Independent auditor's report

To: The Supervisory Board and Shareholders of X5 Retail Group N.V.

Building a better working world

Report on the audit of the financial statements 2018 included in the annual report

Our opinion

We have audited the financial statements 2018 of X5 Retail Group N.V., based in Amsterdam, the Netherlands. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

- The accompanying consolidated financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2018, and of its result and its cash flows for 2018 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- The accompanying company financial statements give a true and fair view of the financial position of X5 Retail Group N.V. as at 31 December 2018, and of its result for 2018 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

- The consolidated statement of financial position as at 31 December 2018;
- The following statements for 2018: the consolidated statement of profit or loss, the consolidated statements of comprehensive income, cash flows and changes in equity;
- The notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

- The company statement of financial position as at 31 December 2018;
- The company statement of profit or loss for 2018;
- The notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of X5 Retail Group N.V. in accordance with the EU Regulation on specific requirements regarding statutory audit of public-interest entities, the "Wet toezicht accountantsorganisaties" (Wta, Audit firms supervision act), the "Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten" (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore we have complied with the "Verordening gedrags- en beroepsregels accountants" (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Materiality

Materiality	RUB 2.7 billion (2017: RUB 2.4 billion)
Benchmark	2.5% of EBITDA
Explanation	Based on our professional judgment, we consider an earnings-based measure as the most appropriate basis to determine materiality. On the basis of our analysis of stakeholders' needs and main KPIs set for the Management Board, we believe that EBITDA is an important benchmark for the financial performance of the Group. The materiality and applied benchmark are in line with the 2017 audit.

We have also taken misstatements into account and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of RUB 135 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

X5 Retail Group N.V. is established in the Netherlands and is head of a group of subsidiaries operating food retail stores in Russia (“the Group”). The financial information of all these entities is included in the consolidated financial statements of the Group.

We are responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out. The Group accounting function is centralized in Moscow and Nizhny Novgorod and the Group is primarily managed as a single operating unit with multiple operating segments. We have used the work of EY Moscow to perform full-scope audit procedures to obtain sufficient coverage for financial statement line items from a consolidated financial statement perspective. We executed a program of regular communication that has been designed to ensure that the audit progress and findings were discussed between us and the audit team of EY Moscow. We have visited EY Moscow during planning and execution phases, as well as held meetings with the Group’s Management Board, finance and reporting, risk management, internal audit and legal representatives.

By performing the procedures mentioned above, we have been able to obtain sufficient and appropriate audit evidence of the group’s financial information to provide an opinion on the consolidated financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of goodwill

(see note 12 to the financial statements)

Risk	As a result of past acquisitions, the Group carries capitalized goodwill with a value of RUB 95 billion as at 31 December 2018. In accordance with the requirements of IAS 36 Impairment of Assets, management performs an impairment assessment of the capitalized goodwill on an annual basis. The Group identified the cashflow generating units to be the operating segments for each of its retail formats. The goodwill impairment assessment is performed at the level of these cashflow generating units. The impairment assessment includes the assessment of the recoverable amount based on expected cash flows. These cash flows are based on current budgets and forecasts approved by the Supervisory Board and are extrapolated for subsequent years based on consumer price index. Key assumptions used are revenue growth, projected EBITDA margin and the discount rate. We consider this to be a key audit matter as the goodwill amount is significant, the assessment requires significant judgment and there is complexity in the valuation methodologies used to determine whether the carrying value of goodwill is appropriate, which includes the assumptions used within models to support the recoverable amount of goodwill.
Audit approach	We obtained an in-depth understanding of the Group’s methodology used for performing the goodwill impairment test and ensured it is in accordance with EU-IFRS. We challenged management’s key assumptions used in the goodwill impairment test and compared the assumptions used with industry trends and forecasts developed by independent analysts. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias. Regarding the key assumptions used and methodology applied, we involved internal valuation experts, who compared assumptions used in the model with observable market data and verified the methodology applied is compliant with EU-IFRS. We tested mathematical accuracy of the impairment testing model, reconciled internal inputs in the model with audited accounting records and ensured consistency of data used for goodwill impairment testing with other information obtained during the audit. We considered the adequacy of the disclosures to the financial statements.
Key observations	We consider Management Board’s key assumptions to be within a reasonable range of our own expectations and goodwill to be fairly stated. Additionally we consider the related disclosures in note 12 to the financial statements to be adequate.

