

O'KEY Group S.A.
Annual Report

2016

O'KEY
GROUP OF COMPANIES



BRINGING FRESHNESS
TO OUR CUSTOMERS

O'KEY IS A MODERN, MULTI-FORMAT FOOD RETAILER IN RUSSIA WITH A PASSION FOR QUALITY, BEST VALUE PROPOSITION AND THE AMBITION TO DELIVER A UNIQUE CUSTOMER EXPERIENCE

15 years
OF HISTORY

623 k m²
OF SELLING SPACE
compared to 593 k m² in 2015

14.5%
CAGR REVENUE
growth in RUB terms (2009–2016)





Overview

<u>Financial & Operational Highlights</u>	<u>3</u>
<u>At a Glance</u>	<u>4</u>
<u>Highlights of 2016</u>	<u>6</u>



Strategic Report

<u>Chairman and Chief Executive's Statement</u>	<u>8</u>
<u>Market Overview</u>	<u>10</u>
<u>Our Strategy</u>	<u>12</u>
<u>Operational Review</u>	<u>14</u>
– <u>Hypermarkets and Supermarkets</u>	
– <u>Discounter Stores</u>	
– <u>Private Label Relaunch in Hypermarkets and Supermarkets</u>	
– <u>Online Shopping</u>	
– <u>Supply Chain Transformation in Hypermarkets and Supermarkets</u>	
<u>Financial Review</u>	<u>24</u>
<u>Corporate Social Responsibility</u>	<u>28</u>

Corporate Governance

<u>Corporate Governance System</u>	<u>32</u>
– <u>Board of Directors</u>	
– <u>Committees of the Board of Directors</u>	
– <u>Senior Management</u>	
<u>Risk Management</u>	<u>41</u>
<u>Shareholder and Investor Information</u>	<u>45</u>
<u>Management & Directors Responsibility Statement</u>	<u>48</u>

Financial Statements

<u>Report of the Réviseur d'Entreprises Agréé</u>	<u>49</u>
<u>Consolidated Financial Statements</u>	<u>50</u>
<u>Notes to the Consolidated Financial Statements</u>	<u>55</u>



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REVENUE GROWTH IN 2016



Overview

FINANCIAL & OPERATIONAL HIGHLIGHTS

We delivered solid operational results in 2016 with the Group's total annual revenue increasing by 8.0%, driven by the Company's ambitious transformation of key business processes and the development of the discounter format.

<div style="text-align: right; margin-bottom: 10px;">↑ 8.0%</div> <div style="font-size: 2em; font-weight: bold; color: red;">623</div> <div style="font-weight: bold;">K m²</div> <p>SELLING SPACE compared to 593 k m² in 2015</p>	<div style="text-align: right; margin-bottom: 10px;">↑ 8.0%</div> <div style="font-size: 2em; font-weight: bold; color: red;">+2.2%</div> <div style="font-weight: bold;">yoy</div> <p>GROUP LFL REVENUE</p>	<div style="text-align: right; margin-bottom: 10px;">↑ 8.0%</div> <div style="font-size: 2em; font-weight: bold; color: green;">175,471</div> <div style="font-weight: bold;">RUB mln</div> <p>TOTAL REVENUE</p>
<div style="text-align: right; margin-bottom: 10px;">↑ 1.5%</div> <div style="font-size: 2em; font-weight: bold; color: red;">110</div> <div style="font-weight: bold;">stores</div> <p>NET OF DISCOUNTERS</p>	<div style="text-align: right; margin-bottom: 10px;">↑ 1.5%</div> <div style="font-size: 2em; font-weight: bold; color: red;">+4.5%</div> <div style="font-weight: bold;">yoy</div> <p>RETAIL REVENUE GROWTH net of discounters</p>	<div style="text-align: right; margin-bottom: 10px;">↑ 1.5%</div> <div style="font-size: 2em; font-weight: bold; color: green;">11,845</div> <div style="font-weight: bold;">RUB mln</div> <p>EBITDA net of discounters</p>
<div style="text-align: right; margin-bottom: 10px;">↘ 8.5%</div> <div style="font-size: 2em; font-weight: bold; color: red;">164</div> <div style="font-weight: bold;">stores</div> <p>TOTAL NUMBER compared to 146 in 2015</p>	<div style="text-align: right; margin-bottom: 10px;">↘ 8.5%</div> <div style="font-size: 2em; font-weight: bold; color: red;">+27.7%</div> <div style="font-weight: bold;">yoy</div> <p>GROUP OPERATING CASH FLOW GROWTH</p>	<div style="text-align: right; margin-bottom: 10px;">↘ 8.5%</div> <div style="font-size: 2em; font-weight: bold; color: green;">9,253</div> <div style="font-weight: bold;">RUB mln</div> <p>GROUP EBITDA</p>

Overview

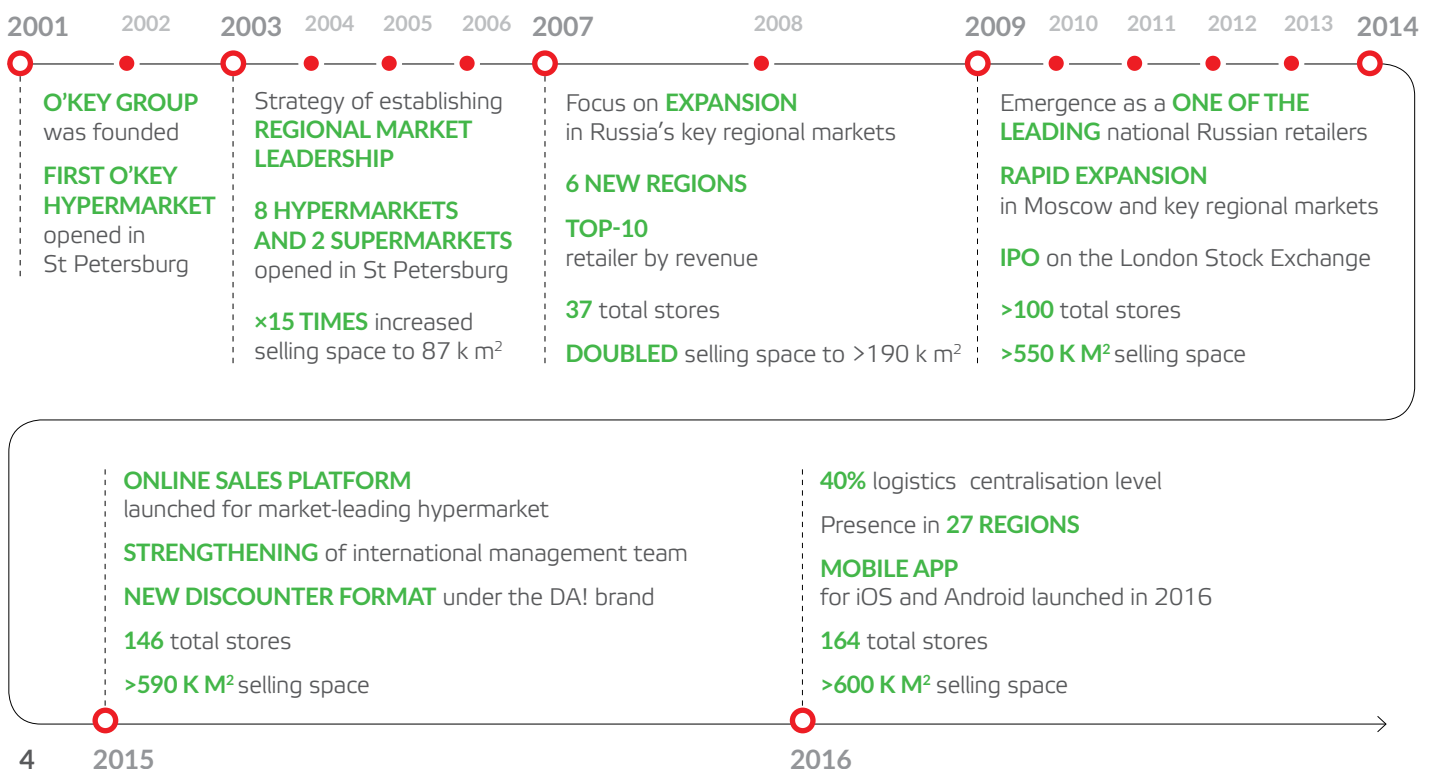
AT A GLANCE

O'KEY Group is the seventh largest food retailer in Russia by revenue. Our primary retail format is the modern, Western European style hypermarket under the O'KEY brand. This is underpinned by our chain of O'KEY supermarkets and our DA! discounter chain. We opened our first hypermarket in St Petersburg in 2002 and have continued to grow ever since. O'KEY is the first among Russian food retailers to launch and actively develop e-commerce operations in St Petersburg and Moscow offering a full range of hypermarket products for home delivery.

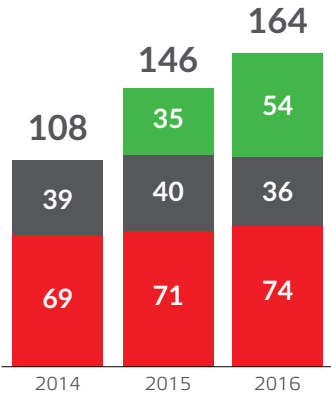
Key facts:

- ◆ **15 years history**
- ◆ **Experienced** management team
- ◆ One of the **market leaders** in St Petersburg with a strong presence in Moscow and other large cities in Russia
- ◆ **Strong brand** known for the quality of products and best-in-class shopping experience
- ◆ **Three differentiated formats** of modern food retail: hypermarket, supermarket and discounter format
- ◆ **High logistics centralisation level:** one federal and two regional distribution centres for hypermarket and supermarket segment, one distribution centre for discounter stores
- ◆ **more than 25,000 employees**

Our History:



Number of stores by format*



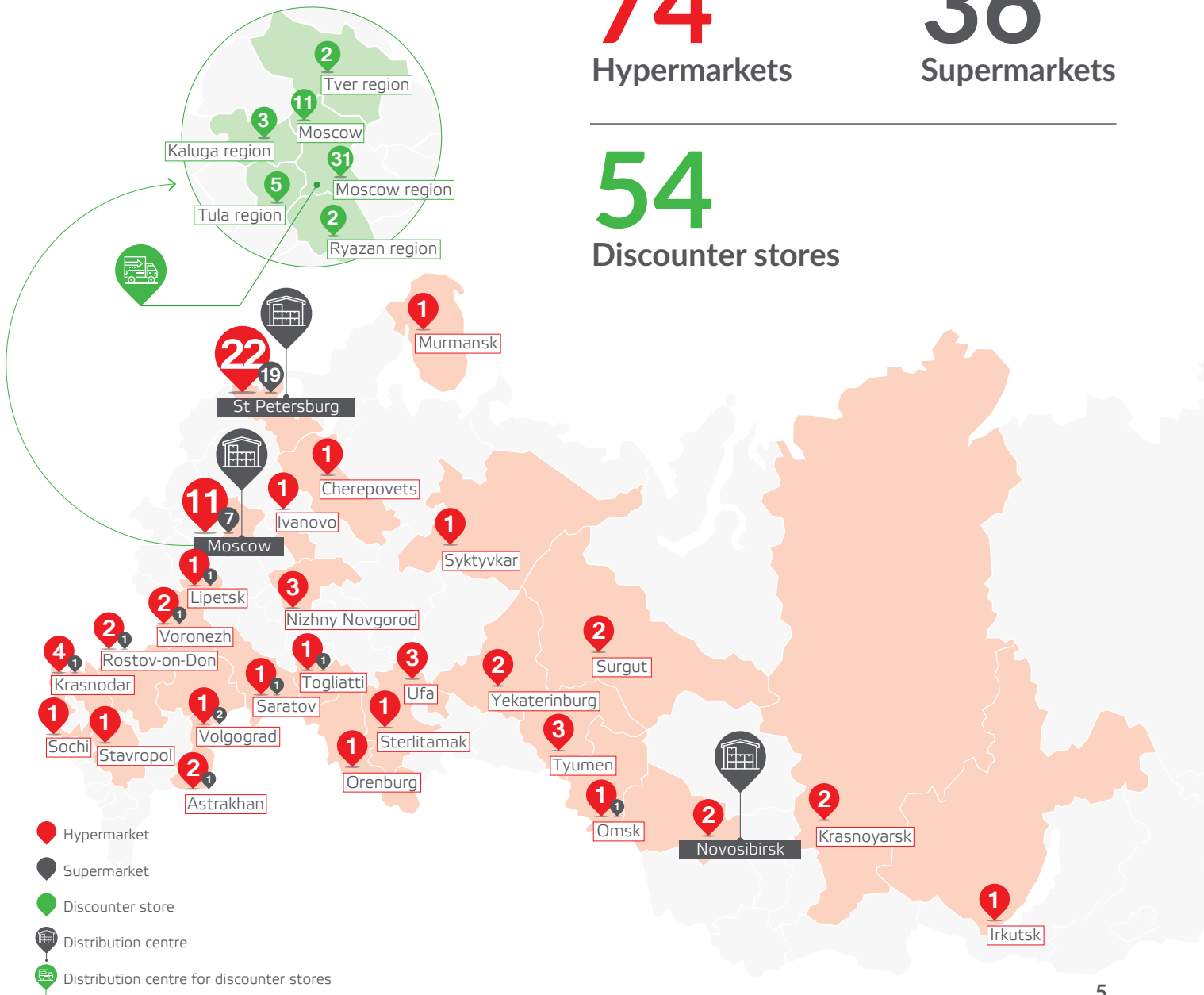
164

stores in 32 Russian cities

74
Hypermarkets

36
Supermarkets

54
Discounter stores



* As at 31 December 2016.

Overview

HIGHLIGHTS OF 2016



Customer focus

In 2016, our efforts were aimed at enhancing the best customer value proposition, which is based on competitive pricing and availability of a wide range of high-quality goods, including our private label products, as well as providing attractive promotions for even more outstanding customer experience. During 2016 in order to support our customer focus, we completed the build-up of our commercial team under a new management structure, comprising four divisions for long shelf life products, short shelf life products, non-food products and private label products.



Renewed hypermarket concept

In 2016, O'KEY launched a "compact city" hypermarket concept and renewed its hypermarket concept.

The new "compact city" concept, featured in a recently opened hypermarket in St Petersburg, offers a big choice of fresh produce, including farm products, and an extended range of our own production items. Renewed concept is more functional and has product zones organised by category, a smart and efficient concept of non-food, a better in-store navigation, enabling customers to easily find the required products. These features also allow us to use selling space more efficiently and boost sales per square metre.

For more details see p. [14](#)



Private labels and partnership with local producers

O'KEY continues the global relaunch of its private label products for hypermarket and supermarket segment. In April 2016, the Company launched an "O'KEY" line-up in the middle price segment. Also we have strengthened our supplier base to include market leaders as well as the most popular producers in the regions. Local enterprises are often able to produce high quality products and offer reasonable prices; cooperation with them is therefore beneficial for us due to the reduction of logistics costs.

For more details see p. [19](#)



Logistics

In 2015-2016, O'KEY opened one federal and two regional distribution centers in Moscow and St Petersburg for hypermarket and supermarket segment. Our transformed supply chain gives opportunities for further improvement of the inventory turnover, on-shelf availability and working capital management. In addition to this it leads to the shrinkage rate decrease and margin improvement through tight control over the supply chain.

For more details see p. [22](#)



IT systems

We continued to roll out the new IT infrastructure in hypermarkets and supermarkets supported by the latest IT solutions aimed at increasing business efficiency. In 2016, we continued to implement the ERP system (MS Dynamics AX 2012) complemented by the business oriented solutions such as Oracle RPAS. In addition, the project aimed at improving merchandise planning (JDA) was completed in 2016. The transformation of processes and systems will continue and is expected to improve the performance of the Company significantly over 2017-2018.



Loyalty programme

In 2016, we continued to focus on our customer needs, including the launch of a pilot project designed to make personalised special offers to customers based on their loyalty card information. Another milestone was the launching a new co-branded credit card jointly with ROSBANK. The new debit card also gives customers additional savings opportunities.



Online shopping

In 2016, we significantly expanded our delivery zones which now include the whole of the Moscow and St Petersburg areas.

We also **expanded the product range** to 25,000 SKUs.

In 2016, O'KEY launched an iOS and Android mobile app to facilitate online shopping.



DA! discount stores

In 2016, we continued to develop our discount business segment in line with our strategic plans.

As of December 31, 2016, O'KEY now operates 54 discount stores located in Moscow and the surrounding regions. In 2016 we have put considerable emphasis on improving the product range (PLs, branded products, in-outs) and fine-tuning it to the needs of our customers.

For more details see p. [21](#)

For more details see p. [17](#)

Strategic Report

CHAIRMAN AND CHIEF EXECUTIVE'S STATEMENT

DEAR CUSTOMERS, INVESTORS, COLLEAGUES AND PARTNERS,

2016 was an eventful and challenging year for O'KEY and the Russian retail sector as a whole. The retail sector in Russia continued to be adversely affected by the weak macroeconomic environment. Economic uncertainty and rising inflation led to a reduction in both real wages and disposable income, resulting in the lower purchasing power of Russian consumers. The larger retail formats also faced aggressive competition from a growing number of convenience stores.

Looking back at 2016, I can say that we successfully managed to implement our business transformation programme while responding in a timely manner to both market challenges and customer needs.

In order to address the twin challenges of preserving traffic and average ticket size, we focused on our customer needs enhancing the best customer value proposition, which is based on competitive pricing and availability of a wide range of high-quality goods, including our private label and local products, as well as providing attractive promotions for even more outstanding customer experience.

We put considerable effort into improving efficiency in our hypermarket and supermarket business segment as well as further expanding our discounter stores. We have strengthened our senior management team with best-in-class professionals and completed the build-up of our commercial team under a new management structure, comprising four divisions for long shelf life products, short shelf life products, non-food products and private label products. The organisational changes we have made in commercial purchasing are aimed at increasing our focus on individual product categories.

Overall, our strategy delivered strong operating results in 2016 with the Group's total annual revenue increasing by 8.0%, while traffic grew by 9.3% over the same period. Total revenue in the hypermarket and supermarket segment rose by 4.9% for the year, with traffic growing by 2.6% and average ticket size increasing by 1.7% over the same period. The main annual LFL indicators were also positive in this segment with the retail revenue of all the Group's LFL stores up by 2.2% in 2016.

As for financial results, EBITDA declined by 8.5% due to continuing roll-out of discounters, although the Group considers this to have now peaked with a significant improvement in EBITDA now expected in this and future years. EBITDA net of discounters increased by 1.5%, as a result of continuing efforts to boost efficiency of the business. We maintain a conservative approach to borrowing – our debt leverage remains sustainable, based on such metrics as a net debt to EBITDA ratio of 2.7 as of the end of 2016.

Our approach to the expansion of traditional retail formats remained conservative; as planned, we opened four new hypermarkets and one new supermarket in 2016. In our stores we implemented some elements of a new concept offering customers a unique “complete solution” experience. At the same time, we also launched our new “compact city” concept hypermarket in St Petersburg. Our strategic objective is to transform O'KEY in order to cater better to the needs of the modern customer by offering stores which are more functional and most convenient for shopping.

By opening new distribution centres in Moscow and St Petersburg, we were able to increase our logistics centralisation level from 15% in 2015 to 40% in 2016, and, by the end of 2017, we plan to increase this figure to 60%.

We derived considerable benefits in 2016 from the transformation of our supply chain and stock management activities, which included a new automatic ordering, forecasting and replenishment process, as well as increased supplier centralisation. This resulted in significant on stock availability improvements, less shrinkage, reduced labour costs and commercial margin improvement.

Last year we also began to see the first benefits from the implementation of a number of IT projects designed to automate our most important commercial operations such as space planning, product range and demand forecasting, price management and others. We have been able to reduce operating costs while maintaining a high level of quality as the new system ensures that our shelves are always filled with a wide range of fresh products.

We maintain superiority in online shopping in Russia, offering a wide range of both food and non-food products. In 2016 we began to receive the results of our significant investment in this area to date, registering a very positive response from consumers, with sales for the year increasing tenfold compared to the prior year to reach RUB 661 million.

In 2016, we put great emphasis on transforming our corporate culture in order to maintain operational stability in the face of difficult market conditions, while retaining and developing our key talent. During the year, we implemented a variety of new HR projects which focused on the improved assessment of employee performance, motivation and development.

We ended the fourth quarter of 2016 with 54 discounter stores in Moscow and surrounding regions. We have worked tirelessly on the range of products we offer our customers (PLs, branded products, in-outs), fine-tuning it to their needs.

As a result of these successful changes and the growing awareness of our private labels brands as well as the discounter store concept itself, we were pleased to see that LFL revenue at our discounter stores grew by 64.1% in Q4 2016 with traffic volume and basket value increasing by 36.4% and 20.4%, respectively.

