# Realising our potential

ANNUAL REPORT 2016

LENTA

# AT THE BEGINNING OF 2014, WE SET THE GOAL OF DOUBLING RETAIL SPACE WITHIN THREE YEARS. THIS WAS ONE OF OUR MOST IMPORTANT STRATEGIC TARGETS ESTABLISHED AT OUR IPO.

It was an ambitious target but we had the confidence and clear understanding of how to achieve it. It is important to deliver not just rapid growth, but successful growth for all our stakeholders. In November 2016, we announced this tremendous early achievement and are very proud as we continue to be one of the most efficient food retailers in Russia.


## Realising our potential

### EXPANDING OUR SPACE

We have more than doubled our selling space in three years.

Read more on page 06


### INCREASING OUR PRESENCE

We have doubled store numbers since our IPO.

Read more on page 08

### DELIVERING RESULTS

We have doubled our sales growth since our IPO in 2014.

Read more on page 10

# Highlights of the year

## Financial highlights

**306.4bn +21.2%**
Revenue (RUB)

**67.8bn +20.4%**
Gross profit (RUB)

**31.8bn +13.1%**
Adjusted EBITDA (RUB)

**11.2bn +8.9%**
Net profit (RUB)

## Operational highlights

- Total sales were up 21.2%, like-for-like sales were up 3.9% and like-for-like ticket rose 4%.
- Total selling space across our store base grew to 1,146,148 sq.m – an increase of 29.9% year-on-year.
- We opened stores in eight new cities. At the year end Lenta had a presence in 77 cities across Russia.
- At the end of the year we had over 10.5 million active loyalty cardholders, an increase of 25% on the previous year.


**To see the report online go to:**
**www.lentainvestor.com/en/investors/annual-reports**

**Strategic report**

02 At a glance
04 Where we are
06 Realising our potential
12 Chairman's statement
14 Chief Executive Officer's review
16 Business model
18 Market overview
22 Strategy
24 Operating review
36 Financial review
40 Principal risks and uncertainties
48 Corporate social responsibility


**Corporate governance**

67 Introduction from the Chairman
68 Board of Directors
70 Senior Management team
72 Our corporate governance framework
77 Board Committees
90 Relations with shareholders
90 Responsibility statement


**Financial statements**

92 Statement of management's responsibilities for the preparation and approval of the consolidated financial statements
93 Independent auditor's report
96 Consolidated statement of financial position
97 Consolidated statement of profit or loss and other comprehensive income
98 Consolidated statement of cash flows
99 Consolidated statement of changes in equity
100 Notes to the consolidated financial statements


**Appendices**

142 List of cities as of 31 December, 2016
144 Glossary
145 Further information
146 Cautionary statements

## At a glance

# RUSSIA'S FASTEST GROWING HYPERMARKET OPERATOR

### What we do

Lenta sells high quality, affordable products in its hypermarkets and supermarkets. We provide great value for money and aim to provide the best promotions in the market for our customers.

### Our strategy

Our growth strategy is to expand our store network rapidly, whilst maintaining strong like-for-like sales. High levels of operating efficiency generate good returns that finance our growth.


**11.9%**

Lenta private label proportion of total sales

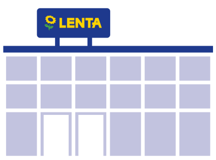
**191**

Hypermarkets


We operate 191 hypermarkets across Russia. Located mainly in urban areas for convenience, they are usually open 24/7. Our three main store formats range from 3,000 sq.m to 7,000 sq.m, enabling us to provide the optimum store for each location and provide our customers with the products they want.

Read more on page 25

### MORE ACHIEVEMENTS OF 2016




**11**

We acquired 11 new stores from food retailer Kesko and reopened them all on the same day.


**480,145**

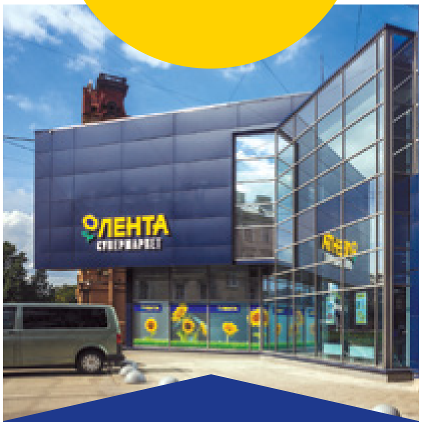
At the year end over 1.8 million people participated in Lenta's Social Card programme, 480,145 of whom joined in 2016.

**44.8**

We delivered over 1.47 million man-hours of training, with an average of 44.8 hours per person.

Lenta is Russia's largest hypermarket operator by selling space and the fifth largest food retailer by total sales. In 2016 we were the country's fastest growing hypermarket operator.

**49**
Supermarkets




Our 49 supermarkets are located principally in the Moscow, St. Petersburg and Central regions. Designed for frequent visits, these smaller format stores stock a wide range of everyday essentials – and are located in urban areas, typically within a 20-minute walk for the majority of our customers.

→ Read more on page 26

**161**
Fleet

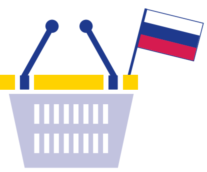

Our flexible, low-cost supply chain guarantees maximum on-shelf product availability across our network of stores. Our substantial truck fleet comprises 161 owned delivery vehicles and our state-of-the-art distribution centres have the capacity to serve over 250 hypermarkets and 250 supermarkets.

→ Read more on page 32

**26,000**
Product range

We offer a wide range of great value, high quality products, including branded goods and more affordable private label variants. Our standard hypermarket stocks around 26,000 SKUs – and whilst our core ranges feature in all our stores, many products are sourced locally to satisfy regional tastes and preferences.

→ Read more on page 29



**95%**

95% of fresh food sourced in Russia.


**17**

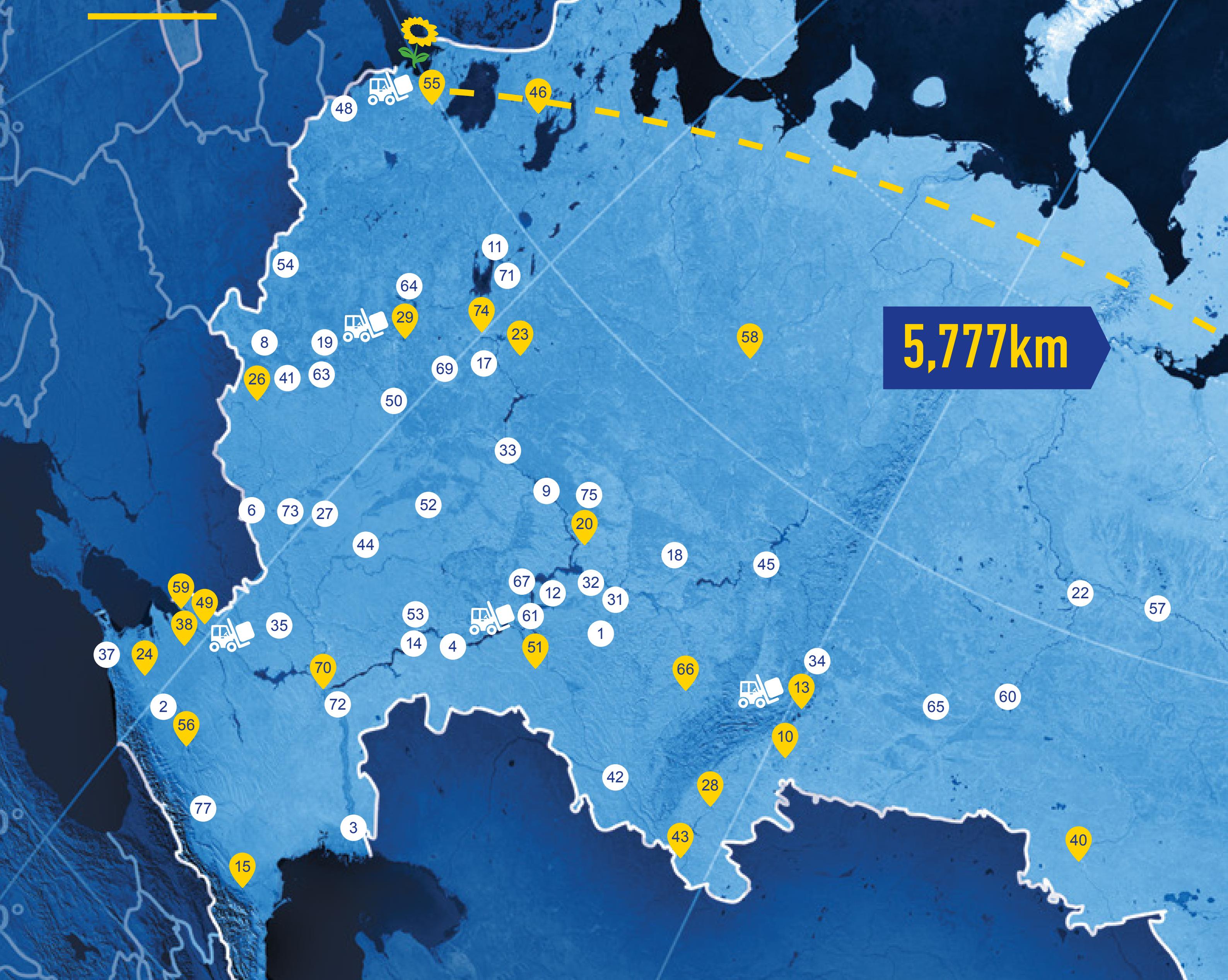
We opened 17 supermarkets, a record annual high, bringing the total to 49.

**11,000**

We created around 11,000 new jobs in 2016, and a total of 19,000 employees were recruited into new roles.

Where we are

# ACCELERATING OUR EXPANSION




In 2016 Lenta continued to expand its geographic footprint.

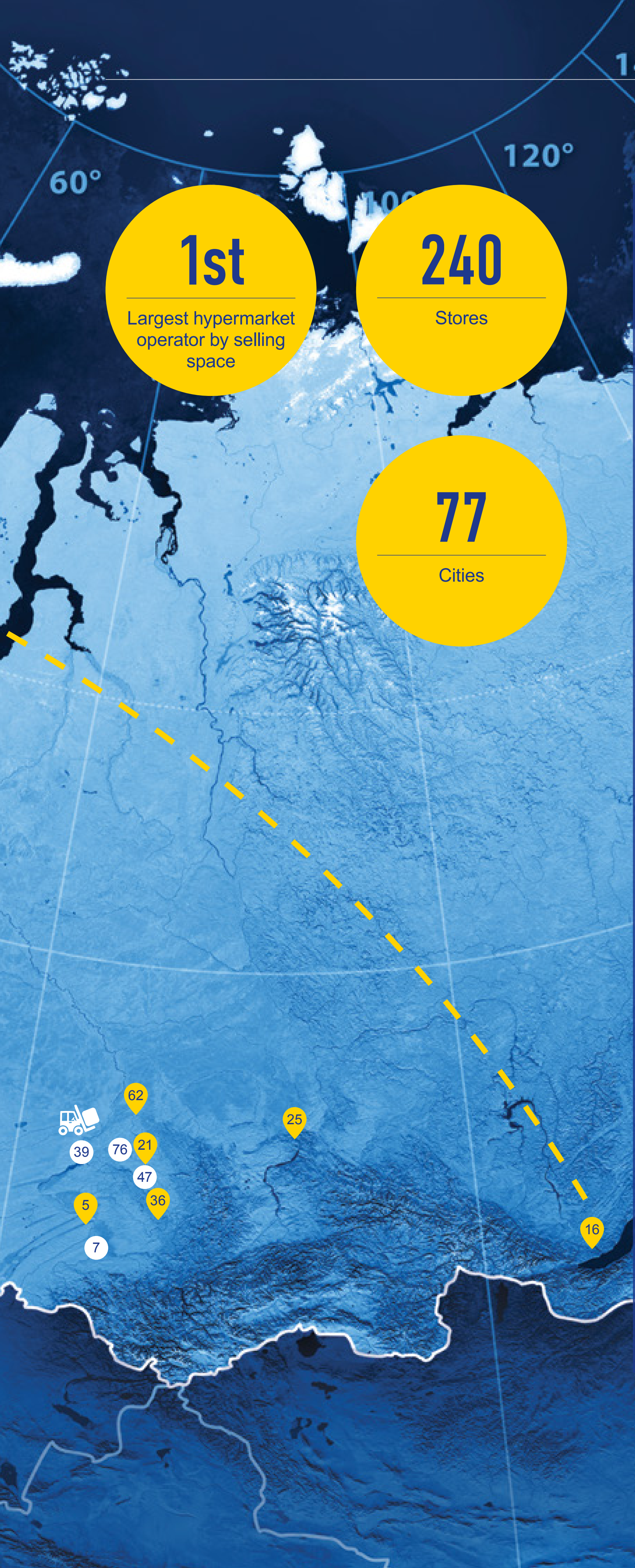
At the year end we had a total of 240 stores, comprising 191 hypermarkets and 49 supermarkets. We continued to build on our presence in the areas where we already operate. We also extended our reach, rolling out Lenta stores into eight new cities.

We now have a presence in 77 cities, including all 15 Russian cities with more than 1 million inhabitants.

Read more on page 24

### NEW CITIES

- Ekaterinburg
- Grozny
- Kazan
- Kostroma
- Kursk
- Novoshakhtinsk
- Orsk
- Samara




**1st**
Largest hypermarket operator by selling space

**240**
Stores

**77**
Cities

## KEY

New store openings
Existing stores

1. Almetyevsk
2. Armavir
3. Astrakhan
4. Balakovo
5. Barnaul
6. Belgorod
7. Biysk
8. Bryansk
9. Cheboksary
10. Chelyabinsk
11. Cherepovets
12. Dimitrovgrad
13. Ekaterinburg
14. Engels
15. Grozny
16. Irkutsk
17. Ivanovo
18. Izhevsk
19. Kaluga
20. Kazan
21. Kemerovo
22. Khanty-Mansiysk
23. Kostroma
24. Krasnodar
25. Krasnoyarsk
26. Kursk
27. Lipetsk
28. Magnitogorsk
29. Moscow
30. Murmansk
31. Naberezhnye Chelny
32. Nizhnekamsk
33. Nizhniy Novgorod
34. Nizhniy Tagil
35. Novocherkassk
36. Novokuznetsk
37. Novorossiysk
38. Novoshakhtinsk
39. Novosibirsk
40. Omsk
41. Orel
42. Orenburg
43. Orsk
44. Penza
45. Perm
46. Petrozavodsk
47. Prokopievsk
48. Pskov
49. Rostov-on-Don
50. Ryazan
51. Samara
52. Saransk
53. Saratov
54. Smolensk
55. St. Petersburg
56. Stavropol
57. Surgut
58. Syktyvkar
59. Taganrog
60. Tobolsk
61. Togliatti
62. Tomsk
63. Tula
64. Tver
65. Tyumen
66. Ufa
67. Ulyanovsk
68. Velikiy Novgorod
69. Vladimir
70. Volgograd
71. Vologda
72. Volzhskiy
73. Voronezh
74. Yaroslavl
75. Yoshkar Ola
76. Yurga
77. Zheleznovodsk

## DISTRIBUTION CENTRES

- Ekaterinburg
- Moscow
- Novosibirsk
- Rostov-on-Don
- St. Petersburg
- Togliatti

Read more on page 142

Realising our potential

# EXPANDING OUR SPACE

**1,146,148m²**

We have more than doubled our selling space over the last three years

## Growing faster than ever

Whilst other hypermarket players have slowed down, Lenta has continued to grow its presence rapidly. In 2016, we opened 77% of the net selling space added in the hypermarket segment, up from 35% in 2015.

## We now have approximately 20% of all hypermarket selling space in Russia

Our distinctive compact urban model is focused on food and tailored to the Russian market, and we have extended our range of hypermarket formats to increase our flexibility across different catchment areas.

## Rapidly growing our supermarket format

Our supermarkets are a huge success with our customers and deliver high sales densities. In 2016 we opened a record 17 supermarkets, adding nearly 13,000 sq.m of selling space. We are increasing the number of store openings and aim to deliver an eightfold increase in supermarket selling space by 2020.

Read more on page 25

Realising our potential

# INCREASING OUR PRESENCE

## 240 stores

Doubling store numbers since IPO and setting a new record in store openings

## We have opened stores in 30 new cities since 2014

In 2016 we exceeded our initial targets for new store openings and now have a presence in 77 cities across Russia. We see the huge potential for expansion through organic growth as well as the acquisition of high quality assets that are a good strategic fit with our business.

## We now have a presence in all 15 Russian cities with over one million inhabitants

We carefully assess new opportunities for strategic fit and returns. Whilst our medium-term focus continues to be on Moscow, St. Petersburg and Russia's largest cities, we see considerable long-term potential for an additional 400 Lenta hypermarkets in new and existing target cities over time.

## Acquisition of Kesko's food business

In line with our strategy of fast-paced network expansion, we significantly strengthened our market presence with the acquisition of 11 hypermarkets from Kesko. These high quality, complementary store locations extend our reach in a highly competitive region. They were integrated, rebranded and reopened as Lenta stores in under a week.


Read more on page 24


## Realising our potential

# DELIVERING RESULTS

**RUB 306.4bn**

Double growth of our total sales since IPO

## Lenta now has more than ten million active Loyalty Card holders

The number of Lenta Loyalty Card holders grew at a 30% CAGR over the last three years, with increasing card penetration, now at 93% of total sales. Customer data obtained from card use provides us with key competitive advantages in driving our customer-centric business.

## Customers trading up

Many of our traditional 'budget' customers have responded to our strong promotions on premium brands, trading up as the price differential has shrunk. We pitched our affordable quality Lenta brand at precisely this price point, providing a great value alternative and capturing the custom of this important group.

## Value for money proposition

In line with our strategy, we maintain a strong focus on pricing and our customers have become increasingly responsive to the attractive discounts and promotions we offer. We know they appreciate our actions because we rank either first or second for price perception in almost every city where we have a presence.

Read more on page 29

# Chairman's statement

# BUILDING VALUE, DRIVING GROWTH

Lenta continued to flourish in 2016, delivering strong sales and maintaining the momentum for growth established over the previous three years.

**John Oliver**
Chairman

### Continuing our progress

In the three years since Lenta's IPO, we have accomplished a great deal. 2016 saw us continue to grow our sales, profit and cash flow, while continuing to consolidate our existing presence in Russian cities – and establish ourselves in many new ones.

Since 2014 we have not only more than doubled our selling space ahead of schedule, but also the size of the Company itself, both in terms of sales and the number of stores we operate. Set in the context of a difficult operating climate, these achievements demonstrate the effectiveness of our planning, the clarity of our strategy and the flexibility of our business model.

### Performing in a tough environment

Trading conditions in Russia remained difficult for food retailers in 2016. I am therefore delighted to report that Lenta not only weathered the tough conditions, but thrived in them. Our robust low price/low cost business model was key to this success, as was our ability to adapt quickly to changing circumstances which enabled us to deliver yet another excellent result.

Our customers are at the heart of our business; it's therefore crucial that we listen carefully to them, so we can understand exactly what they want from Lenta. This is particularly true in hard times, as customers' shopping habits and priorities change. The data we derive from the use of our Loyalty Card continues to be invaluable: it informs our decision-making, enables us to respond to these changes and helps us to anticipate future trends.

> WE HAVE DELIVERED A COMPELLING TRACK RECORD OF GROWTH, WITH SALES DENSITIES ABOVE THOSE OF OUR FEDERAL PEERS AND CONSISTENTLY HIGH MARGINS.

### Corporate governance

I strongly believe that the foundations of good governance lie in the core values and behaviours established by the Board. We are extremely fortunate to have a talented group of individuals on the Lenta Board who are committed to promoting the highest standards of ethics and business practice, setting the 'tone from the top'.

We also have what I believe to be the most effective management team in the industry, with a unique entrepreneurial culture. They in turn are supported by a strong base of second and third tier managers, ready to grow and improve the company; we continue to invest in this next generation of Lenta's leaders.

Our Board composition and Senior Management team have remained unchanged since our IPO and this is the most stable leadership team in the Russian food retail space.

As Lenta grows in size and complexity, it is more important than ever that we have the right people, systems and culture to ensure we maximise growth opportunities, while mitigating the risks to which we are exposed. Our governance standards are already best-in-class – and we continue to strive for the highest international standards of corporate stewardship.

### Building value, driving growth

Our performance to date is testament to the effectiveness of our strategy. We have delivered a compelling track record of growth, with sales densities above those of our federal peers and consistently high margins. Our adaptable hypermarket model has proven successful across a wide range of very different catchment areas and our supermarket pilot has been converted into an important strategic growth driver.

Improvements in sourcing, efficiency and capex reductions support high returns for now and in the future.

