contain any material inaccuracies;
- there have been no material failings in the effectiveness of X5's internal risk management and control systems;
- there are no material risks or uncertainties that could reasonably be expected to have a material adverse effect on the continuity of X5's operations in the coming 12 months;
- based on the current state of affairs it is appropriate that the financial reporting is prepared on a going concern basis (notes 30(c) and 32 to the consolidated financial statements).

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

The Management Board

19 March 2019

Supervisory and Management Boards



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Supervisory Board

1 Stephan DuCharme

Chairman of the Supervisory Board

Stephan DuCharme, a dual US/German citizen, is managing partner at L1 Retail, the retail investment branch of LetterOne, and currently serves on the Board of the holding company of Holland & Barrett International. Stephan served as CEO and Chairman of the X5 Management Board from July 2012 until November 2015, after having previously served on X5's Supervisory Board beginning in 2008. Prior to X5, he held senior management positions with Alfa Group, the European Bank for Reconstruction and Development (EBRD) and Salomon Brothers Inc. He graduated with distinction from the University of California at Berkeley and received an MBA from INSEAD.

2 Mikhail Fridman

Member of the Supervisory Board

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

3 Peter Demchenkov

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

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

4 Andrei Elinson

Member of the Supervisory Board

Andrei Elinson, a Russian citizen, is the Managing Partner at A1, the key investment subdivision of Alfa Group, where he has worked since March 2018. Currently, Mr. Elinson is also a member of the Supervisory Board of Alfa Group. Between December 2015 and March 2018, Mr. Elinson was the Director of Asset Management at CTF Consultancy Limited. Prior to joining CTF, Mr. Elinson was Deputy CEO of Basic Element, where he worked from August 2007, with responsibility for managing companies in the aviation, construction, automotive, financial and other industries. From 1997 to 2007, Mr. Elinson worked at Deloitte CIS, and later became a partner in 2005. Mr. Elinson graduated with honours from the Accounting and Auditing Faculty at the Russian State Finance Academy. Mr. Elinson is a US Certified Public Accountant and a US Certified Fraud Examiner. He holds a Certificate in Company Direction (UK).

5 Geoff King

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

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

6 Michael Kuchment

Member of the Supervisory Board

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

7 Karl-Heinz Holland

Member of the Supervisory Board

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

8 Nadia Shouraboura

Member of the Supervisory Board

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

Management Board

9 Igor Shekhterman

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

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

10 Frank Lhoëst

Company Secretary, Member of the Management Board

Frank Lhoëst, a Dutch national, joined X5 in 2007, having previously held several positions at Intertrust Group. Frank graduated from Leiden University with a degree in Law.

Report of the Supervisory Board

The Supervisory Board is responsible for supervising and advising the Management Board and overseeing the Company’s general course of affairs, strategy and operational performance. In performing its duties, the Supervisory Board acts in accordance with the interests of the Company and

its affiliated businesses, taking into consideration the overall good of the Company and the relevant interests of all its stakeholders. In X5’s two-tier corporate structure under Dutch law, the Supervisory Board is a separate body operating fully independently of the Management Board.

Composition and profile of the Supervisory Board

X5’s Supervisory Board currently consists of eight members, with a majority of five independent members. On an ongoing basis, the Supervisory Board reviews the profile of its size and (future) composition, as well as its rotation schedule, taking into account the evolving nature of X5’s business and activities and the desired expertise and background of the members of the Supervisory Board. The Supervisory Board profile is published on X5’s corporate website.

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

In order to fill these vacancies, and mindful of the profile of the Supervisory Board, the Supervisory Board nominated Karl-Heinz Holland and Nadia Shouraboura as independent members of the Supervisory Board. Both of the new members were nominated based on their extensive experience as leading retail industry professionals. As former CEO of Lidl Group, Karl Heinz Holland has wide-ranging expertise in European retail and a track record of establishing Lidl as a powerhouse in the European food retail

while Nadia Shouraboura’s nine years at Amazon have provided her with extensive experience in the development of innovative concepts for modern retail as well as technology- and data-driven solutions for consumers. Both nominees were appointed by the General Meeting of Shareholders on 30 August 2018.

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

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

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

An overview of the current composition of the Supervisory Board and a short biography of each member is presented in the Corporate Governance Report on pages 212-213.