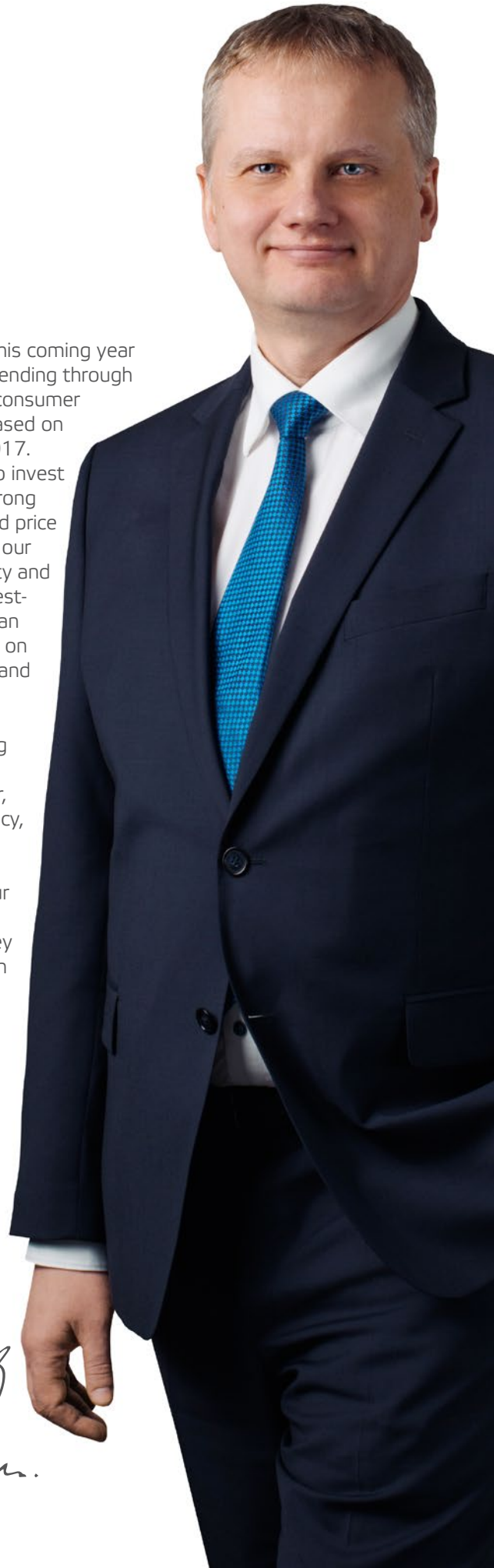
Yours truly,
HEIGO KERA
 Chairman of the Board of Directors
 and Chief Executive Officer of Hypermarket & Supermarket Segment

Outlook

While we do see some upside this coming year from a recovery in consumer spending through real wage growth and slowing consumer price inflation, our strategy is based on a more cautious scenario for 2017. We believe that by continuing to invest in our business today, with a strong focus on improved efficiency and price competitiveness, together with our established reputation for quality and service, we will be one of the best-positioned retailers in the Russian marketplace, ready to capitalise on future growth opportunities as and when they occur.

In 2017 we will focus on making further progress towards becoming a multi-format retailer, enhancing our operating efficiency, accelerating our growth and strengthening our relationship with investors. The quality of our products mix and private label brands will remain one of the key priorities in 2017 and we remain fully committed to improving an overall in-store shopping experience for our customers.

I have no doubt that O'KEY is on an excellent path towards achieving its key strategic goals. On behalf of the Board of Directors and Management Team, I would like to thank all of our stakeholders for their continued belief in the O'KEY story and for staying with us during this challenging year.

Strategic Report

MARKET OVERVIEW

Headwinds

In 2016, the retail sector in Russia continued to be adversely affected by the weak macroeconomic environment and increasing competition.

Macro picture remained subdued with GDP falling by 0.6% on consensus numbers. Low consumer confidence, real wage decline have resulted in the lower purchasing power of a Russian consumer, which has led to 5.2% decline of real retail sales. While at the end of last year negative impulse started diminishing with confidence improving on sequential basis (from 26 in Q2 to 18 points in Q4) and real wages growth accelerating to 1.8% in Q4 vs. 0.3% in Q2, we have not observed any improvement in our numbers yet.

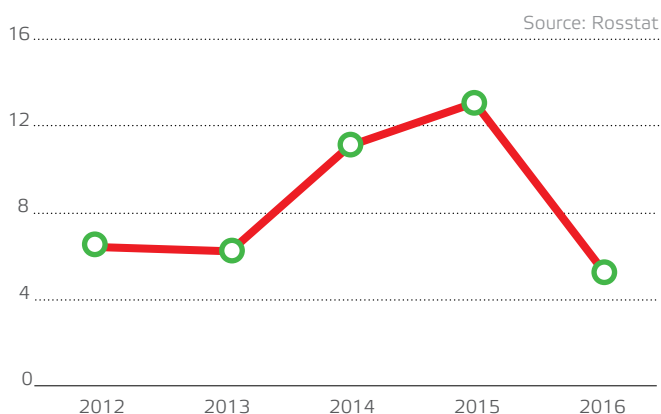
Competitive environment remained challenging in Russia. While consumer wallet has not been expanding, top 10 retailers added 2.2 million of square metres to 2015 net space according to Infoline.

Top 3 retailers added 1.7 million of square metres to their base in 2016 cannibalising not only competitors stores but their own store base as well. Despite this challenging environment, we managed to grow our LFLs across all formats.

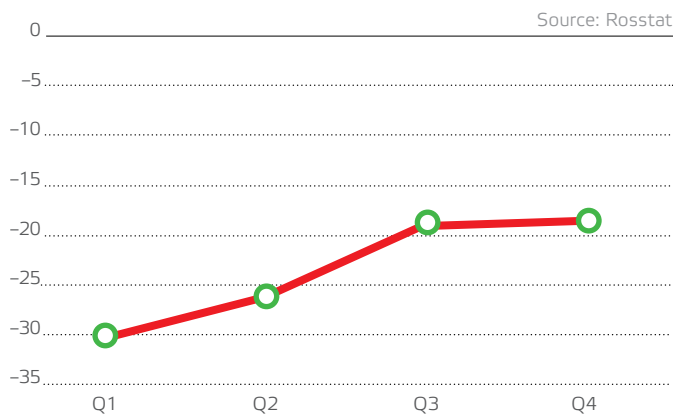
Outlook

While financial analysts according to Bloomberg have a constructive outlook for 2017 expecting Russian GDP to grow by 1.2% in real terms, we remain cautiously optimistic. While we expect some moderate recovery of consumer sentiment, signs of which we have already seen at the end of last year, we expect competitive pressure to persist overall and to remain a key headwind for our business.

Russian Consumer Price Index 2012-2016, YoY change, %



Russian Consumer Confidence Index, 2016, Quarterly, %



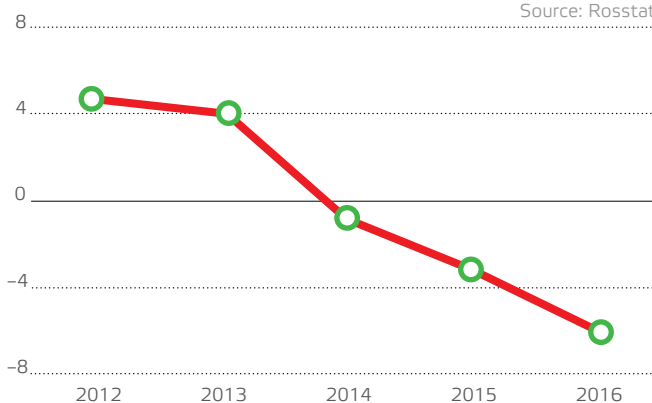


We believe there are limited opportunities to grow for us in the big box segment thus we will focus on quality expansion of “compact city” hypermarkets in cities where we have strong brand presence already. In addition, we see significant potential to improve productivity not only in our stores but also in our headquarters, which, in our view, will drive profitability of our business higher.

Discounters will remain our engine of growth. Recent results are very encouraging and we remain optimistic of the future of the classic discounter concept in Russia. We will therefore continue investing in this format in 2017 and beyond. We believe our discounters are well positioned to withstand growing competitive pressure and the volatile Russian consumer environment.

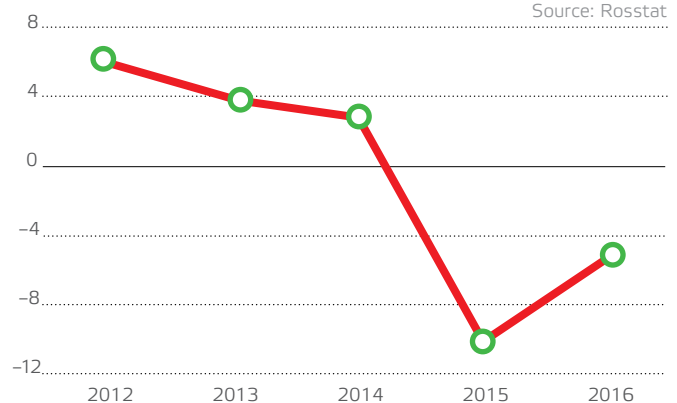
Real Disposable Income Growth, 2012-2016,
YoY change, %

Source: Rosstat



Real Retail Sales Growth, 2012-2016,
YoY change, %

Source: Rosstat



Strategic Report

OUR STRATEGY

Our strategy is built around developing a modern, multi-format food retailer in Russia with a passion for quality, best value proposition and the ambition to deliver a unique customer experience.

We are very optimistic about the future of our discounter format in Russia which will be the growth engine of the Group in the coming years. We plan to more than triple our presence in Moscow and surrounding regions in the the next 3 years aiming to grow significantly our revenues while improving profitability of the business.

In our hypermarket and supermarket segment we see a significant opportunity to improve productivity thus decreasing cost of operations not only at the store level, but also at the headquarter level. In the last 12 months we launched a number of strategic initiatives which in the next 2-3 years should lower our cost structure significantly. At the store level we aim at improving a dynamic, customer driven product range, delivering quality and value at the same time.

DA! Growth engine of the Group



Hypermarkets and supermarkets

Focus on efficiency

Our strategic goals:

1. Achieve substantial cost reduction making our operations on headquarter and store levels more efficient
2. Strengthen leadership position in our core regions

IMPROVE EFFICIENCY

- Introduce state-of-the-art IT solutions to improve business processes in sales and marketing and in logistics and accounting to realise efficiencies across operations
- Enhance technological platform to support the roll-out of new formats and online channel
- Improve commercial margins by securing better terms with suppliers while maintaining attractive product ranges for customers on store shelves
- Leverage 'Big Data' to better understand our customers and cater to their needs

STRENGTHEN OUR PRESENCE

- Expand our key 'city compact' hypermarket format, where shopping becomes a truly enjoyable experience
- Ensure the sustainable growth of our hypermarket footprint in regions where we have strong brand leadership
- Develop online shopping with a wide range of food and FMCG products with attractive pricing and convenient delivery services

ENHANCE SUPPLY CHAIN

- Optimise the supply chain for every product category and SKU, and implement a smart, end-to-end supply chain with a high level of centralisation
- Maintain high shelf availability and optimal inventory levels
- Improve efficiency of logistics supporting imports and private label products

DELIVER THE BEST VALUE PROPOSITION

- Develop our customer-centric approach enhancing the best customer value proposition
- Ensure a truly 'one-stop shop experience' while offering quality products for all wallets
- Increase the share of our affordable private label products in total sales
- Introduce new products & services which ensure the sustainable growth of our company

Operational Review

HYPERMARKETS AND SUPERMARKETS

At O'KEY we are focused on providing an attractive product range at competitive prices, while offering a high level of customer service.



Performance

In 2016, we put considerable effort into boosting efficiency in our traditional hypermarket and supermarket segment. As a result retail revenues for this segment rose by 4.5% to RUB 166.8 billion for the year, with traffic growing by 2.6% and the average ticket increasing by 1.7%. The main annual LFL indicators were also positive in this segment.

In 2016, we used the conservative approach to expansion. As of 31 December 2016, O'KEY operates 164 stores across Russia comprising 74 hypermarkets and 36 supermarkets. During the year, we opened four hypermarkets: two in St Petersburg, one in Moscow and one in Tyumen, as well as one new supermarket in Moscow. We also closed five supermarkets and one hypermarket as part of our initiative to increase overall efficiency.

4.5%
yoy

NET RETAIL REVENUE

2.6%
yoy

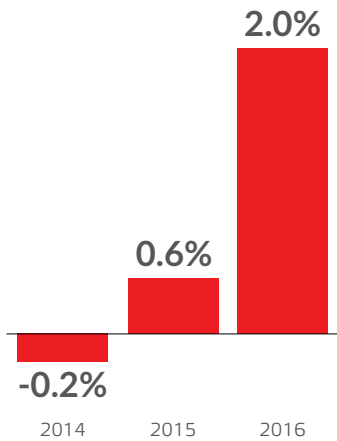
TRAFFIC
net of discounters

2.0%
yoy

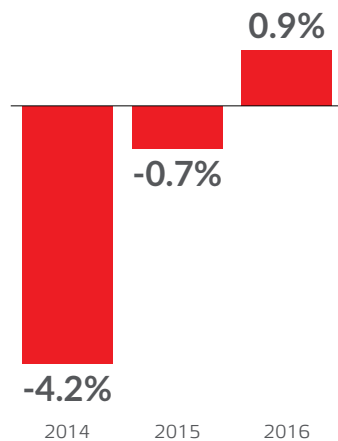
LFL REVENUE
net of discounters

GROUP NET OF DISCOUNTERS LFL

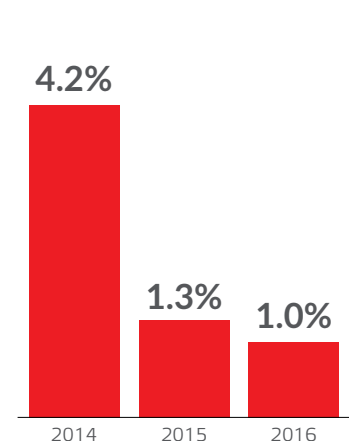
Net retail revenues, %



Traffic, %



Average ticket, %



Renewed concept

We opened one hypermarket in St Petersburg featuring our new concept of the "compact city" hypermarket, where we offer such novel features as a "Fresh Area", arranged like an open market, a self-service green salad bar and a "Farmer's Corner" with fresh dairy products delivered every morning from farms.

In 2016, we also launched renewed hypermarket concept, which vary in new product zones organised by category and more smart and efficient concept of non-food sections, renewed multicoloured navigation, modern look & feel to respond to the customer expectations for fun and hassle-free shopping.

For O'KEY's target audience of modern shoppers, the new stores will have self-checkout counters with Self Scanning technology.

We remain committed to the vision of the O'KEY brand; we are focused on providing a diversified and attractive product range at competitive prices, while offering a high level of customer service. Our strategic objective is to transform O'KEY to cater to the needs of the modern customer.



54 DISCOUNTER STORES LOCATED IN MOSCOW AND THE SURROUNDING REGIONS



Operational Review

DISCOUNTER STORES



ARMIN BURGER
CEO of Discounter Segment

Our DA! Discounter store concept launched in 2015 meets the demands of a wide range of customers. In particular, we are very pleased with the high level of popularity of our private brands, as well as our product range as a whole.

Over the medium to long term, the discounter format provides the Group with a powerful additional growth driver in Russia as we are able to expand into both city neighbourhoods and in urban locations utilising our small store footprints.

In 2017 we plan to open more than 20 new DA! discounter stores. We will continue to improve the product mix, focusing on the quality of our private label brands, as well as improving the overall in-store shopping experience for our customers.



50%

OF TURNOVER
is private label products



+64.1%

yoy

DISCOUNTERS LFL REVENUE

Performance

In September 2015, we launched our new discounter store format under the DA! brand. The hard discounter store format is well-established in Western and Central Europe, but today it is still unique and innovative to the Russian market. As of 31 December 2016, O'KEY now operates 54 discounter stores located in Moscow and the surrounding regions.

In 2016, we continued to develop our discounter business segment in line with our strategic plans. We have put a considerable emphasis on improving the product range (PLs, branded products, in-outs) continually adjusting it to the needs of our customers. As a result of these changes, we have seen a growing popularity in our private labels brands resulting in the overall success of the discounter concept. We are pleased to report that LFL revenue in our discounter segment grew by an impressive 64.1% in the fourth quarter, with the traffic and average ticket increasing by 36.4% and 20.4%, respectively. We see a further strengthening of this trend in Q1 2017 and are very pleased with the overall performance.

Our unique value proposition

We believe that we managed to develop a unique concept for the Russian market, which has been already recognised by the consumer. Everyday low prices, high quality products and an excellent shopping experience are a part of our DNA. We achieve it through:

- ◆ **Carefully selecting our private label producers** to ensure the best possible quality.
- ◆ **The high share of private labels** allows us to offer the best prices to our customers.
- ◆ **Our own logistics** which allow us to have a 100% centralisation level with daily deliveries of fresh products to all of our stores.
- ◆ **The lowest in-store operating costs** due to the low number of SKUs and efficient route planning.
- ◆ **Our modern design and well trained personnel** create an excellent shopping experience.

UNDER O'KEY PRIVATE LABEL BRAND MORE THAN

1,000+
SKUs

A glass jar of raspberry jam with a red lid. The label features the O'KEY logo (a stylized leaf) and the text 'ВАРЕНЬЕ малиновое' (Raspberry Jam) and '320 г'. Several fresh raspberries are placed in front of the jar.

Operational Review

PRIVATE LABEL RELAUNCH IN HYPERMARKETS AND SUPERMARKETS

Over the last few years, O`KEY Group commenced a private label brand relaunch project covering mainly food categories.

The first step was to launch the "That's What You Need!" brand (November 2015) in the low price tier. This initiative was followed by an O`KEY private label brand line-up in the middle price segment (April 2016). Currently there are 1,000+ SKUs under both brands.

In 2016, we significantly strengthened our supplier base to include market leaders as well as the most popular local producers in the regions. This is a key element of our strategy as we look to grow our margin in this segment and maintain traffic by offering the best value for money proposition to our customers. We believe that our key competitive advantage is the price-quality ratio we are able to offer: our own private label products are not burdened with advertising and other marketing costs, so they are 20-30% cheaper than branded alternatives; this provides more choice for our customers and promotes healthy competition on the shelf. Our plan is to double the share of private label brands in the coming year, including non-food categories.

We have implemented a special quality control programme "Trademark O`KEY – Customers` Guarantee" as a part of our quality control system for products and goods under our private label. The programme includes testing both production facilities as well as samples in independent accredited laboratories.

125 contracts
SIGNED
with producers in the regions



Local suppliers and local producers

O`KEY actively cooperates with local suppliers and producers to expand its local range of produce. The company practices this approach in all regions of operations, implementing our programme of "retail chain – federal, products – local".

In 2016, we held fairs at our Krasnodar and Ufa stores to promote local produce, where around a hundred regional producers across a wide range of food categories participated. The fairs attracted a significant number of customers who were given the opportunity to sample local products and benefit from special price.

In May 2016, O`KEY organised a trade and procurement conference for producers of the Republic of Bashkortostan. We aim to offer a clear and transparent approach to all our suppliers. We are very interested in potential new regional partners and local producers, especially in the popular fresh and ultra-fresh product categories. In August 2016, O`KEY participated in a meeting with leading national chains and manufacturers in the Saratov region. We are convinced that the trend of "local consumer patriotism" will continue to increase.

Award

At the Third International Exhibition PRIVATE LABEL AWARDS (organised by IPLS) O`KEY received the award for Best Private Label Brand in the Food Segment.



5.4 MLN VISITORS OF ONLINE STORE IN 2016



Operational Review

ONLINE SHOPPING

We see a growing trend in online shopping in Russia, our online store and a new mobile app take full advantage of this by making the online shopping experience more intuitive, quicker and more convenient.



Performance

In 2016, we continued to implement our strategy of using the latest technology to give our customers new shopping channels and experiences while continuing to grow our revenues.

In the reporting period we benefited from the results of our investment in online shopping to date, with sales for the year in this segment increasing tenfold to RUB 661 million, compared to 2015. The total number of online orders also showed a similar increase, while our online customer base grew to 99,500 people. During 2016, O'KEY delivered 1,453 tonnes of products via the online channel.

During 2016, we significantly expanded our delivery zones, which now include the whole of the Moscow and St Petersburg urban areas. As at the end of the year we offered five "click and collect" pick-up points in Moscow and four in St Petersburg. Another important step, which we took in 2016, was the launch of our new mobile online shopping app for iOS and Android devices, designed to make the whole online shopping experience more convenient and less time-consuming.

Our advantages

- Our Online Shopping platform is based on **the latest state-of-the-art IT solutions**.
- **Large product range** offered via the online channel of up to 25,000 SKU.
- **Online orders are fulfilled by the closest hypermarket** to the customer, while customers can choose whether to receive their order via "click and collect" at a **nearby pick-up point** or by using our home delivery service.

1,453 tonnes
DELIVERED
 compared to 126 tonnes in 2015

500,000
CUSTOMERS
 the average number of visits per month

Award

In 2016, our Online Shopping platform received the Global CIO "Project of the Year Award" for the second year in a row in the Retail and Distribution category.



Operational Review

SUPPLY CHAIN TRANSFORMATION IN HYPERMARKETS AND SUPERMARKETS

Over the last two years O'KEY has completely transformed its hypermarket and supermarket supply chain by increasing the centralisation rate from 10% to 40%.



Our advantages

Our new approach allows the Group to:

- ◆ **decrease inventory turnover** and working capital management;
- ◆ **reduce the shrinkage rate** through tight control over the supply chain;
- ◆ **improve commercial margin**;
- ◆ **improve on-shelf availability**;
- ◆ **reduce administration costs** at the store level; and
- ◆ **reduce storage space** in stores.

Group evolved from relying on six small distribution centres to the establishment of one federal and two regional distribution centres which better serve our needs.

We have achieved a notable improvement in efficiency during 2016, by implementing a new category management system which is unique to the Russian market.

The high quality of our distribution centres, the high percentage of our own staff and our outsourcing fleet guarantee that fresh products are delivered from the moment of order to our stores within 18 hours.

● **Fast logistics**

12-18 hours between order and delivery to store for Fresh categories

● **Up to 30 days**

Maximum time products spend in the distribution centres and stores

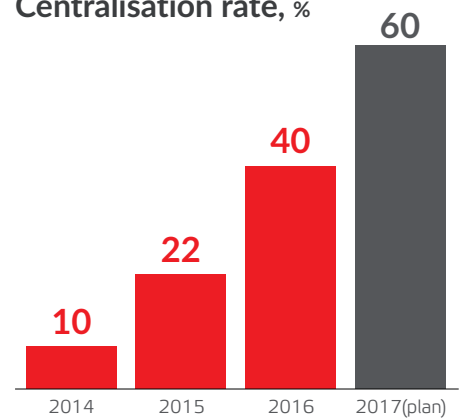
● **Inventory – smart management**

split of categories of goods by supplier between DCs and stores

● **40% Centralisation**

level in 2016

Centralisation rate, %



OPENED IN 2015-2016

28 K m²



St Petersburg



Moscow

OPENED IN 2016

52 K m²



Novosibirsk

Strategic Report

FINANCIAL REVIEW

RUB million	2016	2015	Year-on-year change, %
Revenue	175,471	162,510	8.0%
Gross profit	40,209	38,367	4.8%
Gross margin	22.9%	23.6%	-0.7 p.p.
EBITDA	9,253	10,109	-8.5%
EBITDA margin	5.3%	6.2%	-0.9 p.p.
EBITDA net of discounters	11,845	11,672	1.5%
EBITDA margin net of discounters	7.0%	7.2%	-0.2 p.p.
EBITDA of discounters	(2,592)	(1,563)	65.8%
Net (loss)/profit	(138)	1,918	-107.2%

Revenue

In 2016, the Group revenue increased by 8.0% year-on-year with LFL revenue rising by 2.2%. The LFL revenue growth was primarily attributable to a 0.9% increase in the average LFL ticket due to inflation and a 1.2% increase in LFL traffic despite significant changes in customer behaviour driven by the deterioration in macroeconomic conditions, the decline in disposable incomes and intensifying competition.