### Corporate social responsibility

We are a fast growing business operating in a highly competitive trading environment. Nevertheless, all of our decision-making is predicated on 'doing the right thing in the right way'. Our customers trust us to provide high quality, great value products – but they also expect us to behave with integrity towards our employees, suppliers, local communities and the environment.

Our customers and staff are also our neighbours; hence most of our CSR activities are focused on areas close to where we operate. In these difficult economic times, we fully recognise our responsibility to provide tangible support – and our actions reflect that. They include donations of food to those in most need, construction of local community facilities and the extension of our social card programme within our growing base of Loyalty Card holders, store network and cities of presence.

### Securing a sustainable future

At Lenta, we're good at what we do – and the coming years will see us continue to drive growth in hypermarkets. We aim to become a top three multi-format retailer in terms of sales – and the leading hypermarket player – in the Russian market. Alongside this, the acceleration of our supermarket roll-out programme will help us become a fully-fledged multi-format retailer in the near future.

Our consistent, proven strategy will ensure we continue the momentum for growth that has been established over the past three years. Our ambitions will only be realised however, through a combination of prudent financial management, strong governance and a dedicated workforce. We will retain our focus on profitable growth, balancing capex and returns in order to continue delivering market-leading returns. We will also maintain our healthy balance sheet and conservative approach to leverage.

I would like to thank our employees for the dedication, commitment and enthusiasm they applied to the challenges of 2016. I am grateful to my fellow Directors for their wise counsel, and to our Senior Management team who have steered Lenta so ably through such a busy year. Our customers, suppliers and shareholders also have my sincere thanks for their ongoing loyalty and support.

**John Oliver**
Chairman

## Chief Executive Officer's review

# A YEAR OF MILESTONES FOR LENTA

We maintained strong growth in 2016 and achieved several key milestones, demonstrating the ongoing successful execution of our strategy. We are now Russia's fastest growing hypermarket operator, accounting for approximately 20% of all hypermarket selling space in the country. We also accelerated our flourishing supermarket programme during the year.

**Jan Dunning**
Chief Executive Officer

### Another strong performance

2016 was another challenging year for Lenta, yet it was also a remarkably successful one. Full year sales rose 21.2% to RUB 306.4 billion (2015: RUB 252.8 billion), including a 3.9% increase in like-for-like sales.

Despite the ongoing economic pressures in Russia and weakness in the consumer environment, we exceeded – earlier than planned – one of the most important strategic targets established at our IPO: to double our total selling space within three years. We opened 51 hypermarkets on a net basis in 2016, setting a new record for Lenta store openings in a single year, and resulting in a total of 191 hypermarkets at the end of the year.

Our value-for-money supermarket format builds on the same DNA as our hypermarkets. This complementary format is becoming an increasingly important part of our business, demonstrating high sales density, good comparable revenue growth and exponential growth potential. With 17 supermarkets opened during the year, there were 49 stores at the year end, giving us 46,285 sq.m of selling space in this highly popular format – and a combined total – including hypermarkets – of 1,146,148 sq.m.

### A competitive marketplace

The uncertain macro environment ensured that competition among food retailers remained intense in 2016. The ongoing dual pressures of high inflation and squeezed household incomes mean that customers have become accustomed to spending with caution. They continue to restrict their shopping trips and keep to a list, constantly comparing prices and looking for the best value from retailers.

> OUR CONSISTENT COMMERCIAL STRATEGY WAS DESIGNED TO HELP US REALISE OUR FULL MARKET POTENTIAL – AND HAS STOOD THE TEST OF TIME.

**77**

Cities

We engage directly with our extensive customer base through our highly successful Loyalty Card programme. Launched 15 years ago, it has continued to grow steadily, passing the 10 million active cardholders milestone in 2016. We use valuable transaction data from our Big Data Customer Insight Programme to help us track the competitive dynamics of our offer and understand how our customers are shopping – as well as their changing tastes and preferences. This information enables us to tailor our assortment and marketing activities to provide the optimum product mix and create targeted offers and promotions on the products our customers want. Sales from promotions in 2016 were outstanding – proof that Lenta's business model is perfectly aligned to the prevailing consumer environment.

### Continuing our growth story

Our performance has been supported by several key pillars: our commercial proposition and processes, low pricing, high execution standards, low cost base, effective use of data and our flexibility and entrepreneurship.

The Russian retail market presents the most efficient operators with huge growth potential, combined with attractive returns. Our proven low price/low cost business model enables us to pursue our strategy for growth.

With its extensive geographic footprint, Lenta is a genuinely federal chain, successfully operating different store formats to suit different catchment areas.

In line with our strategy, we reinforced our hypermarket presence across Russia in 2016. Siberia retained its position as the largest region, with almost 20% of the Company's total hypermarket selling space.

We opened hypermarkets in eight new cities during the year, and strengthened our presence in Russia's largest cities, bringing the total number of cities of presence to 77. With new stores in Ekaterinburg, Samara and Kazan, we now have a presence in all 15 Russian cities with more than one million inhabitants.

We strengthened our supermarket position, adding 12,774 sq.m of selling space during the year, representing a 38% growth in this format. To support this exceptional growth, we opened a new supermarket distribution centre in Moscow, with the capacity to serve over 150 stores.

In December, we opened 11 new hypermarkets in St. Petersburg, acquired through the purchase of Kesko's food retail business in Russia. With their complementary locations, sizes and designs, these stores are a very good fit for Lenta and significantly strengthen our network in the region.

We remain the partner of choice for our suppliers, and worked hard during the year to maintain our procurement excellence. We significantly decreased our supply chain costs and are well-positioned to sustain our new wave of store roll-outs.

Our consistent commercial strategy was designed to help us realise our full market potential – and has stood the test of time. At the time of our IPO in early 2014, we set ourselves the target of doubling our retail space in three years. Many observers felt that this goal was too ambitious, but we were always confident we could achieve it – because we had a clear understanding of exactly how to do so.

**191**

Hypermarkets

The fact that we have delivered on our promises – and consistently executed our strategy in a challenging macro and consumer environment – is testament to the talent and commitment of our strong and stable management team.

### Looking ahead

We are already working on new projects in 2017 and are planning ahead for 2018 and beyond. We intend to add approximately 200,000 sq.m of new selling space in the year ahead – and aim to open about 30 new hypermarkets and about 50 supermarkets, in new as well as existing regions. Delivering rapid growth is important, but not at any cost. It also has to be successful and sustainable – for our customers, business partners and shareholders. As we look to the future, our confidence in Lenta's business model, our strategy and our people remains as strong as ever.

Our aim for 2017 is to continue to deliver attractive returns on investment and build long-term value for our shareholders, maintaining our strong financial position and a thoughtful balance between growth and profitability. We will continue to enhance our offer to customers and consolidate our position as one of Russia's most efficient multi-format retailers.

**Jan Dunning**
Chief Executive Officer

Business Model

# HOW WE CREATE VALUE

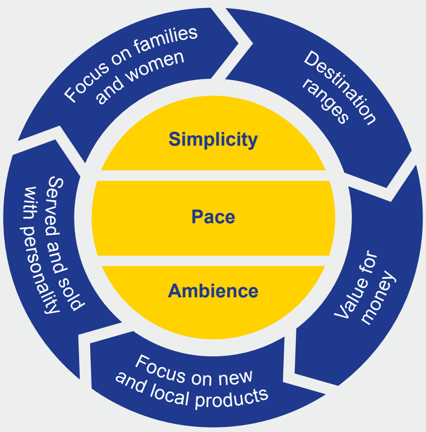
## VALUE PROPOSITION FOR CUSTOMERS

**Our differentiated value proposition**
Helping our customers live a better life by spending less

**Low price leadership**
- Loyalty card
- Deep, frequent and inspiring promotions
- Frequent price comparisons

**Product offering for broad family needs**
- Store of choice for select authoritative ranges
- Relevant SKUs
- Focus on new and local products

**Neighbourhood shopping**
- Easily accessible one-stop-shop
- Value-added features




## PRICE-LED HYPERMARKET MODEL

**Low cost execution**
Standardised store layouts
Simple to navigate/low cost
- 82% ownership of property vs. 18% leased

### Formats

**Hypermarket**
- Standard
- Compact
- Supercompact

**Supermarket**

### Supply chain

**Integrated supply chain**
underpinned by a network of distribution centres

**Our fleet**
161 owned trucks

**Current capacity**
to serve
250+ hypermarkets
250+ supermarkets

**Seven owned distribution centres**

**Strong IT**

Underpinned by our corporate social responsibility

Value remains at the core of Lenta's customer proposition. We maintain a strong price perception in line with our commercial strategy.

## LENTA LOYALTY CARD

**Enhances like-for-like sales**

### Insight drives

- Direct marketing promotions
- Pricing
- Category management
- Strong relationships with suppliers

### Captures information

Captures information about every customer at every point of contact. This enables us to build highly personalised profiles of customer types which we define across ten segments – allowing us to meet the needs of all our customers in a personalised way.

### Lenta Loyalty Card

| | |
|---|---|
| Active cardholders | 10.5m |
| Price advantage for customers | 5% |
| Spend penetration | 93% |

## DRIVING OUR STRATEGY FOR GROWTH

### Driving Lenta forward

We remain focused on driving the business forward in pursuit of our long-term goals. Our proven strategy enables us to confidently manage and grow Lenta – even in challenging times.

Delivering profitable like-for-like growth

Strengthening our existing presence

Exploiting white space potential

Format evolution

Read more on page 22

## CREATING VALUE

**Selling space** '000 sq.m — **+29.9%**

| | |
|---|---|
| 2016 | 1,146 |
| 2015 | 882 |
| 2014 | 701 |

**Total sales** RUB bn — **+21.2%**

| | |
|---|---|
| 2016 | 306.4 |
| 2015 | 252.8 |
| 2014 | 194.0 |

**Adjusted EBITDA** RUB bn — **+13.1%**

| | |
|---|---|
| 2016 | 31.8 |
| 2015 | 28.1 |
| 2014 | 21.4 |

**Earnings per share*** RUB '000 — **+2.7%**

| | |
|---|---|
| 2016 | 0.115 |
| 2015 | 0.112 |
| 2014 | 0.105 |

**Number of employees**** FTE — **+18.9%**

| | |
|---|---|
| 2016 | 45,689 |
| 2015 | 38,414 |
| 2014 | 35,100 |

*One share represents interest in five GDRs.

**FTE (full-time employee as at the end of the period).

Read more on page 48

## Market overview

# AN ATTRACTIVE MARKET FOR THE LARGEST PLAYERS

The Russian retail food market is fragmented, especially when viewed in an international context. However, it remains attractive for the federal players, presenting good growth opportunities.

### An ongoing challenge for retailers and consumers

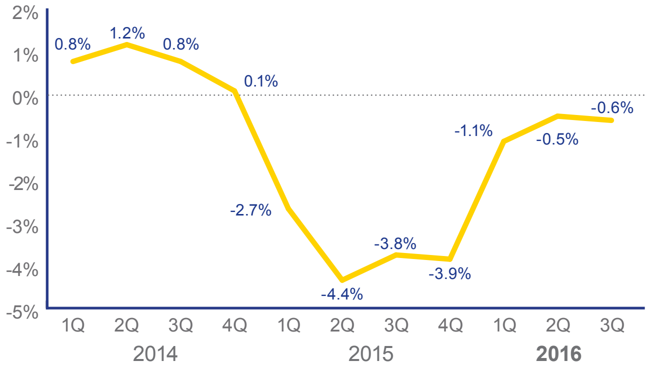
The operating environment remained challenging in 2016. Consumers continued trading down to more affordable products in an effort to stretch their already squeezed household budgets as far as possible.

The Russian economy has been in recession since the beginning of 2015 – and remained under severe pressure in 2016. Beset by a variety of domestic and international challenges including economic sanctions and lower oil prices, GDP declined. However, the rate of decline slowed – and there is a sense that Russian consumers are gradually adapting to their straitened circumstances.

In real terms, Russian consumer spending declined by 17% in the last two years and household incomes are down 11% in three years. While food inflation fell to 5%, food retail sales growth had slowed to zero by the end of 2016.

**Economy in recession since 1Q 2016**

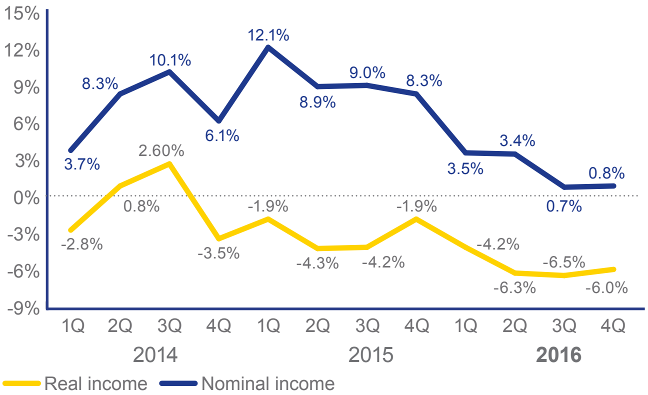
Real GDP, quarterly y-o-y %




Source: Rosstat

**Real incomes down 11% in 3 years**

Household income, quarterly y-o-y %




Source: Rosstat

> CONSUMERS ARE ALSO LOOKING FOR A RETAIL EXPERIENCE THEY CAN TRUST TO GIVE THEM GOOD QUALITY AND LOW PRICES. THIS FAVOURS THE MOST EFFECTIVE OPERATORS SUCH AS LENTA.

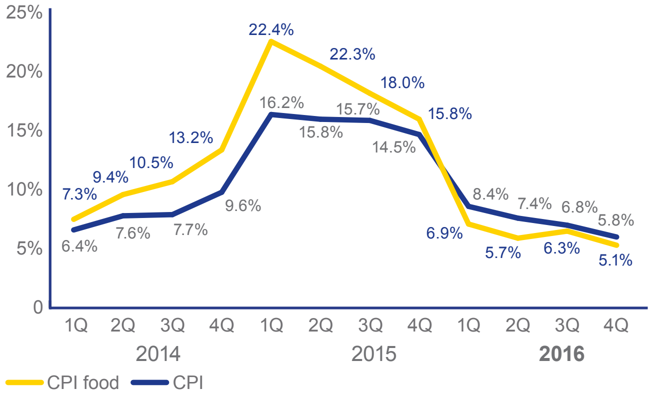
## An attractive market for federal chains

The Russian retail food market is fragmented, especially when viewed in an international context. However, it remains attractive for the federal players, presenting good growth opportunities.

Competition between retailers remained intense in 2016 amid high levels of discounting and promotional activity. However, consumers are also looking for a retail experience they can trust to give them good quality and low prices. This favours the most effective operators such as Lenta – those that can adapt to changing circumstances – delivering a superior shopping experience and excellent value for money.

### Food inflation down to 5%

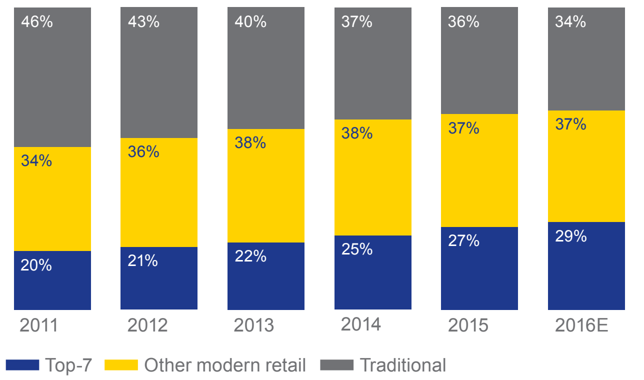
CPI, quarterly y-o-y %




Source: IHS, Rosstat

### Share of the largest retailers is growing rapidly...

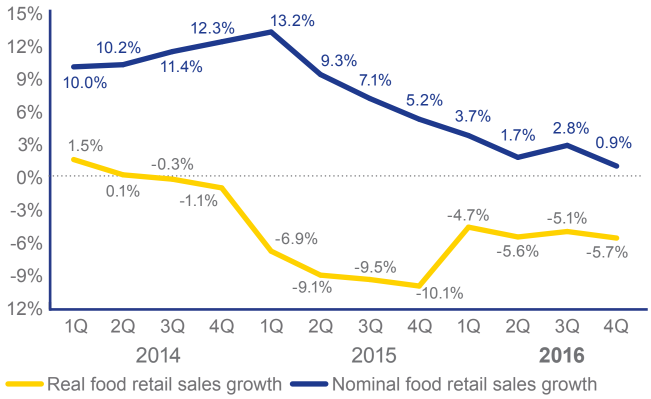
Share of grocery retail sales, %




Source: Company information, Infoline, Euromonitor

### Food retail sales growth has slowed to zero

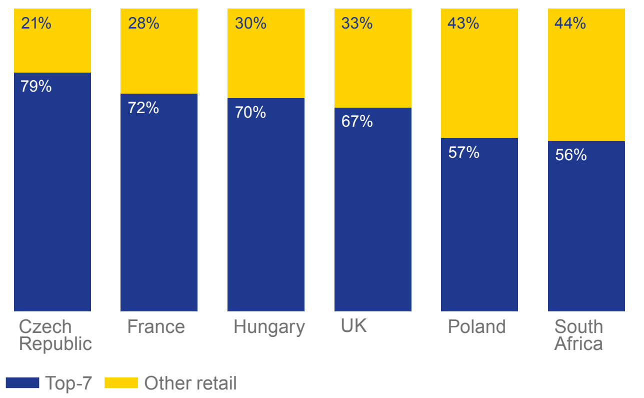
Food retail sales, quarterly y-o-y %




Source: Rosstat

### ...but remains fragmented in an international context

Share of grocery retail sales in 2016E, %

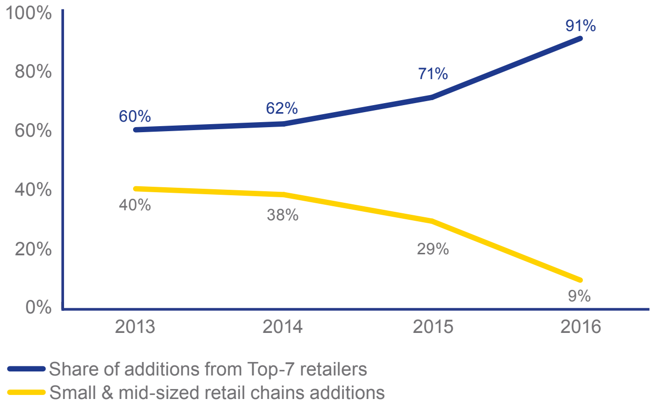



Source: Company information, Infoline, Euromonitor

# Market overview continued

Due in part to the challenging economic situation, traditional retail formats continue to lose share. Most smaller modern retailers have either slowed or stopped expansion, with many beginning to close or sell stores. There is virtually no current active development of shopping malls. 'Federal' chains – those with a presence in most regions – now account for almost all net space additions. Trends during the year indicated how the hierarchy of the top seven food retailers will be shaped. The top two players' growth is increasingly swift, whereas others are experiencing slower growth.

**Selling space growth is driven by federal chains**
Share of selling space additions, %




Source: Company information, Infoline, Euromonitor

ALTHOUGH UBIQUITOUS IN MOST OTHER RETAIL MARKETS, SUPERMARKETS ARE STILL AN UNDERDEVELOPED BUSINESS IN RUSSIA. WE BELIEVE THIS REPRESENTS A GROWTH OPPORTUNITY FOR LENTA.

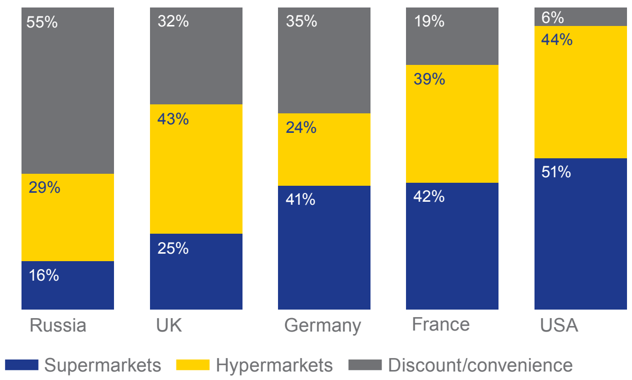
## Deepening our hypermarket presence, growing our supermarket offer

The Russian market does not have the same penetration of modern retail formats as the rest of Europe – or much of the rest of the world. Despite the ongoing challenges of the macroeconomic and consumer environments however, we believe the sector has real promise.

The hypermarket has proved itself to be an attractive format for consumers, but consumers need a compelling reason to travel a little further to visit and spend their money in a hypermarket, rather than a smaller local store. Lenta delivers this by providing an attractive combination of assortment breadth, quality and value for money. Lenta's consistent commercial strategy is tactically adapted to the volatile market – and this is reflected in our success at winning new customers and retaining their loyalty.