Composition of the committees

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

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

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

Induction and ongoing education

Induction and ongoing education are key elements of good governance. Following their appointment, new Supervisory Board members go through X5’s strategic, financial, legal and reporting affairs with senior Company executives. In addition, prior to their appointment, they are invited to meetings of the Supervisory Board and its committees. On an ongoing basis, and together with members of senior management, members of the Supervisory Board visit stores and distribution centres to expand their knowledge of local operations, opportunities and challenges.

As part of the follow-up measures to the 2017 Supervisory Board assessment, the Board critically reviewed and improved

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

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

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

Meetings of the Supervisory Board

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

The plenary Supervisory Board meetings in June, September and December included a half-day strategy session, thus ensuring sufficient time for meetings and discussions on specific topics, such as operational performance, strategy and management development. The CEO attended all meetings, and CFO and other members of senior management were regularly invited to present. In 2018, the Supervisory Board held regular private sessions without members of the Management Board present to independently discuss matters related to the

performance, functioning and development of members of the Executive Board. The external auditor attended the meeting in March at which the 2017 Annual Report and financial statements were recommended for adoption by the Annual General Meeting of Shareholders. In between the Supervisory Board meetings, several informal meetings and telephone calls took place among Supervisory Board members and members of the Management Board and other Company management to consult with each other on various topics and to ensure that the Supervisory Board remains well informed about the running of the Company's operations.

The Supervisory Board confirms that all Supervisory Board members have adequate time available to give sufficient attention to the concerns of the Company. In 2018, the attendance rate was 100% for both the Supervisory Board and the committee meetings.

- the leadership strategy for the Perekrestok retail format, with ongoing focus on value proposition and performance of regional stores versus cosmopolitan stores, as well as growth strategy for the format's online business;
- the growth strategy for the hypermarket format Karusel, driven by innovative pilot projects to strengthen the format as a distinct brand within X5's multi-format strategy;
- the private-label strategy and implementation programme for each of the formats.

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

- the financial reporting process and in particular the approval of the 2017 Annual Report and review of the 2018 half-yearly and quarterly financial reports;
- the agenda and explanatory notes for the Annual General Meeting of Shareholders to be held in May 2018, including the dividend proposal;
- reports by the internal and external auditors;
- impact of the new IFRS 16 accounting standards for lease accounting to be implemented as of 2019;

- the assessment of cooperation with the external auditor, based on a report from the Audit and Risk Committee;
- the regular assessment of the members of the Executive Board, including talent management and succession planning;
- a review of the profile and composition of the Supervisory Board, particularly in the context of the in-depth board evaluation performed by an external evaluator during the autumn of 2017 and the changing composition of the Board in 2018;
- X5's Group Leadership Diversity Policy, codifying the Company's commitment to supporting and valuing inclusiveness and diversity, and setting diversity targets in terms of age, skills, background and gender;
- the amendment of the Supervisory Board's rules of procedure, in line with new Board practices and the revised Dutch Corporate Governance Code that entered into force on 1 January 2017;
- the corporate social responsibility strategy and initiatives;
- updates to X5's risk landscape and risk appetite, as well as risk mitigation measures and internal controls;
- The annual budget for 2019.

Activities in 2018

In 2018, the Supervisory Board reviewed various matters related to all significant aspects of the Company, its activities and operational results, strategy going forward and the management team and its development.

Throughout the year, the Board continued to monitor the implementation of X5's corporate strategy, with a focus on long-term value creation through operational excellence and X5's capacity to adjust to changing customer needs. Against the background of an increasingly competitive environment and challenging macroeconomic conditions conditions as well as technological disruption, the Supervisory Board particularly focussed on measures to strengthen X5's current businesses, with specific attention paid to operational efficiencies and improving customer experience through the use of technology and innovation.

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

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

As part of the ongoing performance review of the Company's various functions and business divisions, the main topics reviewed and discussed by the Supervisory Board included:

- the leadership strategy for the Pyaterochka retail format, with renewed focus on assortment and value proposition, human resources, quality of service, operational efficiencies and cost discipline, as well as organisation structure in view of the format's size and geographic span;

Board evaluation

X5 undertakes an annual review of its Supervisory Board, its committees and its individual members. The evaluation operates on a three-year cycle, with one externally led evaluation followed by two subsequent years of internal evaluations.

