Financial review

X5 Retail Group continued to perform well in 2018, with results that reflect the strategic priorities that the Company has approved. We demonstrated balanced growth, with revenue increasing by 18.3% year-on-year to RUB 1,533 billion. We increased our gross margin thanks to our reduced reliance on promo, as well as our focus on operating efficiency, including successful measures to control shrinkage by the new team at Pyaterochka, which had an impact on our profitability starting from the third quarter.

X5 worked hard to implement efficiency measures throughout the year: we further developed a leaner logistics structure, renegotiated lease agreements and leveraged technology-driven solutions throughout our business to help optimise costs. At the same time, 2018 was a year when average annual food inflation amounted to just 1.7% year-on-year, while non-food and services inflation amounted to 3.4% and 3.9% year-on-year, respectively. This contributed to SG&A costs (excl. D&A and impairment costs) rising at a faster rate than our sales, increasing by 83 b.p. to 17.9% of revenue.

Our adjusted EBITDA[1] performance was in line with our targets, rising by 10.8% year-on-year to RUB 110 billion. X5 Retail Group's adjusted EBITDA margin was 7.2%. Net profit for 2018 amounted to RUB 28.6 billion. In line with X5's dividend policy, the Board of Directors has recommended a dividend of RUB 25.0 billion for 2018, or RUB 92.06 per GDR, which represents 87% of net profit.

While continuing to invest in smart and balanced growth, we have maintained a strong balance sheet, and the Company's net debt/EBITDA ratio at the end of 2018 was 1.70x. We reduced the weighted average effective interest rate on our total debt from 9.51% for FY 2017 to 8.39% for FY 2018 as a result of ongoing efforts to reduce interest expenses and reflecting declining interest rates in Russian capital markets in the first half of the year.

We look forward to another year of balanced growth in 2019. While we expect the food retail sector to continue to face a difficult environment, with no growth in real disposable income and stiff competition in the retail sector, X5 Retail Group is up to the challenge and will continue to focus on further adapting to customer needs, while making the business more efficient.

[1] Adjusted EBITDA is EBITDA before costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 122-125.

Svetlana Demyashkevich
Chief Financial Officer

Financial review

The financial and operational information contained in this financial review comprises information about X5 Retail Group N.V. and its consolidated subsidiaries (hereinafter jointly referred to as "we", "X5" or the "Company"). The following is a review of our financial condition and results of operations as of 31 December 2018 and for the years ended 31 December 2018 and 31 December 2017.

The consolidated financial statements and related notes thereto are available on pages 226-292 of this document and were prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

Key highlights

Revenue

RUB **1,533** bln

18.3% year-on-year increase

Gross profit margin

24.1%

27 b.p. year-on-year increase

Adjusted EBITDA margin

7.2%

49 b.p. year-on-year decrease

Net debt/EBITDA

1.70x

Capital expenditure

RUB **83.7** bln

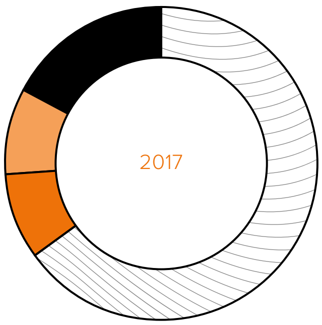
15.2% year-on-year decrease

Dividends

RUB **25** bln

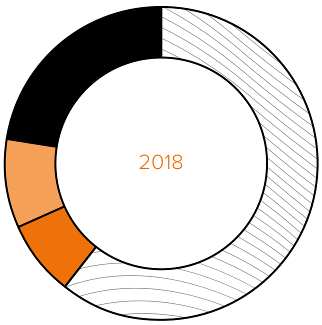
RUB 92.06 per GDR, 87.3% of consolidated IFRS net profit

Capital expediture structure, %



New store openings	65
Refurbishments	9
Logistics	10
IT, maintenance and other	16

RUB **98.6** bln



New store openings	61
Refurbishments	8
Logistics	9
IT, maintenance and other	22

RUB **83.7** bln

Results of operations for the year ended 31 December 2018 compared to the year ended 31 December 2017

The following table and discussion provide a summary of our consolidated results of operations for the years ended 31 December 2018 and 31 December 2017.