Although ubiquitous in most other retail markets, supermarkets are still an underdeveloped business in Russia. We believe this represents a growth opportunity as the needs of many Russian customers – such as choice, quality, price and service – are evolving to align more closely with full service/value supermarkets, just as they have in more developed markets.

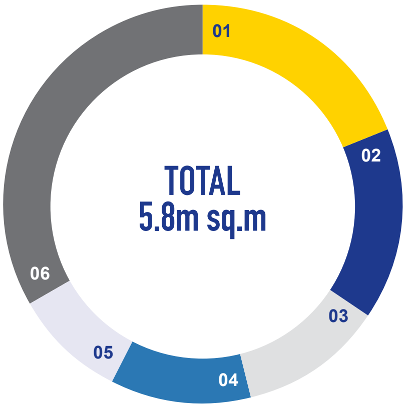
**Supermarket share is higher in other markets**
Share of total selling space, %




Source: Company information, Infoline, Euromonitor

There are some large players, but the supermarket segment is even more fragmented than the market as a whole.

**Hypermarkets – Top 5 share 67%**
Total selling space: 5.8m sq.m
Selling space growth in 2016: +6%




01
Lenta – **19.1%**

02
Auchan[1] – **15.4%**

03
Magnit – **11.9%**

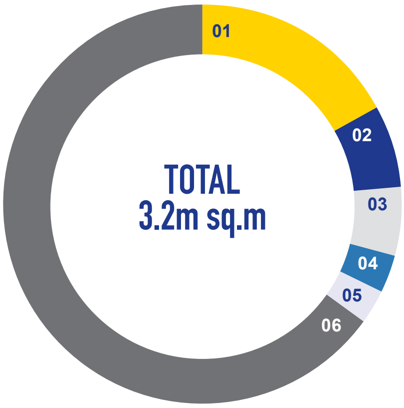
04
Metro Group – **11.2%**

05
O'KEY – **9.4%**

06
Other – **33.1%**

Source: Company information, Infoline as of 31 December 2016
(based on Top-190 retailers study)

**Supermarkets – Top 5 share 36%[2]**
Total selling space: 3.2m sq.m
Selling space growth in 2016: +3%




01
Perekrestok – **17.1%**

02
Magnit Family – **6.6%**

03
Atak – **5.5%**

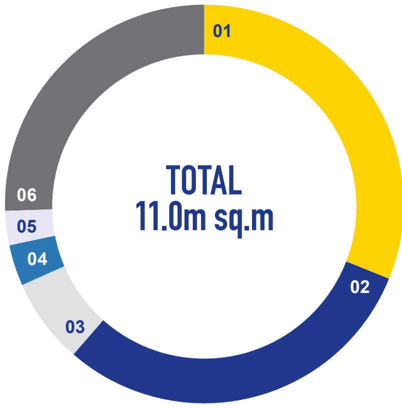
04
Billa – **3.0%**

05
Victoria[3]
supermarkets – **2.9%**

06
Other – **64.8%**

Source: Company information, Infoline as of 31 December 2016
(based on Top-190 retailers study)

**Convenience/discounters – Top 5 share 75%**
Total selling space: 11.0m sq.m
Selling space growth in 2016: +13%




01
Magnit – **31.3%**

02
Pyaterochka – **30.1%**

03
Dixy – **7.0%**

04
Svetofor – **3.3%**

05
Krasnoye &
Beloye – **2.8%**

06
Other – **25.5%**

Source: Company information, Infoline as of 31 December 2016
(based on Top-190 retailers study)

We see multiple opportunities for Lenta to capitalise on its expertise in hypermarkets and flourish in the supermarket format. It will inevitably take time for the economy to fully recover from the current challenging circumstances. In the meantime however, the difficult economic circumstances are leading to an acceleration in the shift of consumer spending and market share to larger and more efficient operators.

1 Auchan, Auchan City and Nasha Raduga as per Infoline report.

2 Excluding SPAR presence in Russia.

3 Including eight supermarkets (11,000 sq.m of selling space) in Kaliningrad in the premises acquired from Sedmoy Kontinent in December 2016.

Strategy

# BUILDING VALUE, DRIVING GROWTH


**Strategic priorities**

Delivering profitable like-for-like growth

Strengthening our existing presence

Exploiting white space potential

Format evolution

In a difficult trading environment, we continued to execute our proven strategy; strengthening our existing presence, attracting new customers in new locations and growing the business.

| Overview | Progress in 2016 |
|---|---|
| Ongoing investment in our low price/low cost business model keeps us competitive and drives sales in our existing stores. With growing numbers of loyal customers, we maintain our price leadership through a combination of factors including innovative promotions, focused category management and in-depth analysis of customer behaviour via our Big Data Customer Insight Programme. | In the prevailing difficult consumer environment, we continued to provide Lenta's customers with more of the products they wanted at affordable prices. We carefully tailored our ranges and promotions to help them make the most of their budgets – and our actions were rewarded with an increase in like-for-like sales of 3.9% and average like-for-like ticket growth of 4%. Read more on page 24 |
| Consolidating our presence in areas where we already have stores is a priority for us. Our sizeable land bank and active project pipeline provide us with numerous opportunities to reinforce Lenta's position in these cities. We benefit from high levels of brand awareness and established infrastructure – as well as existing relationships with local suppliers, contractors and the community at large. | We continued to strengthen our position in all the key Russian regions in 2016, increasing our penetration – and market share – in those areas where we already have stores, thanks to our loyal and growing customer base. During the year, 80% of our new selling space was opened in areas where we already operate, including 11 new stores in the St. Petersburg area acquired from Kesko. Read more on page 25 |
| Despite Russia's ongoing economic challenges, we continue to see considerable potential for Lenta to expand and flourish in this large and fragmented market. To date, there is still relatively little penetration of modern retail formats – particularly hypermarkets – in many towns and cities. We therefore regard expansion into new cities as a key strategic opportunity for our business. | The expansion of our retail operations across Russia continued apace in 2016. We opened hypermarkets in 27 cities, eight of which were brand new locations for Lenta, and now have a presence in 77 cities, including all 15 cities with a population of over 1 million people. We comfortably beat our target of doubling selling space in the three years to December 2016. Read more on page 24 |
| Our various hypermarket formats are carefully designed to address specific local needs in different urban locations. Likewise, with our complementary supermarket formats, we able plan and build precisely the right store for every available site and its expected customer traffic, which means they are highly cost-effective. The standardised designs also enable rapid roll-out. | We now have three additional variants of our Compact hypermarket format, which has delivered increased flexibility. During the year, we created a dedicated team to focus exclusively on developing our highly successful supermarket format – and also continued to refresh and update store layouts and displays to maintain their appeal and highlight key product categories. Read more on page 25 |

## Looking ahead

In the year ahead, we aim to open approximately 30 new hypermarkets and around 50 new supermarkets. These will be in both existing and new regions for Lenta, adding a total of around 200,000 sq.m of selling space.

Longer term, our aim is to become a top three multi-format food retailer and the biggest hypermarket player in Russia. We will accomplish this through retaining a focus on profitable growth, and carefully balancing capex and returns – with the aim of continuing to deliver market-leading performance whilst maintaining a healthy balance sheet.

We aim to double selling space by 2020. We will use our detailed customer data and format flexibility to select the best locations for our stores and see potential for more than 400 hypermarkets in Russia to be located within a 10–15 minute drive of most customers. Likewise there are good opportunities for supermarkets to gain a substantially bigger share of the market, as customers become more demanding – and our value for money supermarket is well placed to capture this growth.

Throughout our ongoing expansion, we will retain our focus on improvements in sourcing and efficiency as well as capex reduction.

## Operating review

# LEADING THE WAY

The Russian retail market presents the most efficient operators with significant potential for future growth, combined with attractive returns. Lenta continued to grow rapidly in 2016 and delivered impressive results.

### HIGHLIGHTS OF THE YEAR

- Total sales for the year were up 21.2% to RUB 306.4 billion (2015: RUB 252.8 billion).
- Like-for-like sales grew 3.9%.
- Total selling space growth of +29.9% in 2016.

**Total sales for the year were up 21.2% to RUB 306.4 billion (2015: RUB 252.8 billion). Like-for-like sales grew 3.9% and the average like-for-like ticket grew by 4.0%, while traffic showed a 0.1% decline.**

Difficult trading conditions in 2016 presented considerable challenges for retailers and customers alike. Nevertheless, Lenta's operations proved resilient. We continued to adjust to the vagaries of the retail environment and customers appreciated the efforts we made to help them stretch their budgets. Once again we demonstrated that our business model is robust and flexible enough to enable us not just to withstand the toughest of circumstances, but to thrive in them. We continued to attract business away from our competitors – and the number of unique customers exceeded sales growth in both new and like-for-like stores in all regions.

The execution of our growth strategy continued apace, and we opened new stores in eight new cities. At the year end we had a presence in 77 cities across Russia. We added a total of 263,765 sq.m of new selling space on a net basis, which has given us a total of 1,146,148 sq.m – an increase of 29.9% year-on-year. This meant that we comfortably beat our own 2014 prediction of doubling selling space within three years to the end of 2016.

We take a disciplined approach to the planning of new stores. Every potential new location goes through a rigorous selection and evaluation process, which includes sophisticated analysis of the catchment area using our proprietary models to determine projected returns on investment.

> ONCE AGAIN WE DEMONSTRATED THAT OUR BUSINESS MODEL IS ROBUST AND FLEXIBLE ENOUGH TO ENABLE US NOT JUST TO WITHSTAND THE TOUGHEST OF CIRCUMSTANCES, BUT TO THRIVE IN THEM.

We own most of our stores, but the choice of whether to own or rent depends on the specific circumstances in each city and location. Ownership has the key advantage of allowing us to build stores to our own designs, which are optimised for efficiency and precisely adapted in size and layout to the catchment area served. Ownership also protects us from rental cost inflation as well as the potential loss of store leases. Importantly, building our own stores allows us to expand more rapidly in attractive, high-return catchment areas where land is available, but where there are no suitable stores to rent. Ownership is, however, more capital intensive. Availability of attractive rental opportunities for hypermarkets is more limited than for supermarkets, so we typically own the vast majority of our hypermarkets, while renting a high proportion of supermarkets.

With the ability to develop and manage both large and small stores, we continue to evaluate new ways of serving our customers; however and whenever they choose to shop with us.

## Consolidating our presence in existing locations

Growing our market share in areas where we already have a presence is a key component of our strategy. We use customer data and analytics to carefully choose optimal locations and our variety of proven formats means we can deliver the most appropriate size and type of store for a particular neighbourhood. This ability to adapt to different catchments enables us to achieve high store densities in our chosen cities.

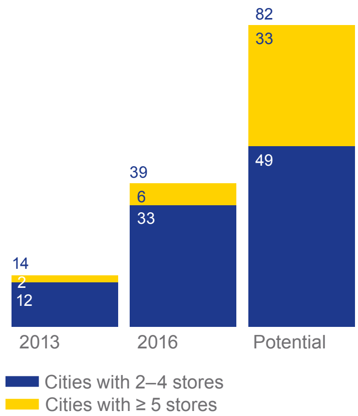

## STRATEGIC ACQUISITION EXPANDS OUR NETWORK

In December we opened 11 new stores acquired from food retailer Kesko, which previously operated under the K-Ruoka brand. The high quality Kesko stores were an excellent strategic fit for Lenta, being compatible with our own formats, in complementary locations to our existing stores – and with an efficient and motivated workforce.

The newly acquired stores were seamlessly integrated, rebranded and reopened at modest cost – and within just six days – highlighting the successful collaborative efforts of employees within both businesses. Eleven new Lenta hypermarkets opened on the same day across the St. Petersburg area, improving our reach in a highly competitive region.

In 2016 we accelerated this growth, with almost 80% of new selling space opened in cities where we already operate. Any pressure on traffic in existing stores is more than offset by the long-term benefits of being located precisely where our customers want us – with a stronger market position.

**Increasing Lenta's store penetration in existing cities**[1]
# of cities



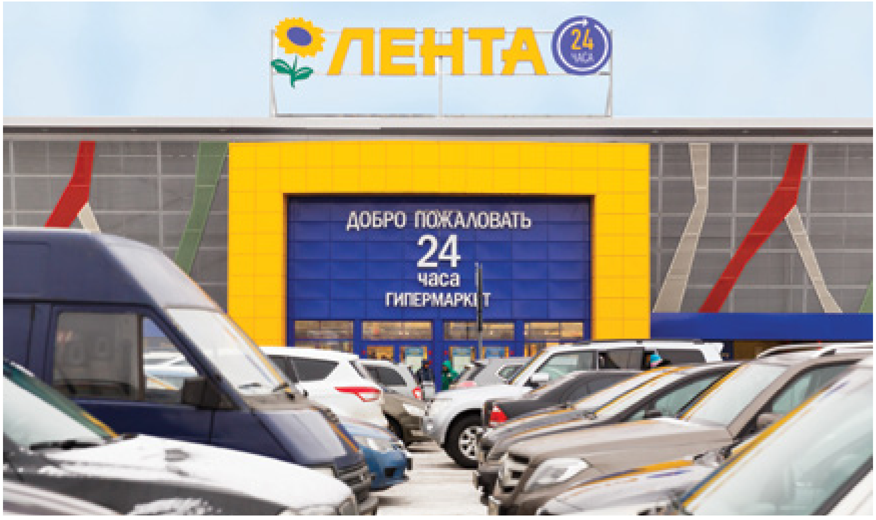

1 From 1 May 2015, all stores located in Moscow city and the Moscow Region are shown as 'Moscow'. All stores located in the Leningrad Region and St. Petersburg are shown as 'St. Petersburg'.

Source: Company information

## Hypermarkets

Most of our hypermarkets are open 24 hours a day, seven days a week. They are typically located in – or very close to – residential areas with good transport links. Lenta operates three hypermarket formats: 'Standard' (typically 7,000 sq.m of selling space), 'Compact' (typically 5,000 sq.m of selling space) and 'Supercompact' (typically 3,000 sq.m of selling space). Our Compact format now comprises three additional variants, which has increased our flexibility and allows us to deliver attractive investment returns in an even wider range of catchment areas. Regardless of size, all of our hypermarkets offer an extensive range of groceries and general merchandise, with loyal customers generally visiting once or twice a week.

# Operating review continued




In 2016, we opened 51 hypermarkets on a net basis, giving us a total of 191 hypermarkets at the year end. These new stores exceeded our initial organic target of at least 40 openings, and our revised guidance of at least 50 openings by the year end. This figure includes 11 stores in St. Petersburg, which were acquired as part of the purchase of Kesko Food Retail's business in Russia – the largest acquisition in our history. The Kesko stores were integrated and reopened under the Lenta banner in just six days.

Our new store openings added 250,991 sq.m of hypermarket selling space on a net basis, representing an increase of 29.6% in this format over the year.

**51**

hypermarkets opened on a net basis

We opened hypermarkets in 27 cities in 2016. Eight of these – including Ekaterinburg, Samara and Kazan – were new locations for Lenta. A notable addition to our portfolio was our first hypermarket in Grozny. We now have a hypermarket presence in 77 cities. We are now present in all fifteen Russian cities with a population of over one million people; over the last three years we have increased our hypermarket selling space in these cities by approximately 140%. This includes increases of over 50% in St. Petersburg and almost 70% in Moscow.

Even in these straitened times, we see considerable growth potential for our hypermarket store format – and expansion opportunities continue to present themselves. Our hypermarket pipeline remains healthy and we will maintain the momentum of new store development into 2017 and beyond by carefully prioritising opportunities for strategic fit and returns. In the medium term, our primary focus remains on Moscow, St. Petersburg and the largest cities, combined with our ongoing programme of roll-outs to existing and new smaller cities.


## NEW SUPERMARKETS FOR BUSY NEIGHBOURHOOD CENTRES

We are accelerating growth of our successful supermarket format. As part of this strategy, we signed lease contracts with Edisonenergo LLC (part of the ADG Group) in January 2017 for 36 supermarkets. Located in newly developed neighbourhood shopping and entertainment centres, the stores are being built on the sites of former Moscow cinemas at the hearts of high-traffic residential areas.

The neighbourhood centres will provide a wide range of consumer outlets, entertainment and essential services, including educational, social and cultural facilities, which will attract frequent visits from local people. Lenta is leasing around 47,000 sq.m of total space for the supermarkets, the first of which will open towards the end of 2018.

### Supermarkets

A strategic extension of our hypermarket format, supermarkets have become a well-established – and increasingly important – format for Lenta. Designed specifically for frequent visits for everyday purchases, they are located within walking distance of residential areas in the Moscow, St. Petersburg and Central regions. This community-based format enables us to penetrate local retail markets where locating a hypermarket would not be feasible. In 2016 we doubled the number of supermarket store openings.

The average selling space of Lenta's supermarkets is approximately 900 sq.m. These stores generate high sales per square metre and in 2016 delivered good like-for-like growth of 5.5% and an increase in like-for-like customer traffic of 1.9%. The average like-for-like ticket increased by 3.5%.

Our first pilot supermarket opened in Moscow in 2013. During 2016 we opened 17 supermarkets, a record annual high, bringing the total to 49. These new stores exceeded our original guidance of opening at least double the number of supermarkets opened in 2015. We added 12,774 sq.m of supermarket selling space, which represents a 38.1% growth in the format.

In January 2017, we signed lease contracts with Edisonenergo LLC, part of real estate developers ADG Group, which is building a network of neighbourhood shopping and entertainment centres across Moscow. The agreements cover 36 locations for future Lenta supermarkets in the region and represent some 47,000 sq.m of total space (approx. 30,300 sq.m of selling space). The first of these new stores is scheduled to open at the end of 2018.

In December 2016 we also signed an agreement to acquire eight properties in Novosibirsk for conversion to supermarkets.

Our supermarket format has proven itself to be highly attractive to consumers. In addition, over time, the scale advantages of Lenta and other federal chains will lead many local grocery retailers to exit the market. We therefore anticipate significant opportunities for growth in the supermarket sector, both organic and potentially through acquisitions, where they fit with our business model and location criteria. In line with our strategy, we plan to accelerate the development of this format – we opened our first supermarket in Siberia in February 2017.

With a dedicated team focused exclusively on developing supermarkets, we have a strong pipeline of store projects. We aim to deliver an eightfold increase in supermarket selling space by 2020 and are extending the network of stores around our existing distribution centres from 2017. We have the potential to reach over 100 supermarkets in Moscow alone over the next three years.

> EVEN IN THESE STRAITENED TIMES, WE SEE CONSIDERABLE GROWTH POTENTIAL FOR THIS STORE FORMAT – AND EXPANSION OPPORTUNITIES CONTINUE TO PRESENT THEMSELVES.

**17**

supermarkets opened during 2016, a record annual high

# Operating review continued

## Lenta Loyalty Card

Lenta operates a long-established and highly successful loyalty card programme, with 93% of all purchases in our stores made using the card. In addition to offering discounts on customer purchases, it provides us with valuable real-time information on customer behaviour. Cardholders obtain a 5% minimum discount every time they use their card and benefit from exclusive access to special promotions, with extra discounts of up to 50%. Additional reductions are also offered on goods for customers in most need of social support, with a further 3–8% discount.

In 2016 we passed a notable milestone, reaching 10.5 million active cardholders during the year. This represents an impressive increase of 25% year-on-year. Our credentials are consistently verified through in-depth customer research and Lenta's loyalty scheme is regarded by Russian shoppers as the best of its kind in the market.

We accumulate transaction data on all card-related purchases. Analysis of this information enables us to track product performance across our stores, understand our customers' changing tastes and habits and provide them with attractive, individually tailored offers. These include 'Thank You' mailshots, which are designed – and proven – to increase customer loyalty, traffic and basket size.

We send offers to all contactable customers frequently. These incorporate a range of incentives: from single product discounts and category offers to money off a customer's entire shop. We piloted a range of new card-related initiatives during the year including customer birthday offers, campaigns aimed at recapturing lost customers and region-specific promotions.

The coming year will see us introduce additional loyalty card-based activities including improved rewards for new customers and housewarming congratulations.


**10.5m**

Active cardholders

### Big Data Customer Insight Programme

We started collecting data on customer transactions in 2008 and launched our Big Data Customer Insight initiative four years later. The programme has delivered significant competitive advantage for Lenta, helping us maintain our position as one of the most rapidly growing food retailers in the Russian market. We use customer data across all the key levers at Lenta, to drive sales and performance, including pricing, promotions, assortment and personalisation initiatives.

Our Big Data Customer Insight Programme enables us to track shopping trends; for example, whether customers are shopping in our stores more or less frequently, and whether they are buying significantly more or less on each visit. Data derived from Lenta loyalty card transactions has also prompted a new approach to the way in which we understand customer behaviour.