Throughout the year, the Supervisory Board reflected on the recommendations from the Board assessment performed by an external party in 2017, with as key points of attention enhanced focus on the profile and composition of the Board, making sure that the Board remains "fit for tomorrow", further emphasis on the induction and development of new and current Board members, and improving the effectiveness of discussions in

the boardroom. With the appointment and nomination of new Supervisory Board members in 2018 and January 2019, and enhanced Board induction and development initiatives as described in this report, the Supervisory Board ensured that it made good progress in its continuous development as a team, that it has a balanced composition that suits the Company in its current life stage, and that it works well together in an open and constructive atmosphere.

The Supervisory Board attaches great value to these evaluations. They ensure continuous focus on the quality of the activities, composition and functioning of the Supervisory Board and its committees and its relationship with the Executive Board.

Meetings of the committees

Audit and Risk Committee

The role of the Audit and Risk Committee is described in its charter, which is available on the Company's website. On 31 December 2018, the Audit and Risk Committee consisted of Geoff King (Chairman), Andrei Elinson and Karl-Heinz Holland. In 2018, the Committee held four meetings in person. Additional meetings were held by conference call when necessary, for instance to review the publication of the half-yearly results. As a rule, all meetings were attended by the CFO, the external auditor and the internal audit director, while the Chairman and CEO were invited to attend all meetings. Other members of the Supervisory Board and senior management were invited when necessary or appropriate. The Committee met once with the external auditor without the presence of management.

In 2018, the Committee focussed on, among other things, overseeing the integrity and quality of X5's financial reporting and the effectiveness of the internal risk and control systems. The Committee reviewed the Company's annual and interim financial statements, including non-financial information, the quarterly results and related press releases, as well as the outcomes of the year-end audit. The Committee discussed relevant and new accounting standards, with increased focus on the impact of lease accounting under IFRS 16. Throughout the year, the Committee reviewed the level of financial provisions, key movements in the balance sheet and any contingent liability movements. As part of this review, the Committee paid specific attention to controls and initiatives in the area of working capital management.

Furthermore, the Committee reviewed and approved the audit plans of the internal and external auditors, with a focus on scoping, materiality and key risks. The Committee monitored the progress of the internal and external audit activities, including a review of observations identified as a result of the internal audit activities during the quarter, quarterly procedures performed by the external auditor and the audit performed at year end by the external auditor. The Committee oversaw follow-up by management to the recommendations made in the internal and external management letters.

In 2018, the Audit and Risk Committee, together with management, conducted its periodic assessment of the functioning and independence of the external auditor, in line with the Company's Rules on External Auditor Independence and Selection. The results were shared with the current auditors, and actions to further improve optimising the auditor relationship were agreed. The main conclusions of this assessment, including

the proposed external audit fees for the next three-year period, were shared with the Supervisory Board for the purpose of submitting the reappointment of the external auditor to the General Meeting of Shareholders.

Throughout the year, the Committee closely monitored risk management and the risk management process, including the timely follow-up to high-priority actions and risk mitigation measures based on quarterly progress updates. In the context of periodic ethics and compliance updates, the Committee reviewed whistle-blower reports, and dedicated specific attention to economic and political sanctions and their impact on X5's operations. Furthermore, the Committee reviewed activities and initiatives related to detection and prevention of misconduct and irregularities, and risk-mitigating measures to protect the Company in these areas.

The Committee extensively discussed the effectiveness of the internal control framework. Each quarter, the agenda includes a discussion of current control topics, including internal audit findings and the external auditor's reflections on the control framework. These discussions guided management and Internal Audit to focus on the right priorities throughout the year, to mitigate any significant risks or weaknesses and to build a relevant internal audit plan for 2019.

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

The Audit Committee also discussed other issues, including:

- the external auditor's report with respect to accounting and audit issues and internal control recommendations in respect of their audit of the 2017 consolidated financial statements;
- quarterly interim financial reports and trading updates;
- X5's financing strategy;
- X5's dividend policy;
- tax matters;
- IT infrastructure and data security;
- material legal cases;
- regulatory compliance and changes in legislation, with

- ongoing attention to Russian trade law and its proposed amendments on the return of unsold goods to suppliers, effective as of 1 January 2019;
- the effectiveness of the internal audit function and its plans to develop in the coming years;
- non-audit fee payments to the incumbent external auditor, ensuring the level of expenditure does not exceed the internal Company guideline of 70% of the annual audit fee in any given year.