Profit and loss statement: highlights

Russian roubles (RUB), mln[1]	2018	2017	% change, y-o-y
Revenue	1,532,537	1,295,008	18.3
incl. net retail sales[2]	1,525,015	1,286,949	18.5
Pyaterochka	1,197,772	1,000,942	19.7
Perekrestok	230,848	186,936	23.5
Karusel	90,818	89,302	1.7
Gross profit	369,720	308,938	19.7
Gross profit margin, %	24.1	23.9	27 b.p.
Adj. SG&A[3]	(271,641)	(217,773)	24.7
Adj. SG&A, % of revenue	17.7	16.8	91 b.p.
Adj. EBITDA	109,871	99,131	10.8
Adj. EBITDA margin, %	7.2	7.7	(49) b.p.
Operating profit	58,154	57,758	0.7
Operating profit margin, %	3.8	4.5	(67) b.p.
Net profit	28,642	31,394	(8.8)
Net profit margin, %	1.9	2.4	(56) b.p.

[1] Please note that in this and other tables and text, immaterial deviations in the calculation of percentage changes, subtotals and totals are explained by rounding.
[2] Net of VAT and revenue from wholesale operations and revenue from franchise services and other services
[3] Adjusted SG&A is SG&A before depreciation, amortisation and impairment costs as well as costs related to the LTI programme, share-based payments and other one-off remuneration payments. For more information on alternative performance measures, see pages 122-125.

Revenue and net retail sales

In 2018, X5's revenue increased by 18.3% year-on-year to RUB 1,533 billion. Net retail sales for 2018 grew by 18.5% year-on-year, driven by a 1.5% increase in LFL sales and a 17.0% sales growth contribution from an 18.0% rise in selling space.

The Company's proximity store format, Pyaterochka, was the main driver of growth in 2018: Pyaterochka's net retail sales rose by 19.7% year-on-year, driven by a 0.9% increase in LFL sales and an 18.8% contribution to sales growth from a 19.5% expansion in selling space.

The Company's supermarket format, Perekrestok, had the highest pace of growth among the Company's formats on the back of successful adaptation of the format's CVP to consumer needs: Perekrestok's net retail sales rose by 23.5% year-on-year, driven by a 5.9% increase in LFL sales and a 17.6% contribution to sales growth from a 22.6% expansion in selling space.

Karusel's net retail sales growth decelerated to 1.7% year-on-year mainly due to the closure of eight hypermarkets for refurbishment in 2018.

The Company demonstrated positive LFL traffic for both core formats, Pyaterochka and Perekrestok, reaching 0.9% at the Group level in 2018.

Gross profit

The Company's gross profit margin in 2018 increased by 27 basis points year-on-year to 24.1%, primarily due to improvement in the commercial margin as a result of a more balanced approach to promo and the format mix effect from proportionally more sales at Perekrestok, which has a higher commercial margin than the X5 average. Management initiatives focused on reducing shrinkage levels in H2 2018 also had a positive impact on gross profit margin.

Summary of operational results

2018 net retail sales results, % change y-o-y	Average ticket	Number of customers	Net retail sales
Pyaterochka	(0.3)	19.8	19.7
Perekrestok	(0.7)	24.2	23.5
Karusel	3.9	(2.3)	1.7
X5 Retail Group	(0.5)	18.9	18.5

Selling space at end of period, square metres	31-Dec-18	31-Dec-17	% change, y-o-y
Pyaterochka	5,291,421	4,426,808	19.5
Perekrestok	781,538	637,242	22.6
Karusel	382,024	385,271	(0.8)
X5 Retail Group	6,463,735	5,479,741	18.0

2018 LFL[1] results, % growth y-o-y	Sales	Traffic	Basket
Pyaterochka	0.9	0.4	0.5
Perekrestok	5.9	6.2	(0.4)
Karusel	(0.0)	(3.1)	3.2
X5 Retail Group	1.5	0.9	0.6

[1] LFL comparisons of retail sales between two periods are comparisons of retail sales in the local currency (including VAT) generated by relevant stores. The stores that are included in LFL comparisons are those that have operated for at least 12 full months. Their sales are included in the LFL calculations starting from the day of the store's opening. We include all stores that fit our LFL criteria in each reporting period.