> WE STARTED COLLECTING DATA ON CUSTOMER TRANSACTIONS IN 2008 AND LAUNCHED OUR BIG DATA CUSTOMER INSIGHT INITIATIVE FOUR YEARS LATER.

Detailed analysis has enabled us to identify ten key customer lifestyle profiles, depending on how much they spend, how often they shop and the items they buy. We can therefore cater directly to the specific needs and preferences of each group, providing them with personalised discounts and relevant offers that enhance their experience with us, generate additional sales and boost loyalty. We also use these profiles to help us refine and plan our product ranges, merchandising and advertising activities.

Our sophisticated analytical capabilities support our commercial model and additional enhancements will further cement our leading position in this field. In the coming year we will continue developing our use of customer transaction data, both internally and with external partners. This includes a range of activities, including work to evaluate the effectiveness of various promotional channels including billboards, facades and catalogues.

### Product range

Our standard format hypermarket carries around 26,000 SKUs. This provides an attractive range of choices for customers, while being significantly fewer than some of our competitors. We are therefore able to reap considerable efficiency benefits, both in store and across our supply chain. A carefully edited range of products displayed in well-planned space also enables time-pressed customers to quickly find the products on their list, which improves their overall shopping experience.

All of our stores carry an extensive range of high quality products that offer great value for money. However, we also customise our category assortment to varying degrees in different regions, since local tastes and preferences across Russia inevitably vary widely. This geographic flexibility is a key differentiator for Lenta.

In 2016, fresh food accounted for 39.8% of combined supermarket and hypermarket sales. Dry groceries comprised 48.1%. Our non-food category, which includes clothing, homeware and seasonal goods accounted for 12.1% of sales.

Total food sales (fresh and dry combined) grew by 21.5%. Non-food sales rose 18.8%. Non-food products comprised 12.5% of total hypermarket sales, compared with 3.0% of total supermarket sales.

**+21.5%**

Total food sales growth (fresh and dry combined)

# Operating review continued


Centralised production continues to play a key role in our drive for cost efficiency. It also enables us to source ingredients and raw materials directly, maintain the highest standards of quality and keep our shelves filled with the freshest products. Bakery products, salads and ready meals are among the popular categories of own-produced fresh foods. Sales amounted to RUB 39 billion, some around 13% of our total sales and an increase of 18% on the previous year.

Volumes of peeled vegetables produced centrally increased from five to 153 tonnes per month and the number of stores receiving these products increased from six to 40, with the assortment expanding from six to 17 SKUs. We commenced production of Korean salads and pickled cabbage in 2016 and are expanding our centralised production capabilities to include peeled potato, carrot, beet and mixed packs.

We developed and implemented new 'bake-off' technologies in 13 'mother' stores, which in turn supply 30 'daughter' stores. This arrangement enables rapid replenishment of shelves and consistent quality – as well as savings in cost, space and equipment at the daughter stores. We also commenced centralised meat production in Omsk, Siberia, with a mother store producing 80 SKUs, which are vacuum packed in a gas-modified atmosphere for four other stores in the city.

This approach enables us to adapt successfully to a wider range of different catchment areas, maintaining a balanced range of reasonably priced products without compromising the quality of our service. The year ahead will see us introduce our 'bake-off' technology at nine mother stores serving 17 daughter premises.

During the year we introduced a system of regular quality self-assessment, which was implemented in every store. This was underpinned by an enhanced internal quality audit programme, with every store now reviewed on a quarterly basis.

## Private label ranges

In a highly competitive market, we provide great value to our customers through our extensive private label range of everyday essentials. Recognising the pressures on household budgets, we made our quality products even more affordable through the introduction of smaller pack sizes.

Our two leading private label FMCG variants are '365 days' and 'Lenta'. '365 days' comprises 722 SKUs of the most affordable products in their categories. Our 'Lenta' range comprises 583 SKUs of mid-range products, which offer excellent quality at competitive prices.

We are particularly focused on enhancing our private label offerings. In November we announced the launch of a range of private label food products for children, including breakfast cereals, jellybeans and cookies. Co-branded with The Walt Disney Company CIS, the product packaging features several of Disney's best-known cartoon characters. Lenta is the first Russian food retailer to launch such a partnership.

We continued the development of our non-food own brands: 'Home Club' household goods, 'Lentel' home appliances, 'Giardin' gardening goods and 'Friend Made' clothing and accessories – as well as newer brands 'Bigga' toys and 'Actico' sports goods. The share of private label vs. branded goods sales was stable in 2016 due to high levels of promotional activity in premium brands.

## Price leadership and promotions

The consumer environment remained intensely competitive. We closely monitor other retailers' local and national pricing – often twice a week, sometimes daily – to ensure we maintain our price leadership. Our core proposition is to provide great value for money – and our customers appreciate the benefits of our low price/low cost business model. Our continued buoyant profit performance derives from the simple – yet highly effective – mix of high footfall, high sales density and a low cost base. Close collaboration with our suppliers means we can keep costs down and pass on savings to our customers.

All of our promotional activities are carefully planned and continually refined using customer feedback and sales figures. We also consider local buying patterns and regional preferences when devising promotions, so that we maximise brand awareness, attract new customers and build loyalty. In 2016, 38.5% of sales were accounted for by promotions.

We continued our targeted promotional activity and launched several new initiatives during the year, incorporating our Big Data Customer Insight capabilities further into our 'Big Media' and 'Crazy Day' promotions. We are now able to understand the best promotions for sales, unit uplift, customer penetration and returning or new customers. In 2016, we sent customers birthday greetings accompanied by a special offer and focused our efforts on encouraging 'lost' or 'reducing spend' customers to return to Lenta. Both these initiatives resulted in double-digit sales increases.

## IN PARTNERSHIP WITH DISNEY: ANOTHER FIRST FOR LENTA

In November, Lenta and The Walt Disney Company CIS announced a new private label range of co-branded food products for children. This makes us the first company in the Russian food market to launch such a venture – and represents an exciting new stage in the development of Lenta's private labels.

The new range initially comprises six products, which comply with our own high quality standards and Disney's stringent quality and safety requirements. Manufacturing facilities were audited for compliance with international labour conventions and all suppliers for the new range have been certified to ISO 22000 food safety management standards.

# Operating review continued

## Distribution

Lenta's rapid growth is underpinned by a sophisticated, flexible and highly efficient supply chain. Our extensive geographic spread across Russia means we must overcome a complex set of logistical hurdles in order to keep our stores stocked at optimum levels with the right products at the right time. Our stores are therefore supplied through a combination of deliveries from our own distribution centres and direct deliveries from our suppliers.

Our distribution centres incorporate state-of-the-art technologies and are designed for maximum efficiency. They have the capacity to serve a total of over 250 hypermarkets and 250 supermarkets. During the year we continued to invest in our distribution network, with the opening of a RUB 2 billion dedicated supermarket distribution centre in Moscow – our seventh. This 31,600 sq.m facility has the capacity to serve over 150 supermarkets in the Moscow and Central regions; providing us with a new catalyst for growth in this store format.

In 2016 the centralisation ratio was 50.1% for Lenta's hypermarkets vs. 45.2% in 2015, and 64.5% for our supermarkets vs. 67.9% in 2015. The average distance transported per pallet of goods was 579 km compared with 635 km per pallet in 2015, a decrease of 9%.

Our substantial truck fleet means we maintain tight control of this crucial link in our supply chain. During the year, our owned trucks delivered 53.6% of all deliveries to our stores compared with 39.3% in 2015. At the end of 2016 our fleet comprised 161 owned delivery trucks, an increase of 45%.

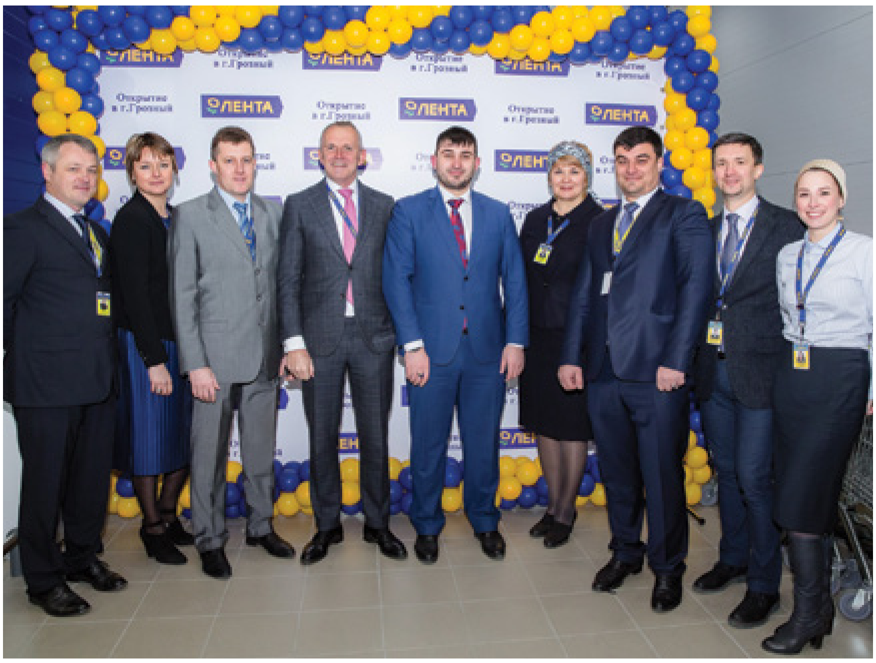
**53.6%**

Deliveries made by our own trucks

## Purchasing and supplier partnerships

Strong relationships with suppliers are a vital component in our growth ambitions. Throughout the year we continued to work closely with our key suppliers, as well as a diverse and growing range of regional and local producers. The fact that we are growing so rapidly makes us very attractive to potential suppliers, since they too stand to benefit from our success. Many of our suppliers offer favourable purchasing terms and conditions, the benefits of which we can pass on to our customers.

In 2016 we established a dedicated Procurement Unit. This specialist team has several functions including sourcing suppliers on a global scale, establishing a unified commercial tendering system and balancing price, quality and supply chain considerations effectively.



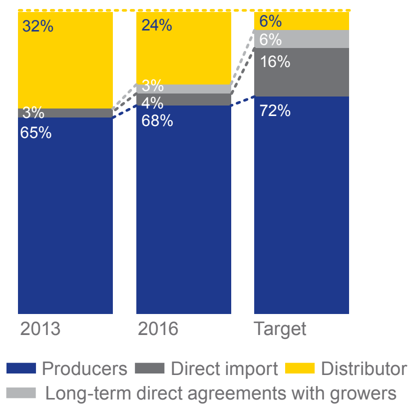
Every Lenta supplier is required to match our own high standards of safety and quality. They must also comply with all relevant legislation, such as packaging regulations and the provision of consumer information. In 2016 we focused on improving the quality of supplied fruit and vegetables, as well as directly imported goods. While we have high expectations of our suppliers, they in turn value us as a fair and reliable partner – in November, Lenta was recognised as the number one partner for suppliers among Russia's largest food retailers in a survey by leading market research company Advantage.

The total number of suppliers increased by 12.9% to 3,178 in 2016, as we continued our rapid expansion. Over 95% of all products purchased in Lenta stores were sourced in Russia, including 19.5% from suppliers located close to the destination store. Some 46% of all the fresh food sold in our stores in 2016 was provided by local producers.

We actively seek new partnerships. Suppliers can approach us directly, but we also seek out producers who will help us extend and enhance our ranges of niche products that appeal to specific local tastes. We take deliveries from many producers at the nearest distribution centre to their facilities, then use our logistics network to distribute nationally, saving costs and cutting lead times involved in getting products to our stores.

In 2016, we started to set up long-term agreements with growers. Through sourcing fruit and vegetables directly in this way, we significantly improved our margins in this competitive category – and will focus on expanding this activity in the year ahead.

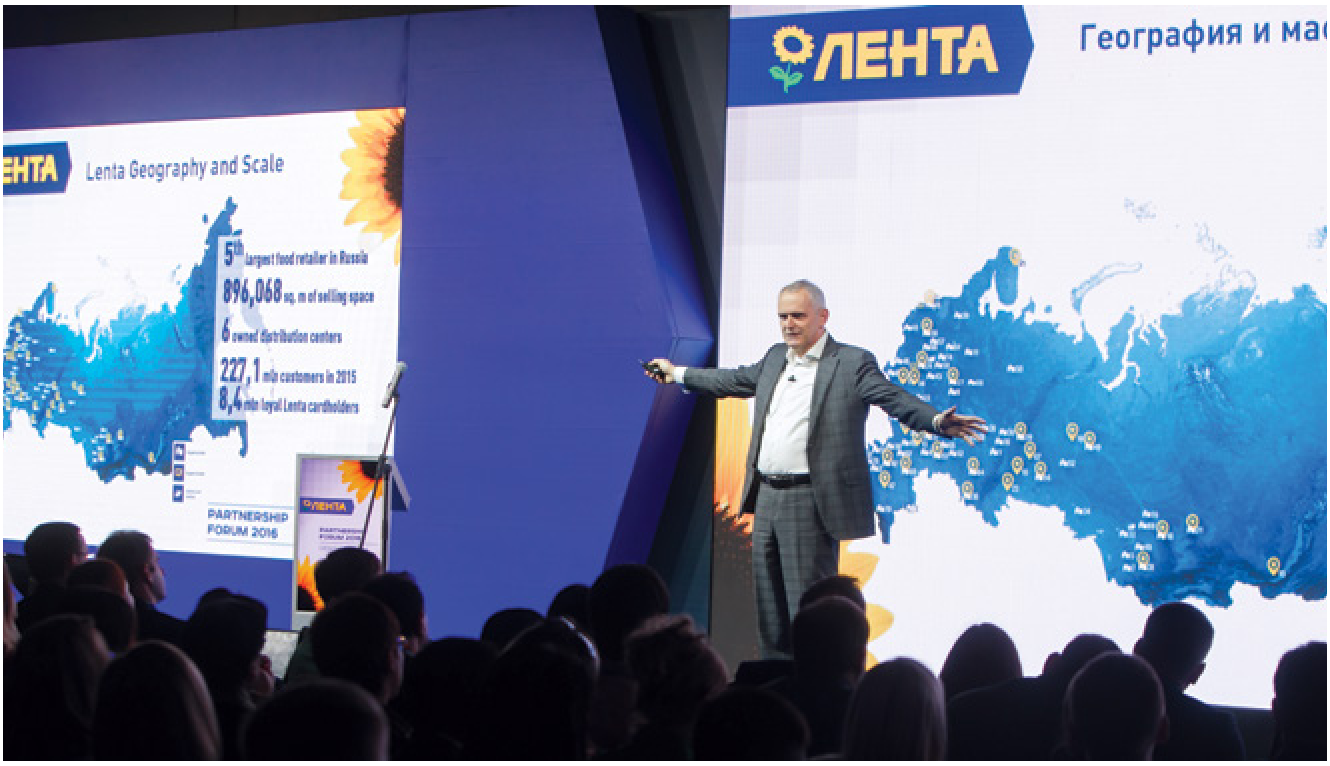
**Going direct/going local**
% share of sales




Source: Company information

| | 2016 | 2015 | 2016 vs. 2015 |
|---|---|---|---|
| Overall number of suppliers: | **3,178** | 2,816 | 12.86% |
| Direct import | **248** | 233 | 6.44% |
| Sourced in Russia | **2,930** | 2,583 | 13.43% |
| % of all supply | | | |
| Direct import | **4.24%** | 3.38% | 0.86pp |
| Sourced in Russia | **95.76%** | 96.62% | -0.86pp |

# Operating review continued




> OUR 2016 PARTNERSHIP FORUM, WHICH WAS ATTENDED BY KEY SUPPLIERS AND PRODUCERS FROM ALL OVER RUSSIA, ENABLED PARTICIPANTS TO DISCUSS OPPORTUNITIES FOR FURTHER COOPERATION AND GROWTH.

We currently buy a wide range of products from 24 countries. Direct import volumes of fruit and vegetables increased by 250% to more than 62,000 tonnes in 2016, with the average direct import share reaching more than 20%. Customers appreciated the significantly higher quality of these products and volumes continue to grow.

During the year, our dry food direct import business processes were defined and aligned within the Company and new projects in five categories were launched and well received by customers. The year ahead will see us further explore joint business plans with our largest partners, sharing customer insights to launch innovations and grow sales. Our 2016 Partnership Forum, which was attended by key suppliers and producers from all over Russia, enabled participants to discuss opportunities for further cooperation and growth.

In December we signed an agreement of intent with Eurotorg, a leading Belarus retailer to explore the potential for joint procurement opportunities for both food and non-food categories. Although such partnerships exist elsewhere, this is a pioneering venture in the CIS markets. We also entered a partnership with Agrokor, one of Europe's largest retailers and Serbia's largest food producer, which is helping us bring fresh produce, food and non-food items to our customers at the best possible prices.

## IT

All of Lenta's operations – from inventory management and supply chain to HR and finance – are supported by best-in-class business applications. Given our growth ambitions, scalability and reliability are at the heart of our IT strategy. Amongst others, we use SAP, Oracle and JDA solutions to support our business activities.

During the year we completed implementation of the SAP Mobile Platform (SMP) service for Lenta's entire chain – a solution that has helped to increase the effectiveness of our in-store staff by reducing the time required for routine operations. We also rolled-out new point of sale software in our stores, which has delivered numerous benefits including improved reliability and functionality for our customers and back-office with lower maintenance costs. The new system also speeds the time-to-market for implementation of new features as the business grows. In December we signed a new long-term contract with SAP, which gives us full access to the latest SAP solutions and technologies.

We launched a new data centre in Moscow, which guarantees the operation of business-critical systems in the event of another data centre's failure. We also rolled-out JDA's Demand and Fulfillment solutions for our entire regular assortment, allowing us to improve stock fulfillment accuracy and further centralise orders to suppliers.


## Merchandising

To ensure we provide our customers with the best possible shopping experience, we plan our store layouts with great care. They all follow a similar floor layout, with logical arrangements of product categories, which makes them easy for customers to navigate. Our stores are specifically designed to showcase our fresh food ranges. Our attractive fruit and vegetable displays take centre stage and we ensure that our strongest promotions and offers are placed in prominent positions in store, including near the entrance.

> IN 2016 WE CONTINUED TO REFRESH AND UPDATE THE LAYOUTS OF OUR EXISTING STORE FORMATS IN ORDER TO MAINTAIN THEIR APPEAL.

In 2016 we continued to refresh and update the layouts of our existing store formats in order to maintain their appeal. Better planning enabled us to highlight key product areas such as children's goods, seasonal offerings and fresh food and promotions more effectively. We also successfully piloted self-service cash desks and are implementing these across our store estate.

We made significant improvements to our store displays during the year, increasing the prominence and accessibility of our private label 365 range and improving the layout of some categories including cosmetics, canned foods and shoes.

# Financial review

# ANOTHER STRONG PERFORMANCE

Increases in sales, selling space and productivity helped to deliver a substantial increase in profits.

**Jago Lemmens**
Chief Financial Officer

**Dear Shareholders**
Despite the challenging economic conditions, Lenta delivered another strong overall financial performance in 2016. Combining rapid growth with continuing high productivity enabled the company to deliver a substantial increase in profits while maintaining a conservative balance sheet.

Total sales grew 21%. Adjusted EBITDA rose 13% to RUB 31.8 billion, and net income increased by 9% to RUB 11.2 billion, while net debt increased to 2.8x EBITDA.

**Gross profit**
RUB bn
+20.4%

| | |
|---|---|
| 2016 | 67.8 |
| 2015 | 56.3 |
| 2014 | 43.7 |

**Net profit**
RUB bn
+8.9%

| | |
|---|---|
| 2016 | 11.2 |
| 2015 | 10.3 |
| 2014 | 9.1 |

> COMBINING RAPID GROWTH WITH CONTINUING HIGH PRODUCTIVITY ENABLED THE COMPANY TO DELIVER A SUBSTANTIAL INCREASE IN PROFITS WHILE MAINTAINING A CONSERVATIVE BALANCE SHEET.

## Sales

Our sales in 2016 were RUB 306.4 billion, a rise of 21.2% compared with growth in 2015 of 30.3%. Our growth was supported by another substantial increase in selling space, which grew by 29.9% compared with 25.8% in 2015. LFL sales grew 3.9%, as the average LFL ticket increased by 4.0%, while LFL traffic fell by 0.1%.