To address the deteriorating macroeconomic conditions and intensifying competition, we launched a turnaround strategy in the summer of 2015 aimed at responding to our customers' changing demands. As a result, during 2016 we made great progress in re balancing our product range as well as streamlining marketing efforts to drive traffic to our stores. During the year, the Group continued to strengthen its presence with a focus on the most resilient markets. Selling space rose 5.1% in 2016 to 623,000 m² following the opening of four hypermarkets, one supermarket and 19 discounter stores.

Sales Performance	Retail revenue growth, %	Traffic growth, %	Avg. Ticket growth, %
Trade revenue FY 2016	7.6%	9.3%	-1.7%
Trade revenue LFL FY 2016	2.2%	1.2%	0.9%

Cost of goods sold and gross profit

The cost of goods sold increased 9.0% in 2016 to RUB 135,261 million. In the table below, we provide further detail on the cost of goods sold for 2016 and 2015:

RUB million	2016	% percentage of revenue	2015	% percentage of revenue
Revenue	175,471	100.0%	162,510	100.0%
Cost of goods sold, including	(135,262)	77.1%	(124,143)	76.4%
Cost of trading stock (less supplier bonuses)	(128,800)	73.4%	(117,724)	72.4%
Inventory shrinkage	(2,867)	1.6%	(3,391)	2.1%
Logistics costs	(2,771)	1.6%	(2,214)	1.4%
Packaging and labelling costs	(824)	0.5%	(814)	0.5%
Gross profit	40,209	22.9%	38,367	23.6%

Gross profit increased 4.8% to RUB 40,209 million in 2016, compared to RUB 38,367 million in 2015. However, the overall gross margin contracted by 0.7 percentage points in 2016 to 22.9% due to better customer value proposition and the effect of the lower gross margin in the developing discounter format (compared to hypermarket and supermarket segment). Total logistics costs rose by 25.2% in 2016 to RUB 2,771 million compared to 2015 as a result of

the ongoing logistics centralisation and the continued expansion of the discounter format, however, net logistics costs (including discounts from suppliers included in cost of trading stock) stayed at the same level year-on-year. Shrinkage costs in 2016 fell by 15.5% to RUB 2,867 million compared to 2015 due to tighter controls over both purchasing and writing-off of goods.

General, selling and administrative expenses

RUB million	2016	% percentage of revenue	2015	% percentage of revenue	Change, p.p.
Personnel costs	(16,185)	9.2%	(14,989)	9.2%	0.0
Operating leases	(5,344)	3.0%	(4,728)	2.9%	0.1
Depreciation and amortisation	(4,550)	2.6%	(3,838)	2.4%	0.2
Communication and utilities	(3,486)	2.0%	(3,047)	1.9%	0.1
Advertising and marketing	(1,795)	1.0%	(1,651)	1.0%	0.0
Repairs and maintenance costs	(1,183)	0.7%	(940)	0.6%	0.1
Security expenses	(825)	0.5%	(740)	0.5%	0.0
Insurance and bank commission	(737)	0.4%	(687)	0.4%	0.0
Operating taxes	(713)	0.4%	(759)	0.5%	-0.1
Legal and professional expenses	(603)	0.3%	(660)	0.4%	-0.1
Materials and supplies	(302)	0.2%	(300)	0.2%	0.0
Other costs	(41)	0.0%	(33)	0.0%	0.0
Total general, selling and administrative expenses	(35,764)	20.4%	(32,371)	19.9%	0.5

The Group's general, selling and administrative expenses grew by 10.5% year-on-year to RUB 35,764 million in 2016, which was primarily attributable to an increase in D&A resulting from expansion of discounter stores and the opening of new owned hypermarkets and supermarket and the higher lease expenses of discounter format. Another reason is an increase in communication and utilities mostly due to adding new stores and increased utilities' tariffs. As a percentage of revenue, the Group's general, selling and administrative expenses increased by 0.5 percentage points to 20.4% in 2016.

Personnel costs

Although personnel costs grew 8.0% year-on-year to RUB 16,185 million in 2016, they remained stable as a percentage of revenue compared to the prior year. This was a result of Group's continuing focus on increasing labour productivity in hypermarkets and supermarkets resulting in the 0.5 percentage points decrease in personnel costs for this segment as a percentage of revenue in the second half of the year. Overall the increase in costs was primarily due to the expansion of the discounter segment, a 5.2% increase in average headcount and an increase in salaries in line with industry trends.

Operating leases

The 13.0% year-on-year rise in lease costs in 2016 was primarily attributable to discounter store lease payments following the launch of this new format in September 2015, and which therefore, only operated for part of the year, as well as the impact of the depreciation of the rouble on lease payments of some stores which were linked to the US dollar and euro.

Advertising and marketing

Advertising and marketing costs increased by 8.8% in 2016 but remained stable as a percentage of revenue compared to the prior year despite the Group renewing its hypermarket concept and implementing new promotional activities such as personalised communications. In addition, the increase in costs was due to the new discounter stores' marketing activities.

EBITDA of the segments

RUB million	2016	2015	Year-on-year change, %
EBITDA	9,253	10,109	-8.5%
EBITDA margin	5.3%	6.2%	-0.9 p.p.
EBITDA net of discounters	11,845	11,672	1.5%
EBITDA margin net of discounters	7.0%	7.2%	-0.2 p.p.
EBITDA of discounters	(2,592)	(1,563)	65.8%

EBITDA net of discounters increased by 1.5% year-on-year to RUB 11,845 million in 2016, with the EBITDA margin net of discounters reaching 7.0% of revenue. The negative EBITDA of the discounters rose by 65.8% in 2016, although the Group considers this to have now peaked with a significant improvement in EBITDA now expected in this and future years.

Financing costs

Financing costs increased by 4.0% to RUB 3,550 million in 2016. The Group's average loan portfolio (consolidated debt stood at RUB 36,295 million as of 31 December 2016 compared to RUB 35,558 million on 31 December 2015) did not change significantly (+2.1% vs 2015) and the Group's weighted average interest rate decreased to 11.0% in 2016 from 12.5% in 2015 due to the successful refinancing of approximately 65% of the loan portfolio.

Net (loss)/profit for the year

Net profit fell by 107.2% year-on-year to register a loss of RUB 138 million in 2016 which was primarily due to the expansion of discounter format and costs associated with it. The decline in net profit was also caused by one-off expenses. The Group is making a considerable progress to improve business efficiency which led to the closure of one hypermarket and five supermarkets during the year. As a result, the loss from the disposal of other non-current assets relating to stores and land plots in Moscow and other regions amounted to RUB 568 million (compared to RUB 126 million in 2015). There was also an impairment charge of RUB 434 million, which mainly related to several stores in the regions.

In 2016, the Group did not benefit from any tax reimbursements and realised a tax expense in the amount of RUB 409 million. Whereas in 2015, the Group realised an income tax benefit of RUB 16 million due to a tax reimbursement of RUB 702 million in relation to 2013 and 2014.

Cash flow and working capital

RUB million	2016	2015
Net cash from operating activities	11,673	9,140
Net cash used in investing activities	(5,413)	(2,332)
Net cash used in financing activities	(4,529)	(2,884)
Net increase in cash and cash equivalents	1,730	3,924
Effect of exchange rate fluctuations on cash and cash equivalents	(35)	34

Cash flows from operating activities

In 2016, operating cash flow was negatively impacted by a decline in the gross margin while working capital demonstrated positive dynamics. As a result, net cash from operating activities increased by 27.7% to RUB 11,673 million in 2016. Cash receipts from customers grew by 7.7% during the year in line with the revenue increase.

Cash flow used in investing activities

Net cash used in investing activities increased from RUB 2,332 million in 2015 to RUB 5,413 million in 2016 mainly due to significant asset sales in 2015. In 2016, investments net of proceeds from sales of property, plant and equipment and intangible assets decreased from RUB 8,621 million to RUB 6,331 million.

Cash flow used in financing activities

Proceeds from new loans and borrowing, less repayments, reached RUB 1,018 million in 2016 as the Group made significant repayments during the period.

In addition, dividend payments decreased by 10.4% from RUB 1,644 million in 2015 to RUB 1,472 million in 2016.

Working capital

As of 31 December 2016, the Group's working capital, defined as current assets (excluding cash and cash equivalents) less current liabilities (excluding short-term loans), was a negative RUB 12,734 million compared to negative RUB 8,023 million as at the end of 2015. This reflects the Group's achievements in terms of improving both stock levels and the overall efficiency of logistics. Working capital figures in the food retail industry are usually negative, and the Group intends to maintain a negative working capital position.

The Group considers the net debt/EBITDA ratio as the principal means of evaluating the impact on its operations of the size of the Group's borrowings. As of 31 December 2016, O'KEY's net debt/EBITDA ratio was 2.7x.

RUB million	Year ended 31 December 2016	Year ended 31 December 2015
Total debt	36,295	35,558
Short-term debt including interest accrued on loans	4,622	12,000
Long-term debt	31,673	23,558
Less cash and equivalents	11,463	9,768
Net debt	24,832	25,790
Net debt/EBITDA	2.7	2.6

Strategic Report

CORPORATE SOCIAL RESPONSIBILITY

At the core of O’KEY’s HR Policy is the development of a culture within the Company which focuses on a continued drive towards competitiveness and growth through effective human capital management*.

The HR policy is accordingly focused on two key areas: to attract the best of the best and retain talented employees within the Company.

Corporate culture

In 2016, we began to transform our corporate culture based on increasing employee engagement and efficiency. As a first step in this process, we refocused our corporate values on business fundamentals. The next step involved implementing a number of HR initiatives designed to improve performance across all business units, both retail stores and executive support functions. This initiative has resulted in lower staff turnover and more performance-oriented staff.

We believe that a focus on raising both employee engagement levels and performance, will translate into much higher levels of customer service in our stores which in turn contributes to the improved operational performance of the business. In essence, we believe that “A happy employee means a happy customer”.



Employee engagement

During 2016, all business divisions were focused on improving the Company’s operational performance, which would have been impossible without an improvement in employee engagement. In order to better monitor and manage employee engagement, we carried out an employee survey for the first time last year. Approximately 20,000 employees, or about 80% of the Company’s staff, took part and we were encouraged by the results which found that employee engagement at O’KEY is comparable to the average for Russia’s Food Retailing industry as a whole. Accordingly, we then developed an Employee Engagement boost plan which we have rolled out throughout the Company both by department and by store.

Internal communications

The Company adheres to the principles of openness and transparency in order to create a positive working environment for our employees. All our internal communications serve as a guide for our new corporate values, allowing us to communicate our acceptable standards of employee behaviour and business organisation principles. We strive to reach out to every one of our employees through a range of proactive internal communication channels aimed at involving our employees in the everyday life of the Company. Next year we are planning to expand our communication channels by making more use of various digital tools of communication.

During 2016, we held a number of employee engagement boost events in order to encourage every division to work on improving the engagement rate in 2017. We have developed new formats for promoting internal strategic discussions, such as a new ‘Leadership Forum’ and the introduction of cross-functional meetings, which have created an open platform to address specific operational issues.

* The consolidated HR profile refers to hypermarket and supermarket segment.

OKEY also participates in industry-wide retail events and thus in June 2016, we celebrated the 50th anniversary of the professional retail industry in Russia by participating in the first-ever industry-wide “retail” race, “Towards customers 2016”. The five-kilometre race involved more than 2,500 participants from leading retailers across the country while O’KEY’s running team consisted of 50 employees from our stores in 17 different cities. Thanks to their brilliant enthusiasm and team spirit, the O’KEY team came overall second in the event.



Health and safety

We are committed to providing our customers with a safe shopping environment and our employees with safe working conditions. As part of our Health and Safety monitoring process, we conduct regular audit of our store and work sites to ensure they are in full compliance with Russian legislation governing workplace safety.

We have also developed and implemented integrated systems for the regular tracking of working conditions and for logging all accidents and injuries, in line with best international practices. We have a systematic approach for investigating any accidents involving our employees or customers. Our employees are trained in work safety in accordance with the highest professional standards. Thanks to this approach, the number of work-related injuries in 2016 continued to fall compared to the prior year. We also achieved significant results in terms of the reduction in the occupational injury rate, which fell by 22% in 2016.

Personnel Structure and Headcount

Our recruitment policy is designed to attract people of all ages and nationalities, beliefs and gender to work in the Company. We aim to attract potential employees with experience and knowledge who will contribute to achieving outstanding results for the Company. As such our recruitment policy focuses on finding the best experience in the market, enriching our culture and traditions. There are currently more than 24,000 employees in the segment, mostly employed in the food retail division, and approximately 70% of these are women. O’KEY’s employees form a young and dynamic team, 43% of our employees are under 35 years old.

Retaining the talented

We understand that ensuring excellent customer service is inextricably linked to maintaining a high level of permanent and, therefore, fully trained staff in our stores. In 2016 we achieved significant results in maintaining high levels of permanent staff and consequently reducing the level of staff turnover. This has resulted in a 20 percentage-point reduction in staff turnover in our stores from 65% in 2015 to 44% in 2016.

The low staff turnover rate has also boosted the overall percentage of trained staff from 74% of all staff at the end of 2015 to 96% by the end of December 2016. This has had a very positive impact on the business, where not only have our stringent operational standards been consistently met but we have also achieved excellent levels of customer service as evidenced by our highest-ever Mystery Shopping score of 94%. Clearly training & development, as well as improved employee engagement, can deliver outstanding results.

In line with transforming our corporate culture to focus more on business performance, we have re-oriented our training and development system, increasing the use of digital training programmes and focusing on improving employee performance. We no longer carry out “face-to-face training” and have instead switched to a new “blended learning” approach. In May 2016, we launched O’KEY Academy, our new E-learning facility which now satisfies all our basic training needs for retail staff. It has reduced the amount of time an employee needs to spend on basic training, allowing the employee to gain the same practical skills which are then practiced with a mentor afterwards.

Corporate personnel training and development system

O'KEY ACADEMY

35 training courses

46 tests

for management and personnel efficiency improvement have been developed

>27,000

OF EMPLOYEES
upgraded their skills

For newly-hired employees we have developed an introductory a training programme called "School for Beginners", where employees learn the basic skills to perform their duties. There are group training sessions for all new employees, including a "welcome" training session, merchandising standards training and an "O'KEY Style Leader" training session. Approximately 96% of our new-hires who have joined the Company since July 2016, have completed the "School for Beginners" training programme. In October 2016, we also launched an updated mentoring system.

In 2016, we also launched a programme whereby suppliers were invited to train our staff. This involved the development of special product courses showing employees how to provide the best advice to customers when choosing products such as fish, meat and beer etc, while some "live" training on beauty products was also provided.

Compensation and benefits

Building and maintaining O'KEY's remuneration system is one of the key focus areas of our HR strategy in terms of being able to attract and retain the best talent in the industry.

In order to increase the productivity of employees in our stores, distribution centres and warehouses, in 2016 the Company made significant changes to its remuneration system. We aim to ensure that we offer competitive salaries to our employees through the regular indexation of wages and, for example, in 2016 the average salary in the company increased by 8.9%.

O'KEY cares for the welfare of all of our employees, providing them with a range of extra benefits in addition to the mandatory package of social security benefits provided under Russian legislation. For example, O'KEY offers its employees extra benefits such as supplementary medical insurance, subsidised access to gym and sports facilities and, if required, access to emergency financial aid.

Corporate whistle-blowing policy

To establish an atmosphere of transparency, confidence and trust, and ensure that our employees comply with our values and corporate culture, in 2016 we implemented a corporate whistle-blowing policy. The spectrum of issues covered under this policy includes breaches of ethics, issues relating to the Labour Law of the Russian Federation, interaction between colleagues and management and staff cooperation issues.

Preventing Corruption

We have put in place clear policies to prevent corruption in our business as well as to detect and avoid potential conflicts of interest. The O'KEY Group has a 'zero tolerance' policy towards corruption. This is applied rigorously to our internal processes and is enshrined in our contractual relationships with suppliers. Our managers adhere to strict policies regarding gifts and discounts. We maintain a confidential whistle-blower e-mail address for reporting potential conflicts to our internal audit and security departments. Also any person may use the call-centre to complain.

In addition to existing procedures, we have taken additional measures to prevent future violations. Throughout 2016, our efforts focused on continued awareness building, training both managers and employees to identify potential instances of corruption or conflicts of interest and making them aware of the resources available for reporting these issues without fear of negative repercussions.

O`KEY and local communities

O`KEY endeavours to be a significant contributor to the local communities in which we operate, as well as to the Russian economy and society in general. Our stores operate in more than 30 cities and towns across Russia, including metropolitan areas as well as smaller towns with under a thousand inhabitants. We employ thousands of people, a responsibility which we take very seriously, as they and their families depend on us, the successful execution of our strategy and our business performance, for their livelihoods.

O`KEY has built an integrated programme of both charity and social investment designed to align the Group's objectives with addressing the broader social problems of the local communities in which we operate. This approach involves working together with local authorities, business partners, non-governmental organisations and our customers for the benefit of local communities as a whole.

In line with our mission, we place particular emphasis on targeted assistance and support programmes helping orphans and children lacking parental care, as well as large families with five or more children.

Our key areas of charitable activity:

- ◆ Holistic support of large families, designed to improve their financial position.
- ◆ Support for gifted children lacking parental care.
- ◆ Support of educational programmes for children in orphanages.

Supporting vulnerable population groups

We consider it our responsibility, as one of Russia's leading food retailers, to ensure, to the best of our ability, that vulnerable sections of society have access to basic food products at affordable prices. For several years now, we have been offering holders of state social cards, additional discounts at our stores in Moscow, the Moscow region and Saint Petersburg as well as in Krasnoyarsk and Murmansk, and we plan to continue this practice going forward. In the mentioned above regions veterans, pensioners, schoolchildren, students and pregnant women enjoy a 3-5% discount, making purchases at our stores. In the Moscow Region, we also provide discounts to social workers caring for the disabled.

Food aid

In December 2016, O`KEY, in partnership with the Charity Foundation "Place under the Sun", launched a charity project 'Kind Purchase' to collect food and basic items and provide for vulnerable families across the Leningrad Region. This project became the first step of our charity campaign, planned for the year of 2017.

Within the seven days of this event over 1,000 of our customers donated more than 600 food packages, toys and sweets to low-income families and families raising children with disabilities, through seven of our St Petersburg hypermarkets, which were involved in the project. Food aid before the New Year celebration was provided to more than 700 families in the wider Leningrad region.

Treatment support

We keep being a partner of the St Petersburg charitable organisation, helping children and adults suffering from cancer – AdVita. O`KEY has been supporting this foundation for more than three years organising different campaigns in our stores in St Petersburg to raise funds and placing donation boxes next to our check-outs for our customers to be able to help those who suffer. AdVita supports the leading medical institutions in St Petersburg, and all the collected in the stores money via this organisation is given to those people, who fight cancer.

Festival "Step towards!"

In May 2016, the annual international creative festival for children and youth with disabilities "Step towards!" was held in St Petersburg for the ninth time. Over four years of collaboration with the festival, we have seen thousands of talented children participate in a variety of prestigious competitions with the "Step towards!" festival becoming a springboard towards new achievements and creative successes. The festival brought together 350 participants from 32 regions in Russia as well as from foreign countries.

Volunteering

We are particularly proud that many of our charitable projects have grown out of initiatives started by our employees. We believe it is crucial to foster and support this passion through our efforts locally. In St Petersburg, for example, our employees are driving a major programme to provide goods to orphanages, NGOs and religious charitable organisations helping children. In 2017 this initiative will be supported and the number of the aid recipients will definitely grow.

Corporate Governance

CORPORATE GOVERNANCE SYSTEM

O'KEY Group S.A. is a company incorporated under the Laws of the Grand Duchy of Luxembourg with Global Depositary Receipts (GDRs) listed on the London Stock Exchange, and as such is not required to comply with the UK Corporate Governance Code.

O'KEY Group is committed to managing and conducting its operations in accordance with applicable regulations of Luxembourg and the London Stock Exchange.

We recognise our obligation to our shareholders to adopt appropriate standards of governance and control both at the Board level and within our management teams and aim to establish and support a corporate governance framework that is necessary for development of our business and meets the requirements of our shareholders.

KEY ELEMENTS OF OUR CORPORATE GOVERNANCE POLICY INCLUDE:

- Appointing individuals with relevant skills and experience to our Board of Directors and its committees with knowledge of the Group and its business to enable them to discharge their respective duties and responsibilities effectively.
- The Board is responsible for taking key decisions relating to the Group strategy and strategic direction.
- The Board exercises oversight of the Group's internal control and risk management procedures.
- The Board is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.
- The Group has in place a system of Board Committees, which ensures due consideration of key decisions by experienced individuals and provides an appropriate system of checks and balances, including in the areas of remuneration and incentives.

BOARD OF DIRECTORS

The Company's Board of Directors plays the key role in organising an efficient corporate governance system. The Board is vested with the broadest powers to manage the business of the Company and to authorise and perform all acts of disposal and administration falling within the purposes of the Company.

The Board is responsible for taking the strategic decisions in respect of operation and development of the Group, as well as overseeing the risk management and internal audit function of the Group. The decisions related to the day-to-day operations of the Group are delegated to the management (on our management team see page [35](#) of the Report).