With respect to the external auditor's management letter about the 2018 financial year, the Audit and Risk Committee confirms that the management letter contained no significant items that need to be mentioned in this report.

Nomination and Remuneration Committee

The role of the Nomination and Remuneration Committee is described in its charter, which is available on the Company's website. On 31 December 2018, the Nomination and Remuneration Committee consisted of Peter Demchenkov (Chairman), Stephan DuCharme, Andrei Elinson and Karl-Heinz Holland. The Nomination and Remuneration Committee held six meetings in 2018, including two meetings held by conference call. The CEO was invited to attend every meeting, and other members of the Supervisory Board and senior management were invited when necessary or appropriate.


In 2018, the Committee's main areas of focus were succession planning for the Supervisory Board and overall succession and management development processes, with specific attention paid to new executive succession planning following changes in the management team during the first half of the year. Also, as part of an in-depth analysis of corporate culture, the Committee reviewed measures to increase employee engagement, recognising that the quality and commitment of staff, supported by simple and efficient end-to-end processes, are key factors in a customer-centric business approach. In this context, the Committee also discussed the Company's approach to the level and structure of compensation for personnel other than members of the Executive Board, with a focus on operational and store personnel.

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

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

The Nomination and Remuneration Committee further reviewed and prepared the following items for recommendation or report to the full Supervisory Board, as part of its ongoing responsibilities:

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

 For information on the remuneration policy, see Remuneration on pages 221-225. Details of actual remuneration in 2018 can be found in notes 27 and 28 to the consolidated financial statements.

Related-Party Committee

The role of the Related-Party Committee is described in its charter, which is available on the Company’s website. On 31 December 2018, the Related-Party Committee consisted of Geoff King (Chairman) and Nadia Shouraboura. In 2018, the Related-Party Committee convened once in person to discuss, in particular, safeguards to make sure that pre-approved related-party transactions are periodically tested to ensure ongoing competitiveness. Resolutions in writing were taken when necessary during the year. Under the Company’s Related-Party Transactions Policy, the Related-Party Committee reviews transactions of a recurring nature that are pre-approved by the Supervisory Board; transactions with a materiality threshold for either the Company or members of the Supervisory Board, Management Board and Executive Board; and transactions that qualify as significant related-party transactions as defined in the policy. Pursuant to this policy, the Related-Party Committee specifically reviewed the following transactions in 2018:

- service agreements with Alfa Services Limited;
- the supply agreement with Alidi following its acquisition of Central Distribution Company;

- a joint venture agreement with Sovcom Bank for distribution of online orders through a network of parcel lockers in Pyaterochka and Perekrestok stores;
- an agreement with Sovcombank on the use of Halva instalments card in stores;
- agreements with Vimpelcom related to the supply of hardware for stores and mobile application support for store personnel;
- the sublease of storage space in Tyumen to Hoff;
- an agreement with Alfabank on Perekrestok “Mobile Wallet” loyalty cards.

These transactions were discussed and approved by the Related-Party Committee and/or the Supervisory Board with due observance of best practice provisions 2.7.3 and/or 2.7.5 of the Corporate Governance Code, as well as the rules set forth in Article 10 (Conflicts of Interest) of the rules of procedure of the Supervisory Board, which are available on the Company’s website. The Supervisory Board determined that, to the extent that any of the listed transactions constituted a conflict of interest for certain members of the Supervisory Board, such conflict did not undermine the independent judgement of these Supervisory Board members while performing their duties for X5.

Remuneration

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

Financial Statements

This Annual Report and the 2018 consolidated financial statements, audited by Ernst & Young Accountants LLP, were presented to the Supervisory Board in the presence of the Management Board and the external auditor. Ernst & Young’s report can be found on pages 293-301.

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

for distribution as dividends. The proposed dividend amounts to RUB 92.06 per GDR with a nominal value of EUR 0.25.

The Supervisory Board furthermore requests that the Annual General Meeting of Shareholders grant discharge to the members of the Management Board for their management and to the members of the Supervisory Board for their supervision in 2018.

The Supervisory Board wishes to express its sincere appreciation for the results achieved and would like to thank the Executive Board and all X5 employees for their continued dedication and efforts in 2018.

