Dear stakeholders,

We chose leading and evolving as the theme of the X5 Retail Group 2018 annual report because it fully reflects our core achievements in the past year as well as our goals for the future.

Challenging consumer and macroeconomic conditions made 2018 a difficult year for the entire food retail industry in Russia. While we worked hard to address these external challenges, we also underwent a significant reshuffle in our top-level operational management. Nonetheless, X5 Retail Group managed to deliver positive LFL performance, and we continued to expand our network of stores. In fact, looking back at 2018, I believe we faced these challenges as a cohesive team that evolved through these changes to become even stronger and more motivated to deliver results.

Some of the key areas where we are leading Russia’s food retail market include: by the end of 2018, we further strengthened our position as the largest player, with a market share of 10.7%; we continued to expand Perekrestok Online, our online supermarket; and we continued to roll out our data-driven loyalty programmes across all three formats, with Pyaterochka still the only proximity store in Russia to offer customers a loyalty card. By the end of 2018, we had 37.5 million active card holders across our three formats, which represents over 30% of Russia’s adult population.

Igor Shekhterman
Chief Executive Officer
At the same time, we are constantly evolving in order to maintain and further strengthen our leadership. We have adjusted our approach to growth at Pyaterochka, which operates in the highly competitive proximity segment, to focus on smart and balanced expansion to maintain margins and returns on investments as opposed to the rapid openings of previous years. At Perekrestok, we are nearing completion of our refurbishment programme, which is a major element of the supermarket format’s refreshed CVP. At Karusel, we continue to refine the new branding and operating model aimed at broadening the format’s appeal and increasing sales densities.

Some of the key highlights from 2018 include:

- Revenue grew by 18.3% to RUB 1.53 trillion, driven by an 18.0% rise in selling space and a 1.5% increase in LFL sales
- We achieved growth in LFL traffic and basket at the group level. LFL traffic growth accelerated in Q4 2018 at both core formats compared to the previous quarter. We are particularly pleased with the LFL traffic growth of 8.2% at Perekrestok, the highest level achieved since Q2 2011.
- Our adjusted EBITDA margin was in line with our internal target and remained above 7.0% in 2018, despite a challenging macro environment
- We continued to adhere to our dividend policy and recommended a dividend of RUB 25.0 billion (RUB 92.06 per GDR) for 2018
- We expanded our omnichannel offering with the expansion of Perekrestok Online to St Petersburg, as well as parcel lockers and cooperation with delivery services at Karusel. Perekrestok Online was particularly successful in 2018, with expansion into St Petersburg, the opening of two new dark stores and significant growth in the number of orders handled to over 408 thousand for the year.
- We regularly fine-tune our assortments in response to changing demand, and we are now piloting technology that will allow us to efficiently and accurately “clusterise” the assortment at Pyaterochka stores, depending on considerations like location, customer income and other demographic factors, as well as competition. We are also working to further improve the quality and range of our private-label offerings across our formats, with a focus on unique and exclusive features that set us apart from our peers.

Finally, our loyalty programmes, which are offered by each of our formats, use big-data-enabled analytical tools to help us understand our customers better and to provide programme members with a convenient and more personalised shopping experience. Loyalty card penetration in traffic in December reached 48% at Pyaterochka, 49% at Perekrestok and 81% at Karusel. As an illustration of the importance and success of our loyalty programmes, 37% of Pyaterochka’s customers in 2018 had loyalty cards, and these same customers accounted for 58% of the format’s net retail sales for the year.

A new strategy with a focus on the future

We have updated the way that we approach our strategic decision-making to ensure that we focus on achieving long-term leadership and value creation for our stakeholders. As we evolve to address increasing competition and changing customer expectations, we will focus on three key areas:

- **Strengthening the existing business:** This strategic priority has a clear focus on building and further enhancing X5 Retail Group’s current offline business by continuing to successfully adapt to customer needs and by increasing operating efficiency
- **Creating new innovative capabilities:** We already have in place an innovative business process that searches for,
reviews, pilots and implements innovative technologies that help us build a strong and sustainable business. X5 piloted 37 projects at its stores in 2018 that aim to either increase our top-line sales or to improve bottom-line profitability.

- **Creating business competencies to be a next-generation retailer:** We understand that the greatest opportunity for, and threat to, our business is technology-based disruption, and we aim to embrace the possibility of such disruption by developing an omnichannel business for all of our formats and adopting a business model that will enable X5 Retail Group to evolve and remain a leader even as the next generation of food retail emerges.

**Smart growth and efficiency**

Until recently, Russian food retailers were focused on growth by rapidly opening new stores and entering new geographies. The competitive environment, previously defined by low levels of penetration of modern retail, was supportive of such expansion, as was the macroeconomic situation. In the current environment characterised by greater maturity of the retail market and a more challenging macro-backdrop, X5 has adopted a new approach to achieving sustainable growth in its business. Our focus now is on selecting better locations by applying stricter requirements to new openings, improving efficiency and maintaining our return on invested capital. This new approach is reflected in the 21% year-on-year decline in the pace of new openings at Pyaterochka in FY 2018.
In addition to decelerating new openings, we continue to seek out and implement ways to improve operating efficiency across X5 Retail Group. This includes a wide range of initiatives, from renegotiating lease agreements to reducing shrinkage and streamlining store staffing. At the same time, we are leveraging data-enabled tools and innovations to further optimise our business by introducing better and faster analytical tools, as well as deepening the automation of processes.