The Board is also a management body of O'KEY Group S.A. and is authorised to take all decisions in respect of O'KEY Group S.A. unless they are reserved for the General Meeting. The Board is not authorised to issue or buy back shares. The repurchase by the Company of its own shares is subject to the conditions set out in the Company Law and the Articles.

There are five members of our Board, including one independent director. The General Meeting of Shareholders appoints Board members by a simple majority of votes cast, for a period not exceeding six years or until their successors are elected¹.

Our current Board of Directors was elected at the General Meeting of Shareholders held on 13 October 2015.

1. The rules governing the appointment and replacement of the Directors are set out under the Law of 10 August 1915 on Commercial Companies, as amended, and the Articles (in particular Articles 8, 15 and 16). The consolidated version of the Articles is published under the Shareholders section on <http://okeyinvestors.ru/shareholder/documents/>

MEMBERS OF THE BOARD OF DIRECTORS OF O'KEY GROUP S.A. AS AT 31 DECEMBER 2016:

HEIGO KERA

Group Chairman and CEO of Hypermarket and Supermarket Segment, Member of the Audit Committee, Chair of the Remuneration Committee

Born in 1966

Heigo is a graduate of the Tallinn Technical University (Estonia) and holds a degree in economics.

Heigo was elected as a Member of the Group's Board of Directors on 30 June 2010, with effect from 13 July 2010, re-elected on 28 October 2013 and 13 October 2015, effective from the same date.

Work experience

Heigo was appointed Chief Executive Officer of O'KEY Group effective 1 May 2015. Heigo has been the owner and, since 2008, a Member of the Board of Directors of Silverko Consult OU, an Estonian consulting group with an international client base. From 2008, he worked as Retail Projects Manager with HT Project Management OU, where he was responsible for launching a gourmet supermarket in Ukraine. Prior to that, from 2002 until 2008, he provided private consultancy services, including research on retail markets in Belarus, Kazakhstan and China.

DMITRII TROITSKII

Director
Member of the Remuneration Committee

Born in 1965

Dmitrii graduated from the Leningrad Shipbuilding Institute, now known as the State Marine Technical University of St Petersburg, and holds a degree in engineering.

Dmitrii was elected as a Member of the Group's Board of Directors on 30 June 2010, with effect from 13 July 2010; he was re-elected on 28 October 2013 and 13 October 2015, effective from the same date.

Dmitrii indirectly owns approximately 23.49% of the shares of O'KEY Group S.A.

Work experience

From 2005 until 2007, Dmitrii served as a Member of the Board of Directors of the Ochakovo Dairy Plant. He also serves as a Member of the Supervisory Board of Bank Saint Petersburg, a position he has held since December 2005, and as Development Director of Neva-Rus, a position he has held since 2005.

BORIS VOLCHEK

Caraden Director
Member of the Audit and Remuneration Committee

Born in 1966

Boris graduated from the Leningrad Institute of Railway Engineers, now known as the St Petersburg State University of Communications, and holds a degree in engineering.

Boris was elected as a Member of the Group's Board of Directors on 30 June 2010, with effect from 13 July 2010, re-elected on 28 October 2013 and 13 October 2015, effective from the same date.

Boris indirectly owns 28.02% of the shares of O'KEY Group S.A.

Work experience

Boris has also served as President of the Union Group of companies since 1995. In addition, since 2000, he has served as General Director of St Petersburg Automobile Museum.

DMITRY KORZHEV

Director
Member of the Audit Committee

Born in 1964

Dmitry graduated from the Leningrad Shipbuilding Institute, now known as the State Marine Technical University of St Petersburg, and holds a degree in engineering.

Dmitry was elected as a Member of the Group's Board of Directors on 30 June 2010, with effect from 13 July 2010, re-elected on 28 October 2013 and 13 October 2015, effective from the same date.

Dmitry indirectly owns approximately 23.49% of the shares of O'KEY Group S.A.

Work experience

From 2005 until April 2010, Dmitry served as a Member of the Supervisory Board of Bank Saint Petersburg.

MYKOLA BUJINYCKYI

Independent Director
Chair of the Audit Committee

Born in 1950

Mykola graduated from Edinburgh University in the UK and is also a fellow of the Chartered Institute of Management Accountants and a Member of the Institute of British Management. He holds a joint diploma in management accounting.

Mykola was elected as a Member of the Group's Board of Directors on 13 October 2015. He also served on the Board in 2010-2013.

Work experience

His experience includes over 35 years in international financial management and over 20 years' experience in Russia. Before working in Russia, he spent seven years as a management consultant with Coopers & Lybrand. Prior to that, he worked for several years in senior financial management positions in the oil support services, construction, IT and retail sectors. In addition, he has experience in corporate finance including investment appraisals, raising funds on public and private equity and debt markets, as well as dealing with international financial institutions, banks and ratings agencies.

MEETINGS OF THE BOARD OF DIRECTORS

Meetings of Board of Directors are held regularly in compliance with the approved work schedule for the year. The Board’s work schedule is determined on the basis of strategic planning and the reporting cycle. Whenever an urgent matter needs to be considered Extraordinary Board meetings are organised, or, if a personal meeting cannot be organised due to short notice, the Board can adopt a circular resolution by a unanimous vote. It is the Board Chairman’s responsibility to determine the Board’s work plan and to include additional items in the plan.

Participation of Board members in meetings of the Board of Directors and its Committees in 2016

Member	Board of Directors (3 meetings)	Audit Committee (5 meetings)	Remuneration Committee (1 meetings)
HEIGO KERA	3/3	5/5	1/1
DMITRII TROITSKII	By proxy, 3/3	Not a member	By proxy, 1/1
DMITRY KORZHEV	3/3	5/5	Not a member
BORIS VOLCHEK	By proxy, 3/3	By proxy, 5/5	By proxy, 1/1
MYKOLA BUINYCKYI	3/3	5/5	Not a member

COMMITTEES OF THE BOARD OF DIRECTORS

The main role of the Committees is to provide assistance to the Board in preparing and adopting decisions in its respective functional areas, as well as to ensure that matters brought for consideration by the Board of Directors are scrutinised prior to Board meetings. The meetings of the Committees usually take place before the Board meeting. Board Committees have broad procedural powers, may engage independent external experts, obtain any information from the Company’s executive management that falls within their remit and may use any other Company resources, as well as set tasks for the Company’s management.

There are two committees on the Board of Directors, the Audit Committee and the Remuneration Committee. The composition and the key responsibilities of the Board’s committees are described below.

Audit Committee

The Audit Committee oversees the internal audit function, the effectiveness of risk management and the internal controls of the Company and the Group, and approves and monitors the performance of the internal audit plan for the year. The Audit Committee reviews and assesses the integrity of the Company’s annual and half yearly financial statements. In relation to the external Audit,

the Audit committee: monitors the External Auditor’s independence, issues recommendations to the Board as to the appointment of the external auditor, monitors the management letter and recommendations of the external auditor to management and follows-up open items with management, and plans and agrees the scope of the audit of financial statements for the year with the External Auditor.

The Audit Committee comprises four Board members: Mykola Buinycky (Committee Chairman), Boris Volchek, Dmitry Korzhev, Heigo Kera and two non-directors: Ilya Ilin, Alvidas Brusokas.

Remuneration Committee

The responsibilities of the Remuneration Committee include reviewing compensation policy, making proposals to the full Board of Directors regarding the remuneration of Executive Directors and management, and advising on any benefit or incentive schemes. The Board of Directors determines the remuneration and any bonuses paid to the Chief Executive Officer of O’KEY Group.

The Remuneration Committee includes three Board members: Heigo Kera (Committee Chairman), Boris Volchek, Dmitrii Troitskii and two non-directors: Ilya Ilin, Alvidas Brusokas.

Corporate Governance

SENIOR MANAGEMENT

O'KEY's management team consists of experienced professionals, whose expertise and enthusiasm drive our success. We have recruited within Russia and internationally to ensure we have the best people, who are able to bring a global perspective on the business combined with deep knowledge of the Russian marketplace. The team was further strengthened through the recruitment of selected senior managers in 2016.



HEIGO KERA

CEO of Hypermarket and Supermarket Segment

Heigo is a graduate of the Tallinn Technical University (Estonia) and holds a degree in economics.

Heigo was elected as a Member of the Group's Board of Directors on 30 June 2010, with effect from 13 July 2010, re-elected on 28 October 2013 and 13 October 2015, effective from the same date.

Work experience

Heigo was appointed Chief Executive Officer of O'KEY Group effective 1 May 2015. He was with the Group from the very beginning, and was first employed by the O'KEY Group to provide consultancy services on the development of a hypermarket format concept in Russia from 1998 until 2002. Heigo has been the owner and, since 2008, a Member of the Board of Directors of Silverko Consult OU, an Estonian consulting Group with an international client base. From 2008, he worked as Retail Projects Manager with HT Project Management OU, where he was responsible for launching a gourmet supermarket in Ukraine. Prior to that, from 2002 until 2008, he provided private consultancy services, including research on retail markets in Belarus, Kazakhstan and China.

See the next section for **hypermarket and supermarket management team** p. [36](#)



ARMIN BURGER

CEO of Discounter Segment

Armin has a graduate degree in economics from the University of Freiburg, Germany.

In October 2013, Armin was appointed Chief Executive Officer ("CEO") of DA!, the Group's Discounter Chain. In his current role he oversees all aspects of the development of the discounter format, including operations, the management of real estate, buying, information technology, human resources, marketing, public and investor relations.

Work experience

Armin has extensive retail experience in both discount and other retail formats. Prior to joining O'KEY, he spent nearly two decades in progressively senior roles at Aldi in both Germany and the UK, and also at Hofer KG in Austria. From 2012 to 2013, he was CEO and a Member of the Supervisory Board of Praktiker AG, where he managed the company's restructuring process. In April 2011, he founded Vienna Estate SE, an Austrian real-estate developer, and from February 2011 to June 2012, he headed the Supervisory Board of Vivatis AG, in Austria.

He has a highly experienced team of managers working with him on further development of the discounter format.

HYPERMARKET AND SUPERMARKET MANAGEMENT TEAM



DMITRY PRYANIKOV

Deputy CEO

Dmitry graduated from the Department of Economics and Management at the Peter the Great Saint Petersburg Polytechnic University.

Dmitry was appointed Deputy CEO of O'KEY Group in July 2016. He is responsible for overseeing all business support functions, including the business procedures and processes division, the IT department, the project office, the legal and insurance department as well as the internal control and audit departments.

Work experience

Dmitry has been with O'KEY since the establishment of the Group. Initially he served as the Finance Director of the O'KEY trading company prior to his appointment as CFO of the Group. Dmitry's leadership of the finance team was instrumental in achieving our successful initial public offering (IPO) on the London Stock Exchange in November 2010. Prior to joining O'KEY, Dmitry held various positions at the Bank of Saint Petersburg and other private companies from 1995 to 2001.



KONSTANTIN ARABIDIS

CFO

Konstantin is a graduate of the Department of Technical Cybernetics at the Peter the Great Saint Petersburg Polytechnic University and of the Department of Economics at the Saint Petersburg University. Konstantin is a member of Association of Chartered Certified Accountants (ACCA).

Konstantin was appointed Chief Financial Officer (CFO) of the O'KEY Group in July 2016. In his role, he is focused on building modern business-oriented finance function and manages all related business streams such as liquidity management, accounting, controlling, investments and others. Also, Konstantin oversees Group's corporate reporting and investor relations.

Work experience

Konstantin joined the Group in January 2012 from PwC where he was involved in auditing and consulting projects in various industries. In O'KEY he was responsible for a full array of finance functions and a number of essential business projects within the Company.



PAVEL TOMANEK

Sales Director

Pavel graduated from Masaryk University in Brno, the Czech Republic, with a degree in clinical psychology.

Pavel joined O'KEY Group in 2015 as Sales Director for the Northwest and Southern regions. In February 2016, he became Sales Director for all regions and in this role is responsible for developing and implementing the Group's strategy with regard to strengthening O'KEY's market leadership as well as the operational management of stores. His role is focused on growing store traffic, the development and implementation of innovative retail solutions, increasing trade turnover and EBITDA, and creating and maintaining strong regional management teams.

Work experience

Pavel has extensive retail experience, have worked for 15 years at leading international retail chains. For example, before joining O'KEY, he spent three years at X5 Retail Group and, prior to that was responsible for operations and logistics at Lenta and was a regional director for Tesco in the Czech Republic.



MARC LEBLOND

Supply Chain Director

Marc holds a degree in Transport and Logistics from Val de Marne University, Paris, as well as professional development diplomas in Finance and Accounting.

Marc was appointed as Supply Chain Director in 2014 to achieve a step-change in our supply chain infrastructure and ensure the success of this transformation.

Work experience

Previously, Marc served as Supply Chain Director for X5 Retail Group. Prior to this, he worked as IT & Supply Chain Director for Orangina Schweppes. As a seasoned logistics professional with more than four decades of expertise, he has also worked at such companies as Galeries Lafayette, Carrefour and Lactalis.



ELENA POLOZOVA

Human Resources Director

Elena graduated from the Department of Business and Management at Lipetsk State Technical University with a degree MBA, with a specialisation in Human Resources, from the Moscow International Higher School of Business ('MIRBIS').

Elena has headed the Human Resources ('HR') Department for O'KEY Group since September 2015. She joined O'KEY in January 2013 and over the following two years served in various HR management positions in the Group's Sales Department. In her role, she oversees the Group's centralised HR function, which sets the strategy for developing the Group's human capital, as well as introducing best practices in HR for increasing employee productivity.

Work experience

Elena is highly experienced with more than a decade of experience in HR. Before joining O'KEY, she was an HR business partner at Magnit, overseeing its HR processes.



ANTON FARLENKOV

Head of Strategy and M&A

In 2016, Anton was appointed Head of strategy and M&A.

In his current role, he has the lead responsibility for advising the Board of Directors on determining the strategic direction of the company and overseeing the implementation of its development plan across formats, as well as broadening Group's communications with the international business and investment community.

Work experience

Anton joined O'KEY Group from Goldman Sachs, where he ran the EEMEA equity research team and for over 9 years worked as a senior equity research analyst covering the consumer, retail and transportation logistics sectors. Prior to joining Goldman Sachs Anton held commercial and IT related positions in Royal Dutch Shell (the Netherlands) and Infoshare (the US).

HYPERMARKET AND SUPERMARKET MANAGEMENT TEAM



ALLA SYNKO

*Commercial Director,
Dry & Drinks, FMCG*

Alla graduated from the Saint-Petersburg University of Economics and Finance with a degree in economics.

In July 2016, Alla was appointed Commercial Director of the new Dry & Drinks, FMCG division.

Alla is responsible for the purchasing of long shelf life products including drinks and alcohol. As Commercial Director of the division, she is also responsible for improving margins, the development of private label products and other areas.

Work experience

Alla joined the Group from Kesko FoodRus where she worked as a commercial director for four years. She joined O'KEY Group in 2005 as a category manager and was later promoted to Head of Purchasing for the North-West region. In 2010, she was appointed as Operations Director for Supermarkets.



OXANA SHULIKO

Commercial Director, Ultra Fresh & Fresh

Oxana graduated from the Saint-Petersburg State Electrotechnic University.

In July 2016, Oxana was appointed Commercial Director of the new Ultra Fresh & Fresh Products division.

Oxana manages the purchasing of short shelf life products and "fresh" products. She is also in charge of the own production of the Group including bakery and culinary.

Work experience

Oxana joined O'KEY Group from Lenta where she worked as the director responsible for products with a short shelf life for six years. Prior to joining Lenta, she worked at X5 Retail Group. She started her career at O'KEY in 2001, at the founding of the Company and served as a category manager where she was responsible for the launch of sales of culinary products.



MAXIM PLATONOV

Commercial Director, Non-Food

Maxim graduated from the Saint-Petersburg University of Economics and Finance with a degree in management.

In July 2016, Maxim was appointed Commercial Director of the new Non-Food division.

He is responsible for the entire range of non-food products, including children's products and adult clothing and shoes.

Work experience

Maxim joined O'KEY Group from Intertorg where he was responsible for hypermarkets operating under the SPAR brand. Between 2001 and 2010 he worked at O'KEY Saint Petersburg's hypermarket in a variety of roles including most latterly as Head of Purchasing and prior to that as Product Range Director and as Purchasing Director for Non-food Products.



MILINA SEVCIKOVA MIKULOVA

Private Label Commercial Director

Milina graduated from the University of Economics in Prague (International Relations) and holds a degree from the Commerce & Management School (I'ECG) in Orleans (France).

In September 2016, Milina was appointed the Commercial Director of the Private Label division.

In her role, Milina is responsible for the product range, production, supply, pricing, positioning and promotion of the O'KEY private label brands as well as focusing on margin improvements in the business. Her main priority is to improve the quality of O'KEY private labels.

Work experience

Milina has a proven commercial, marketing and project management track record in Russia, Eastern Europe and Africa. From 1998 to 2005, she worked at Carrefour, AHOLD and Metro Group. From 2005 to 2009, Milina served as Commercial Director & Management Board Member at Lenta. More recently, she held various executive positions at Metrika (DIY), Yoo! Mart Ltd (Ghana, Africa) and 585 Gold.



REMENNIKOVA ELENA

E-commerce Director

Elena graduated from the Saint-Petersburg University of Economics and trade with a degree in economics. She received an MBA degree from the Stockholm school of Economics which included her thesis on "The History of Creation of Private Labels".

Elena joined the company in 2013 and is responsible for creating and developing online sales. Under her leadership, O'KEY created and launched its new online shopping website, initiated a pick-up service and commenced regular home deliveries.

Work experience

Prior to joining O'KEY Elena was a head of AMF, an international delivery network of flowers and gifts. Previously she was also Commercial Director of Utkonos, where she was responsible for purchasing, marketing, advertising and processing. She also worked as a procurement director at both Pyaterochka and Carousel.

Changes made to the Senior Management Team in 2016

NAME	DATE	CHANGE
Pavel Tomanek	February 2016	Appointed Sales Director
Alla Synko	April 2016	Appointed Commercial Director, Dry & Drinks, FMCG
Anton Farlenkov	May 2016	Appointed Head of Strategy and M&A
Oxana Shuliko	June 2016	Appointed Commercial Director, Ultra Fresh & Fresh
Konstantin Arabidis	July 2016	Appointed Chief Financial Officer
Dmitry Pryanikov	July 2016	Appointed Deputy CEO
Maxim Platonov	July 2016	Appointed Commercial Director, Non-Food
Milina Sevcikova Mikulova	September 2016	Appointed Private Label Commercial Director

Diversity

O'KEY Group is working on adoption of the diversity policy. However, as can be seen from the information on the senior management team, O'KEY Group aims to employ the members of the team most suitable and qualified for their post and function, irrespective of their age, gender, origin. The requirements to educational and professional backgrounds are such as to insure that the member of the team possesses the skills and experience necessary to perform their function.

Board of Directors and Management Remuneration

In 2016, key management personnel of O'KEY Group were paid an aggregate amount of RUB 476,012 thousand in remuneration and other compensation. Members of the Board of Directors of O'KEY Group S.A. and the Audit Committee of O'KEY Group S.A. were paid a net fee of US\$596,521.88. No more than US\$800,000 is to be paid per year in compensation to the entire Board and other senior officers of O'KEY Group S.A.

Corporate Governance

RISK MANAGEMENT

Risk management system

The risk management system is aimed at providing a reasonable guarantee that the Company's strategic goals will be achieved in a timely manner and that the level of risks faced by the Group remains acceptable for management and shareholders. We operate a unified approach to risk management through the Group Risk Standard which comprises a range of relevant tools and methodologies aimed at early risk detection and risk mitigation.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. Internal Audit assists the Group's Audit Committee in its oversight role. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations. Identified risk areas are monitored quarterly and followed by a coordinated improvement programme.

Our challenges in 2016

In 2016, we noticed that the continuing market downturn set high demands on operating efficiency as to maintain the profitability levels of our store operations we had to focus more and more on operating efficiency. We implemented additional monitoring to ensure that any deviations from standard operating procedures were detected early to limit any losses to operational efficiency and transparency as far as possible.

The additional monitoring concept was designed not only to ensure compliance with the Company standards but also to support the identification of potential improvements and initiate cross-functional improvement projects.

The continuing market downturn has also raised the risk of increased fraudulent activities. To mitigate that risk we implemented several additional (Internal Control) activities which were related to detailed analyses of our suppliers' commercial history and financial reporting transparency as well additional requirements for insurance coverage. Our risk analysts participate fully in tender committees to highlight any deviations from standard procedures or additional risks.

We have responded quickly to any hotline information suggesting fraudulent activity, with our analysts thoroughly investigating any potential internal and/or external fraudulent activities which might compromise the interests of the Company.

In addition to that, in 2016 we tightened our information security rules. All our employees now have to pass awareness training sessions on information security risks and have signed consent forms confirming their awareness of, and responsibility for, any violation of information security rules.

Principle risks

Below we describe the key risks that could have a material adverse effect on our business, our financial and operational performance and, as a result, could impact our share price and our reputation. Additional risks not known to us, or those risks that we currently consider immaterial, may also impair our business operations. We do not expect to incur any risks that may jeopardise the continuity of our business.