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

RUB mln	2018	2017	% change, y-o-y
Staff costs	(119,883)	(99,124)	20.9
% of revenue	7.8	7.7	17 b.p.
incl. LTI and share-based payments	(2,243)	(2,938)	(23.7)
staff costs excl. LTI % of revenue	7.7	7.4	25 b.p.
Lease expenses	(75,392)	(60,080)	25.5
% of revenue	4.9	4.6	28 b.p.
Utilities	(31,942)	(23,795)	34.2
% of revenue	2.1	1.8	25 b.p.
Other store costs	(17,208)	(15,450)	11.4
% of revenue	1.1	1.2	(7) b.p.
Third-party services	(12,463)	(10,854)	14.8
% of revenue	0.8	0.8	(2) b.p.
Other expenses[2]	(16,996)	(11,408)	49.0
% of revenue	1.1	0.9	23 b.p.
SG&A (excl. D&A&I)	(273,884)	(220,711)	24.1
% of revenue	17.9	17.0	83 b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	**(271,641)**	**(217,773)**	**24.7**
% of revenue	**17.7**	**16.8**	**91 b.p.**

[2] As a result of the adoption of IFRS 9, the Company changed the presentation of its condensed consolidated interim statement of profit or loss by reclassifying net impairment losses on financial assets out of selling, general and administrative expenses.
The Company made a decision to reclassify income from the sale of recyclable materials from other expenses (SG&A) to lease/sublease and other income.

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

In 2018, adjusted SG&A expenses as a percentage of revenue increased year-on-year by 91 basis points to 17.7%, mainly due to increased staff costs, lease expenses, utilities costs and other expenses on the back of low food inflation as well as non-food and services inflation exceeding food inflation.

Staff costs (excluding LTI and share-based payments) in 2018, as a percentage of revenue, increased year-on-year by 25 basis points to 7.7% due to the Company's decision to increase compensation for in-store personnel in line with market benchmarks in Q3 2017, with nominal wage growth outpacing shelf inflation.

Lease expenses as a percentage of revenue in 2018 increased year-on-year by 28 basis points to 4.9%, mainly due to the growing share of leased space in X5's total real estate portfolio, which accounted for 76% as of 31 December 2018, compared to 73% as of 31 December 2017, as well as lease inflation rising faster than shelf inflation.

Utilities expenses as a percentage of revenue increased year-on-year by 25 basis points to 2.1% due to tariffs growing faster than shelf inflation.

In 2018, other store costs as a percentage of revenue declined year-on-year by 7 basis points to 1.1%, driven by lower security costs, materials and maintenance expenses.

In 2018, third-party services as a percentage of revenue changed immaterially compared to 2017, totalling 0.8%.

Other expenses as a percentage of revenue increased by 23 basis points year-on-year in 2018 to 1.1%, primarily due to reclassification of proceeds from the sale of recyclable materials to other income in 2018, an increase in acquiring costs driven by a 7 percentage point rise in the penetration of card payments during the course of 2018, and the low base effect in 2017 associated with the release of provisions.

Long-term incentive (LTI) programme

Accruals have been made in the consolidated financial statements for the year ended 31 December 2018 related to the old LTI programme, which focused on achieving leadership in revenue terms, while the new LTI programme is aimed at maintaining leadership in revenue terms and achieving leadership in terms of enterprise value multiple relative to peers. In total, RUB 2,171 million was accrued in 2018 for both LTI programmes.

The new LTI programme is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred and conditional payouts in order to maintain the focus on long-term goals and to provide for an effective retention mechanism. In comparison to the old 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 new LTI programme are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and, as an additional long-term objective, leadership in terms of enterprise value multiple relative to peers. Additionally, the LTI programme includes triggers related to the EBITDA margin to ensure that profitability is not sacrificed and related to the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management.

As described in the Remuneration Report on pages 221-225, the targets under the second stage of the old LTI programme were achieved in 2017. Therefore, an accrual of RUB 1,552 million has been made in the consolidated financial statements for the year ended 31 December 2018 related to the old LTI programme.

The Company also accrued a liability of RUB 619 million for the probable achievement of the target to maintain revenue leadership from the new LTI programme. All LTI accruals and attributable social taxes since the beginning of the old programme are summarised in the table below.