The Supervisory Board

19 March 2019

Remuneration

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

Remuneration policy

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

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

The objective of X5’s remuneration policy is twofold:

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

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

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

Benchmarking with industry peers

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

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

Total direct compensation

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

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

Base salary

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

Short-term incentive (STI)

The annual incentive for members of the Executive Board is predicated upon both quantitative financial and individual performance measures. The on-target payout as a percentage of base salary is 100%, contingent on the targets being fully achieved, with a cap at 140% of the base salary in the event of above-target performance.

At the beginning of each financial year, the Supervisory Board sets the performance measures and their relative weight, the targets to be achieved for each performance measure, as well as performance ranges, i.e., the value below which no payout will be made (the threshold), the on-target value and the maximum payout level. Financial performance measures comprise components related to the Company’s operational performance, particularly sales growth, operating margin and return on investment, with a profitability threshold as a condition for STI payout. Individual performance measures include divisional performance or key project-related targets.

Both financial and individual performance measures contribute to the Company’s success in the short term, while also securing the Company’s long-term objectives. X5 does not disclose the actual targets set, as they are considered commercially sensitive.

Long-term incentive (LTI)

In 2018, the General Meeting of Shareholders approved a new LTI programme that was developed by the Supervisory Board since targets under the previous programme were achieved in 2017. Whereas the 2015-2018 LTI programme was specifically designed to support the Company’s ambitious transition to accelerated growth and expansion in line with long-term strategic targets, the Supervisory Board recognised that the Company is entering a new stage with enhanced focus on sustainability and strategic objectives that contribute to long-term value creation for the Company. The new LTI is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred, conditional payouts in order to maintain the focus on long-term goals and to provide for an effective retention mechanism. In comparison to the 2015-2018 LTI programme, it is designed for a wider group of participants within the Company and aims to create greater balance between short- and long-term compensation of the programme participants.

Targets under the LTI are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and enterprise value multiple relative to competition. Additionally, the LTI includes thresholds related to (i) the EBITDA margin to ensure that profitability is not sacrificed and (ii) the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management. Under the programme, 50% of the total award is paid in 2021 subject to maintaining achieved targets until the end 2020, while the other 50% is deferred to 2022 subject to maintaining achieved targets in 2021 with a profitability threshold

as a condition for deferred payout. This creates a focus on long-term goals throughout the programme and provides an effective mechanism for motivating and retaining executives who are critical to the Company’s continued success.

The size of each individual cash award is based on the participant’s annual base salary and LTI scale, reflecting his/her role and contribution to meeting the LTI targets at both individual and team levels, with a maximum of 133% per year of the participant’s base salary during the three-year programme. The total available fund for all payouts under the LTI programme is capped at 5% of average EBITDA during the three-year period of the programme.

Contractual arrangements

Members of the Management Board are engaged on the basis of a management services agreement with a four-year term, to be extended upon reappointment by the Annual General Meeting of Shareholders. The CEO, as a Russia-based member of the Management Board, also has an employment contract with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract reflect the relevant responsibilities of each member of the Management Board in the Netherlands and in Russia.

Clawback

The Supervisory Board may recover from members of the Management Board all or part of a paid bonus if such bonus is based on incorrect information regarding the targets or the conditions of the bonus. Furthermore, the Supervisory Board has the discretionary authority to adjust an unpaid bonus to an appropriate amount if payment of the bonus is considered unreasonable or unfair.

Other remuneration components

Members of the Executive Board may be offered a number of other arrangements, such as an expense allowance, medical insurance, accident insurance and life insurance, in accordance with Company policy. The Company’s policy does not allow personal loans or guarantees to members of the Executive Board, nor does the Company provide pension arrangements for members of the Executive Board.

Severance arrangement

The severance payment is limited to a maximum of six months’ base salary for Management Board members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances. No severance pay is awarded if the agreement is terminated at the initiative of the Executive Board member or in the event of seriously culpable or negligent behaviour on his/her part.

Insurance and indemnity arrangements

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

Although the insurance policy provides broad coverage, X5’s directors and officers may incur uninsured liabilities. Members of the Management Board may be indemnified by the Company against any claims arising out of, or in connection with, the general performance of their duties, provided that such claim is not attributable to gross negligence, wilful misconduct or intentional misrepresentation by the director or officer in question. Similar indemnities granted by the Company to members of the Supervisory Board were approved by the 2016 Annual General Meeting of Shareholders.

2018 Management Board Remuneration

The Management Board remuneration for 2018 is in accordance with the remuneration policy for members of the Management and Executive Board adopted at the General Meeting of shareholders on 7 May 2015.