Impairment of stores and other non-current assets

(notes 10,11 and 13 to the financial statements)

Risk	The Group operates more than 14,000 retail stores in Russia. The associated value of stores and other non-current assets, such as property, equipment and intangible assets excluding goodwill, approximated RUB 332 billion as at 31 December 2018 and is considered a key audit matter due to the magnitude of the carrying value as well as the judgment involved in assessing the recoverability of the invested amounts. Management assesses annually the existence of triggering events for potential impairment of assets, or reversals thereof. With respect to underperforming stores management assesses the impairment and impairment reversal on an annual basis using an internal calculation model. For the impairment, management first determines the value in use for each store and compares this to the carrying value. Where the carrying value is higher than the value in use, the fair value less cost of disposal is determined. The judgment involved focuses predominantly on the discount rate and future store performance, which is, among others, dependent on the expected revenue and the local competition. The expected revenue is determined based on the strategic growth plan prepared with reference to macroeconomic forecasts. Judgment is also involved in determination of the fair value of property undertaken on the basis of internal and external property valuation reports.
Audit approach	Among other audit procedures, we assessed appropriateness of the Group's policies and procedures to identify triggering events for potential (reversal of) impairment of stores and other non-current assets. For underperforming stores, we challenged management's key assumptions used in the cash flow forecast such as revenue growth and corroborated these assumptions through comparison to management's internal forecasts, external data and historical performance. We assessed accuracy of management's forecasts used in prior year to identify potential bias. We involved our internal valuation experts to evaluate the methodology, inputs and assumptions used in the model for consistency with general practice and market observable data. The audit of the model also included verification that the impairment methodology is consistently applied and that the model is mathematically accurate. We involved our internal real estate valuation experts to assess the (market) property valuations performed by the Group. We also assessed objectivity and competency of external appraisers engaged by the Group. We considered the adequacy of the disclosures to the financial statements.
Key observations	We consider Management Board's key assumptions to be within a reasonable range of our own expectations and stores and other non-current assets to be fairly stated. Additionally we find the related disclosures in notes 10, 11 and 13 to the financial statements to be adequate.

Recognition of vendor allowances

(see note 2.24 to the financial statements)

Risk	The Group receives various types of vendor allowances such as rebates and service fees. Rebates largely depend on volumes of products purchased and service fees are received for promotional activities that the Group undertakes with respect to certain products. These allowances represent a significant component of cost of sales and are recognized as a reduction of the inventory cost value. While the majority of the allowances are settled during the financial year, a substantial amount remains outstanding at each year-end and is recognized as part of trade receivables. We consider this to be a key audit matter because allowance arrangements are individually different, can be complex and recognition of vendor allowances and related receivables require a certain level of judgment by management, for example, timing of delivery of the service and evidence thereof. Moreover, the allocation of the allowances to inventory cost value also has an element of judgment. The Group evaluates all required disclosures for vendor allowances and determines that these are appropriately included in the financial statements.
Audit approach	Our procedures included testing of internal controls related to occurrence, completeness and measurement of the allowances recognized in the accounting system and covered both, IT application and manual controls, including controls related to periodic reconciliations with vendors. We verified that the Group is in compliance with relevant laws and regulations in relation to these vendor allowances, including the new trade law implemented in 2017. We selected a sample of vendors and obtained direct confirmations from vendors of their settlements with the Group. We tested on a sample basis documents supporting journal entries regarding the recognition of vendor rebates and service fees. In addition, we performed margin analysis and we reviewed subsequent collections on prior period vendor allowance receivables and subsequent collections of the vendor allowances receivable in the current year. We verified that the policy for the reduction of inventory cost related to vendor allowances is appropriate and has been applied correctly. We considered the adequacy of the disclosures to the financial statements.
Key observations	We did not identify material exceptions and we found the Management Board's recognition of vendor allowances to be reasonable. Additionally we found the related disclosures in note 2.24 to the financial statements to be adequate.