STRATEGIC RISKS

Name of Risk	Definition & Potential Impact	Mitigating Actions
Economic outlook	Our business is affected by uncertainties associated with changing economic conditions, particularly in the current environment of global economic instability. Therefore, we may face reduced customer demand as the income and purchasing power of our customers decrease under the impact of the weaker macroeconomic environment exacerbated by declining oil prices and sustained rouble volatility.	We closely monitor the changes in the macroeconomic environment, income levels, consumer confidence index and other indicators. Therefore, if significant unfavourable developments occur, we are ready to take corrective steps and adjust our business model.
Competition risk	The retail sector in Russia is highly competitive. We face strong competition from other retailers (Russian and international), some of which are larger and have greater resources. Retail chains compete mainly over store locations, product ranges, price, service and store conditions. Some competitors might be more effective and faster in capturing certain market opportunities, which in turn may negatively impact our market share and our ability to achieve our performance and expansion targets.	We maintain and further develop our key differentiators that create loyalty and lend uniqueness to our offering. We constantly monitor our customers' perception of O'KEY and that of our main competitors to ensure we can respond appropriately. Our pricing policy, based on the price-matching concept, aims to guarantee the competitiveness of the core product range.
Political risk	Political developments may adversely impact the macroeconomic environment and the market in which our company operates. Although political stability in Russia has improved, Russia is still a state whose political, economic and financial systems are rapidly developing and changing.	Although these risks are outside the control of the Group, O'KEY monitors political developments closely and maintains strong relationships with various national industry bodies.
Regulatory risk	Our operations are subject to various government regulations and industry specific legislation with respect to quality, packaging, health and safety, labelling, distribution and other standards. Some regulations are still being developed in Russia. Current and future government regulations or changes thereto may require us to change the way we run our operations and could result in cost increases. Failure to comply with regulations can also lead to reputational damage.	We aim to ensure compliance with all applicable regulations by monitoring regulatory developments and changes, and following up and responding to changes in regulations and standards in a timely manner. Monitoring results in a timely update of relevant internal policies/bylaws and, consequently, the Group's business processes.

OPERATIONAL RISKS

Changing customer expectations	We strive to provide our customers with a wide range of goods and services at competitive prices. However, we recognise that our customers' shopping habits and expectations are influenced by the economic environment and will change over time.	We are constantly assessing and reviewing our business processes to ensure that we follow the evolving customer expectations. To maximise the efficiency and relevance of such assessments, we monitor internal and external reports on retail market development and changes in O'KEY positioning. We are developing IT solutions, particularly a Client Relationship Management (CRM) system, which will enable us to understand better and react quicker to changes in consumer behaviour.
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Name of Risk	Definition & Potential Impact	Mitigating Actions
Employee recruitment and retention	<p>Competition for highly qualified management and store personnel remains intense in Russia. To meet our expansion plans we need highly skilled employees. Our future success depends in part on our continued ability to hire and retain new employees. We understand that any inability to attract and retain highly qualified employees and key personnel in the future could have a material adverse effect on our business.</p>	<p>To improve motivation we have developed a system of Performance Appraisal that is conducted on a regular basis and rewards employees based on their individual results. We also promote internal opportunities for career development via trainings and special programmes. Additionally, to facilitate the adaptation of new employees, we organise introductory courses and coaching in our stores.</p>
Supply chain risk	<p>Our financial performance depends in part on reliable and effective supply chain management. We rely on third parties to supply us with merchandise and services. The third parties that supply us with merchandise and services also have other customers and may not have sufficient capacity to meet all of their customers' needs, including ours, during periods of excess demand. Shortages and delays could materially harm our business. Unanticipated increases in prices could also adversely affect our performance. Furthermore, we may be exposed to risk of delays and interruptions to our supply chain as a consequence of natural disasters, in case we are unable to identify alternative sources of supply in a timely manner.</p>	<p>To minimise the impact of potential disruptions in deliveries, we form a short list of suppliers for every product in every city. This ensures that if one supplier is unable to fulfil an order, an alternative supplier can provide it. We also opened one federal and two regional distribution centres during 2015-2016 in hypermarket and supermarket segment. This allows us to have the stable trade stock at warehouse to ensure that we will have no product shortage in stores.</p>
IT Platform Development	<p>Execution of our strategic targets requires adaptation of current IT infrastructure to the changing business needs. As the business grows the complexity of processes supporting it and diversity of tasks around such growth are increasing. Delayed or inappropriate decisions on development of the infrastructure can lead to failures in meeting Group goals and impede attainment of longer-term goals.</p>	<p>We are actively upgrading our existing IT systems and implementing new IT solutions to ensure that we are well supported for the future growth.</p>
Managing store opening process	<p>The achievement of our expansion strategy depends upon our ability to locate and acquire locations for future stores, manage counterparties involved in the construction process and obtain all necessary permits. There are several factors which may affect our ability to open new stores:</p> <ul style="list-style-type: none"> — Availability of locations that meet our investment criteria; — Ability of subcontractors to deliver results in a timely manner; — Risks associated with developers' ability to execute projects; — Regulatory system and permitting process run by local administrations; — Local community action opposed to the location of specific stores at specific sites. — These factors alone or in combination may negatively impact our store opening process and result in significant opening delays. 	<p>We aim to maintain a large portfolio of approved and secured projects for future development to cover more than two years of expansion. We also conduct regular performance reviews for our subcontractors to ensure sufficient control over construction process. Finally, we maintain active and constructive dialogue with local authorities in accordance with the law to resolve emerging issues.</p>
IT security threats	<p>We are observing an increase in IT security threats and higher levels of professionalism in computer crime. Our systems and solutions, as well as those of our counterparties remain potentially vulnerable to attacks. Depending on their nature and scope, such attacks could potentially lead to the leakage of confidential information, improper use of our systems, manipulation and destruction of data, sales downtimes and supply shortages, which in turn could adversely affect our reputation, competitiveness, and business, financial and operational performance.</p>	<p>We employ a number of measures, including employee training, comprehensive monitoring of our networks and systems, and maintenance of backup and protective systems such as firewalls and virus scanners in attempt to reduce the threats to our IT security.</p>

FINANCIAL RISKS

Name of Risk	Definition & Potential Impact	Mitigating Actions
Providing sufficient level of financing	Recent changes in the macroeconomic situation might result in a liquidity squeeze and tightening of lending policies by Russian banks. Given the expansion programme in the coming periods, issues with availability of external financing or significant changes in its cost can negatively impact our Group's ability to execute its expansion programme.	We maintain available lines of credit to close potential liquidity gaps. We diversify and enlarge the list of partnering banks to increase our control over the availability and cost of financing. Our securities are listed on the London Stock Exchange which allows us to utilise the secondary placement of shares as an alternative way of financing.
Tax regulations	Russian tax law has complex tax rules, which may be interpreted in different ways and tax rules are subject to frequent changes. Examinations by tax authorities and changes in tax regulations could adversely affect our business, and financial and operational performance. Changes in tax law could result in higher tax expense and payments. Furthermore, legislative changes could materially impact tax receivables and liabilities as well as deferred tax assets and deferred tax liabilities.	Our tax and legal specialists review compliance with applicable tax regulations, current interpretations issued by the authorities and judicial precedents resulting from tax disputes. This work is conducted on a regular basis and in a consistent manner and ensures we are aware of any changes that we may need to enforce.
Changes in working capital	Inability to control and manage elements of the working capital can result in negative changes for the operating cash flow and lead to liquidity gaps and excessive reliance on external financing.	We exercise constant control over the working capital, which is detailed in our monetary policy. The aim of this policy is to minimise prepayment balances and control of overdue receivables. We are also taking steps to improve stock management efficiency by establishing and monitoring KPIs and organising training sessions for store employees.
Risks of currency and interest rates volatility	We are exposed to fluctuations in exchange rates because of loans received in USD and contractual obligations in USD and EUR. Although measures are taken to minimise this risk, there can be no assurance that exchange rate and interest rate fluctuations will not negatively influence our results.	We manage interest rate risks by borrowing money at fixed rates with the long tenor. All facilities do not provide the lender with the right to increase the interest rate due to any changes on the money market. Certain currency risks are controlled through switching the payments into roubles, setting caps or hedged using derivative financial instruments.
Risk of misstatements in financial statements	We face exposure to risks relating to failures in proper financial reporting and the classification of accounting entries, and risks of making inaccurate accounting estimates.	We regularly test internal controls over financial reporting to prevent misstatements in financial statements. We have a qualified team of finance professionals preparing our financial statements, and our consolidated IFRS financial statements preparation process is completely automated.

For a description of financial risks and exposure calculation please refer to **Note 27** in the [Group Consolidated Financial Statements](#)

Corporate Governance

SHAREHOLDER AND INVESTOR INFORMATION

General Meetings of Shareholders

The General Meeting of Shareholders is the supreme governing body of O'KEY Group S.A.

The General Meetings of shareholders are convened and held in accordance with Luxembourg legislation and the Articles of O'KEY Group S.A.

According to the Articles of O'KEY Group S.A. an Annual General Meeting shall be held in Luxembourg at the registered office of the Company, or at any such other place as may be specified in the convening notice of the meeting, on the last Friday of April at 10.00 a.m.

The next Annual General Meeting will be held on April 28, 2017 at 10.00 a.m. CET. The convening notice specifying the address of the meeting and the agenda will be sent and published not later than fourteen days before the meeting.

Share capital structure

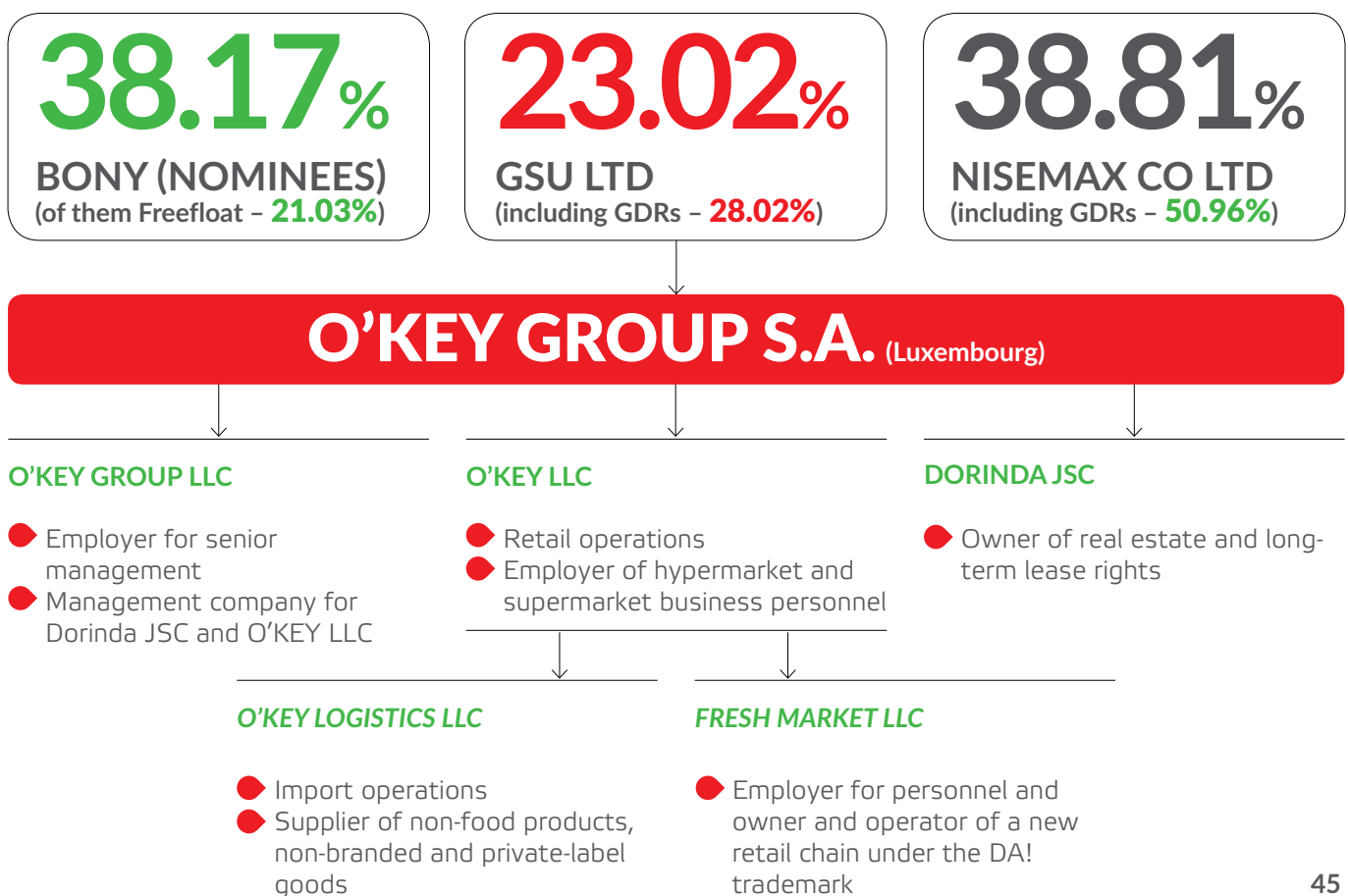
The issued share capital of the Company as of 31 December 2016 amounts to EUR 2,690,740 represented by 269,074,000 shares.

As of 31 December 2016, out of the 269,074,000 registered shares of the Company, 102,709,012 shares were admitted to trading on the London Stock Exchange in the form of global depository receipts ("GDRs").

No other securities have been issued by the Company.

All shares issued by the Company have equal rights as provided for by the law of 10 August 1915 on commercial companies, as amended (the "Company Law") and as set forth in the Articles, save for the special rights granted to the Caraden Shareholder set forth below (under Special control rights).

Legal and Ownership Structure



There were no substantial changes in ownership in 2016. In May 2016 GSU informed the company that it had acquired additional GDRs increasing its ownership from 25.02% to 28.02% of total outstanding share capital.

Transfer Restrictions

As of 31 December 2016 and the date hereof, to the knowledge of the Company, all the shares in issue in the Company are freely transferable, provided that the transfer formalities set out under Article 6 of the Articles are fulfilled.

The Company has no information about any agreements between shareholders which may result in restrictions on the transfer of securities or voting rights, as mentioned under Article 11 (1) (g) of the Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.

Significant shareholdings

The three major shareholders of the Group are its founders Mr Dmitry Korzhev (who indirectly owns approximately 23.49% of the outstanding share capital), Mr Dmitrii Troitskii (who indirectly owns approximately 23.49% of the outstanding share capital) and Mr Boris Volchek (who indirectly owns approximately 28.02% of the outstanding share capital).

Special Control Rights

All the issued and outstanding shares of the Company have equal voting rights and there are no special control rights attaching to shares of the Company.

The Caraden Shareholder (as defined in the Articles) has, under the condition of holding a minimum amount of shares in the Company, a specific right with respect to the appointment and removal of Directors since at least one Director (designated as the Caraden Director) must be appointed from a list of candidates proposed from the Caraden Shareholder and may be removed at the initiative of the Caraden Shareholder (additional information may be found under Article 8 of the Articles).

The positive vote of the Caraden Shareholder is required, under certain conditions, to amend the provisions of the Articles relating to: (i) the rights and prerogatives of the Caraden Shareholder; and (ii) the appointment, removal, replacement, rights, prerogatives and positive vote of the Caraden Director (additional information may be found under Article 16.4 of the Articles).

Control System in Employee Share Scheme

The Company doesn't have an employees' share scheme.

Voting Rights

Each share issued and outstanding in the Company bears one vote.

The Articles do not provide for any voting restrictions.

In accordance with the Articles, a record date for the admission to a general meeting may be set by the Board (Article 15 of the Articles). Only those Shareholders as shall be shareholders of record on any such record date shall be entitled to be notified of and to vote at any general meeting and any adjournment thereof, or to give any such consent, as the case may be.

In accordance with the Articles, the Board may determine such other conditions that must be fulfilled by Shareholders for them to take part in any meeting of shareholders in person or by proxy (Article 15 of the Articles).

Shareholders' Agreements with Transfer Restrictions

The Company has no information about any agreements between shareholders which may result in restrictions on the transfer of securities or voting rights.

Appointment of the Directors, Amendment of the Articles

The rules governing the appointment and replacement of the directors and the amendment of the Articles are set out under the Luxembourg Company Law and the Articles (in particular Articles 8, 15 and 16).

The consolidated version of the Articles is published under the shareholders section on <http://okeygroup.lu/sharedocs>

Significant Agreements or Essential Business Contracts

The Board is not aware of any significant agreements to which the Company is a party and which take effect, alter or terminate upon a change of control of the Company following a takeover bid. The Board has considered essential business contracts and concluded that there are none.

Agreements with Directors and Employees

As of the date hereof, no agreements between the Company and its Directors or employees exist that provide for compensation if the Directors or the employees resign or are made redundant without valid reason or if their employment ceases because of a takeover bid.

Dividend policy

To determine the recommended amount of dividends that will be payable, the Group's Board of Directors abides by the dividend policy. The general meeting of shareholders, upon recommendation of the Board of Directors, determines how the remainder of the annual net profits of the Company should be disposed of, including by way of stock dividend, it being understood that, the remaining net profits of the Company left after payment of dividends shall be used for business development of the Company and its subsidiaries and the development of the retail business of the Group in Russia. Interim dividends may be declared and paid (including by way of staggered payments) by the Board of Directors subject to observing the terms and conditions provided by law either by way of a cash dividend or by way of an in kind dividend. In 2016, O'KEY Group paid a total of US\$23 million in dividends.

Disclosure

O'KEY Group S.A. makes all obligatory disclosures in a timely manner and endeavours to comply with best disclosure practices, even those which are not strictly obligatory for the Company (such as the publication of half-year and quarterly results, material events for the Group etc.). Information is disclosed via the RNS service of the London Stock Exchange as well as on the Company's website.

As the Company is the issuer of GDRs, the adoption of MAR did not substantially change its disclosure obligations. There have been no substantial changes in our approach to disclosure in 2016 compared to 2015.

Corporate Governance

MANAGEMENT & DIRECTORS RESPONSIBILITY STATEMENT

We confirm, to the best of our knowledge, that the consolidated financial statements which have been prepared in accordance with the International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of O'KEY Group S.A., and the undertakings included in the consolidation taken as a whole, and that the consolidated Directors' report includes a fair review of the development and performance of the business and the position of O'KEY Group S.A. and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

Luxembourg, 27 March 2017

DMITRY KORZHEV
Member
of the Board of Directors

MYKOLA BUINYCKYI
Member
of the Board of Directors

HEIGO KERA
Chairman/CEO

KONSTANTIN ARABIDIS
CFO

Financial Statements

REPORT OF THE REVISEUR D'ENTREPRISES AGREE

To the Shareholders of
O'KEY GROUP S.A.
13, rue Edward Steichen
L-2540 Luxembourg

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of O'KEY GROUP S.A., which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Board of Directors' responsibility for the consolidated financial statements

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Responsibility of the Réviseur d'Entreprises agréé

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted for Luxembourg by the Commission de Surveillance du Secteur Financier. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the judgement of the Réviseur d'Entreprises agréé, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the Réviseur d'Entreprises agréé considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of O'KEY GROUP S.A. as of 31 December 2016, and of its consolidated financial performance

and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Other information

The Board of Directors is responsible for the other information. The other information comprises the information included in the consolidated Directors' report and the Corporate Governance Statement but does not include the consolidated financial statements and our report of réviseur d'entreprises agréé thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report this fact. We have nothing to report in this regard.

Other matter

The Corporate Governance Statement includes information required by Article 68bis paragraph (1) of the law of 19 December 2002 on the commercial and companies register and on the accounting records and annual accounts of undertakings, as applicable for the year ended 31 December 2016.

Report on other legal and regulatory requirements

The consolidated Directors' report, is consistent with the consolidated financial statements and has been prepared in accordance with the applicable legal requirements.

The information required by Article 68bis paragraph (1) letters c) and d) of the law of 19 December 2002 on the commercial and companies register and on the accounting records and annual accounts of undertakings, as applicable for the year ended 31 December 2016 and included in the Corporate Governance Statement is consistent with the consolidated financial statements and has been prepared in accordance with applicable legal requirements.

Luxembourg, 27 March 2017

KPMG Luxembourg Société coopérative
Cabinet de révision agréé
Jean-Manuel Sérís

Financial Statements

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

FOR THE YEAR ENDED 31 DECEMBER 2016

'000 RUB	Note	2016	2015
	36		re-presented
ASSETS			
Non-current assets			
Investment property	18	572,542	564,000
Property, plant and equipment	15	48,241,868	43,088,062
Construction in progress	15	3,485,879	6,694,671
Lease rights	16	4,578,535	4,847,537
Intangible assets	17	893,103	635,058
Deferred tax assets	20	1,277,273	654,512
Other non-current assets	19	2,002,680	2,745,910
Total non-current assets		61,051,880	59,229,750
Current assets			
Inventories	21	13,706,868	12,628,304
Trade and other receivables	22	5,871,010	6,937,346
Prepayments		958,467	1,515,881
Other current assets		41,250	—
Cash and cash equivalents	23	11,463,467	9,768,130
Total current assets		32,041,062	30,849,661
Total assets		93,092,942	90,079,411
EQUITY AND LIABILITIES			
Equity			
Share capital		119,440	119,440
Legal reserve		10,597	10,597
Additional paid-in capital		8,555,657	8,903,606
Hedging reserve		(75,329)	(138,872)
Retained earnings		13,324,398	14,757,649
Translation reserve		720,301	838,547
Total equity	24	22,655,064	24,490,967
Non-current liabilities			
Loans and borrowings	26	31,673,078	23,558,269
Deferred tax liabilities	20	692,091	826,874
Other non-current liabilities		139,304	99,352
Total non-current liabilities		32,504,473	24,484,495
Current liabilities			
Loans and borrowings	26	4,465,260	11,750,125
Interest accrued on loans and borrowings	26	156,870	249,605
Trade and other payables	27	32,480,892	28,817,333
Current income tax payable		830,383	286,886
Total current liabilities		37,933,405	41,103,949
Total liabilities		70,437,878	65,588,444
Total equity and liabilities		93,092,942	90,079,411

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2016

'000 RUB	Note	2016	2015
Revenue	8	175,470,671	162,510,392
Cost of goods sold		(135,261,292)	(124,143,425)
Gross profit		40,209,379	38,366,967
General, selling and administrative expenses	9	(35,764,206)	(32,371,077)
Other operating income and expenses	10	(1,050,739)	(148,353)
Operating profit		3,394,434	5,847,537
Finance income	12	281,631	81,691
Finance costs	12	(3,550,403)	(3,413,258)
Foreign exchange gain/(loss)	13	145,973	(614,562)
Profit before income tax		271,635	1,901,408
Income tax (expense)/benefit	14	(409,425)	16,299
(Loss)/profit for the year		(137,790)	1,917,707
Other comprehensive (loss)/income			
<i>Items that will never be reclassified to profit or loss</i>			
Exchange differences on translating to presentation currency		(118,246)	266,887
<i>Items that are or may be reclassified subsequently to profit or loss</i>			
Change in fair value of hedges and reclassification from hedging reserve	12	79,428	(308,749)
Other comprehensive income		(170,999)	—
Income tax on other comprehensive income	12,14	(15,885)	61,750
Other comprehensive (loss)/income for the year, net of income tax		(225,702)	19,888
Total comprehensive (loss)/income for the year		(363,492)	1,937,595
(Loss)/earnings per share			
Basic and diluted (loss)/earnings per share (RUB)	25	(0.5)	7.1

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 55 to 89.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2016

'000 RUB	Note	Share capital	Legal reserve	Additional paid-in capital	Hedging reserve	Retained earnings	Translation reserve	Total equity
Balance at 1 January 2015		119,440	10,597	8,903,606	108,127	14,483,713	571,660	24,197,143
Total comprehensive income for the year								
Profit for the year		—	—	—	—	1,917,707	—	1,917,707
Other comprehensive income								
Foreign currency translation differences		—	—	—	—	—	266,887	266,887
Change in fair value of hedges and reclassification from hedging reserve	12	—	—	—	(308,749)	—	—	(308,749)
Income tax on other comprehensive income	14	—	—	—	61,750	—	—	61,750
Total other comprehensive income		—	—	—	(246,999)	—	266,887	19,888
Total comprehensive income for the year		—	—	—	(246,999)	1,917,707	266,887	1,937,595
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends paid	24	—	—	—	—	(1,643,771)	—	(1,643,771)
Total contributions by and distributions to owners		—	—	—	—	(1,643,771)	—	(1,643,771)
Balance at 31 December 2015		119,440	10,597	8,903,606	(138,872)	14,757,649	838,547	24,490,967

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 55 to 89.