LTI programme expenses,
including social security contributions (SSC)

RUB mln	2018	2017	2016	2015
Old programme	1,552	2,876	3,053	3,607
New programme	619	–	–	–
TOTAL LTI	**2,171**	**2,876**	**3,053**	**3,607**

EBITDA and adjusted EBITDA

RUB mln	2018	2017	% change, y-o-y
Gross profit	369,720	308,938	19.7
Gross profit margin, %	24.1	23.9	27 b.p.
Adj. SG&A (excl. D&A&I and LTI and share-based payments)	(271,641)	(217,773)	24.7
% of revenue	17.7	16.8	91 b.p.
Lease/sublease and other income	12,293	8,196	50.0
% of revenue	0.8	0.6	17 b.p.
Adj. EBITDA	**109,871**	**99,131**	**10.8**
Adj. EBITDA margin, %	**7.2**	**7.7**	**(49) b.p.**
LTI, share-based payments and other one-off remuneration payments expense and SSC	(2,243)	(2,938)	(23.7)
% of revenue	0.1	0.2	(8) b.p.
EBITDA	**107,628**	**96,193**	**11.9**
EBITDA margin, %	**7.0**	**7.4**	**(41) b.p.**

Lease/sublease and other income

As a percentage of revenue, the Company's income from lease, sublease and other operations increased by 17 b.p. year-on-year, totalling 0.8% primarily due to reclassification of income from the sale of recyclable materials in 2018.[1]

EBITDA analysis

As a result of the factors discussed above, X5's EBITDA in 2018 grew year-on-year by 11.9% and totalled RUB 107,628 million, while the adjusted EBITDA margin decreased by 49 b.p. year-on-year to 7.2%.

Analysis by segments

Pyaterochka

RUB mln	2018	2017	% change, y-o-y
Revenue	1,200,457	1,004,406	19.5
EBITDA	92,910	82,891	12.1
EBITDA margin, %	7.7	8.3	(51) b.p.

Pyaterochka's EBITDA margin decreased by 51 b.p. year-on-year to 7.7% due to increased shrinkages in H1 2018, increased compensation for in-store personnel in line with market benchmarks in Q3 2017, growth in lease expenses due to the growing share of leased space, non-food and services inflation increasing at a faster pace than shelf inflation, and the high base effect in 2017 associated with the release of provisions in H1 2017.

[1] The Company made a decision to reclassify income from the sale of recyclable materials from other expenses (SG&A) to lease/sublease and other income.

Perekrestok

RUB mln	2018	2017	% change, y-o-y
Revenue	232,490	188,501	23.3
EBITDA	15,550	13,012	19.5
EBITDA margin, %	6.7	6.9	(21) b.p.

Perekrestok's EBITDA margin decreased by 21 b.p. year-on-year in FY 2018 to 6.7% mainly due to aligning in-store personnel compensation to market benchmarks, higher lease expenses due to the growing share of leased space, growth in utilities costs and non-food and services inflation increasing at a faster pace than shelf inflation.

Karusel

RUB mln	2018	2017	% change, y-o-y
Revenue	92,458	90,608	2.0
EBITDA	4,423	4,618	(4.2)
EBITDA margin, %	4.8	5.1	(31) b.p.

Karusel's EBITDA margin declined by 31 b.p. year-on-year to 4.8% on the back of a higher share of promo, increased compensation for in-store personnel, the closing of eight stores for refurbishment in 2018 and non-food and services inflation increasing at a faster pace than shelf inflation.

Other segments

RUB mln	2018	2017	% change, y-o-y
Revenue	7,132	11,493	(37.9)
EBITDA	(235)	(68)	245.6
EBITDA margin, %	(3.3)	(0.6)	(270) b.p.

Other segments include Perekrestok Express. In 2017, X5 made the strategic decision to sell this format. In Q1 2019, the Company plans to close all remaining stores.

Corporate Centre

RUB mln	2018	2017	% change, y-o-y
EBITDA	(5,020)	(4,260)	17.8

Corporate expenses rose by 17.8% year-on-year in 2018, mainly due to increased lease expenses from the new office building and additional costs arising from X5's investments in innovations, omnichannel development and big data.

Depreciation, amortisation and impairment costs

Depreciation, amortisation and impairment costs in 2018 totalled RUB 49,474 million (RUB 38,435 million for 2017), increasing as a percentage of revenue by 26 b.p. year-on-year to 3.2%. This was due to continuous changes in the composition of buildings, with a growing share of fixtures and fittings versus foundation and frame driven by the growing share of leased space in X5's total real estate portfolio and low level of food inflation.

Non-operating gains and losses

RUB mln	2018	2017	% change, y-o-y
Operating profit	58,154	57,758	0.7
Operating profit margin, %	3.8	4.5	(67) b.p.
Net finance costs	(18,667)	(16,017)	16.5
Net FX result	(447)	75	n/m
Profit before tax	39,040	41,816	(6.6)
Income tax expense	(10,398)	(10,422)	(0.2)
Net profit	**28,642**	**31,394**	**(8.8)**
Net profit margin, %	**1.9**	**2.4**	**(56) b.p.**

Non-operating gains and losses analysis

Net finance costs in 2018 amounted to RUB 18,667 million, a 16.5% increase from 2017. The effect from the higher level of gross debt as of 31 December 2018 compared to 31 December 2017 was partially offset by the decreased weighted average effective interest rate on X5's total debt from 9.51% for FY 2017 to 8.39% for FY 2018 as a result of declining interest rates in Russian capital markets and actions taken to minimise interest expenses.