The following table provides an overview of the Management Board’s actual remuneration that became unconditional in 2018 or at year end (in millions of Russian roubles). For disclosures in line with IFRS reporting requirements, which are accrual-based over earning/performance periods and partly depend on estimations/assumptions, see note 8 “Related party transactions” on page 254.

Name, Unit: RUB mln	Year	Base salary ¹	Short-term incentive ²	Long-term incentive ³	Total
I. Shekhterman	2018	60	62	170	292
	2017	46	36	211	293
F. Lhoëst	2018	20	13	–	33
	2017	18	10	–	28
TOTAL	2018	80	75	170	325
	2017	64	46	211	321

Ad (1) – Base salary

In 2018, the Supervisory Board reviewed and approved an adjustment within the total remuneration package for the members of the Executive Board, based on a base salary benchmarking analysis in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation. Accordingly, in line with compensation levels in peer group companies, Mr. Shekhterman’s annual base salary was increased to RUB 70,000,000 (2017: RUB 42,000,000). The table reflects actual base salary amounts, including adjustments based on the number of days spent on vacation and business trips in 2018, in accordance with Russian labour law.

For Mr. Shekhterman, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr. DuCharme when in office as CEO specifically for hiring and retention purposes and to safeguard continuity in the interest of the Company and its shareholders, as Mr. Shekhterman’s leadership and skills are considered to be crucial for the continuity of the Company’s growth and success. As disclosed when Mr. Shekhterman took office in 2015, his reward package does not include a severance entitlement; instead, he will be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman will be entitled to the difference upon completion of his full term as CEO.

Ad (2) – Short-term incentive

Short-term incentives are based on results achieved in 2018 and payable in 2019. For 2018, the Supervisory Board determined that 50% of the total on-target bonus opportunity for the CEO depends on achieving quantitative financial performance measures, and 50% on individual performance measures. Financial performance measures consist of elements related to the Company’s operational performance, including EBITDA and return on investment, with a profitability threshold as a condition for STI payout. For the Company Secretary, the STI is based on achievement of individual performance measures, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO and 60% for the Company Secretary. The achievement of all performance targets was assessed and determined by the Supervisory Board for each Management Board member individually. As of 31 December 2018, all financial targets set for the CEO by the Supervisory Board in particular operating margin and return on investment were achieved above target within a 110% outperformance range. Taking into account achievement levels of individual performance measures, this resulted in payouts of 108% of base salary for Mr. Shekhterman and 58% of base salary for Mr. Lhoëst.

Ad (3) – Long-term incentive

The 2015-2018 LTI programme came to an end when targets under the second stage of the programme were achieved in 2017. Under the programme’s deferred payout mechanism, 50% of the total award under the second stage of the programme was paid to Mr. Shekhterman in 2018, with a final 50% deferred payout in 2019.

Internal pay ratio

The ratio of the total salary expense of the Management Board vs. total average salary expense per employee (excluding LTI) is presented in the table below:

Pay ratio between	Year	Ratio
CEO X5 vs. Employees X5	2018	206:1
	2017	174:1
Company Secretary vs. Employees X5	2018	59:1
	2017	61:1

The pay ratio is calculated by dividing the total remuneration of the respective Management Board members by the average remuneration of all X5 employees over 2017 and 2018 to convey the year-on-year changes. The average remuneration per employee is calculated as the total labour costs derived from note 27 on page 268 divided by the number of employees on an FTE basis. Given the irregular nature of awards under the LTI programme and the fact that not every member of the Management Board participates in the LTI programme, LTI awards are not included in the pay ratio for fair and consistent presentation purposes.

As is commonly understood, pay ratios are specific to the company’s industry, geographical footprint and organisational model. As a major food retail company, the relatively small number of executive staff vs. operational staff in stores and warehouses across seven federal districts in Russia adds to the variety of pay within the Company and substantially differentiates the average employee compensation with compensation levels of Executive Board members. For companies in other industries, this will be different. Furthermore, pay ratios can be volatile over time, as they can greatly depend on the Company’s annual performance since that performance impacts the remuneration of the Executive Board much more than of all other employees.

Remuneration policy in 2019 and beyond

In 2018, the remuneration policy as described in this report was applied. It is the intention that the current policy will in principle be continued in the next financial year and beyond.

The Supervisory Board

19 March 2019