'000 RUB	Note	Share capital	Legal reserve	Additional paid-in capital	Hedging reserve	Retained earnings	Translation reserve	Total equity
Balance at 1 January 2016		119,440	10,597	8,903,606	(138,872)	14,757,649	838,547	24,490,967
Total comprehensive income for the year								
(Loss) for the year		—	—	—	—	(137,790)	—	(137,790)
Other comprehensive income								
Foreign currency translation differences		—	—	—	—	—	(118,246)	(118,246)
Change in fair value of hedges and reclassification from hedging reserve	12	—	—	—	79,428	—	—	79,428
Income tax on other comprehensive income	14	—	—	—	(15,885)	—	—	(15,885)
Other comprehensive income		—	—	—	—	(170,999)	—	(170,999)
Total other comprehensive income		—	—	—	63,543	(170,999)	(118,246)	(225,702)
Total comprehensive income for the year		—	—	—	63,543	(308,789)	(118,246)	(363,492)
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends paid	24	—	—	(347,949)	—	(1,124,462)	—	(1,472,411)
Total contributions by and distributions to owners		—	—	(347,949)	—	(1,124,462)	—	(1,472,411)
Balance at 31 December 2016		119,440	10,597	8,555,657	(75,329)	13,324,398	720,301	22,655,064

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 55 to 89.

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2016

'000 RUB	2016	2015
Cash flows from operating activities		
Cash receipts from customers	199,801,345	185,480,172
Other cash receipts	684,044	381,666
Interest received	257,541	49,708
Cash paid to suppliers and employees	(186,678,063)	(175,156,270)
Operating taxes	(670,313)	(681,509)
Other cash payments	(76,312)	(205,326)
VAT paid	(1,485,904)	(762,978)
Income tax paid	(159,780)	34,651
Net cash from operating activities	11,672,558	9,140,114
Cash flows from investing activities		
Purchase of property, plant and equipment and lease rights (excluding VAT)	(5,880,420)	(8,348,734)
Purchase of other intangible assets (excluding VAT)	(450,701)	(272,017)
Proceeds from sales of property, plant and equipment and intangible assets (excluding VAT)	917,819	6,289,003
Net cash used in investing activities	(5,413,302)	(2,331,748)
Cash flows from financing activities		
Proceeds from loans and borrowings	24,498,000	18,002,000
Repayment of loans and borrowings	(23,480,067)	(14,911,105)
Interest paid	(3,939,956)	(4,303,410)
Dividends paid	(1,472,411)	(1,643,771)
Other financial payments	(134,577)	(28,205)
Net cash used in financing activities	(4,529,011)	(2,884,491)
Net increase in cash and cash equivalents	1,730,245	3,923,875
Cash and cash equivalents at beginning of the period	9,768,130	5,810,182
Effect of exchange rate fluctuations on cash and cash equivalents	(34,908)	34,073
Cash and cash equivalents at end of the year	11,463,467	9,768,130

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 55 to 89.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2016

1 Reporting entity

(a) Organisation and operations

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union for the year ended 31 December 2016 for O'KEY Group S.A. and its subsidiaries (together referred to as the "Group").

The Company was incorporated and is domiciled in Luxembourg. The Company was set up in accordance with Luxembourg regulations. The main part of the Group is located and conducts its business in the Russian Federation.

The major shareholders of the Group are three individuals, Mr.Korzhev, Mr.Troitsky and Mr.Volchek ("the shareholder group"). They also have a number of other business interests outside of the Group.

As at 31 December 2016 the Company's shares are listed on the London Stock Exchange in the form of Global Depositary Receipts (GDRs).

Related party transactions are detailed in note 32.

The Company's registered address is: Luxembourg 13, rue Edward Steichen, L – 2540.

The Group's principal business activity is the operation of a retail chain in Russia under the brand name "O'KEY". In September 2015 the Group launched the discounter chain under the brand name "Da!". At 31 December 2016 the Group operated 164 stores including 54 discounter stores (31 December 2015: 146 stores including 35 discounter stores) in major Russian cities, including but not limited to Moscow, St.Petersburg, Murmansk, Nizhniy Novgorod, Rostov-on-Don, Krasnodar, Lipetsk, Volgograd, Ekaterinburg, Novosibirsk, Krasnoyarsk, Ufa, Astrakhan and Surgut.

(b) Business environment

The Group's operations are primarily located in the Russian Federation. Consequently, the Group is exposed to the economic and financial markets of the Russian Federation which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in the Russian Federation.

The imposition of economic sanctions on Russian individuals and legal entities by the European Union, the United States of America, Japan, Canada, Australia and others, as well as retaliatory sanctions imposed by the Russian government, has resulted in increased economic uncertainty including more volatile equity markets, a depreciation of the Russian Rouble, a reduction in both local and foreign direct investment inflows and a significant tightening in the availability of credit. In particular, some Russian entities may be experiencing difficulties in accessing international equity and debt markets and may become increasingly dependent on Russian state banks to finance their operations. The longer term effects of implemented sanctions, as well as the threat of additional future sanctions, are difficult to determine.

The consolidated financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2 Basis of accounting

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union and were authorised for issue by the Board of Directors on 27 March 2017.

3 Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Russian Roubles. All financial information presented in RUB has been rounded to the nearest thousand, except when otherwise indicated. Functional currency of the Company is USD and functional currency of Russian subsidiaries is RUB.

The results and financial position of the Group entities, which functional currencies are different from Russian Roubles, are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate of the year end;
- profit and loss items for each statement of profit and loss and other comprehensive income are translated at the date of transaction;
- all resulting exchange differences are recognised as translation reserve in equity.

At 31 December 2016 the principal rate of exchange used for translating foreign currency balances were USD1 = RUB 60.6569; EUR 1 = RUB 63.8111 (2015: USD 1 = RUB 72.8827; EUR 1 = RUB 79.6972).

4 Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Judgments that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Tax legislation. The Group is subject to income taxes in several jurisdictions. Significant judgment is required in determining the provision for income taxes.

The major part of the tax burden refers to Russian tax, currency and customs legislation, which is subject to varying interpretations. Refer to note 31.

Bonuses from suppliers. The Group receives various bonuses from suppliers which represent a significant reduction in cost of sales and inventory cost. The calculation of these amounts is in part dependent on an estimation of whether amounts due under agreements with suppliers have been earned at the reporting date based on inventory purchased and other conditions. The process for calculating and recording supplier bonuses involves significant manual processes which are more susceptible to error. Furthermore, the allocation of the bonuses to inventory cost also has some element of judgement.

Determination of net realizable value of inventory.

The Group performs analysis of stock for write-off as at each reporting date and writes down inventories to their net realizable value when necessary. For details of approach used for determination of net realizable value refer to note 21.

Determination of recoverable amount of property, plant and equipment.

For those stores, where impairment indicators exist as at reporting date, the Group estimates recoverable amount being higher of its value in use and fair value less cost of disposal.

For details of impairment testing performed as at 31 December 2016 refer to note 15.

5 Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities.

When measuring the fair value of an asset or a liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

- **Level 1:** quoted prices (unadjusted) in active markets for identical assets or liabilities.
- **Level 2:** inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- **Level 3:** inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Fair values have been determined for measurement and for disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Investment property

An external, independent valuation company, having appropriate recognised professional qualifications and recent experience in the location and category of property being valued, values the Group's investment property every year. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of the valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably and willingly.

Appraisers considered current prices in an active market. The appraisers used average between the income and comparative approaches for determining the fair value.

Valuations reflect, when appropriate, the type of tenants actually in occupation or responsible for meeting lease commitments or likely to be in occupation after letting vacant accommodation and the allocation of maintenance and insurance responsibilities between the Group and the lessee.

(b) Non-derivative financial assets

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. This fair value is determined for disclosure purposes.

(c) Derivatives

The fair value of interest rate swaps is estimated by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and counterparty when appropriate.

(d) Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. Fair value of bonds payable was determined for disclosure purposes based on active market quotations (Level 1 fair value).

6 Operating segments

The Group is engaged in management of retail stores located in Russia. Although the Group is not exposed to concentration of sales to individual customers, all the Group's sales are in the Russian Federation. As such, the Group is exposed to the economic development in Russia, including the development of the Russian retail industry. The Group has no significant non-current assets outside the Russian Federation.

The Group identified its operating segments in accordance with the criteria set in IFRS 8 *Operating Segments* and based on the way the operations of the Group are regularly reviewed by the chief operating decision maker to analyze performance and allocate resources within the Group.

The Group's chief operating decision maker has been determined as the CEO.

The Group has two reportable segments: O'KEY and Da!. Each segment has similar format of their stores which is described below:

- O'KEY –chain of modern Western European style hypermarkets under the "O'KEY" brand reinforced by O'KEY supermarkets throughout Russian Federation;
- Da! – chain of discounter stores in Moscow and Central region.

The assortment of goods in each chain is different, and the segments are managed separately. For each of the segments, the CEO of the Group reviews internal management reports on at least a monthly basis.

Within each reportable segment all business components demonstrate similar characteristics:

- the products and customers;
- the business processes are integrated and uniform: the components manage their operations centrally. Purchasing, logistics, finance, HR and IT functions are centralized;
- the components' activities are mainly limited to Russia which has a uniform regulatory environment.

The CEO assesses the performance of the operating segment based on earnings before interest, tax, depreciation and amortization (EBITDA) adjusted for one-off items. Term EBITDA is not defined in IFRS. Other information provided to the CEO is measured

in a manner consistent with that in the consolidated financial statements. The accounting policies used for the segment reporting are the same as accounting policies applied for the consolidated financial statements as described in note 35.

The segment information for the year ended 31 December 2016 is as follows:

'000 RUB	O'Key		Da!		Total	
	2016	2015	2016	2015	2016	2015
External revenue	169,695,802	161,822,399	5,774,869	687,993	175,470,671	162,510,392
Inter-segment revenue	—	—	30,274	12,338	30,274	12,338
EBITDA	11,845,435	11,672,274	(2,592,229)	(1,563,108)	9,253,206	10,109,166

Inter-segment revenue for 2016 amounts RUB 30,274 thousand (2015: RUB 12,338 thousand) and relates to a rental agreement between LLC Fresh Market (operator of discounter chain Da!) and LLC O'Key.

A reconciliation of EBITDA to (loss)/profit for the year is as follows:

'000 RUB	Note	2016	2015
EBITDA		9,253,206	10,109,166
Revaluation of investment property	10	(27,055)	(49,854)
Loss from disposal of non-current assets	10	(568,004)	(126,069)
Impairment of non-current assets	10	(434,370)	(41,127)
Loss from write-off of receivables	10	(279,015)	(137,696)
Impairment of receivables	10	(395)	(848)
Depreciation and amortisation	9	(4,549,933)	(3,838,115)
Finance income	12	281,631	81,691
Finance costs	12	(3,550,403)	(3,413,258)
Foreign exchange gain/(loss)	13	145,973	(614,562)
Other expenses		—	(67,920)
Profit before income tax		271,635	1,901,408
Income tax (expense)/benefit		(409,425)	16,299
(Loss)/profit for the year		(137,790)	1,917,707

7 Subsidiaries

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

Subsidiary	Country of incorporation	Nature of operations	2016 Ownership/voting	2015 Ownership/voting
LLC O'Key	Russian Federation	Retail	100%	100%
JSC Dorinda	Russian Federation	Real estate	100%	100%
LLC O'Key Group	Russian Federation	Managing Company	100%	100%
LLC O'Key Logistics	Russian Federation	Import operations	100%	100%
LLC Fresh Market	Russian Federation	Retail and real estate	100%	100%

8 Revenue

'000 RUB	2016	2015
Sales of trading stock	165,210,286	153,112,272
Sales of self-produced catering products	7,269,694	7,172,270
Revenue from sale of goods	172,479,980	160,284,542
Rental income	1,620,671	1,529,250
Revenue from advertising services	1,370,020	696,600
Total revenues	175,470,671	162,510,392

Total revenues comprise sale of goods, rental income from tenants, which rent trade area in the Group stores and income from placing advertising in the Group stores.

9 General, selling and administrative expenses

'000 RUB	Note	2016	2015
Personnel costs	11	(16,185,073)	(14,988,722)
Operating leases	29	(5,343,910)	(4,728,035)
Depreciation and amortisation	15, 16, 17	(4,549,933)	(3,838,115)
Communication and utilities		(3,485,840)	(3,046,569)
Advertising and marketing		(1,795,089)	(1,650,564)
Repairs and maintenance costs		(1,182,822)	(940,327)
Security expenses		(825,314)	(739,972)
Insurance and bank commission		(737,305)	(687,075)
Operating taxes		(713,223)	(758,886)
Legal and professional expenses		(602,704)	(659,763)
Materials and supplies		(301,595)	(300,245)
Other costs		(41,398)	(32,804)
		(35,764,206)	(32,371,077)

Fees billed to the Company and its subsidiaries by KPMG Luxembourg Societe cooperative, and other member firms of the KPMG network during the year are as follows:

'000 RUB	2016	2015
Auditors' remuneration for annual and consolidated accounts	13,902	13,905
Auditors' remuneration for other assurance services	4,721	3,534
Auditors' remuneration for tax advisory services	115	855
	18,738	18,294

10 Other operating income and expenses

'000 RUB	Note	2016	2015
Loss from disposal of non-current assets		(568,004)	(126,069)
Impairment of non-current assets	15, 16, 17	(434,370)	(41,127)
Loss from write-off of receivables		(279,015)	(137,696)
Impairment of receivables		(395)	(848)
Loss from revaluation of investment property	18	(27,055)	(49,854)
Sundry income and expense, net		258,100	207,241
		(1,050,739)	(148,353)

Loss from disposal of other non-current assets amounted RUB 568,004 thousand (2015: RUB 126,069 thousand) relating to stores and land plots in Moscow and other regions which the Group closed or disposed of during the year 2016.

Sundry income includes gain in the amount of RUB 203,256 thousand (2015: RUB 115,871 thousand) from one-off construction services performed to third party.

11 Personnel costs

'000 RUB	2016	2015
Wages and salaries	(10,706,956)	(9,894,169)
Social security contributions	(3,352,398)	(3,036,655)
Employee benefits	(1,100,248)	(965,467)
Other personnel costs	(1,025,471)	(1,092,431)
Total personnel costs	(16,185,073)	(14,988,722)

During the year ended 31 December 2016 the Group employed 25 thousand employees on average (2015: 25 thousand employees on average). Approximately 95% of employees are store and warehouse employees and the remaining part is office employees.

12 Finance income and finance costs

'000 RUB	2016	2015
Recognised in profit or loss		
Interest income on loans, receivables and bank deposits	264,891	67,866
Other finance income	16,740	13,825
Finance income	281,631	81,691
Interest costs on loans and borrowings	(3,497,546)	(3,413,258)
Reclassification from hedging reserve	(52,857)	—
Finance costs	(3,550,403)	(3,413,258)
Net finance costs recognised in profit or loss	(3,268,772)	(3,331,567)

The above financial income and costs include the following in respect for assets/(liabilities) not at fair value through profit and loss:

Total interest income on financial assets	281,631	81,691
Total interest expense on financial liabilities	(3,550,403)	(3,413,258)

Recognised in other comprehensive income

Change in fair value of hedges	79,428	(308,749)
Income tax on income and expense recognised in other comprehensive income	(15,885)	61,750
Finance income/(costs) recognised in other comprehensive income, net of tax	63,543	(246,999)

During 2016 the Group has capitalised interests in the value of property, plant and equipment. The amount of capitalised interest comprised RUB 491,704 thousand (2015: RUB 1,054,770 thousand).

In 2016 a capitalisation rate of 11.24% was used to determine the amount of borrowing costs eligible for capitalisation (2015: 12.99%).

13 Foreign exchange gain/(loss)

During 2016 the Russian Rouble strengthened against the USD. Net foreign exchange gain recognized in profit and loss in the amount of RUB 145,973 thousand for the year ended 31 December 2016 (2015: loss RUB 614,562 thousand) mainly relates to USD-denominated borrowing. In 2016 the Group has not used hedging instruments to hedge foreign exchange risks.

The Group's risk management policy is to receive borrowings in the same currency which generated revenue (Russian Rouble). As at 31 December 2016, the share of USD-denominated borrowings in Group's debt was not significant. The Group's exposure to currency risk is disclosed in note 28.

14 Income tax (expense)/benefit

The Group's applicable tax rate is the income tax rate of 20% for Russian companies (2015: 20%).

'000 RUB	2016	2015
Current tax (expense)/benefit	(1,182,854)	559,716
Deferred tax benefit/(expense)	773,429	(543,417)
Total income tax (expense)/benefit	(409,425)	16,299

Income tax recognised directly in other comprehensive income

'000 RUB	2016			2015		
	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Foreign currency translation differences	(118,246)	—	(118,246)	266,887	—	266,887
Change in fair value of hedges and reclassification from hedging reserve	79,428	(15,885)	63,543	(308,749)	61,750	(246,999)
	(38,818)	(15,885)	(54,703)	(41,862)	61,750	19,888

Reconciliation of effective tax rate:

'000 RUB	2016	2015
Profit before income tax	271,635	1,901,408
Income tax at applicable tax rate (2016: 20%, 2015: 20%)	(54,327)	(380,281)
Effect of income taxed at different rates	(33,110)	(41,053)
Tax effect of items which are not deductible for taxation purposes:		
— Inventory shrinkage expenses	(94,522)	(100,783)
— Other non-deductible expenses	(101,470)	(64,619)
Tax withheld on dividends received from subsidiaries	(143,415)	(88,213)
Adjustments to current income tax for previous periods	7,601	702,255
Other items	9,818	(11,007)
Total income tax (expense)/benefit	(409,425)	16,299

During the year ended 31 December 2015 tax authorities reimbursed to the Group RUB 702,255 thousand of income tax previously paid for 2013 and 2014.

The amount of income tax reimbursed for previous years was recognized as reduction of income tax expense and relates to expenses, which the Group treats as deductible since 2014.

15 Property, plant and equipment

'000 RUB	Land	Buildings	Leasehold improvements	Machinery and equipment, auxiliary facilities and other fixed assets	Construction in progress	Total
Cost or deemed cost						
Balance at 1 January 2015	6,024,426	29,540,699	5,414,339	11,627,685	7,203,116	59,810,265
Additions	99,682	315,512	—	2,124,001	8,775,248	11,314,443
Transfers	—	3,894,591	1,901,588	974,790	(6,770,969)	—
Disposals	(1,284,920)	(1,337,159)	(397,779)	(379,596)	(2,512,724)	(5,912,178)
Balance at 31 December 2015	4,839,188	32,413,643	6,918,148	14,346,880	6,694,671	65,212,530
Balance at 1 January 2016	4,839,188	32,413,643	6,918,148	14,346,880	6,694,671	65,212,530
Additions	61,050	1,330,346	—	2,044,418	3,558,131	6,993,945
Transfers	—	4,867,621	1,182,516	497,253	(6,547,390)	—
Transfers from Lease rights	127,317	—	—	—	—	127,317
Disposals	(6,079)	(9,375)	(393,091)	(1,343,184)	(219,533)	(1,971,262)
Balance at 31 December 2016	5,021,476	38,602,235	7,707,573	15,545,367	3,485,879	70,362,530
Depreciation and impairment losses						
Balance at 1 January 2015	—	(3,693,025)	(1,608,556)	(7,299,022)	(22,324)	(12,622,927)
Depreciation for the year	—	(1,044,440)	(462,381)	(1,991,854)	—	(3,498,675)
Impairment losses	—	(41,127)	—	—	—	(41,127)
Disposals	—	128,567	231,563	350,478	22,324	732,932
Balance at 31 December 2015	—	(4,650,025)	(1,839,374)	(8,940,398)	—	(15,429,797)
Balance at 1 January 2016	—	(4,650,025)	(1,839,374)	(8,940,398)	—	(15,429,797)
Depreciation for the year	—	(1,181,577)	(606,709)	(2,344,466)	—	(4,132,752)
Impairment losses	—	(434,370)	—	—	—	(434,370)
Disposals	—	31	80,095	1,282,010	—	1,362,136
Balance at 31 December 2016	—	(6,265,941)	(2,365,988)	(10,002,854)	—	(18,634,783)
Carrying amounts						
At 1 January 2015	6,024,426	25,847,674	3,805,783	4,328,663	7,180,792	47,187,338
At 31 December 2015	4,839,188	27,763,618	5,078,774	5,406,482	6,694,671	49,782,733
At 31 December 2016	5,021,476	32,336,294	5,341,585	5,542,513	3,485,879	51,727,747

During 2016 the Group has capitalised interest in the value of property, plant and equipment. The amount of capitalised interest comprised RUB 491,704 thousand (2015: RUB 1,054,770 thousand). In 2016 capitalisation rate of 11.24 % was used to determine the amount of borrowing costs eligible for capitalisation (2015: 12.99%).