Long-term incentive programme (LTI)

(see note 27 to the financial statements)

Risk	The Group has two long-term incentive programmes in place. The first one was introduced in 2015 and runs until 31 December 2019. The second one was approved in December 2017 and runs until 31 December 2020. Targets under the LTI programmes are structured to align the long-term interests of shareholders and management, with a focus on maintaining market leadership in terms of revenue and, as additional long-term objective set in the second LTI programme, market leadership in terms of enterprise value multiple relative to competitors, without sacrificing EBITDA margin. The total available fund for all pay-outs under the first LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved. The total available fund for all pay-outs under the second LTI programme is capped at 5% of average EBITDA during the three-year period of the program. Each stage of the LTI programmes includes a deferred component of conditional pay-outs in order to maintain the focus on long-term goals throughout the programme. The size of each individual cash award is based on a pre-determined score reflecting the participant's role and contribution to meeting the LTI targets, both at individual and team level. For each LTI participant, total LTI pay-out may be adjusted downwards based on individual performance during the period of the programme. We consider this to be a key audit matter due to significant judgment involved in determination of appropriate accounting policies and estimates used in LTI calculations.
Audit approach	We obtained an in-depth understanding of the Group's new LTI programme and methodology used for recognition of LTI expenses. We challenged management's key assumptions used in the LTI expense calculation for both new and existing LTI programmes. This includes the period over which the expenses should be accrued in relation to both the LTI phases and targets achieved in 2018 as well as those expected to be achieved in future years. We tested accuracy of prior year estimates and assumptions used by management to identify potential bias. We tested mathematical accuracy of LTI expense calculations, reconciled internal inputs in the calculations with audited accounting records and ensured consistency of data used for LTI calculations with other information obtained during the audit. We considered the adequacy of the disclosures to the financial statements.
Key observations	We did not identify material exceptions in the LTI expenses and we consider the Management Board's key assumptions to be within a reasonable range of our own expectations and the related disclosures in note 27 to the financial statements to be adequate.

Effect of IFRS 16 transition disclosure

(see note 4 to the financial statements)

Risk	IFRS 16 Leases, becomes effective for annual reporting periods beginning on or after 1 January 2019. The application of this new standard as disclosed in note 4 will have a material effect on components of the financial statements and the presentation of the net assets, financial position and results of operations of the Group. The analysis performed on the initial application of the standard indicates that the amount of lease liabilities and right-of-use assets that will be recognised as a result of the transition falls in the range of RUB 410 – 460 billion. The difference between the amount of lease liabilities and right-of-use assets will be reflected as a decrease in equity. We believe that this is a key audit matter because of the magnitude of the effect and complexity of the implementation process, which required to identify all lease contracts and process significant volumes of data associated with lease contracts. Also such matters as discount rates and lease terms involves significant management judgments.
Audit approach	We obtained an in-depth understanding of the Group's methodology used for assessment of the IFRS 16 transition adjustment. We challenged management's key assumptions and judgments including those used in determination of the lease term and discount rates. We also considered completeness of the lease contracts population identified by the Group. Our procedures included testing of internal controls related to measurement of IFRS 16 transition adjustment and covered both IT application and manual controls. We selected a sample of lease contracts and manually recalculated for their right-of-use assets and lease liabilities at 1 January 2019. We tested on a sample basis documents supporting lease contracts master data used for IFRS 16 right-of-use assets and lease liabilities calculation at 1 January 2019. We considered the adequacy of the IFRS 16 transition disclosures to the financial statements.
Key observations	We did not identify material exceptions and we found the Group's IFRS 16 transition disclosure in note 4 to the financial statements to be adequate.

In prior year we included a key audit matter in relation to the Depreciation of buildings. We consider this no longer a key audit matter because it was resolved in prior year.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- The Chairman's statement;
- The Management Report;
- The Supervisory Board Report;
- The Remuneration Report;
- Other information as required by Part 9 of Book 2 of the Dutch Civil Code.

Based on the following procedures performed, we conclude that the other information:

- Is consistent with the financial statements and does not contain material misstatements;
- Contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is substantially less than the scope of those performed in our audit of the financial statements.

The Management Board is responsible for the preparation of the other information, including the Management Report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information as required by Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

Following the appointment by the extraordinary general meeting of shareholders on 12 November 2015, we were engaged by the Supervisory Board on 15 December 2015 as auditor of X5 Retail Group N.V. as of the audit for the year 2016 and have operated as statutory auditor since that date.

No prohibited non-audit services

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

Description of responsibilities for the financial statements

Responsibilities of the Management Board and the Supervisory Board for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Management Board is responsible for such internal control as the Management Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Management Board is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Management Board should prepare the financial statements using the going concern basis of accounting unless the Management Board either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Management Board should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit engagement in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not detect all material errors and fraud during our audit.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included among others:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Concluding on the appropriateness of the Management Board's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit. In this respect we also submit an additional report to the Audit Committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine the key audit matters: those matters that were of most significance in the audit of the financial statements. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, 19 March 2019

Ernst & Young Accountants LLP
Signed by G.A. Arnold