Income tax expenses decreased by 0.2% in 2018, and profit before tax decreased by 6.6% year-on-year. In 2018, X5's effective tax rate increased to 26.6% from 24.9% in 2017. In 2017, the Company had a positive effect from the application in foreign jurisdictions of rates other than the standard statutory rate of 20%.

Consolidated cash flow

RUB mln	2018	2017	% change, y-o-y
Net cash from operating activities before changes in working capital	**107,827**	**96,830**	**11.4**
Change in working capital	19,609	(11,386)	n/m
Net interest and income taxes paid	(29,402)	(26,786)	9.8
Net cash flows generated from operating activities	**98,034**	**58,658**	**67.1**
Net cash used in investing activities	**(92,760)**	**(87,274)**	**6.3**
Net cash (used in)/generated from financing activities	**(8,436)**	**38,017**	**n/m**
Effect of exchange rate changes on cash and cash equivalents	(75)	14	n/m
Net (decrease)/increase in cash and cash equivalents	**(3,237)**	**9,415**	**n/m**

Cash flow analysis

In 2018, the Company's net cash from operating activities before changes in working capital increased by RUB 10,997 million, or 11.4%, year-on-year, totalling RUB 107,827 million and reflecting the overall growth of the business. The positive change in working capital was primarily due to business growth and the subsequent increase in accounts payable, while initiatives to improve the collection of accounts receivable yielded positive results. Inventory management also improved as the Company continued to optimise its assortment and business processes.

Net interest and income tax paid in 2018 increased year-on-year by RUB 2,616 million, or 9.8%, totalling RUB 29,402 million, driven by higher weighted average gross debt during the period compared to the period-end. The effect from increased gross debt as of 31 December 2018 compared to 31 December 2017 was partially offset by the lower weighted average effective interest rate on X5's debt for 2018.

As a result, net cash flows generated from operating activities in 2018 totalled RUB 98,034 million, compared to RUB 58,658 million for the same period in 2017.

Net cash used in investing activities, which generally consists of payments for property, plants and equipment, totalled RUB 92,760 million in 2018, compared to RUB 87,274 million in 2017, mainly due to the cash payment for O'Key's supermarket business that was made in 2018, while capital expenditures for the same deal are reflected in 2017 financial statements.

Net cash used in financing activities totalled RUB 8,436 million in 2018, compared to net cash generated from financing activities of RUB 38,017 million in 2017. This was related to growth of net cash flow from operating activities.

Liquidity update

RUB mln	31-Dec-18	% in total	31-Dec-17	% in total	31-Dec-16	% in total
Total debt	207,764		194,296		156,033	
Short-term borrowings	60,435	29.1	58,674	30.2	45,168	28.9
Long-term borrowings	147,329	70.9	135,622	69.8	110,865	71.1
Net debt	**183,396**		**166,691**		**137,843**	
Net debt/EBITDA	**1.70x**		**1.73x**		**1.81x**	

Liquidity analysis

As of 31 December 2018, the Company's total debt amounted to RUB 207,764 million, 29.1% of which was short-term debt and 70.9% was long-term debt. The Company's debt is 100% denominated in Russian roubles. As of 31 December 2018, 100% of X5's debt had fixed interest rates. Net debt/EBITDA was at 1.70x as of 31 December 2018.

As of 31 December 2018, the Company had access to RUB 341,502 million in available credit limits with major Russian and international banks.

Dividends

The dividend policy was approved by the X5 Supervisory Board in September 2017. When considering a dividend recommendation to the General Meeting of Shareholders, the Supervisory Board will be guided by a target consolidated net debt/EBITDA ratio of below 2.0x, in line with the Company's financing strategy.

Based on the Company's 2018 financial results, the Company's Supervisory Board has made a recommendation to pay dividends for 2018 in the amount of RUB 25,000 million/RUB 92.06 per GDR, which represents 87.3% of X5 Retail Group's 2018 net profit. This proposal will be considered by the AGM, which will be held on 10 May 2019.