Depreciation expense of RUB 4,132,752 thousand has been charged to selling, general and administrative expenses (2015: RUB 3,498,675 thousand). Impairment loss in the amount of RUB 434,370 thousand was recognized in 2016 (2015: RUB 41,127 thousand).

As at 31 December 2016 the Group performed impairment test for low-performing stores. For four stores carrying amount exceeded recoverable amount and the Group recognized an impairment loss of RUB 434,370 thousand.

For two stores relating to "O'Key" segment the Group determined recoverable amount being their fair value less cost of disposal. The fair value measurement has been categorised as a Level 3 fair value based on the inputs to the valuation technique used. An estimate was made of annual net operating income which is mainly based on annual net rent rate of RUB 7,200 – 10,500 per sq. m. and full occupancy. Discount rate of 15.7%-16.7% was applied to discount future

cash flows. Recoverable amount of stores amounted to RUB 1,676,000 thousand and impairment loss amounted to RUB 381,420 thousand.

For two stores relating to "Da!" segment the Group determined recoverable amount being their value in use. Recoverable amount of stores amounted to RUB 74,000 thousand and impairment loss amounted to RUB 52,950 thousand. Discount rate of 13% was applied to discount future cash flows.

Security

At 31 December 2016, 4 stores have been pledged to third parties as collateral for borrowings (2015: 4 stores). Refer to notes 26 and 31.

16 Lease rights

Leasehold rights consist of initial cost of land lease and premises. Lease rights include purchase price and costs directly attributable to the acquisition of lease rights for land plots and premises.

Lease rights are amortised over the period of the lease: 49-51 years for land leases and 8-19 years for leases of premises.

Movements in the carrying amount of lease rights were as follows:

'000 RUB	Note	2016	2015
	36		re-presented
Cost			
Balance at 1 January		6,287,181	5,880,558
Additions		36,000	761,180
Transfers to land		(140,565)	—
Disposals		(157,856)	(354,557)
Balance at 31 December		6,024,760	6,287,181
Amortisation and impairment losses			
Balance at 1 January		(1,439,644)	(1,264,563)
Amortisation charge		(174,640)	(190,899)
Transfers to land		13,248	—
Disposals		154,811	15,818
Balance at 31 December		(1,446,225)	(1,439,644)
Net book value		4,578,535	4,847,537

Amortisation of RUB 174,640 thousand has been charged to selling, general and administrative expenses (2015: RUB 190,899 thousand).

As at 31 December 2016 the Group reassessed its plans in relation to certain land lease rights which it previously planned to lease for a period of up to 50 years.

Now the Group plans to acquire these land plots in ownership within 1-10 years after reporting date.

This resulted in decrease of residual useful lives of certain lease rights from 50 years to 1-10 years.

The Group expects that change in estimated useful life will result in increase of lease rights amortization for 2017 by RUB 99,500 thousand.

17 Intangible assets

'000 RUB	Note	Software	Other intangible assets	Total
	36			re-presented
Cost				
Balance at 1 January 2015		851,771	49,708	901,479
Additions		241,279	78,404	319,683
Transfer		(44)	44	—
Balance at 31 December 2015		1,093,006	128,156	1,221,162
Balance at 1 January 2016		1,093,006	128,156	1,221,162
Additions		476,499	24,677	501,176
Disposals		(160,307)	(4,424)	(164,731)
Balance at 31 December 2016		1,409,198	148,409	1,557,607
Amortisation and impairment losses				
Balance at 1 January 2015		(420,815)	(16,748)	(437,563)
Amortisation for the year		(137,318)	(11,223)	(148,541)
Transfer		56	(56)	—
Balance at 31 December 2015		(558,077)	(28,027)	(586,104)
Balance at 1 January 2016		(558,077)	(28,027)	(586,104)
Amortisation for the year		(220,700)	(21,841)	(242,541)
Disposals		160,252	3,889	164,141
Balance at 31 December 2016		(618,525)	(45,979)	(664,504)
Carrying amounts				
At 1 January 2015		430,956	32,960	463,916
At 31 December 2015		534,929	100,129	635,058
At 31 December 2016		790,673	102,430	893,103

Amortisation and impairment losses

Amortisation of RUB 242,541 thousand has been charged to selling, general and administrative expenses (2015: RUB 148,541 thousand).

18 Investment property

(a) Reconciliation of carrying amount

'000 RUB	Note	Investment property
Investment properties at fair value as at 1 January 2015		548,500
Expenditure on subsequent improvements		65,354
Fair value loss (unrealized)	10	(49,854)
Investment properties at fair value as at 31 December 2015		564,000
Investment properties at fair value as at 1 January 2016		564,000
Expenditure on subsequent improvements		35,597
Fair value loss (unrealized)	10	(27,055)
Investment properties at fair value as at 31 December 2016		572,542

(b) Measurement of fair value

The carrying amount of investment property is the fair value of the property as determined by registered independent appraisers having an appropriate recognised professional qualification and recent experience in the location and type of the property being valued.

The fair value measurement for investment property has been categorised as a Level 3 fair value based on the inputs to the valuation technique used (see note 5).

The appraisers used average between the income and comparative approaches for determining the fair value. Under income approaches an estimate was made of annual net operating income which is mainly based on annual net rent rate of RUB 7,000 per sq. m. (2015: RUB 7,000 per sq. m.) and expected occupancy of 93% (2015: 95%). Discount rate of 13% (2015: 19%) was applied to discount future cash flows.

There were no direct operating expenses arising from investment property that did not generate rental income for the year ended 31 December 2016 (2015: Nil).

19 Other non-current assets

'000 RUB	Note	2016	2015
	36		re-presented
Long-term prepayments to entities under control of shareholder group		894,175	651,302
Prepayments for property plant and equipment		769,210	1,703,876
Long-term deposits to lessors		339,295	390,732
		2,002,680	2,745,910

Long-term prepayments to entities under control of the shareholder group represent prepayments for rent of hypermarkets for the period until 2034. Related party transactions are detailed in note 32.

20 Deferred tax assets and liabilities

(a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

'000 RUB	Assets		Liabilities		Net	
	2016	2015	2016	2015	2016	2015
Investment property	994	—	—	(1,113)	994	(1,113)
Property, plant and equipment	173,210	357,514	(974,315)	(922,764)	(801,105)	(565,250)
Construction in progress	—	—	(267,198)	(210,954)	(267,198)	(210,954)
Intangible assets	—	—	(126,179)	(95,313)	(126,179)	(95,313)
Other non-current assets	—	—	(101,467)	(118,434)	(101,467)	(118,434)
Inventories	602,017	572,154	(1,510)	(29,245)	600,507	542,909
Trade and other receivables and payables	615,767	—	(577,189)	(261,414)	38,578	(261,414)
Long-term investments	6,613	—	—	—	6,613	—
Tax loss carry-forwards	1,234,439	537,207	—	—	1,234,439	537,207
Tax assets/(liabilities)	2,633,040	1,466,875	(2,047,858)	(1,639,237)	585,182	(172,362)
Set off of tax	(1,355,767)	(812,363)	1,355,767	812,363	—	—
Net tax assets/(liabilities)	1,277,273	654,512	(692,091)	(826,874)	585,182	(172,362)

(b) Unrecognised deferred tax liability

As at 31 December 2016 a temporary difference of RUB 23,979,879 thousand (2015: RUB 22,842,672 thousand) relating to investments in subsidiaries has not been recognised as the Group is able to control the timing of reversal of the difference, and reversal is not expected in the foreseeable future. If the temporary difference were reversed in form of distributions remitted to the Company, then an enacted tax rate of 5-15% would apply.

(c) Movement in temporary differences during the year

'000 RUB	1 January 2016	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2016
Investment property	(1,113)	2,107	—	994
Property, plant and equipment	(565,250)	(235,855)	—	(801,105)
Construction in progress	(210,954)	(56,244)	—	(267,198)
Intangible assets	(95,313)	(30,866)	—	(126,179)
Other non-current assets	(118,434)	16,967	—	(101,467)
Inventories	542,909	57,598	—	600,507
Trade and other receivables and payables	(261,414)	315,877	(15,885)	38,578
Long-term investments	—	6,613	—	6,613
Tax loss carry-forwards	537,207	697,232	—	1,234,439
	(172,362)	773,429	(15,885)	585,182

'000 RUB	1 January 2015	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2015
Investment property	(4,203)	3,090	—	(1,113)
Property, plant and equipment	(669,692)	104,442	—	(565,250)
Construction in progress	(149,162)	(61,792)	—	(210,954)
Intangible assets	(14,649)	(80,664)	—	(95,313)
Other non-current assets	60,656	(179,090)	—	(118,434)
Inventories	674,915	(132,006)	—	542,909
Trade and other receivables and payables	247,782	(570,946)	61,750	(261,414)
Tax loss carry-forwards	163,658	373,549	—	537,207
	309,305	(543,417)	61,750	(172,362)

21 Inventories

'000 RUB	2016	2015
Goods for resale	13,370,212	12,436,674
Raw materials and consumables	700,673	595,017
Write-down to net realisable value	(364,017)	(403,387)
	13,706,868	12,628,304

Due to write-off and discount given for obsolete and slow moving goods for resale the Group tested the related stock for write-off and also wrote down the related inventories to their net realisable value, which resulted in decrease of carrying value of stock by RUB 364,017 thousand as at 31 December 2016 (2015: RUB 403,387 thousand).

The write down to net realisable value was determined applying the percentages of discount on sales and write-offs of slow moving goods to the appropriate ageing of the goods. The percentages of discount were based on the management's best estimate following the experience of the discount sales.

The write-down is included in cost of goods sold.

22 Trade and other receivables

'000 RUB	2016	2015
Trade receivables	545,464	362,599
VAT receivable	1,562,138	1,902,761
Prepaid taxes other than income tax	132,565	67,747
Prepaid income tax	14,282	791,787
Bonuses receivable from suppliers	3,081,243	1,653,027
Other receivables	535,318	2,159,425
	5,871,010	6,937,346

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 28.

23 Cash and cash equivalents

'000 RUB	2016	2015
Cash on hand	417,766	404,853
Bank current account	589,988	739,135
Term deposits	8,240,763	7,180,674
Cash in transit	2,214,950	1,443,468
Cash and cash equivalents	11,463,467	9,768,130

Term deposits had original maturities of less than three months.

The Group keeps its deposits in the following banks: VTB bank, Saint-Petersburg bank, Unicredit bank, BNP Paribas.

The Group's exposure to credit and currency risks related to cash and cash equivalents is disclosed in note 28.

24 Equity

Reconciliation of number of shares from 1 January to 31 December is provided in the table below.

<i>Number of shares unless otherwise stated</i>	Ordinary shares	
	2016	2015
Par value	EUR 0.01	EUR 0.01
On issue at 1 January	269,074,000	269,074,000
On issue at 31 December, fully paid	269,074,000	269,074,000

As at 31 December 2016 the Group's subscribed share capital of RUB 119,440 thousand (EUR 2,691 thousand) is represented by 269,074,000 shares with a par value of 0.01 EUR each.

In accordance with Luxemburg Company Law, the Company is required to transfer a minimum of 5% of its net profits for each financial year to a legal reserve. This requirement ceases to be necessary once the balance of the legal reserve reaches 10% of the issued share capital. The legal reserve is not available for distribution to the shareholders. There were no transfers to legal reserve during 2016 (2015: nil).

In July 2016 the Group paid interim dividends to shareholders in amount of RUB 1,472,411 thousand (2015: RUB 1,643,771 thousand).

Interim dividends paid were recognised as distribution to owners in the Consolidated Statement of Changes in Equity. Interim dividends for 2016 comprise distribution of profit in the amount of RUB 1,124,462 thousand and additional paid-in capital redemption in the amount of RUB 347,949 thousand.

Dividends per share recognised as distribution to shareholders for the year ended 31 December 2016 amounted to RUB 5.5 (2015: RUB 6.1).

In April 2016 shareholders of the Company approved annual dividends for the year ended 31 December 2015. The amount of annual dividends for 2015 was paid by the Group to shareholders as interim dividends in 2015 in the amount of RUB 1,643,771 thousand.

25 (Loss)/earnings per share

The calculation of basic earnings per share at 31 December 2016 was based on the loss attributable to ordinary shareholders of RUB 137,790 thousand (2015: profit RUB 1,917,707 thousand), and a weighted average number of ordinary shares outstanding of 269,074,000, calculated as shown below. The Company has no dilutive potential ordinary shares.

<i>Number of shares</i>	2016	2015
Issued shares at 1 January	269,074,000	269,074,000
Weighted average number of shares for the year ended 31 December	269,074,000	269,074,000

26 Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 28.

'000 RUB	2016	2015
Non-current liabilities		
Secured bank loans	2,500,000	5,000,000
Unsecured bank facilities	23,000,000	17,052,875
Unsecured bonds	5,243,118	385,144
Unsecured loans from related parties	929,960	1,117,400
Unsecured loans from third parties	—	2,850
	31,673,078	23,558,269
Current liabilities		
Secured bank loans	2,500,000	—
Unsecured bank facilities	1,000,000	1,770,125
Unsecured bonds	962,410	9,980,000
Unsecured loans from third parties	2,850	—
Loans and borrowings	4,465,260	11,750,125
Unsecured bonds interest	146,904	238,714
Interest accrued on loans	9,966	10,891
Interest accrued on loans and borrowings	156,870	249,605
	4,622,130	11,999,730

As at 31 December 2016 loans and borrowings with carrying value of RUB 5,000,000 thousand were secured by property, plant and equipment (2015: RUB 5,000,000 thousand). Refer to note 31.

As at 31 December 2016 the Group has RUB 15,800,000 thousand (2015: RUB 6,300,000 thousand) of undrawn, committed borrowing facilities available in respect of which all conditions present had been met.

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

'000 RUB	Currency	Year of maturity	31 December 2016		31 December 2015	
			Face value	Carrying amount	Face value	Carrying amount
Unsecured bonds	RUB	2017–2021	6,205,528	6,205,528	10,365,144	10,365,144
Secured bank facility	RUB	2017–2018	5,000,000	5,000,000	5,000,000	5,000,000
Unsecured bank facility	RUB	2017–2021	24,000,000	24,000,000	18,823,000	18,823,000
Unsecured loans from related parties	USD	2018	929,960	929,960	1,117,400	1,117,400
Unsecured loans from other companies	RUB	2017	2,850	2,850	2,850	2,850
			36,138,338	36,138,338	35,308,394	35,308,394

In April 2016 the Group placed unsecured bonds on Moscow Exchange in the amount of RUB 5,000,000 thousand. The bonds mature after 5 years in 2021. However, bond holders have an option to claim repayment after 2.5 years – in October 2018.

Compliance with loan covenants

The Group monitors compliance with loan covenants on an ongoing basis. Where noncompliance is unavoidable in management's view, the Group requests waiver letters from the banks before the year-end, confirming that the banks shall not use its right to demand early redemption.

At 31 December 2016 and during the year then ended the Group complied with all loan covenants.

27 Trade and other payables

'000 RUB	2016	2015
Trade payables	29,374,499	24,000,558
Advances received	350,816	1,772,204
Taxes payable (other than income tax)	1,085,381	627,824
Payables to staff	1,339,925	1,603,412
Deferred income	99,489	85,310
Interest rate swap liability	147,019	173,590
Other current payables	83,763	554,435
	32,480,892	28,817,333

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 28.

28 Financial instruments and risk management

(a) Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies

(i) Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

'000 RUB	Note	Carrying amount	
		2016	2015
Trade and other receivables	22	4,162,025	4,175,051
Cash and cash equivalents	23	11,463,467	9,768,130
		15,625,492	13,943,181

Due to the fact that the Group's principal activities are located in the Russian Federation the credit risk is mainly associated with its domestic market. The credit risks associated with foreign counterparties are considered to be remote, as there are only few foreign counterparties and they were properly assessed for creditability.

(ii) Trade and other receivables

The Group has no considerable balance of trade receivables because the majority of its customers are retail consumers, who are not provided with any credit.

are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(b) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers, bonuses receivable and investments.

Therefore the Group's trade receivables primarily include receivables from tenants and receivables connected to provision of advertising services. Usually the Group provides advertising services to suppliers of goods sold in O'Key stores. Thus, the credit risk in part of trade receivables is mostly managed through procedures for selection of suppliers and tenants.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main component of this allowance is a specific loss component that relates to individually significant exposures.

Impairment losses

The aging of trade and other receivables at the reporting date was:

'000 RUB	Gross 2016	Impairment 2016	Gross 2015	Impairment 2015
Not overdue and past due less than 90 days	4,045,013	—	4,064,535	—
Past due 90-180 days	43,875	—	57,304	—
Past due 181-360 days	36,658	—	36,799	—
More than 360 days	67,736	(31,257)	45,690	(29,277)
	4,193,282	(31,257)	4,204,328	(29,277)

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

'000 RUB	2016	2015
Balance at beginning of the year	29,277	28,429
Impairment loss recognised	1,980	848
Impairment loss reversed	—	—
Balance at end of the year	31,257	29,277

The management has performed a thorough analysis of the recoverability of the receivables and impaired the balances outstanding for more than 1 year. Based on past experience management believes that normally the balances outstanding less than 360 days should not be impaired.

(iii) Cash and cash equivalents

The Group held cash and cash equivalents of RUB 11,463,467 thousand at 31 December 2016 (2015: RUB 9,768,130 thousand), which represents its maximum credit exposure on these assets. Cash and cash equivalents are mainly held with banks which are rated from Ba2 to Ba3 based on Moody's rating.

(c) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Liquidity risk management is a responsibility of the Treasury under the supervision of the Group's Financial Director. The Group's liquidity risk management objectives are as follows:

- Maintaining financial independence: a share of one creditor in debt portfolio should not exceed 30%;
- Maintaining financial stability: the ratio DEBT/EBITDA should not exceed 4.0;
- Monitoring of compliance with debt covenants;
- Planning: timely preparation of operating, investing and financing cash-flow forecasts on rolling basis.

(i) *Exposure to liquidity risk*

The following are the contractual maturities of financial liabilities, including future interest payments:

2016

'000 RUB	Carrying amount	Contractual cash flows	0-6 mths	6-12 mths	1-5 yrs
Non-derivative financial liabilities					
Secured bank loan	5,001,141	(5,467,111)	(1,445,164)	(1,394,695)	(2,627,252)
Unsecured bonds	6,352,432	(7,574,128)	(1,076,276)	(734,925)	(5,762,927)
Unsecured bank facilities	24,008,799	(31,602,297)	(2,214,692)	(1,202,048)	(28,185,557)
Unsecured loans from related parties	929,960	(1,010,471)	(37,096)	(37,096)	(936,279)
Unsecured loans from other companies	2,876	(2,878)	(2,878)	—	—
Trade and other payables	30,945,206	(30,945,206)	(30,945,206)	—	—
	67,240,414	(76,602,091)	(35,721,312)	(3,368,764)	(37,512,015)

As at 31 December 2016 Group's current liabilities exceed current assets by RUB 5,892,343 thousand (2015: RUB 10,254,288 thousand). Excess of current liabilities over current assets is usual for retail industry. The Group uses excess of trade and other payables over inventory to finance its investing activities.

In April 2016 the Group placed unsecured bonds on Moscow Exchange in the amount of RUB 5,000,000 thousand. The bonds mature after 5 years in 2021. However, bond holders have an option to claim repayment after 2.5 years – in October 2018.

2015

'000 RUB	Carrying amount	Contractual cash flows	0-6 mths	6-12 mths	1-5 yrs
Non-derivative financial liabilities					
Secured bank loan	5,000,000	(5,858,020)	(207,034)	(210,466)	(5,440,520)
Unsecured bonds	10,603,858	(11,277,679)	(5,724,587)	(5,125,475)	(427,617)
Unsecured bank facilities	18,833,868	(23,184,757)	(1,846,406)	(2,216,104)	(19,122,247)
Unsecured loans from related parties	1,117,400	(1,303,777)	(44,329)	(44,329)	(1,215,119)
Unsecured loans from other companies	2,873	(2,878)	(25)	(1)	(2,852)
Trade and other payables	26,331,994	(26,331,994)	(26,331,994)	—	—
	61,889,993	(67,959,105)	(34,154,375)	(7,596,375)	(26,208,355)

There are no payments due after 5 years.

(d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group buys derivatives in order to manage market risk. All such transactions are carried out within the guidelines set in Group's policy on hedging market risk. The Group applies hedge accounting in order to manage volatility in profit or loss.

(i) Currency risk

The Group holds its business in the Russian Federation and mainly collects receivables nominated in Russian Roubles. However, financial assets and liabilities of the Group are also denominated in other currencies, primarily US Dollar.

Thus the Group is exposed to currency risk, which may materially influence the financial position and financial results of the Group through the change in carrying value of financial assets and liabilities and amounts on foreign exchange rate gains or losses. The Group ensures that its exposure is kept to an acceptable level by keeping the proportion of financial assets and liabilities in foreign currencies to total financial liabilities at an acceptable level. From time to time the Group converts assets and liabilities from one currency to another. The Group regularly considers the necessity of using derivatives to hedge its exposure to currency risk.

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows based on notional amounts:

'000 RUB	USD-denominated 2016	USD-denominated 2015
Trade and other receivables	1,760	2,101
Cash and cash equivalents	3,582	750
Unsecured loans from related parties	(929,960)	(1,117,400)
Trade and other payables	(176,595)	(760,753)
Gross exposure	(1,101,213)	(1,875,302)
Net exposure	(1,101,213)	(1,875,302)

The following significant exchange rates applied during the year:

Russian Rouble equals	Average rate		Reporting date rate	
	2016	2015	2016	2015
US Dollar	67.0349	60.9579	60.6569	72.8827

Sensitivity analysis

A 20% weakening of the RUB against USD at 31 December 2016 would have decreased equity and profit and loss by RUB 220,243 thousand (2015: RUB 375,060 thousand). This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant. The analysis was performed on the same basis for 2015.