**Selling space**
'000 sq.m

**+29.9%**

| | |
|---|---|
| 2016 | 1,146.1 |
| 2015 | 882.4 |
| 2014 | 701.2 |

**306.4bn**
RUB total sales

| Y-on-Y growth | 1H 2016 | 2H 2016 | 2016 | 2015 |
|---|---|---|---|---|
| **Total sales** | 21.9% | 20.6% | **21.2%** | 30.3% |
| **LFL sales** | 5.2% | 2.9% | **3.9%** | 9.1% |
| LFL traffic | 2.1% | -2.0% | **-0.1%** | 3.9% |
| LFL ticket | 3.0% | 5.0% | **4.0%** | 5.0% |

**67.8bn**
RUB gross profit

**23.7bn**
RUB operating profit

## Gross margin

We achieved notable improvements in supplier conditions, supply chain efficiency and Lenta's own production performance. However, these gains were offset by the price investments we made to shield our customers from some of the impact of inflation. As a result our gross margin decreased slightly by 0.2pp to 22.1%.

The increased density of our distribution network enabled a reduction in the average distance for goods transportation by 9% to 579km/pallet in 2016, compared to 635km/pallet in 2015. Combined with a higher centralisation ratio of 50.8%, this led to a reduction in supply chain costs as a percentage of sales to 1.2% in 2016 from 1.3% in 2015. In-store production margins improved 42bps thanks to the implementation of our 'mother/daughter' centralisation concept.

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

SG&A increased to 15.2% of sales, 0.9pp higher than 2015, while adjusted SG&A, which excludes rent paid on land, equipment and premises leases, depreciation and one-off non-operating costs increased 0.5pp to 11.4% in 2016.

Ongoing productivity gains were substantial. Operational improvements in stores led to higher labour productivity, despite the growing number of stores in the ramp-up phase, and resulted in flat personnel costs as a percentage of sales (5.7% in 2015).

Despite continuous operational improvements, other costs included in adjusted SG&A (which include marketing, utilities and other housing costs, but exclude rent and depreciation) increased by 0.5pp to 5.7% of sales in 2016. This was due to a combination of increased marketing costs employed to drive customer loyalty and additional traffic, rising tariffs for utilities, and increases in housing costs driven by the growing number of stores – as well as expenditure to support Lenta's rapid organic expansion and the acquisition of 11 hypermarkets from Kesko.

Rent expenses as a % of sales remained almost flat at 1.1%, due to a higher share of new owned selling space. Depreciation increased by 0.3pp to 2.5% of sales as a result of Lenta's rapid expansion.

# Financial review continued

## EBITDA

Adjusted EBITDA (which is reported EBITDA adjusted for non-recurring one-off items such as changes in accounting estimates and one-off non-operating costs and income) reached RUB 31.8 billion in 2016 (+13.1% compared to 2015) with an Adjusted EBITDA margin of 10.4%.

| RUB (millions) | 2016 | 2015 | % Change 2016–2015 |
|---|---|---|---|
| **Adjusted EBITDA** | **31,759** | 28,080 | 13.1% |
| One-off expenses and income[1] | **369** | 61 | – |
| **Reported EBITDA[2]** | **31,390** | 28,018 | 12.0% |

1 One-off expenses and income in 2016 were professional fees associated with M&A activity. In 2015 these were professional services fees primarily incurred in connection with optimisation of the Group corporate legal structure, development of employee incentive plans and cost and income related to Lenta's public offerings carried out in March and October 2015.

2 Reported EBITDA (as set out in note 6 of the IFRS financial statements) includes all operating income and expenses excluding interest, tax, depreciation and amortisation as well as certain other expenses.

## Interest

Net interest expenses were RUB 9.2 billion, a slight decrease compared to 2015 (RUB 9.3 billion). This was due mainly to lower interest rates offsetting a substantial increase in total borrowings to fund store openings, supply chain development and the Kesko acquisition.

We managed to reduce the cost of our debt throughout the year, from 12.5% in the first three months to 11.2% in the fourth quarter. This was due mainly to the combined effects of continuing reductions in MosPrime rates and improvements in the terms and conditions of our long-term loan facilities. Our weighted average cost of debt in 2016 decreased to 11.9% (180bps lower than 2015).

## Tax

The effective tax rate rose from 20.1% in 2015 to 23.0% in 2016. The main driver of this change was a one-off permanent difference related to the Kesko acquisition and an intra-Group loan that generated a taxable gain in 2016 versus deductible losses the previous year.

## Net income

Net profit rose 8.9% to RUB 11.2 billion from RUB 10.3 billion in 2015. This was driven by growth in EBITDA, partly offset by increased depreciation and income tax. The net profit margin fell to 3.7% (2015: 4.1%). While this figure was supported by almost flat interest expenses, it was affected by a higher effective rate of tax, mainly due to one-off effects.

## Capital expenditure

Our capital expenditure rose to RUB 54.3 billion, an increase of 73.0% on 2015 (RUB 31.4 billion). This was principally due to rapid ongoing organic expansion: additional investments in land purchases and hypermarket construction – combined with a higher share of owned selling space and the RUB 11.4 billion acquisition of Kesko's food retail business in Russia. Lenta's capital expenditure in 2016 was funded by operating cash flow and debt.

## Cash flow

Net cash generated from operating activities, before net interest and income taxes paid, of RUB 27.9 billion rose 7.7% compared to 2015 (RUB 25.9 billion). This was driven primarily by growth in EBITDA, partly offset by an increase in working capital. Trade payables grew slower than inventory and trade receivables as a result of the new trade law. Another effect was a marked increase in taxes receivable from RUB 1.3 billion on 31 December 2015 to RUB 3.9 billion on 31 December 2016. This was driven by VAT receivable on the high capex in 2016.

## Summary cash flow

| RUB (millions) | Full year ended 31 December 2016 | Full year ended 31 December 2015 | Y-o-Y growth |
|---|---|---|---|
| Profit before income tax | **14,553** | 12,872 | 13.1% |
| Cash from operating activities before movements in working capital | **32,578** | 28,288 | 15.2% |
| Movements in working capital | **(4,668)** | (2,378) | 96.3% |
| Cash from operating activities | **27,910** | 25,911 | 7.7% |
| Net interest | **(7,902)** | (9,090) | -13.1% |
| Income tax | **(289)** | (896) | -67.7% |
| Net cash generated from operating activities | **19,719** | 15,924 | 23.8% |
| Net cash used in investing activities | **(54,257)** | (31,370) | 73.0% |
| Net cash generated from financing activities | **25,120** | 25,865 | -2.9% |
| **Net increase/(decrease) in cash and cash equivalents** | **(9,418)** | 10,420 | – |
| **Cash and cash equivalents at the end of the period** | **13,038** | 22,456 | -41.9% |

### Net debt and leverage

As of 31 December 2016, Lenta's net debt stood at RUB 89.2 billion. We ended the year with a net debt to Adjusted EBITDA leverage of 2.8x compared with 1.9x at the end of the previous year. Adjusted EBITDA to net interest was 3.4x. The increase in leverage was attributable to capex spending on expansion and the acquisition of the Kesko stores in December 2016.

All of the Company's debt is denominated in Russian Roubles, most of which is long-term with an average maturity of 2.3 years. At the year end, total debt was RUB 102.2 billion compared to RUB 76.1 billion in 2015. The Company had a cash balance of RUB 13.0 billion as of 31 December 2016.

Lenta has RUB 44.2 billion of undrawn short- and long-term facilities.

While some improvement in the trading environment appears likely, the economy will remain challenging for retailers and their customers in the year ahead. However, our effective low price/low cost business model and healthy financial position means we are well positioned to succeed in these conditions; we will continue to strengthen our presence while maintaining rigorous control of our cost base in order to deliver profitable growth. We will remain focused on delivering attractive returns on our new investments while maintaining a strong balance sheet in 2017 and beyond.

### Summary balance sheet

| RUB (millions) | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Property, plant and equipment | **147,812** | 104,016 |
| Other non-current assets | **13,761** | 11,023 |
| Inventories | **27,491** | 22,782 |
| Trade and other receivables | **17,036** | 13,647 |
| Cash and cash equivalents | **13,038** | 22,456 |
| Advances paid | **2,670** | 2,265 |
| Other current assets | **4,362** | 2,203 |
| **Total assets** | **226,170** | 178,392 |
| | | |
| Equity | **58,369** | 47,130 |
| Long-term borrowings | **66,956** | 65,149 |
| Other long-term liabilities | **7,362** | 5,254 |
| Trade and other payables | **56,172** | 48,820 |
| Short-term borrowings and short-term portion of long-term borrowings | **35,245** | 10,773 |
| Other short-term liabilities | **2,066** | 1,265 |
| Total liabilities and equity | **226,170** | 178,392 |
| | | |
| Net debt/Adjusted EBITDA | **2.8x** | 1.9x |

**Jago Lemmens**
Chief Financial Officer

# Principal risks and uncertainties

### Risk management

We define risk as 'an uncertain future event that could affect the Company's ability to achieve its objectives.' Understanding how different risks potentially influence our business is integral to the decision-making process at Lenta. We continuously monitor all material risks to our operations, taking action as necessary to mitigate and manage them – and anticipate new ones.

Our risk management process applies across all functions and comprises four main stages:

- identification;
- assessment;
- response;
- monitoring, reporting and escalation.


### Stage 1 – Risk identification

To ensure a comprehensive risk profile, we conduct a 'top down' strategic risk assessment on a biannual basis. This supplements a quarterly functional 'bottom up' evaluation, which identifies risks at operational levels in the company. Risk identification is also embedded into key processes including budgeting, business planning, capital expenditure and performance management.

### Stage 2 – Risk assessment

Risks are assessed to determine their likelihood and potential impact. They are assessed on a 'Current' and 'Target' basis, which helps to inform management oversight and privatisation. Risks are assessed over a three-year time horizon using Lenta's Risk Assessment Criteria, which comprise four-point probability and severity scales.

### Stage 3 – Risk response

When the Current severity of a risk exceeds acceptable levels, action may need to be taken to bring it in line with the Target risk position. Risk Owners retain accountability for managing the risk, with details of all planned activities and delivery milestones set out in risk response plans.

### Stage 4 – Risk monitoring, reporting and escalation

This involves the timely tracking, capture and sharing of risk information to enable review and notification of changes in risk exposure by management. It supports understanding and enables decisions on risk response to be taken, including management interventions to avoid a risk occurring – or reduce its impact should it occur.

The entire process is supported by a governance structure that clearly defines risk-related roles and responsibilities at each level of the Company. The Lenta Board has overall accountability for ensuring that risks are effectively managed across the business. The Audit Committee oversees and challenges the effectiveness of our approach. The management team provides risk oversight of commercial operations and undertakes a biannual 'top down' assessment for the Audit Committee and Board to review. Functional heads across the business are accountable for implementing the risk management activity in their respective areas.

### A new policy

As we have continued to grow, we have recognised the need to establish and embed a more structured approach to managing risk within the business. During 2016 we launched a new Risk Management Policy, setting out clearly the principles and standards to be adhered to throughout Lenta and establishing a common approach and minimum requirements for risk management activities within the Company. The policy creates a common language for risk and provides us with multiple benefits, including:

- informed decision-making to help deliver consistent and improved business performance through avoiding unwanted surprises and achievement of opportunities;
- identification and management of key risks that could have a material impact on the business;
- clear accountability and ownership of risk management;
- an improved view of key controls, their effectiveness and gaps in the control environment;
- a clear path for the functions to raise significant risks to the Senior Management team, Audit Committee and Board;
- a proactive, risk-aware culture across the business;
- assurance to the Board and Audit committee that processes and behaviours are embedded to ensure significant risks are consistently identified, understood and effectively managed.


The policy is owned by the Chief Financial Officer and is reviewed on an annual basis. Compliance with the policy is mandatory for all levels of management within Lenta; guidance on how to apply the process and supporting tools are provided via a dedicated Risk Management intranet site. Risk Management awareness and training is provided to all staff commensurate with their roles and responsibilities. By the end of the year, 50 employees – most of whom report directly to the Senior Management team – had been trained to identify risks across the business, and 'owners' of principal risks had been nominated.

With our new policy in place, we now have a comprehensive and robust framework, enabling us to ensure that risk is managed to a consistently high standard across all of our operations.

### The risk landscape

Several events and developments occurred in 2016 that could have a potentially severe impact on the business.

The ongoing weakness in consumer demand required us to remain focused on our commercial proposition to continue to attract customers. With the help of our detailed consumer insight, we further developed individually targeted offers and ensured that our usual promotional activities remained relevant for customers. The growing proportion of sales accounted for by promotions shows they have become more relevant, since the actual number of products on promotion remained unchanged. With the help of our Big Data Customer Insight Programme we also improved our assortment, increasing the share of local products. Thanks to our sourcing initiatives, we were largely able to mitigate the effects of pricing pressures and the increased promotional share.

A new trade law was implemented in July 2016, which reduced back margins on food supply to a maximum of 5% of purchases – and also reduced the payment terms. Any new agreements after 13 July had to comply with the new law, with existing agreements compliant by 1 January 2017. Lenta ensured that all annual negotiations were concluded in time and all agreements with suppliers signed. We had also already switched a large part of fresh food supplies to a net-net basis (without back margin) from around mid-2015. In the second half of 2016, all existing agreements were renegotiated for application in 2017; with the objective of ensuring that the new terms were at least the same as, or better than, those applicable in 2016. This objective was met.

The high number of store openings could potentially lead to an erosion of standards and store performance. With 52 openings in 2016 following 32 in 2015, a significant proportion of our stores is very young. During the year we implemented a management-level process involving all functions to regularly review underperforming stores and evaluate likely reasons for underperformance (commercial, operational, marketing, people). The reviewing team then defines an action plan to improve the store's performance, which is actively followed up.

A positive development was the continuous decrease in interest rates. This reduced interest rate risk related to our growth, which requires additional funding above our own generated cash flows.

# Principal risks and uncertainties continued

The risk management process is closely aligned to our strategic objectives. We identified 16 principal risks that could potentially have a negative impact on our ability to deliver on our goals. These are set out below, along with their likely impacts and the mitigating actions taken in each case. Each risk is graded according to how the possible impact would affect the achievement of our strategic priorities.

### Our strategic priorities

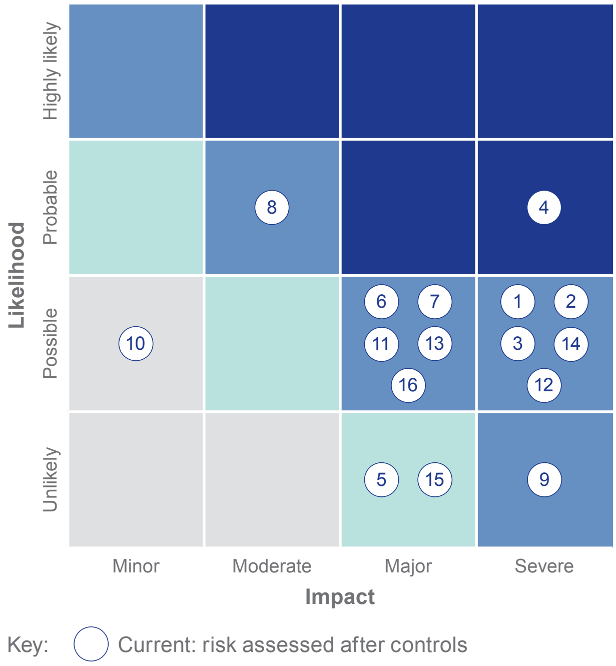
- Delivering profitable like-for-like growth
- Strengthening our existing presence
- Exploiting white space potential
- Format evolution

### Risk categories

- Strategic
- Operational
- Financial
- Legal and compliance

| Risk | No. on map | Impact | Strategic priorities that would be affected |
|---|---|---|---|
| **Regulation resulting in major additional compliance costs** | 1 | Government may introduce regulation of stores in areas such as disabled access or food production standards that result in significant compliance costs and/or adjustment of the business model. | Delivering profitable like-for-like growth; Strengthening our existing presence; Exploiting white space potential |
| **Retail regulation of price/margin** | 2 | Government misunderstanding of the retail sector could result in the introduction of further damaging trade laws, e.g. controls over price or front margin, which could erode sales and margins and/or require changes in the business model. | Delivering profitable like-for-like growth; Strengthening our existing presence; Exploiting white space potential |
| **Major decline in economy** | 3 | There may be further major decline in Russia's economy, devaluation of the Rouble and inflation, resulting in customers cutting back on purchases and reduced sales. | Delivering profitable like-for-like growth; Strengthening our existing presence; Exploiting white space potential |
| **Increased competition** | 4 | Lenta could face markedly increased competition as a result of competitor desperation, consolidation, or a major competitor benefiting from a new management team or additional funding. This could lead to a price war and a resulting impact on Lenta's growth and margins. | Delivering profitable like-for-like growth; Strengthening our existing presence; Exploiting white space potential |

## Principal risks




| Change in 2016 | | How we manage it | Risk categories |
|---|---|---|---|
| ↑ | In 2016 Lenta began preparing for new legal obligations regarding digitalisation and tracking of quality certificates in the supply chain of fresh goods. | Follow up on legislative initiatives and engage with retail association in ongoing lobbying. | **Strategic** |
| ↑ | Implementation of the new retail law in its initial onerous form went against the advice of suppliers, retailers and certain ministries. There is a constant risk of changes in the regulation of the Russian retail sector which can affect consumers and retailers. The industry has thus become even more alert to new initiatives. | Follow up on legislative initiatives and engage with retail association in ongoing lobbying. | **Strategic** |
| ↔ | The Russian economy did not fully recover in 2016. Real wages started to show positive trends, but real household income continues to show negative trends, showing that people are either saving or paying off debts – and are confronted with increased utilities and other fixed payments; hence low demand from customers. | Actively follow up on main economic indicators. | **Strategic** |
| ↑ | Trends during the year indicated how the hierarchy of the top seven food retailers will be shaped. The two top players' growth is increasingly swift, whereas others lag behind and grow slowly.<br><br>Lenta has become the biggest player (by selling space) in the hypermarket sector; while new space additions by other players plunged, Lenta opened a record amount of new space. | Actively monitor competitors' behaviour and changes, understand structural changes in the market. | **Strategic** |

# Principal risks and uncertainties continued

| Risk | No. on map | Impact | Strategic priorities that would be affected |
|---|---|---|---|
| **Competitive sourcing** | 5 | Lenta may not be able to gain access to produce at the 'lowest price', due to competitors pursuing vertical integration or having 'better' relationships with producers. | |
| **New store location** | 6 | New store site selection could be compromised due to the desire to meet rapid growth targets. This results in a fall in average revenue per store and Lenta missing forecast revenue targets. | |
| **Erosion of standards** | 7 | Continued rapid expansion could lead to inconsistent application of the Company's commercial and operational standards, resulting in a substandard product offer (assortment, price and quality) or customer service that damages Lenta's profitability and brand. | |
| **Supply availability** | 8 | A 'suppliers' market' may result in Lenta struggling to purchase the full range of products required to meet customer demand, or suppliers simply not delivering the necessary quantities to Lenta, resulting in lost sales and customers. | |
| **IT system error and data theft** | 9 | A technical malfunction (e.g. change control), could result in an inability to operate a key supply chain system, limiting stock availability or producing errors in pricing, resulting in loss of revenue and potentially long-term customer loyalty. A cyber attack/theft could lead to the loss of personal or valuable commercial data, resulting in negative media headlines, loss of commercial advantage or fines and regulatory investigation. | |
| **Management succession** | 10 | Lenta may not be able to attract management with the necessary skills and experience to support its growth plans, due to a lack of suitably experienced individuals in the country and a reluctance of international candidates to move to Russia. This would result in further management stretch and inappropriate execution of the strategy. | |
| **Food poisoning** | 11 | A lack of independent supplier onboarding and ongoing health and safety audits for high-risk products (e.g. meat, dairy, fish) could result in the sale of contaminated food, potentially causing customer loss of life, negative media coverage, regulatory investigation and reputational damage. | |

| Change in 2016 | How we manage it | Risk categories |
|---|---|---|
| Since the import ban was introduced in 2014, there has been a scarcity of milk and of certain fruit and vegetables, driving retailers to look for new sources. Certain high quality products (e.g. dairy and processed meat) remain unavailable. While local agriculture and farming has picked up considerably, this has led to higher prices for consumers due to limited competition among suppliers in some markets (such as meat and dairy), where suppliers consider their prices in a global context. | Lenta established a separate sourcing team at the end of 2015. This resulted in an increase in local sourcing and the start of long-term cooperation with local growers. There has also been an increase in direct imports, as the new trade law leads to additional benefits from this route in some instances. | **Strategic** |
| The recent crisis resulted in much lower competition for sites from shopping centre developments. The main competitors in the hypermarket sector all slowed their expansion significantly. This has reduced competition for sites, with more locations being available for Lenta. On the other hand, the slow economic development means that new store ramp ups may be slower in some cities, particularly smaller cities. | Lenta has a robust and rigorous investment approval process, combined with a strong post investment process. The investments over the last two years have consequently been steered largely towards bigger cities, existing and wealthy smaller cities that currently offer better prospects. Lenta is experimenting with low capex and lean management models to ensure increased profitability of existing stores, as well as potentially opening up smaller cities in a profitable way. | **Strategic** |
| Lenta added record space in 2016 and has grown the number of employees significantly. | The Company's comprehensive management development programme ensures that it has high calibre managers for new stores and a consistent, Company-wide understanding of our operational standards. Lenta also has rigorous in-store quality assurance processes and commercial KPIs are followed-up on a daily and weekly basis. Operations and commercial teams collaborate to ensure that prices, offer and service are in line with corporate standards and are adapted to local requirements. There are also regular senior management meetings to ensure the maintenance of Lenta's commercial and operational standards. | **Operational** |
| See Risk 5. | See Risk 5. | **Operational** |
| Lenta operates sophisticated business systems that automate or support daily decision-making. Disruptions of major systems could have a significant impact on the business.<br><br>Lenta is a data-rich company; for example it uses customer data more and more intensively. Although not financially sensitive, information on customer shopping habits should not be disclosed to any third party. | The Company has comprehensive procedures in place to ensure continuous IT operations. A comprehensive external audit of IT controls and cyber security was conducted in 2016 and its recommendations will be implemented in 2017. A deep audit will be conducted every two years. | **Operational** |
| Lenta became increasingly attractive for employees relative to most other companies because of the career opportunities it offers in a growing company. Lenta enhanced its management training programmes in 2016, including launching the Lenta Leader programme, to prepare selected managers for promotion to higher management levels. | Lenta's high growth and high standards mean the Company is a preferred employer in food retail, which guarantees a constant inflow of new talent. A strong training programme and well-developed annual performance appraisal processes enable Lenta to identify and develop in-house talent. A low personnel turnover compared to the market shows that it manages this risk well. Lenta has a clear succession plan for its senior management. | **Operational** |
| The share of locally produced food is increasing. However, safety standards in the food industry are often very basic compared to Lenta's own, with responsibility often lying more with the retailer than the supplier. The number of stores with own production operations and related risks is growing. | Lenta's Quality Assurance team works with our commercial team to identify suppliers most likely to deliver substandard goods. New suppliers are audited and Lenta provides free advice to suppliers that need to improve their standards. A risk-based audit approach is applied to all existing suppliers. Self-audit practices are used in in-store production to ensure proper follow up of standards. | **Operational** |