To further support our efficient operations, X5 opened four new distribution centres and purchased 910 new trucks in 2018. This, combined with optimisation of business processes and the introduction of new, technology-based solutions, helped us to achieve sustainable cost savings across our logistics operations. Logistics costs per box declined by over 10% year-on-year in 2018.

**Market environment**

Even as the market leader, we remain constantly vigilant in a challenging market environment. Real income growth in Russia was near zero in 2018, and food inflation remained low for the majority of the year, averaging 1.7% for the year and peaking at 4.7% year-on-year in December. Economic growth remains subdued, with GDP expanding at about 1.8-2.3% p.a. At the same time, we are facing growing competition, especially in core markets like Moscow and St Petersburg, from existing players as well as new, specialised niche stores that seek to capitalise on offerings that meet the expectations of Russia’s increasingly demanding consumers.

We believe that we have chosen the right path to respond to these challenges, as we lay out in this report: strengthening our leadership position through customer-centricity, continued adaptation of our CVP to meet changing consumer demand and a relentless focus on service quality, while also optimising business processes and innovating to enhance efficiency.

We attribute our market leadership first and foremost to the customer value propositions of our three core formats. Other pillars of our success include our well-developed logistics infrastructure and the quality of our management team, which combines vision and the ability to execute.

**A management team ready to evolve**

I am particularly proud of the strong management team that we have at X5 Retail Group, and of the commitment and drive we have seen from within the organisation to help us strengthen our leadership position while growing and transforming the business. In the face of significant changes in the leadership of Pyaterochka and Perekrestok in 2018, we delivered strong results, with many internal candidates stepping up to the challenge and taking on new roles and responsibilities. I am very pleased that X5 was able to offer such excellent career growth opportunities to the talented people who work for the Company. We stand by our strategic objective to develop human capital at all levels of our organisation.

As the market and our customers change, we must stay ahead of these transformations. The management team we present to you in this report is a team that is ready to develop our business and that is committed to success and creating value for all shareholders. The team is motivated with long-term and short-term incentive programmes that we believe align their interests with those of our shareholders.

**Sustainable development**

At X5, we recognise that we bear responsibility for supporting a wide range of stakeholders, business partners and the communities where we operate our more than 14,000 stores.

As a Company, we are continuously working to reduce our impact on the environment: we have built a fleet of modern, low-emission trucks that keep costs down and pollute less than most fleets on the road in Russia; we have installed energy-efficient lighting and refrigeration equipment across our operations to reduce electricity consumption; and we are one of the largest recyclers in Russia, with over 572 thousand tonnes of materials recycled in 2018.
We aim to create value for more than 270,000 people who work for our Company by offering fair compensation packages with clear motivation programmes, training and development opportunities, as well as a safe and healthy working environment. Every single person who works at X5 Retail Group can play an important role in our success, and we want to ensure that we have established the conditions and inclusive working culture to get the best from all of our people.

We contribute to the development of local food producers as we seek to localise our assortment: by conducting training at DCs and using transparent, electronic document systems, we are helping local businesses expand sales by accessing the X5 Retail Group network.

In social welfare, the aspects of our business that we leverage are our areas of strength, like providing food aid to individuals and families in need or partnering with charities to collect donations across our vast network of stores. We believe that using our own infrastructure and expertise provides added value to such initiatives.

**Outlook**

We look ahead with optimism and desire to develop and achieve more. We acknowledge a mix of challenges and opportunities that will shape our plans and affect all players in our sector. The macroeconomic outlook is at best uncertain, with no signs of recovery in consumer confidence or household incomes. This means we must remain focused on strengthening our existing business with meaningful new efficiency measures, while continuing to pursue smart and balanced growth. I believe that X5 Retail Group is among the best-positioned in the industry to use its considerable size and resources to achieve our goals.

We have ambitious goals for implementing innovative technologies and developing omnichannel business models. This will be a key to our future growth, as we leverage technology to both help us increase our sales by expanding our audiences or growing the share of wallet among our customers, while at the same time using innovations to improve the efficiency of our business and reduce costs.

What makes me confident that our goals are achievable is the actual business and management competencies that X5 has been developing over the last two years in the fields of big data, innovation, technology and omnichannel service. X5 is today more advanced than many of its local peers in making innovation part of our day-to-day operations, and my goal as CEO is to see that this competitive advantage is secured and developed further.

Whether short-term or long-term strategic goals, all of our decisions will continue to put our customers at the core. We have built Russia’s largest modern food retailer, and we aim to maintain our #1 position by making improvements to our CVP an ongoing exercise and building a customer-centric culture through all parts of our business.

X5 remains committed to building value for its shareholders, customers, employees and business partners by strengthening its leadership position in Russia’s food retail industry and by evolving to remain a leader as the next generation of retail emerges. I would like to express my gratitude to our customers for their loyalty, to our employees for helping achieve solid results, and to our shareholders and other investors for their continued support and interest in our business.

Igor Shekhterman
Chief Executive Officer