A strengthening of the RUB against USD at 31 December 2016 would have had the equal but opposite effect on equity and profit and loss, on the basis that all other variables remain constant.

(ii) Interest rate risk

The Group has material exposure to interest rate risk. As at 31 December 2016, 6% of the Group's interest bearing financial liabilities were subject to re-pricing within 6 months after the reporting date (2015: 39%).

The Group uses swap to hedge its exposure to variability of interest rates. As at 31 December 2016 the Group had interest swap agreement with VTB bank. Under this agreement the Group swaps Mosprime rate for fixed rate. At inception, the swap had a maturity of three years. As at 31 December 2016 fair value of swap liability was RUB 147,018 thousand (31 December 2015: RUB 173,590 thousand).

Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

'000 RUB	Carrying amount	
	2016	2015
Fixed rate instruments		
Financial assets	8,240,763	7,180,674
Financial liabilities	(36,295,208)	(26,736,999)
Variable rate instruments		
Financial liabilities	—	(8,821,000)

Cash flow sensitivity analysis for variable rate instruments

A change of 500 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis was performed on the same basis for 2015.

'000 RUB	Profit or loss		Equity	
	500 bp increase	500 bp decrease	500 bp increase	500 bp decrease
2016				
Variable rate instruments	—	—	—	—
Interest rate swap	75,000	(75,000)	96,306	(96,845)
Cash flow sensitivity (net)	75,000	(75,000)	96,306	(96,845)
2015				
Variable rate instruments	(441,050)	441,050	—	—
Interest rate swap	163,250	(163,250)	246,893	(231,668)
Cash flow sensitivity (net)	(277,800)	277,800	246,893	(231,668)

(e) Offsetting of financial assets and financial liabilities

The Group may enter into sales and purchase agreements with the same counterparty in the normal course of business. The related amount receivable and payable do not always meet the criteria for offsetting in the statement of financial position. This is because the Group may not have any currently legally enforceable right to offset recognised amounts, because the right

to offset may be enforceable only on the occurrence of future events. In particular, in accordance with the Russian civil law an obligation can be settled by offsetting against a similar claim if it is due, has no maturity or is payable on demand.

The following table sets out the carrying amounts of recognised financial instruments that are subject to the above agreements.

'000 RUB	Trade and other receivables	Trade and other payables
31 December 2016		
Gross amounts	2,356,574	13,602,195
Amounts offset in accordance with IAS 32 offsetting criteria	(5,013)	(5,013)
Net amounts presented in the statement of financial position	2,351,561	13,597,182
Amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria	(2,351,561)	(2,351,561)
Net amount	—	11,245,621
31 December 2015		
Gross amounts	1,222,653	9,429,773
Amounts offset in accordance with IAS 32 offsetting criteria	(1,053)	(1,053)
Net amounts presented in the statement of financial position	1,221,600	9,428,720
Amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria	(1,221,600)	(1,221,600)
Net amount	—	8,207,120

The net amounts presented in the statement of financial position disclosed above form part of trade and other receivables and trade and other payables, respectively. Other amounts included in these line items do not meet the criteria for offsetting and are not subject to the agreements described above.

Amounts offset in accordance with IAS 32 offsetting criteria comprise mainly trade payables for goods and bonuses receivable from suppliers.

(f) Fair values

Basis for determination of fair value of financial assets and liabilities is disclosed in note 5. Fair value of Group's financial assets and liabilities, including loans and borrowings, approximates their carrying amounts.

(g) Fair value hierarchy

Group's derivative financial assets and liabilities comprise interest rate swap which is carried at fair value. Fair value of swap was determined based on observable market data (Level 2 fair value), including forward interest rates.

The Group has no financial assets and liabilities measured at fair value based on unobservable inputs (Level 3 fair value).

Group's bonds are listed on Moscow Exchange. Fair value of bonds payable was determined for disclosure purposes based on active market quotations (Level 1 fair value).

(h) Capital management

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Neither the Company nor its subsidiaries are subject to externally imposed capital requirements, except for statutory requirement in relation to minimum level of share capital; the Group follows this requirement.

29 Operating leases

Leases as lessee

The Group has both owned and leased land plots. The owned land plots are included in property, plant and equipment. Leased land plots are treated as operating leases. In case the Group incurs costs directly attributable to acquisition of operating lease rights, these costs are capitalized as initial cost of land lease and are amortised over the period of the lease (49-51 years). The further information on leases is detailed below.

When the Group leases land plots under operating leases, the lessors for these leases are State authorities and third parties. The leases are typically run for 2-3 years, after which long term operating lease contract is concluded for 49 years.

The Group also rents premises under operating leases. These leases typically run up to 10 years, although some leases may be for longer periods. Property leases can be renewed based on mutual agreement of the lessor and the Group. The Group has subleases. Fees payable by the Group for operating leases of stores comprise fixed payments and contingent rent which is determined as an excess of 2%-6% of the revenue of related stores over the fixed rent rate.

During the year ended 31 December 2016 RUB 5,518,550 thousand was recognised as an expense (including amortisation of Lease rights amounting to RUB 174,640 thousand) in the profit and loss in respect of operating leases (2015: RUB 4,728,035 thousand). Contingent rent recognised as an expense for the year ended 31 December 2016 amounted to RUB 467,947 thousand (2015: RUB 359,180 thousand).

At 31 December, the future minimum lease payments under non-cancellable leases were payable as follows.

RUB 000'	2016	2015
Less than one year	3,771,246	3,012,410
Between one and five years	14,239,837	10,775,153
More than five years	30,089,728	20,743,629
	48,100,811	34,531,192

Leases as lessor

The Group leases out its investment property and some space in the buildings of hypermarkets. During the year ended 31 December 2016 RUB 1,620,671 thousand was recognised as rental income in the consolidated statement of profit or loss and other comprehensive income (2015: RUB 1,529,250 thousand). All leases where the Group is lessor are cancellable. The Group has contingent rent arrangements.

Contingent rent recognised as income amounted to RUB 79,877 thousand for the year ended 31 December 2016 (2015: RUB 67,483 thousand). Contingent rent is determined as an excess of 4%-25% of the tenant's revenue over the fixed rent rate.

30 Capital commitments

The Group has capital commitments to acquire property, plant and equipment and intangible assets amounting to RUB 1,078,308 thousand as at 31 December 2016 (2015: RUB 3,570,470 thousand). The capital commitments mostly consist of construction contracts for stores.

31 Contingencies

(a) Legal proceedings

From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and both internal and external professional advice management is of the opinion that no material losses will be incurred in respect of claims.

(b) Taxation contingencies

The taxation system in the Russian Federation continues to evolve and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities.

Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years;

however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive and substance-based position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in the Russian Federation that are substantially more significant than in other countries. Management believes that it has provided adequately for the Group's tax positions based on its interpretations of applicable Russian tax legislation, official pronouncements and court decisions. In addition to tax liabilities recognised in these consolidated financial statements, the Group is exposed to uncertain tax positions for which no provision has been made because management has assessed that additional payments are not probable. However, the interpretations of the relevant authorities could differ. If the authorities are successful in enforcing their interpretations, the maximum unrecognised exposures approximate RUB 2,400 million as at 31 December 2016.

(c) Assets pledged or restricted

The Group has the following assets pledged as collateral for loans and borrowings:

'000 RUB	Note	2016	2015
Property, plant and equipment (carrying value)	15	2,529,768	2,592,895
Total		2,529,768	2,592,895

32 Related party transactions

(a) Major shareholders

The major shareholders of the Group are three individuals Mr. Korzhev, Mr. Troitsky and Mr. Volchek ("the shareholder group").

(b) Transactions with management

(i) Management remuneration

Key management received the following remuneration during the year, which is included in personnel costs (see note 11)

RUB 000'	2016	2015
Salaries and bonuses	359,436	236,815
Social security contributions	10,718	16,389
Long-service bonus	98,358	28,691
Other payments	7,500	401,165
	476,012	683,060

During the year ended 31 December 2016 the Group revised list of employees included in key management personnel. Comparative information for the year ended 31 December 2015 was represented to reflect current structure of key management personnel.

In addition members of Board of Directors received remuneration in the amount of RUB 59,942 thousand for the year ended 31 December 2016 (2015: RUB 32,438 thousand) which is included in legal and professional expenses.

(c) Transactions with other related parties

Other related parties are entities which belong to the shareholder group (see note 1).

The Group's other related party transactions are disclosed below.

(i) Revenue

'000 RUB	Transaction value 2016	Transaction value 2015	Trade receivable 2016	Trade payables 2015
Services provided:				
Other related parties	2,225	35,562	94	(6,007)
	2,225	35,562	94	(6,007)

All outstanding balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured.

(ii) Expenses

'000 RUB	Transaction value 2016	Transaction value 2015	Prepayments 2016	Prepayments 2015
Other related parties	(788,700)	(726,151)	921,195	936,956
Including:				
Rental fee	(653,097)	(616,077)	—	—
Reimbursement of utilities	(73,197)	(54,518)	—	—
Reimbursement of other expenses	(62,406)	(55,556)	—	—
Other services received:				
Other related parties	(2,756)	(3,922)	2,143	—
Finance costs:				
Other related parties	(81,347)	(76,095)	—	—
	(872,803)	(806,168)	923,338	936,956

All outstanding balances with related parties, except for prepayments for operating leases, are to be settled in cash within six months of the reporting date. None of the balances are secured.

Outstanding balance of RUB 921,195 thousand as at 31 December 2016 comprises prepayments for rent of hypermarkets for the period until 2034 amounting to RUB 925,704 thousand and current liabilities for rent of hypermarkets in the amount of RUB 4,509 thousand. Long-term part of prepayments amounting to RUB 894,175 thousand is disclosed in note 19.

Terms of the leases are such that the Group pays rentals which include the reimbursement of all operating expenses related to these hypermarkets and nearby leased areas and a certain percentage of the Group's retail revenue from the operation of these hypermarkets.

Interest costs on loans from related parties amounted to RUB 81,347 thousand for the year ended 31 December 2016 (2015: RUB 76,095 thousand) and were recorded as finance costs in profit or loss.

All other outstanding balances are to be settled in cash within six months of the reporting date. None of the balances are secured.

(iii) Loans

'000 RUB	Amount loaned 2016	Amount loaned 2015	Outstanding balance 2016	Outstanding balance 2015
Loans paid back:				
Other related parties	—	—	(929,960)	(1,117,400)

The loans from other related parties bear interest at 8% per annum and are payable in 2018.

(d) Pricing policies

Related party transactions are not necessarily based on market prices.

33 Events subsequent to the reporting date

In January 2017 the Group paid interim dividends to shareholders in the amount of RUB 1,418,998 thousand.

In March 2017 the Group announced the appointment of Miodrag Borojevic as its new Chief Executive Officer of hypermarket and supermarket business. He will be succeeding Heigo Kera from May 2017.

34 Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except for the following:

- Derivative financial instruments are stated at fair value;
- Liabilities incurred in cash-settled share-based payment transactions are remeasured at fair value;
- Investment property is remeasured at fair value.

35 Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities, except as explained in note 36, which addresses changes in presentation.

(a) Basis of consolidation*(i) Subsidiaries*

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

(ii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency*(i) Foreign currency transactions*

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising in retranslation are recognised in profit or loss.

(ii) Foreign operations

The assets and liabilities of foreign operations are translated to RUB at the exchange rates at the reporting date. The income and expenses of foreign operations are translated to RUB at exchange rates at the dates of the transactions.

Foreign currency differences are recognised directly in other comprehensive income. Since 1 January 2005, the Group's date of transition to IFRSs, such differences have been recognised in the foreign currency translation reserve. When a foreign operation is disposed of such that control or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. When the Group disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, the relevant proportion of the cumulative amount is reattributed to non-controlling interests. When the Group disposes of only part of its investment in joint venture that includes a foreign operation while retaining joint control, the relevant proportion of the cumulative amount is reclassified to profit or loss.

Foreign exchange gains and losses arising from a monetary item received from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and are presented within equity in the foreign currency translation reserve.

(c) Financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

(i) Non-derivative financial assets and financial liabilities – recognition and derecognition

The Group initially recognises loans and receivables and debt securities issued on the date that they are originated. All other financial assets and financial liabilities are recognised initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

(ii) Non-derivative financial assets – measurement

The Group has the following non-derivative financial assets: loans and receivables.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables comprise trade and other receivables and cash and cash equivalents.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(iii) Non-derivative financial liabilities – measurement

The Group has the following non-derivative financial liabilities: loans and borrowings, bank overdrafts, and trade and other payables.

Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

(iv) Derivative financial instruments

The Group holds derivative financial instruments to hedge its interest rate and foreign currency risk exposures.

On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedged items, including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment,

both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be “highly effective” in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately affect reported net income.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in other comprehensive income and presented in the hedging reserve in equity. The amount recognised in other comprehensive income is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of profit and loss and other comprehensive income as the hedged item. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated, exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in other comprehensive income and presented in the hedging reserve in equity remains there until the forecast transaction affects profit or loss. If the forecast transaction is no longer expected to occur, then the balance in other comprehensive income is recognised immediately in profit or loss.

(d) Transactions with owners

(i) Ordinary shares/share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(ii) Distributions to owners/contributions from owners

The dividends paid to the shareholders are recognised directly in equity once the decision on the payment takes place. The transfers of assets to the related parties (companies under the control of the Group’s ultimate shareholder group) or other benefits to such related parties are recognised directly in equity as distributions to the shareholders.

(e) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment, except for land, are measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 1 January 2005, the date of transition to IFRSs, was determined by reference to its fair value at that date.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalised borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Any gain or loss on disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and is recognised net within “other income” in profit or loss.

(ii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

(iii) Depreciation

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its residual value. Significant components of individual assets are assessed and if a component has a useful life that is different from the remainder of that asset, that component is depreciated separately.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of significant items of property, plant and equipment for the current and comparative periods are as follows:

— Buildings	30 years;
— Machinery and equipment, auxiliary facilities	2-20 years;
— Motor vehicles	5-10 years;
— Leasehold improvements	over the term of underlying lease;
— Other fixed assets	2-10 years.

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(f) Investment property

Investment property is property held by the Group to earn rental income or for capital appreciation and which is not occupied by the Group.

Investment property, including investment property under construction, is initially recognised at cost, including transaction costs, and subsequently remeasured at fair value with any change therein recognised in profit or loss. If fair value of investment property under construction is not reliably determinable, the Group measures that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier).

Fair value of the Group's investment property is determined by independent appraisers, who hold a recognised and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

When the use of a property changes such that it is reclassified as property, plant and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

(g) Intangible assets

(i) Other intangible assets

Other intangible assets that are acquired by the Group have finite useful lives and are measured at cost less accumulated amortisation and accumulated impairment losses. Other intangible assets primarily include capitalised computer software, patents and licenses. Acquired computer software, licenses and patents are capitalised on the basis of the costs incurred to acquire and bring them to use.

(ii) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in the profit or loss as incurred.

(iii) Amortisation

Amortisation is based on the cost of the asset less its estimated residual value.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use since this most closely reflects the expected pattern of consumption of future economic benefits embodied in the asset. The estimated useful lives for the current and comparative periods are as follows:

— software licenses	1-7 years;
— other intangible assets	1-5 years.

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(h) Leased assets

(i) Operating leases

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments, including those on expected termination, are charged to profit or loss on a straight-line basis over the period of the lease.

Where the Group is a lessee in a land lease, the initial cost of land lease is amortized using straight-line method over the period of lease being up to 51 years. Where the Group is a lessee in a lease of premises, the lease rights are amortized using straight-line method over the period of lease being up to 8-19 years.

(ii) Finance leases

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition

the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are shown as other payables (long-term accounts payable for amounts due after 12 months from reporting date). The interest cost is charged to the profit or loss over the lease period using the effective interest method.

(i) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the weighted moving average principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(j) Impairment

(i) Financial assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, indications that a debtor or issuer will enter bankruptcy, observable data indicating that there is measurable decrease in expected cash flows from a group of financial assets.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than investment property, inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(k) Employee benefits

(i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans, including Russia's State pension fund, are recognised as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available. Contributions to a defined contribution plan that are due more than 12 months after the end of the period in which the employees render the service are discounted to their present value.

(ii) Other long-term employee benefits

Other long-term employee benefits represent long-service bonuses. Long-term employee benefits are expensed evenly during the periods in which they are earned by employees.

(iii) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term bonus if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(l) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(m) Revenue

Revenue is measured at the fair value of the consideration received or receivable, net of VAT, returns and discounts.

(i) Goods sold

Revenues from sales of goods are recognised at the point of transfer of risks and rewards of ownership of the goods, for retail trade it is normally at the cash register.

(ii) Services

Revenue from services rendered is recognised in profit or loss when the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Rental income from investment property is recognised in profit or loss on a straight-line basis over the term of the lease. When assets are leased out under an operating lease, the lease payments receivable are recognized as rental income on a straight-line basis over the lease term. Lease incentives granted are recognised as an integral part of the total rental income.

(n) Cost of sales

Cost of sales include the purchase price of the goods sold and other costs incurred in bringing the inventories to the location and condition ready for sale. These costs include costs of purchasing, packaging and transporting of goods to the extent that it relates to bringing the inventories to the location and condition ready for sale.

The Group receives various types of bonuses from suppliers of inventories, primarily in the form of volume discounts and slotting fees. These bonuses are recorded as reduction of cost of sales as the related inventory is sold.

Losses from inventory shortages are recognised in cost of sales.

(o) Finance income and costs

Finance income comprises interest income on issued loans and bank deposits. Interest income is recognised as it accrues in profit or loss, using the effective interest method.

Finance costs comprise interest expense on borrowings and unwinding of the discount on provisions. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

(p) Income tax

Income taxes have been provided in the consolidated financial statements in accordance with Russian legislation, as well as Luxembourg, BVI and Cyprus legislation for corresponding companies of the Group. Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and joint arrangements to the extent that it is probable that they will not reverse in the foreseeable future. A deferred tax asset is recognised for unused tax losses, unused tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

In accordance with the tax legislation of the Russian Federation, tax losses and current tax assets of a company in the Group may not be set off against taxable profits and current tax liabilities of other Group companies.

In determining the amount of current and deferred tax the Group takes into account the impact of uncertain tax positions and whether additional taxes, penalties and late-payment interest may be due. The Group believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Group to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the tax expense in the period that such a determination is made.

(q) Earnings per share

The Group presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

(r) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. All operating segments' operating results are reviewed regularly by the Group's CEO to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

(s) Value added tax

Input VAT is generally reclaimable against sales VAT when the right of ownership on purchased goods is transferred to the Group or when the services are rendered to the Group. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the statement of financial position on a gross basis and disclosed separately as an asset and liability.

(t) Presentation of the statement of cash flows

The Group reports cash flows from operating activities using direct method. Cash flows from investing activities are presented net of VAT. VAT paid to suppliers of non-current assets and VAT in proceeds from sale of non-current assets are presented in line "VAT paid" in operating activities.

(u) Guarantees

The Group considers that financial guarantee contracts entered into by the Group to guarantee the indebtedness of other parties are insurance arrangements, and accounts for them as such. In this respect, the Group treats the guarantee contract as a contingent liability until such time as it becomes probable that the Group will be required to make a payment under the guarantee.

(v) New Standards and Interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2016, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- IFRS 9 **Financial Instruments**, published in July 2014, replaces the existing guidance in IAS 39 **Financial Instruments: Recognition and Measurement**. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

The Group does not intend to adopt this standard early.

The Group expects that the new Standard will not have significant impact on its financial position or performance.

- IFRS 15 **Revenue from Contracts with Customers** establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 **Revenue**, IAS 11 **Construction Contracts** and IFRIC 13 **Customer Loyalty Programmes**. The core principle of the new standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

The Group does not intend to adopt this standard early.

The Group expects that the new Standard will not have significant impact on its financial position or performance.

- IFRS 16 replaces the existing lease accounting guidance in IAS 17 **Leases**, IFRIC 4 **Determining whether an Arrangement contains a lease**, SIC-15 **Operating Leases – Incentives** and SIC-27 **Evaluating the Substance of Transactions Involving the Legal Form of a Lease**. It eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting.

Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases.

The Group is a lessee in significant number of operating lease agreements (stores and land plots). Application of IFRS 16 will result in recognition of these leases as asset on balance sheet. At the same time, a financial liability will be recognized.

The Group does not intend to adopt this standard early as it is not yet endorsed by the European Union.

The Group has not analysed the likely impact of the new Standard on its financial position or performance.

– Disclosure Initiative (Amendments to IAS 7)

The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes.

The amendments are effective for annual periods beginning on or after 1 January 2017, with early adoption permitted.

The Group does not intend to adopt this standard early.

36 Changes in presentation

As at 31 December 2016 the Group presented lease rights as a separate line item in the consolidated statement of financial position. Previously lease rights

were presented as other non-current assets (initial cost of land lease) and intangible assets (lease rights for premises). Comparative information has been re-presented accordingly.

The effect of change in presentation on the statement of financial position as at 31 December 2015 and 1 January 2015 was as follows:

As at 31 December 2015

'000 RUB	As previously presented	Effect of change in presentation	Re-presented
As at 31 December 2015	8,228,505	—	8,228,505
Lease rights	—	4,847,537	4,847,537
Other non-current assets	6,934,782	(4,188,872)	2,745,910
Intangible assets	1,293,723	(658,665)	635,058

As at 1 January 2015

'000 RUB	As previously presented	Effect of change in presentation	Re-presented
As at 1 January 2015	11,543,739	—	11,543,739
Lease rights	—	4,615,995	4,615,995
Other non-current assets	11,004,304	(4,540,476)	6,463,828
Intangible assets	539,435	(75,519)	463,916