# Principal risks and uncertainties continued

| Risk | No. on map | Impact | Strategic priorities that would be affected |
|---|---|---|---|
| **Tax** | **12** | Russia's taxation system is changing constantly and new rules are often ambiguous, leading to uncertainties in the tax position. | |
| **Interest rates** | **13** | Lenta's debt portfolio is partly in variable interest rates, potentially leading to a large increase in interest cost and potential breach of covenants. | |
| **Sourcing of financing** | **14** | Lenta's growth requires additional funding on top of its own-generated cash flow. During disruptions in the banking system, or because of a too high leverage, Lenta may not be able to get the sourcing needed to fulfil its growth plan. | |
| **Compliance with regulations and internal standards regarding store operations** | **15** | Health and safety failings, customer/staff error or inadequate design in store construction and store systems could cause a disaster (e.g. roof collapse), leading to multiple deaths and injuries, negative media headlines and fines. Failures could also lead to store closures by relevant authorities because of non-compliance with safety or environmental regulations. | |
| **Bribery** | **16** | Russia's business environment could lead to an employee acting unethically (paying or accepting a bribe) resulting in a breach of anti-bribery regulations, police investigations and negative media headlines. | |

## VIABILITY STATEMENT

Lenta's long-term goal is to become a top three multi-format food retailer in Russia. Lenta also aims to remain the largest hypermarket player in Russia, measured by selling space and total sales.

Our low price/low cost business model is aimed at generating market-leading sales densities, by consistently implementing our strategy of everyday low prices (EDLP) combined with deep and frequent promotions. Low cost is driven by the combination of high sales densities with efficient business processes and store designs, which optimise store operating and supply chain costs. This is supported by our increasing scale, which enables us to negotiate improved conditions from suppliers.

As a food retailer, Lenta generates large amounts of cash daily – in a relatively predictable way. We prefer to own the majority of our hypermarkets, as this allows us to build stores in our own format to support our low cost operations and supply chain. Building our own stores also gives us better control of the delivery of our development pipeline. However, this growth is capital intensive, requiring additional funding over and above our own cash flow generation.

We depend on banks and the financial markets to fund this gap. Therefore, our strategy is to maintain a strong balance sheet to ensure we have access to capital markets to fund our growth. As part of managing our viability, we ensure our debt has relatively long maturities and limited interest rate risk.

The principal risk affecting Lenta is the impact of significant changes in consumer spending – either due to economic developments or reduced appeal of our commercial offer. We have seen that our model is quickly accepted in new cities where we choose to operate. However, strong economic disturbances will impact our business – along with other retailers – and will influence our ability to generate the required cash flow. This in turn will affect the level of ambition we are able to apply to our expansion programme.

Lenta has a long-term planning horizon. This stretches over the current year and four consecutive years, in line with our long-term growth targets. Our approach to the viability of the business is also influenced by the construction cycle of our new stores. We closely monitor the construction cycle, since a reduction in capex is the main – and most

| | Change in 2016 | How we manage it | Risk categories |
|---|---|---|---|
| ↑ | Tax authorities seem to take a tougher stance in court on tax structuring and find support in courts for that. | The Company will follow up changes in legislation and court practice and reconsider, when necessary, its tax structure. | **Financial** |
| ↓ | Since the interest rate rise at the end of 2014, rates have reduced significantly. The current spread between interest rates and inflation is resulting in one of the highest effective interest rates in the world, which should reduce over time. | Lenta ensures that a reasonable part of debt is in fixed rates or covers upward risk with caps. Stress testing on interest rate risk is conducted quarterly. | **Financial** |
| ↓ | Lenta significantly increased limits with most of its banks ahead of its funding requirements. | The Company has a diversified portfolio of lenders to reduce dependency on limited sources. It ensures it has generous limits approved and undrawn debt available. Lenta also conducts regular stress tests of projected funding requirements and leverage under a variety of negative scenarios to ensure that the company would have adequate funding and that leverage would remain within covenants even with very pessimistic assumptions. | **Financial** |
| ↔ | The high number of new store openings means that there is an increased risk of a mishap in the period before the opening. More new and relatively inexperienced colleagues are involved in the management of our stores and store processes. | Construction standards are rigorously controlled. Comprehensive training and clear procedures ensure that all employees have a thorough understanding of EHS processes. The Audit Committee regularly tracks the EHS status of all operations. A clear investment programme to address non-standard situations is agreed and executed. | **Legal and compliance** |
| ↔ | | Lenta has a clear ethical policy. Third parties with whom Lenta cooperates are informed of the policy and are expected to comply with it. | **Legal and compliance** |

secure – method of preserving cash flow, should operational cash flow be lower than expected. Cancellation of planned projects before the commitment has been made has the most impact, whereas cancelling store investments already under construction leads to capex being spent without any prospect that it will generate returns in the near future.

Taking the above factors into account, the Board reviews the viability of the business between four and six times a year, when the management team proposes capex commitments for new store construction.

The most important factor affecting the Company's access to capital markets to fund growth is a strong balance sheet. Hence the focus of the analysis is on the impact on leverage. Management models the impact of various risk scenarios on sales, EBITDA and generation of operating cash flow, as well as the combined impact of various scenarios happening at the same time. The resultant leverage is reviewed to ensure that in all cases we remain comfortably below our bank covenants, giving the Board confidence that the potential to reduce investment cash outflows is substantial enough to remain viable.

The Directors have determined that the long-term planning horizon over the existing year and four consecutive years is an appropriate timeframe for assessment of the long-term viability of Lenta. The Directors have assessed the viability of Lenta over this period, taking into account the Company's current position and the potential impact of the scenarios described above. Based on the results of our testing, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due during this period.

## Corporate social responsibility

# THE LENTA WAY

Corporate social responsibility is central to the way we do business. It plays a part in almost every decision we make – from choosing locations for our stores to sourcing products for our shelves. 'Doing the right thing' – for our customers, staff, suppliers, communities and the environment – is not just about behaving ethically, it also helps us to secure a long-term sustainable future for Lenta.

Lenta maintains close contact with millions of customers as well as business representatives, and non-profit and governmental organisations on a daily basis. Many years of experience in the Russian market help us to not only understand the social needs of our customers and partners, but also to influence their position on current social issues.

Our approach to corporate social responsibility is therefore based around a deep understanding of local community needs in all of the regions where Lenta is present. Six pillars shape our approach to social responsibility and define our work in this field.

In 2016 we established goals within the context of each of our six pillars – these goals were primarily focused on further investment in the development of our employees, cooperation with local communities, partners and suppliers, supporting our 'value for money' proposition in our stores and further project implementation in the field of environmental protection.

## OUR PILLARS

### RECRUITING, TRAINING AND RETAINING GREAT STAFF

Read more on page 51

### PRICING AND CUSTOMER SATISFACTION

Read more on page 55

### LOCAL SOURCING

Read more on page 56

### CARING FOR THE ENVIRONMENT

Read more on page 58

### MAKING A POSITIVE CONTRIBUTION TO LOCAL COMMUNITIES

Read more on page 60

### PROMOTING HEALTH AND SAFETY

Read more on page 64

# Corporate social responsibility continued

## The Lenta Way

**The Lenta Way comprises a set of core principles which underpin our business and the way we operate. Alongside our ethics policy, they form the basis of our CSR approach and support our ambitions for long-term sustainable growth.**

### Customer satisfaction

We work every day to provide the best possible service for our customers, by constantly taking into account the products they want and the services they demand. Customer satisfaction is the key to our development and improvement.

### Providing customers with low prices every day

Lenta is the leader in terms of price. We have always been the price leader and we are committed to providing our customers with quality products at lower prices than the competition. We ensure that our costs are kept to a minimum so that we can pass savings on to our customers.

### Selling goods of only the highest quality

Our stores only stock fully licensed goods that have been handled under the most hygienic conditions.

### Our employees

We know that if we want to have satisfied customers, we must retain employees who are well trained and motivated.

### Maintaining the highest level of respect for everyone

We pride ourselves on respecting the opinions of our customers, suppliers and employees, encouraging positive criticism and friendly relations.

### Teamwork in everything we do

Only by everyone working together will we be able to satisfy our customers. By encouraging an open environment based on mutual trust, everyone can feel comfortable about asking for assistance from another employee and they can be confident that their voice will be heard.

### Innovation and the constant generation of new ideas

The key to our long-term survival is a continuous flow of innovative ideas. Many of these come from our own staff. We believe that in order to stay ahead of the competition we must continuously implement these new ideas.

## OUR ETHICS POLICY

The Company's Ethics Committee was set up in 2011 and our Ethics Policy forms the basis of the standards and rules applied to any situation. The Policy sets out the obligations of every employee to behave ethically and exhibit the high standards of behaviour we expect. These include:

- no improper payments to authorities or business partners;
- upholding the integrity and good name of the Company in developing long-term relationships with customers, communities and suppliers;
- strict prohibition against directly or indirectly offering, paying, soliciting or accepting bribes or kickbacks in any form;
- no conflicts between personal interests and those of the Company;
- abiding by Lenta's corporate rules and standards, which impose stricter ethical restrictions on employees than those provided in current legislation.

The Ethics Committee reviews complaints and non-compliance on a regular basis. Any instance of non-compliance with the Ethics Policy may lead to disciplinary action by the Company, including dismissal.

Customers, employees and suppliers can contact the Ethics Committee, either anonymously through the Lenta website and Company hotline – or via in-store information desks. In 2016, 475 calls were received via the Company Hotline; up slightly on 2015, indicating the increased level of trust in this method of reporting. Although the overall number of complaints rose, the average number per store decreased markedly.

The Committee's work is reviewed on a regular basis, both by the Audit Committee and by the Board. Ethics Committee reports on the Hotline were reviewed at four audit committee meetings during 2016.

# RECRUITING, TRAINING AND RETAINING GREAT STAFF

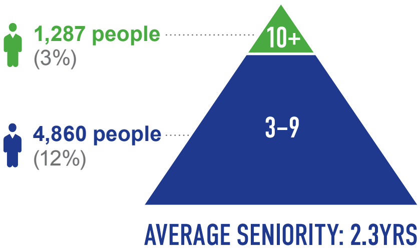
01

**Our people are the key to our long-term success and teamwork, innovation and trust lie at the heart of our culture. Recruiting and training enthusiastic, committed individuals with the right skills helps us provide great customer service.**

## Employee retention

Lenta has an above-average retention rate for the food retail sector; our staff turnover in 2016 fell by two percentage points to 26%, compared with 2015. We will continue to invest in our people, since it improves employee retention and increases productivity and service levels. Our programme of internal promotions and job rotations – combined with individual career plans and recognition initiatives – contributes to lower staff turnover. We also run a variety of employee engagement initiatives including in-store 'gamification' projects, sports events, New Year celebrations for employees' children and charitable activities – all of which contribute to the creation of a positive working environment and strong team spirit.

**Employee length of service**
Years




We also have an excellent retention record at managerial level, thanks to the challenging and innovative job content we provide, alongside development opportunities, competitive pay and a combination of short- and long-term reward programmes.

**Voluntary turnover of senior staff**
2014–16



## People development

We provide our people with a range of training programmes, based on their experience and knowledge. These cover all employee categories and serve our aim to prepare colleagues to facilitate Lenta's growth and advance their own careers.

## Management training

For a fast growing company such as Lenta, the role of our managers is key. Managers guarantee consistency of performance standards and create a strong organisational culture through their leadership style. We constantly need to develop new managers to support our expansion.

In 2016, our Lenta Leader programme underwent a complete overhaul and upgrade. We now have a 'mini-MBA'-style programme (Lenta Leader 2.0), designed in conjunction with the Higher School of Economics, one of Russia's leading universities. Customised to fit with Lenta's needs, the material for the programme was created with the active participation of experienced Lenta managers and built around actual Lenta business cases and reports.

> WE WILL CONTINUE TO INVEST IN OUR PEOPLE, SINCE IT IMPROVES EMPLOYEE RETENTION AND INCREASES PRODUCTIVITY AND SERVICE LEVELS.

# Corporate social responsibility continued


More than 100 store managers, heads of purchasing teams and regional operational managers graduated from the six-month course. During the training, each participant implemented a project using new methods to benefit his or her business unit. Many of these projects will be replicated across the business as examples of best practice. Lenta Leader 2.0 will continue to be an integral element of our management development for the future.

Managers can also participate in our Effective Management programme. During 2016, some 870 mostly store-based colleagues took part. This programme aims to develop managerial skills and covers aspects of management including goal-setting, planning, analysis and decision-making, creating effective teams and motivation. Run by in-house trainers, the programme benefits from the first-hand experience of Lenta store directors.

2016 also saw the roll-out of our performance management process for store and distribution centre employees. Over 3,100 line managers were trained by 27 internal experts in how to give effective and supportive feedback to their staff.

Three of our experienced managers graduated from external pre-MBA programmes and four managers are currently engaged on the UK Open University's MBA programme.

## Store and specialist staff training

Our primary training focus is naturally on our store employees, who are the face of Lenta for our customers. Every store runs a comprehensive induction programme, which includes orientation training explaining Lenta's values, history and structure as well as our policies and standards. We also hold classroom sessions and on-the-job training with dedicated mentors. In 2016, more than 15,300 employees participated in our orientation programme and some 14,000 people were trained as part of the performance management process roll-out.

In 2016, we delivered over 1,470,000 man-hours of training, with an average of 44.8 hours per person. This compares with an average of 30.6 hours per person in 2015. Almost 90% of our training uses internal resources, which enables us to keep costs down. This year, the cost of one learning hour was RUB 27 compared with RUB 30 in 2015. Remote courses have proved to be particularly effective – and in 2016 we increased the amount of remote training we provided by 500%. E-learning comprised some 6% of our total training in 2016.

## Recruitment and career development

At Lenta, there are numerous opportunities for employees to further their careers and fulfil their potential. We actively encourage the advancement of all of our staff, aiming to fill as many vacancies as possible from within. Many aspects of our recruitment process are centralised, including job posting, advertising, candidate attraction and phone interviews. The final stages of selection are however conducted in individual stores and distribution centres. We created around 11,000 new jobs in 2016, and a total of 19,000 employees were recruited into new roles.

### Developing our people

**Effective Management**


PARTICIPANTS

**Giving Feedback**


PARTICIPANTS

**Lenta Leader 2.0**




GRADUATES

Strategic report
Corporate governance
Financial statements
Appendices

## Training in hours

### Man-hours of training 2015

2016 1.47m (+63%)

2015 0.9m

### Average cost of training per hour

2016 RUB 27 (–9.5%)

2015 RUB 30

### Average training hours per employee

2016 45 (+46%)

2015 30.6

### Training

Internal training 83%

External training 11%

Internal e-learning 6%

During the year, three quarters of vacancies were filled by our own employees – and the same proportion of directors of newly-opened stores were also internal candidates. In all, some 3,100 individuals were promoted into new roles and over 11,000 employees benefited from horizontal moves within the organisation.

The speed of our recent growth necessitates constant attention on our hiring processes and protocols as well as a keen focus on succession planning. The best source of our future hypermarket and supermarket managers is our pool of 2,500 section managers, who now comprise a key target constituency for our HR strategy. In order to identify those with the desire and potential to progress, we ran a 'Grow with Lenta' Business Case Challenge for all section managers and their deputies in September 2016. Over 800 people originally registered – and thanks to the Challenge, we have significantly increased our talent pool with 120 capable and talented individuals identified as ready to take the next step on their Lenta career path.

**11,000**
new jobs created

### Remuneration

Lenta seeks to provide a range of attractive employment opportunities and careers. We offer competitive rates of pay, health benefits, uniforms and all necessary protective equipment. Our HR policy is aimed at rewarding high performers with high rewards. We measure 'performance' not only through business results, but also against our Company values and competencies model. To best evaluate the achievements of individuals and identify their future potential, we have a performance management process, which was extended to all employees in 2016. Performance evaluation is linked to pay, ensuring that the highest contributors obtain higher bonuses and pay increases where applicable.

In our stores, we continued to develop our compensation and benefits package to encourage both team results and reward individual effort. For example, we reshaped our store personnel compensation package during the year, reducing the number of individual KPIs in the monthly bonus base, and focusing more on group results such as store sales, productivity and profitability.

In line with a set of established principles, financial support is available for employees who find themselves in difficult circumstances. No mass material assistance was required in 2016, but help was provided where appropriate to colleagues on an individual basis.

# Corporate social responsibility continued

## DIVERSITY

At Lenta, we value diversity and we offer employment opportunities to all able candidates. In matters of recruitment or promotion, decisions are based purely around the professional knowledge and competence of the individual in question.

In every store, we provide a minimum of five job opportunities for people with special needs – and in each distribution centre we offer three of these positions. In 2015, 88 vacancies were filled by candidates from this group. Striving to provide even broader opportunities for people with special needs, we revised our policy to support recruitment and fair pay for people working from home. In cooperation with the St. Petersburg State Employment Fund, Lenta is helping to redesign training programmes specifically aimed at helping those who have difficulty securing employment.

### Overall gender split

- **Female** 72%
- **Male** 28%

### Middle and senior management

- **Female** 35%
- **Male** 65%

### Office employees

- **Female** 66%
- **Male** 34%

### Employee engagement

The links between employee engagement, business performance and customer satisfaction are strong, so we work hard to ensure our people remain up to date with Lenta's progress and plans. In 2016 we rolled out our 'gamification' initiative in 26 stores. This motivational project rewards employees with 'Lenta points' for demonstrating behaviours that support the Company's ethos. Points are exchanged for prizes ranging from T-shirts to household appliances and TVs. Staff achieving the greatest number of points are recognised for their contribution, with best practices and ideas shared between stores.

In October 2016, 37 employees represented Lenta in the annual Trade and Industry 'Best in Profession' awards held in St. Petersburg. Colleagues included 11 food shop assistants, four non-food shop assistants and 22 cashiers, two of whom took first and third places in their category.

In 2016 we held a conference in St. Petersburg for the Company's senior management. Delegates included directors of stores, and regional and divisional directors, as well as the management of our central office (approximately 500 participants). During this event senior management reviewed Lenta's progress over the previous year and set goals for the next one, while sharing the broader strategic outlook.

## LOOKING AHEAD

We know that working in a supportive and collaborative environment brings out the very best in our employees. In the year ahead we will continue to develop the ways in which we inspire, motivate and incentivise our people to deliver outstanding service to our customers.

# PRICING AND CUSTOMER SATISFACTION

## 02

**Our wide range of high quality products is competitively priced – and 'value for money' lies at the heart of our pricing proposition. We continued investing into end prices for our customers despite the difficult economic conditions, endeavouring to give them best value for money.**


We know that great service is also a key differentiator – and plays an important role in customer satisfaction – so our in-store employees are trained to actively engage with customers and deliver the very best customer care.

During 2016 we continued to roll out promotions that have historically proved popular with our customers, such as 'two for one' offers. In the ongoing difficult economic climate however, simple direct discounts continue to be the most sought after option for shoppers on tight budgets. We used information sourced from use of our Loyalty Card use to identify and create better promotions, based on sales data and customer metrics. These have led to increased sales and customer loyalty.

Lenta's Loyalty Card guarantees a discount of 5% on all purchases and went from strength to strength in 2016. Independent surveys during the year showed that the programme continued to be highly rated by our customers.

Also available in all our stores, the Lenta Social Card gives needy citizens an extra discount of between 3% and 8% on basic food and selected household items. At the year end there were over 1.7 million Lenta Social Card holders across Russia, 480,145 of whom joined the scheme in 2016, a 60% increase in the total number of Lenta Social Cardholders. In 2016 we launched our social programme in eight new cities where we have a presence.

The total discounts for participants in Lenta's social programme amounted to RUB 9.92 billion in 2016, meaning each customer saved an average of RUB 5,500 during the year.

### LOOKING AHEAD

We continue to look at ways to make the most of our customers' shopping budgets, through devising appealing promotions in popular ranges and investing in pricing to deliver best value. Our uniquely detailed insight into customer shopping patterns enables us to provide more of what they want, when they want it – and at affordable prices.

# Corporate social responsibility continued

## LOCAL SOURCING

03

STRENGTHENING OUR RELATIONSHIPS WITH LOCAL SUPPLIERS WAS A KEY FOCUS FOR US IN 2016 AND SUCH ALLIANCES BRING MUTUAL BENEFITS TO LENTA AND PRODUCERS ALIKE.

**Sourcing products locally is a distinguishing feature of Lenta's strategy – and one that is valued by our customers. In 2016 95% of our products were sourced from Russian suppliers, including almost 20% sourced from regional suppliers. 46% of our fresh food was locally purchased.**

Strengthening our relationships with local suppliers was a key focus for us in 2016 and such alliances bring mutual benefits to Lenta and producers alike. Avoiding intermediaries and dealing directly with producers enables us to negotiate better prices. Our customers appreciate the consistent quality and freshness of locally grown produce and the shorter distances to our stores mean lead times and logistics costs – such as fuel consumption – are reduced.

We know which farmers grow which products for us. Local provenance and traceability mean we can demonstrate transparency through the supply chain. Every product we sell must also meet the necessary consumer information requirements and comply with the relevant safety, quality and packaging standards.

In 2015, we stocked four dairy farmers' brands in our St. Petersburg stores: Molochnaya Ferma, Stolypinskaya Ferma, SPBFERMA and Losevo. In 2016 we expanded the presence of these brands to the majority of stores in the city and also added two more: Zhivoe Moloko and Kolomenskoe Moloko. We also introduced a separate zone for farm produce in stores, total sales of which grew by almost 200% in 2016 compared with the previous year. We commenced local purchasing of an extensive range of fresh fruit and vegetables in the North-West Federal District, Moscow, Volga, South, Ural and Siberia regions.



### HIGHLIGHTING QUALITY

We continued working to improve the quality of goods supplied to Lenta stores. During the year we supported the St. Petersburg Government's 'Petersburg Quality Mark' project, a system of voluntary certification. Products are labelled with a PQM mark when they have been tested in the 'Petersburg Expertisa' quality control laboratory, which confirms the description of the goods on the package matches its content and quality. We marked our price labels to draw customers' attention to these products, placed PQM signs at store entrances and produced an audio advertisement to promote the scheme.

In 2016 Lenta held events with potential local suppliers in Cheboksary, Balakovo, Kazan, Ekaterinburg and Stavropol. We also assembled our key suppliers and producers from all over Russia in St. Petersburg at the Lenta Partnership Forum in April 2016. At the Forum over 400 participants discussed opportunities for further cooperation and growth.

The number of internal quality audits conducted in 2016 rose by 80% compared with 2015, with each store reviewed on a quarterly basis. During the year the system of self-assessment was developed and implemented in every Lenta store.

We also conducted regular quality audits of our suppliers, with a particular focus on improvements in the quality of fruit and vegetables, directly imported goods and products sourced from local suppliers. We conducted more than 4,800 laboratory tests of suppliers' goods, an increase of 50% on 2015. Twenty potential suppliers failed our audit and are consequently unable to sell their goods through Lenta.

We operate according to the requirements of the HACCP food safety system. This internationally recognised method is regularly updated in line with the growth of our business and any changes in State regulations.

In 2016, we held a series of educational meetings in conjunction with the European Bank for Reconstruction and Development with 20 local suppliers from the South, Ural and Siberian regions. The aim was to support small business development, improve the quality of their products and implement the HACCP system.

## LOOKING AHEAD

We know that our customers appreciate the growing variety and high quality of locally sourced products on our shelves. This element of our strategy is a key differentiator for Lenta; it sets us apart from the competition and will continue to be an area of focus in the years ahead as we forge new relationships with suppliers and provide ongoing support to our local and regional economies.

**4,800**

laboratory tests of suppliers' goods conducted

# Corporate social responsibility continued

## CARING FOR THE ENVIRONMENT

04

**At Lenta, we are committed to reducing our impact on the environment to a minimum, whether caused by our use of materials, energy, transportation or waste disposal. We aim to comply with all relevant legislation relating to our operations – and we work closely with local authorities and communities when planning new store sites. We comply with the environmental standards applicable to us under Russian law and regulations.**

In 2016, we initiated around 100 projects complete with all the relevant documentation for waste disposal and emissions in line with legislation.

### Waste

We produce a variety of waste, which is removed for us by third-party contractors. During 2016 we reduced the amount we produced and continued to improve our recycling rates. We launched a pilot project in St. Petersburg for the centralised collection of secondary raw materials for recycling (card, polyethylene and plastic boxes). The project's aim is to increase recycling rates by improving the sorting method and decreasing the overall quantity of waste. We plan to roll the scheme out across all of the Company's stores.

Over
**25,000**
fluorescent lamps disposed of

### Waste removal/recycling in 2016

| Secondary raw material type | The amount removed/recycled, tonnes<br>Hypermarket (HM) | The amount removed/recycled, tonnes<br>Supermarket (SM) | The amount removed/recycled, tonnes<br>HM+SM | Number of hypermarkets | Number of supermarkets |
|---|---|---|---|---|---|
| Cardboard, paper boxes | 51,002 | 2,730 | 53,732 | | |
| Plastic wrap | 3,309 | 117 | 3,426 | 169 | 48 |
| Plastic | 677 | 48 | 725 | | |

## Energy

During the year we disposed of more than 25,000 fluorescent lamps, which contained mercury vapour. Demercurisation of the lamps was performed by a certified contractor. In total, more than 6.25 kg of mercury was removed from our premises, to be replaced by LED lighting. To date, 91 of our stores have LED lighting. In the coming year we plan to replace the fluorescent lighting in a further 59 stores, requiring an investment of RUB 625 million out of a planned total of RUB 906 million.

We continued to extend our use of eco-efficient refrigerants such as $CO_2$ and R134a GWP. We also began to introduce energy saving glass sliding modules for low temperature fridges, which deliver an energy reduction of 40% due to the reduced frequency of defrosts and reduced load on compressors. To date, some 44 stores have glass modules installed.


### ECO-BOXES

At the end of the year we installed eco-boxes for the safe collection and temporary storage of used batteries in 20 hypermarkets in St. Petersburg. The initiative was implemented in conjunction with the Natural Resource Management Committee of the Government of St. Petersburg. This was the first project under the banner of our new 'Green Lenta' programme, which unifies all our ecological initiatives under one brand.

### LOOKING AHEAD

Our approach to our environmental activities is one of ongoing improvement. We continue to drive our recycling efforts and energy efficiency initiatives. In 2017 we plan to build new sewage treatment plants in 15 stores, with an estimated investment of RUB 90 million.

| | Total trading space, sq.m HM | Total trading space, sq.m SM | Total trading space, sq.m HM+SM | Kg/sq.m HM | Kg/sq.m HM+SM |
|---|---|---|---|---|---|
| | | | | 50.89 | 51.31 |
| | 1,002,274 | 45,000 | 1,047,274 | 3.3 | 3.27 |
| | | | | 0.68 | 0.69 |

**53,732 TONNES OF CARDBOARD = 36,000 PINE TREES SAVED**

# Corporate social responsibility continued

## MAKING A POSITIVE CONTRIBUTION TO LOCAL COMMUNITIES

05

**Lenta traditionally plays an active role in the communities where our stores are located, in keeping with our reputation as a socially responsible company. Each new hypermarket we open has a significant impact on regional economics in terms of developing local territories, reducing food prices, supporting local suppliers, generating 250 new jobs and growing human capital through training and development. Every new store means new taxes for the region's budget and salaries for its citizens.**

In 2016, a wide range of customer groups continued to be a focus for Lenta's community activities and we also undertook various locally based waste management initiatives.

The Company acts systematically, building long-term relationships with regional administrations. We have agreements on social and economic cooperation with authorities in Kemerovo Region, Tomsk Region, Volgograd Region, Republic of Karelia, Saratov Region and Rostov Region. The latter three were initiated in 2016. These alliances help Lenta to improve the quality of its retail operations and strengthen its cooperation with local government to provide coordinated support to people in need.

Our customers also appreciate our proactive, responsible approach. In 2016 we won several prestigious awards and continued our support of socially vulnerable groups, as well as the disabled, veterans, orphans and those on low incomes.

### LOOKING AHEAD

At Lenta, being a good neighbour is part of who we are. The year ahead will see us redouble our efforts to engage with and support those who live and work close to our stores. Our future plans include the federal roll-out of some of our successful regional charitable and environmental projects, extending their benefits to many more communities. We will also develop new educational programmes for our customers, including children and socially vulnerable groups.

### LENTA WINS

**Winner of 'We choose, we are chosen' in Vologda**
Lenta was acknowledged as the best federal retail chain in this competition, which was organised by the regional administration. Determined by public vote, over 70,000 people took part.

**Winner of 'Best Trade, Catering and Public Services Enterprises' in Novosibirsk**
Lenta won the Hypermarket category, with criteria including service development, technical equipment, staff professionalism and provision of benefits to socially vulnerable people. Lenta has had a presence in Novosibirsk for ten years, has links with over 100 local suppliers and provides employment for over 1,700 people in the city.

We remain fully committed to supporting community and environmental initiatives in cities where we have a presence, including festivals, competitions, charity events and educational projects. Some of these annual events have now become traditional for Lenta and local communities.

## LENTA EVENTS



### Victory Day

Lenta presented baskets of products to veterans on Victory Day in numerous Russian cities.

### Festivities and New Year Celebration in Tomsk

Since 2015 we have supported the 'Day of Tomsk Citizen' celebrations through the 'Delicious and Local' gastronomic festival of local produce.

Since 2015 we have supported the official 'New Year Tomsk' celebrations and the popular 'Crystal Tomsk' ice sculpture festival. Our long-term cooperation with the Tomsk Administration was recognised in 2016 as Lenta received the 'Philanthropist of the Year' medal from the City's Mayor.

## KAZAN CITY RACING

For the third year running, Lenta sponsored the prestigious Kazan City Racing car show. Some 30,000 visitors attended the 2016 event in the city's central square, which featured over 30 Russian and international racing drivers. A highlight of the event was a safe driving project: the 'Safe Wheel School', which teaches safe driving skills to young people at a special site. This year's Safe Wheel School was attended by over 300 youngsters.


# Corporate social responsibility continued



**Baby competition in Novosibirsk and Krasnoyarsk**
In conjunction with Komsomolskaya Pravda newspaper and the city administration, Lenta supports an annual sports event for small children.

## TULIPS FOR ST. PETERSBURG

For the fourth year running, Lenta presented a gift of tulip bulbs to the city of St. Petersburg. The Tulip Festival is now an established highlight of the city's year. Since its inception in 2013, the cultivated area has doubled in size, as has the number of bulb varieties.

In 2016, approximately 130,000 bulbs of 95 varieties bloomed in the park. Almost all of these were presented by Lenta, including 11 rare varieties from the 18th and 19th centuries, which can usually only be found in plant breeders' collections. In 2016, the Tulip Festival was attended by some 100,000 citizens and visitors. In the autumn the bulbs were replanted ready for the spring of 2017.

**130,000**
tulips bloomed

### Charity New Year project in North West Region

Lenta's 'Christmas Tree of Wishes' event took place in all 32 Lenta hypermarkets in nine cities of the North West Region. The trees held cards with the gift wishes of over 1,500 children from over 40 regional orphanages. Our customers picked a wish from the tree and bought the present on the card.

### Store tours and masterclasses

We regularly arrange tours and culinary masterclasses for children. Accompanied by their parents or teachers they tour a hypermarket and a production facility, where bakery specialists demonstrate the basics of pastry preparation.
In 2016 several of these events took place in Vologda for children from Kindergarten No 12 Romashka and the Harmony Children's Centre.

## CHARITY PROJECT WITH MARS

In conjunction with the Mars Company, we arranged the 'Give a Smile to Animals from Shelter' charity event in hypermarkets in Moscow and St. Petersburg in October. When buying cat or dog food, 1% of the purchase price was donated to the shelter for homeless animals. We also provided special boxes for pet food collection, with the donated food being sent to the 'Big Hearts' charity fund for distribution to animal shelters.


**1%**

of the purchase price was donated to the shelter for homeless animals

# Corporate social responsibility continued

## PROMOTING HEALTH AND SAFETY

06

**We remain wholeheartedly committed to creating and maintaining a safe environment for our employees and customers.**

As part of our Active Safety programme, store managers conduct daily and monthly 'safety walks' to identify any potential risks to staff and customers, ensure the staff's hazard awareness and check safety equipment. We continued the roll-out of the programme across the Company in 2016. Employees are encouraged to report every incident, no matter how small, so that the cause can be identified and any recurrence prevented.

In 2016, risk checks were carried out in a total of 128 stores and distribution centres, 35 of which were being checked for the second time since the programme roll-out. Results of the checks were included in each store's (or distribution centre's) annual targets.

**128**

risk checks carried out in stores and distribution centres

The injury rate fell by 1% compared to 2015, and working time lost due to injuries represented 0.05% of total hours worked.

**Number of injuries per 100,000 hrs worked**


**2016** (-1%) **2015**

### LOOKING AHEAD

In the year ahead we will:

- promote Active Safety across the Company;
- develop a 'Quality Cluster' for our supermarkets, comprising updated requirements, as well as enhanced cooperation and lines of communication around quality issues; and
- introduce a new integrated complaints and quality management system for our private label goods.

# OUR GOALS FOR 2017

## Our goals for 2017

In addition to our ongoing CSR programmes, we are focusing closely on a specific set of goals for 2017:

1. We will continue to invest in our value-for-money proposition to provide the best offers for our customers.
2. We will expand our social programmes aimed at vulnerable citizens. Alongside our own initiatives, we are open to cooperation with suppliers and other partners to achieve this.
3. We will develop partnerships with local government to strengthen social and economic cooperation.
4. We will further increase local sourcing opportunities for suppliers in a range of industries.
5. We will pursue the development of programmes in environmental care and social activities.
6. We are committed to continued investment in the training and development of our employees to ensure that they are best-in-class in the retail sector.
7. We will work with our suppliers to ensure their commitment to quality and safety aligns with our own.
8. We will look to actively increase employee involvement in working towards all of our CSR goals.

# CORPORATE GOVERNANCE

67 Introduction from the Chairman
68 Board of Directors
70 Senior Management team
72 Our corporate governance framework
77 Board Committees
90 Relations with shareholders
90 Responsibility statement

# Introduction from the Chairman

**John Oliver**
Chairman

## Dear Shareholders

We are committed to showing that Lenta operates with the highest levels of integrity and transparency – and I am therefore pleased to present this overview of Lenta's corporate governance framework. As Chairman, one of my principal responsibilities is the oversight and promotion of good governance. How we conduct ourselves affects all aspects of our business – and is an essential component in our ongoing success and sustainability.

2016 was a milestone year for Lenta. Ahead of schedule, we achieved our objective set three years ago at IPO, of doubling our total selling space. Throughout the period since our IPO, including again in 2016, we have also made significant progress in our pursuit of the highest standards of governance.

### Towards best practice

We are not required to comply with the UK Corporate Governance Code ('the Code'). However, we believe that following the Code's provisions – so far as is appropriate and practicable – is in the best interests of all our stakeholders. We reviewed our governance framework last year. Following this exercise, we implemented a series of new systems and processes, with the aim of moving us closer to becoming a 'best practice' model in corporate governance terms for a Russian operating company.

### Objectives and responsibilities

The main objective of the Board is to ensure the long-term success of the Company and ensure sustained returns for its shareholders. This includes the setting of strategic goals, overseeing our financial and human resource structures, reviewing management performance and determining the Company's risk appetite. The Board sets the 'tone at the top', helping to establish the management culture of the Company.

The Company is exposed to a variety of financial, operational and compliance risks. It is the Board's responsibility to ensure that the Company's risk management measures, internal controls and compliance functions are appropriate and effective. Oversight of the Company's risk management framework is delegated to the Audit Committee.

### Relations with shareholders

Shareholder engagement is an essential aspect of good corporate governance. Throughout the year, the CEO, CFO and I, supported by the Company's investor relations team, and where appropriate, other members of the Board and Senior Management, regularly met with institutional shareholders and sell-side analysts. The Board also receives regular reports from the Head of Investor Relations on the team's activities – and in particular on shareholder sentiment and feedback.

Lenta's corporate governance framework combines leadership with collaboration and lies at the heart of our robust decision-making process. As a Board, we are responsible to our shareholders. We are also driven by our advisory role to complement and support the executive team as it implements our strategy. Certain responsibilities are delegated to four principal Board Committees – Audit, Remuneration, Nomination and Capital Expenditure. Details of their roles, responsibilities and activities during the year is set out in their respective sections.

### Looking forward

The macroeconomic situation in Russia continues to present us – and our customers – with fresh challenges. It affects the choices people make and the way they shop. Even if conditions remain difficult, we will continue to drive improvements in Lenta's performance in 2017.

Our results for 2016 demonstrate our ability to achieve ambitious targets and deliver excellent results. As we start to implement the next phase of our long-term strategy, the leadership team knows it can count on the Board's continued support. I remain confident that we have all the necessary skills to continue to build on our success.

**John Oliver**
Chairman

# Board of Directors

**The Board believes that it has the necessary skills and experience to provide effective leadership and control of the Company. When recommending the Directors for appointment, the Nomination Committee ensured that there was an appropriate balance of skills, experience and backgrounds relevant to the success of the Company.**

## John Oliver (58)
Chairman

John Oliver was appointed a non-executive Director of the Company in October 2009 and has been Chairman of the Board since 2011.

**Board Committees**
Nomination, Remuneration, Capital Expenditure

**Experience**
John is a former TPG partner and led TPG's European Operating Group until December 2013. Prior to joining TPG in 2006, John spent 15 years with General Electric. His roles at GE included CEO of GE Equipment Services Europe, a diverse portfolio of businesses operating in 20 countries, and CEO of GE IT Solutions Europe, an IT infrastructure and services provider, which was turned around and sold under his leadership. Prior to this, he held various roles at GE Medical Systems including GM EMEA Services, VP Global Radiation Therapy and VP Global Vascular Systems. He started his career in 1981 with Schlumberger oilfield services, holding various technical and country general management roles in Africa and Asia-Pacific, then worked for Boston Consulting Group before joining GE.

**Other roles**
Senior Advisor to TPG. Advisor to Vita Group.

**Qualifications**
John graduated with a BSc in Chemical Engineering from Imperial College in 1981, and with an MBA from INSEAD in 1987.

## Jan Dunning (57)
Chief Executive Officer (CEO)

Jan Dunning joined Lenta as CEO in 2009 and was appointed a Director of Lenta Ltd in 2013.

**Experience**
Prior to joining Lenta, Jan was Operations Director of Metro Cash & Carry Russia and then General Manager of Metro Cash & Carry Ukraine. During his six years with Metro in Russia, the business expanded from four to 48 stores. Jan's previous experience also includes three years as General Manager of the Lukas Klamer wholesale business, a subsidiary of the Metro Group in the Netherlands, and over ten years with Aldi North. Over the last 27 years, he has worked in a broad range of retail functions including leadership roles in operations, development, sales, marketing, purchasing and finance.

**Qualifications**
Jan has a History degree from the University of Groningen and an Economics degree from the University of Amsterdam. He also attended management development programmes at INSEAD and the London Business School.

## Jago Lemmens (48)
Chief Financial Officer (CFO)

Jago Lemmens joined Lenta in 2010 as Accounting and Reporting Director, becoming CFO in 2011. He was appointed a Director of Lenta Ltd in 2013.

**Experience**
Prior to joining Lenta, Jago served as Finance Director of OBI Ukraine and, before this, as Finance Director of Metro Cash & Carry Ukraine. During his 26 years in the retail industry, he has held senior positions in finance, accounting and controlling with several major retailers in the Netherlands, including Makro and Lukas Klamer (both part of Metro Cash & Carry) and Vomar.

**Qualifications**
Jago holds a degree in Finance and Auditing from the VU University Amsterdam and completed postgraduate courses in Auditing and Financial Management at the University of Amsterdam. He is a member of the Association of Chartered Auditors and the Association of Registered Controllers, both in the Netherlands.

## Michael Lynch-Bell (63)
Director

Michael Lynch-Bell was appointed an independent non-executive Director of Lenta Ltd in 2013.

**Board Committees**
Audit (Chairman), Nomination, Remuneration

**Experience**
Michael retired from Ernst & Young as Senior Partner in 2012 after a 38-year career with the firm. He was a member of Ernst & Young's audit practice from 1974 to 1997, becoming a partner in 1985. During this period, as well as supervising and being involved in the audit of a number of multinational groups, he advised a wide range of companies on systems and controls, corporate governance, risk management and accounting issues. In 1997, Michael moved to Ernst & Young's Transaction Advisory practice, where he founded and led its UK IPO and Global Natural Resources transaction teams. He has been involved with the CIS since 1991 and has advised many CIS companies on fundraising, reorganisations, transactions, corporate governance and IPOs.

**Other roles**
Michael is also Senior Independent Director and Audit Committee Chairman of Kaz Minerals Plc, a non-executive Director and Audit Committee Chairman of Gem Diamonds Limited, a non-executive Director and Audit Committee Chairman at Seven Energy Ltd and a non-executive Director of Barloworld Limited. He is also active with the charities ActionAid International and 21st Century Legacy.

**Qualifications**
Michael graduated from Sheffield University with a BA in Economics and Accounting in 1974, qualified as an English Chartered Accountant in 1977, and was awarded an Honorary Doctorate of Humane Letters by Schiller International University in 2006.

## Stephen Johnson (53)
Senior Independent Director

Stephen Johnson has been an independent non-executive Director of Lenta Ltd since 2010. He was appointed as Lenta's Senior Independent Director in 2013.

**Board Committees**
Nomination (Chairman), Remuneration (Chairman), Audit, Capital Expenditure

### Experience
Stephen has over 20 years' experience in the retail industry, having been part of the team that turned around and successfully sold Asda to Walmart. Whilst at Asda, Stephen held several senior positions including Trading Director, Commercial Finance Director and Marketing Director. Following his time at Asda, he was CEO of Focus DIY Ltd and of Woolworths Plc, as well as Sales & Marketing Director at GUS Plc. He started his career in management consultancy with Bain & Co.

### Other roles
Stephen has been a non-executive Director of Big Yellow Group Plc since 2010, Chairman of Pocketwatch Bidco Limited since 2015 and Chairman of Poundworld Retail Limited since 2015. He also works with a number of private equity firms primarily focused on Southern and Eastern Europe.

### Qualifications
Stephen graduated from Cambridge University with an Engineering degree.

## Stephen Peel (50)
Director

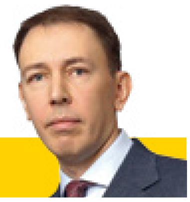
Stephen Peel has been a non-executive Director of Lenta Ltd since 2011.

### Experience
Stephen is the founder of SMP Policy Innovation, a not for profit organisation focused on promoting better public policy. He is also a visiting fellow at the Blavatnik School of Government at the University of Oxford. Prior to this, he spent some 27 years in finance and private equity. From 1989 to 1997 Stephen was in the corporate finance and principal investment areas at Goldman Sachs. From 1997 to 2014, he was a Managing Partner at TPG Capital initially founding and leading its European office and latterly leading its Asian business based in Hong Kong.

### Other roles
Stephen is Chairman of the Advisory Board of Open Contracting Partnership, is a member of the Trilateral Commission and serves on the boards of Global Witness, the Institute of State Effectiveness, The Jackson Institute of Global Affairs at Yale University and the Global Partners Council of the Institute of New Economic thinking.

### Qualifications
Stephen graduated from the University of Cambridge, Downing College with an MA in 1987 and received a Masters of Advanced Studies from Yale University in 2015.

## Dmitry Shvets (44)
Director



Dmitry Shvets was appointed a non-executive Director of Lenta Ltd in 2009.

### Board Committees
Capital Expenditure (Chairman), Nomination, Remuneration

### Experience
Prior to joining TPG Capital in 2008, Dmitry was Operating Director in the mining and metallurgical company Norilsk Nickel, where he was in charge of optimisation of the company's key production assets and was also responsible for the integration of newly acquired assets. From 1998 to 2004 Dmitry worked for McKinsey & Company, where he led projects in industries including consumer goods, retail, transportation, metals and mining, and oil extraction in the areas of strategy, organisation and operational effectiveness. He also worked for the Coca-Cola Company in various marketing roles.

### Other roles
Dmitry is the Head of TPG Capital Russia and is a Director at Fesco Transportation Group.

### Qualifications
Dmitry holds an MBA from Emory University and graduated with honours from the Moscow State Institute of International Relations ('MGIMO').

## Martin Elling (63)
Director

Martin Elling joined Lenta Ltd as a non-executive Director in 2011.

### Board Committees
Capital Expenditure

### Experience
Martin started his career with the UN Food and Agriculture Organization where he worked for 11 years as a financial analyst and economist mostly on World Bank agribusiness and infrastructure. He then joined the European Bank for Reconstruction and Development ('EBRD'), where he was responsible for agribusiness, financial services and energy investments in Ukraine, Romania and Russia. In 1997, Martin left the EBRD to concentrate on investment opportunities in agribusiness, leasing and B2B services in Ukraine and Russia, achieving two successful exits in Ukraine and one in Russia.

### Other roles
Martin advises a number of companies on restructuring and corporate governance. He also occasionally advises the African Parks Foundation on the operational strategy of individual national parks.

### Qualifications
Martin holds an Economics degree from the University of Amsterdam and a postgraduate degree from the University of Wageningen.

## Anton Artemyev (56)
Director

Anton Artemyev was appointed an independent non-executive Director of Lenta Ltd in 2013.

### Board Committees
Audit, Nomination, Remuneration

### Experience
Anton has extensive FMCG experience in Russia and Eastern Europe including 12 years in the brewing industry, where his roles included Executive Vice-President of Baltic Beverages Holding, the largest Eastern European brewing group at the time; President of Baltika Breweries; and Senior Vice-President responsible for Eastern Europe and a Member of the Executive Committee of Carlsberg Group. Prior to this Anton worked in a variety of consulting roles including Partner in Bossard Consultants and Principal in Gemini Consulting/CAP Gemini, where as head of Russian operations he focused on strategy work in various sectors, primarily consumer goods.

### Other roles
Anton is currently Chairman of Fortrent OY, which provides construction equipment rental services in Russia and Ukraine. Fortrent is a 50/50 joint venture between Cramo and Ramirent, who are among the European leaders in this field. He is a member of the Board of Directors of HTT BWH OY, which is a Finnish private subsidiary of another company, Hartwall Capital OY, which has an interest in the Russian wine industry.

### Qualifications
Anton holds a Diploma with honours and a Doctorate in Geography from Leningrad State University. He also studied Management and Economics at Bocconi University and at Henley Management College.

There were no changes to the Board in 2016.

# Senior Management team

**Under the chairmanship of the CEO, our highly skilled Senior Management team implements the strategies set by the Board. With a breadth of experience across the food retail sector, both on the domestic and international front, their leadership is vital to the success of Lenta's day-to-day operations.**

### Jan Dunning (57)
Chief Executive Officer (CEO)

Jan Dunning joined Lenta as CEO in 2009 and was appointed a Director of Lenta Ltd in 2013. Jan's biography appears on page 68 of this report.

### Jago Lemmens (48)
Chief Financial Officer (CFO)

Jago Lemmens joined Lenta in 2010 as Accounting and Reporting Director, becoming CFO in 2011. He was appointed a Director of Lenta Ltd in 2013. Jago's biography appears on page 68 of this report.

### Edward Doeffinger (60)
Chief Operational Officer (COO)

Edward Doeffinger joined Lenta in 2011 as Chief Operational Officer.

**Experience**
Prior to joining Lenta, Edward served as Deputy General Director of Metro Cash & Carry Kazakhstan. Before starting his career in 1991 at Metro Cash & Carry (Germany), Edward held several positions in wholesale companies and worked as Head of the dry food department at the Trade Ministry of the German Democratic Republic. During his more than 30 years' experience in the retail industry he has held senior positions in various countries. In 1994 he obtained his first assignment outside Germany as a board advisor to Metro Cash & Carry in Hungary. After a year in Hungary, Edward became a member of the Metro Jinjiang team (China) and worked as a Store General Director and later as Head of Store Development for several years in China before moving to Russia in 2001. In Russia Edward was responsible for the business operations of Metro Cash & Carry in the Privolzhsky, Ural and Siberian regions. He was also responsible for the Metro Cash & Carry Kazakhstan business operations as a Deputy CEO.

**Qualifications**
Edward has a degree in Economics from the Hochschule fuer Oekonomie Berlin.

### Anna Meleshina (39)
Public Relations and Government Affairs Director

Anna Meleshina joined Lenta in 2013 as Public Relations and Government Affairs Director.

**Experience**
Prior to joining Lenta, Anna served as Corporate Relations Director for Heineken in Russia and served as a member of the global corporate relations leadership team. In addition to her 13-year career in the brewing sector, Anna has held senior positions in non-commercial organisations, including an advisory role at the Honorary Consul of Iceland in St. Petersburg, and as a board member and Deputy Chairman of the Russian Breweries' Association.

**Qualifications**
Anna graduated from the Scandinavian linguistics faculty of the St. Petersburg State University with a diploma cum laude. She also holds an MBA from Henley Management College in the UK.

### Herman Tinga (59)
Commercial Director

Herman Tinga joined Lenta in 2013 as Commercial Director.

**Experience**
Prior to joining Lenta, Herman served as Non-Food Global Category Management & Sourcing Director at Metro AG. With a background in marketing, category management, buying and merchandising, Herman has extensive experience as a senior manager and board member in retail and cash & carry spanning 34 years. For four years, Herman was a board member of Metro Cash & Carry in Russia.

**Qualifications**
Herman has a bachelor's degree from the Netherlands Institute of Marketing.

Strategic report
Corporate governance
Financial statements
Appendices

**Tatiana Yurkevich (44)**
HR Director

Tatiana Yurkevich joined Lenta in 2012 as Human Resources Director.

**Experience**
Prior to joining Lenta, Tatiana served as Human Resources Director at Fazer Bakeries & Confectionery, Russia. During her 18 years in HR management, she has held senior positions in HR including Head of HR at United Heavy Machinery Group and Izhora Plants, and HR Director of Caterpillar European Fabrications and Caterpillar Tosno. Tatiana has experience in leading Six Sigma Program implementation as a Deployment Champion in Caterpillar.

**Qualifications**
Tatiana has a master's degree in International Economics from St. Petersburg State University as well as English and German language degrees from Novosibirsk State Pedagogical University.

**Sergey Prokofiev (48)**
Legal Director

Sergey Prokofiev joined Lenta as Legal and Government Relations Director in 2012.

**Experience**
Prior to joining Lenta, Sergey worked for Metro Cash & Carry for 11 years in different positions including Legal and Compliance Director. He started his career as expert-interpreter and later worked as a lawyer in a major Russian law firm and as a defending attorney at the Moscow City Bar.

**Qualifications**
Sergey graduated from the Military Institute of Foreign Languages ('VKIMO') and the Institute of Law. He holds a PhD in Law from the Institute of Legislation and Comparative Law under the Government of the Russian Federation and an MBA in Strategic Management from California State University.

**Joern Arnhold (46)**
Supply Chain Director

Joern Arnhold joined Lenta in 2011 as Supply Chain Director.

**Experience**
Prior to joining Lenta, Joern had 13 years' experience with Metro Group Logistics ('MGL') where he held various key positions in Germany, Turkey and Russia. As Managing Director of MGL in Russia, Joern was responsible for developing and running logistics operations for the Metro Group sales divisions in Russia.

**Qualifications**
Joern holds a degree in Business Administration from the Georg August University Goettingen.

**Maxim Shchegolev (50)**
Integration and Format Development Director

Maxim Shchegolev joined Lenta in 2012 as Integration and Format Development Director.

**Experience**
Prior to joining Lenta, Maxim held a number of executive positions with O'KEY Group. During his 17 years' experience in the retail industry, Maxim has held a variety of senior positions in business development. In 2008 he was appointed Director of Expansion for O'KEY and was responsible for various aspects of business development, including expert assessment of the competitive environment, and the purchase and lease of real estate for the construction of stores. In 2012, he took a similar position with Lenta. He is responsible for finding and acquiring plots of land, managing the construction and redevelopment of shopping centres, letting out premises owned by the Company, and the development of new stores in leased premises.

**Qualifications**
Maxim graduated from St. Petersburg University of Economics and Finance, the Russian-Dutch School of Marketing and the Higher School of the Ministry of Economic Development and Trade of the Russian Federation.

# Corporate governance

## OUR CORPORATE GOVERNANCE FRAMEWORK

### Compliance with UK Corporate Governance Code

The UK Corporate Governance Code ('the Code') sets out principles and specific provisions on how a company should be directed and controlled to achieve good standards of corporate governance. As a company incorporated in the British Virgin Islands ('BVI') with GDRs admitted to the Official List, we are not required to comply with the provisions of the Code. However, we have chosen to comply with the Code to an appropriate and practicable extent.

As of the date of this report, the Board considers that Lenta fully complies in all material respects with the Code, with the exception of the following provisions:

- the Chairman of the Board was not independent on his appointment;
- there is not a majority of independent directors on the Board;
- the whole Board is available to attend the AGM but it is not a requirement that each member attends;
- the Company commenced implementation of a revised risk management process during the year following a review assisted by external consultants. The process of implementation will be completed during 2017.

The Board does not consider that the above areas of non-compliance expose the Company to any additional risks.

While BVI law imposes certain general duties on company directors (including the duty to act in the best interests of the company), there is no specific corporate governance code or corporate governance regime in the BVI.

### Leadership

The Chairman leads the Board, ensuring its effectiveness while taking account of the interest of the Group's various stakeholders and promoting high standards of corporate governance. There is a clear distinction between the role of Chairman and CEO. Updated descriptions of the roles were agreed by the Board in 2016 and are summarised as follows:

The Chairman's responsibilities include:

- ensuring the Directors receive accurate, timely and clear information;
- facilitating the effective contribution of non-executive Directors and engagement between executive and non-executive Directors;
- building an effective Board;
- the induction of new Directors and further training for all Directors as required;
- communicating effectively with shareholders and other stakeholders and ensuring the Board develops an understanding of the view of stakeholders;
- ensuring an annual evaluation of the Board is conducted and leading the performance evaluation of the CEO and non-executive Directors.

The Chairman holds one-to-one and group meetings with the non-executive Directors – without the executive Directors being present – four times a year. The Chairman was not independent upon his appointment to the Board since, at that time, he was a partner in TPG Capital, one of the Company's major shareholders.

The CEO's responsibilities include:

- leading the development of the Company's strategic direction and implementing the agreed strategy;
- identifying and executing new business opportunities;
- managing the Group's risk profile and implementing and maintaining an effective framework of internal controls;
- building and maintaining an effective management team;
- ensuring effective communication with shareholders and regularly updating institutional shareholders on business strategy and performance.

Stephen Johnson was the Senior Independent Director ('SID') throughout the year ending 31 December 2016. He was selected for the role because of his experience and expertise, both as an executive and non-executive Director with retail and international experience. The key roles and responsibilities of the SID include the following:

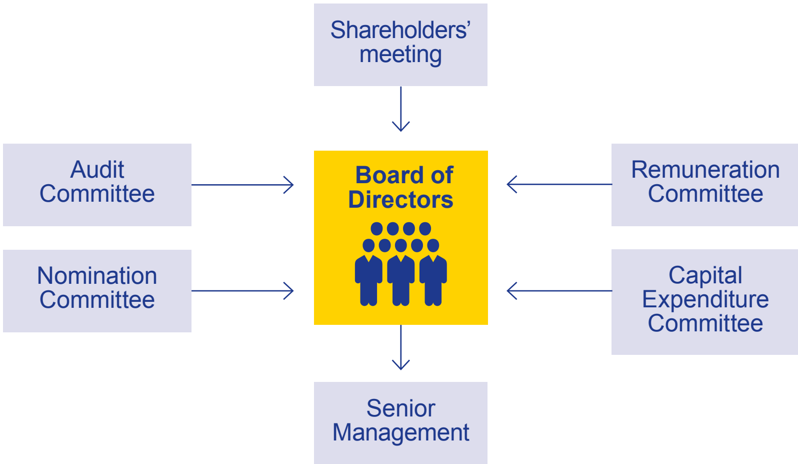
- acting as a sounding board for the Chairman;
- serving as an intermediary for the other Directors when necessary;
- being available to assist in resolving shareholder concerns, should alternative channels be exhausted;
- holding at least one meeting each year with the non-executive Directors without the Chairman present;
- monitoring the training and development requirements of Directors;
- overseeing the Chairman's appraisal and succession, and
- ensuring that Committee chairmen conduct performance evaluations of their Committees.

### Non-executive Directors
The non-executive Directors provide an essential independent element to the Board – and a solid foundation for strong corporate governance. Although all Directors are equally accountable under BVI law, the non-executive Directors fulfil a vital role in corporate accountability. They have responsibility for constructively challenging the strategies proposed by the executive Directors and scrutinising the performance of management in achieving agreed goals and objectives. They also play a key role in the functioning of the Board and its Committees. Between them, the current non-executive Directors have an appropriate balance of skills, experience, knowledge and independent judgement to undertake their roles effectively.

## Matters specifically reserved for the decision of the Lenta Ltd Board of Directors

### Management, strategy and planning
The Board has responsibility for the overall management of the Group. The Board discharges some of its responsibilities directly and discharges others through Board Committees and the Senior Management team. This includes approval of the strategy, for which it has collective responsibility, business plans and budgets, as well as approval of any material restructuring or reorganisation and establishment of new material areas of business. The Board also reviews performance in light of the strategy, objectives, business plans and budgets, ensuring that any necessary corrective action is taken.

### Operations and transactions
This includes approval of significant capital and non-capital expenditure as well as approval of significant asset disposals and any other transactions that could have a material effect on the strategic or financial plans of the Company, including making or responding to takeover bids.



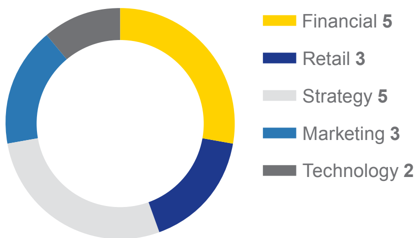

### Capital structure
The Board approves changes relating to capital structure including allotment of shares, reduction of capital (except under employee share plans) and share buy-backs. It also approves major changes to the Group's corporate structure and the Company's listings or its status as a company limited by shares.

### Loans and dividends
This includes approval of any substantial new loan or similar facility (including financial leases) from third parties or material amendment to any such facilities including material loans or similar facilities made available to third parties. The Board also oversees the Company's dividend policy, declaration of interim and recommendation of final dividends and approval of other distributions to shareholders, as well as any new pension schemes or significant changes to existing pension schemes.

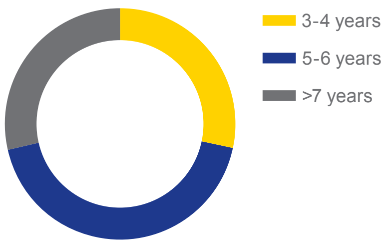
### Public reporting and controls
The Board approves the preliminary trading and half-yearly results announcements as well as the Annual Report and Accounts. It also approves appropriate press releases, material changes in principal accounting policies and practices, treasury policies and related risk management strategy and framework. On recommendation of the Audit Committee, the Board also appoints or removes the external auditor.

### Board of Directors
The Board of Directors manages, directs and supervises the business of the Company. The Board oversees the officers of the Company and succession planning. The Board, in some circumstances, may elect a Director to fill an empty seat on the Board. The Board may also establish committees and set their responsibilities. As shown below, our Directors have a wide range of complementary skills and experience.

**Board members' expertise**




**Tenure of Non-executive Directors**



# Corporate governance continued

### Remuneration
This includes approving the Directors' and Officers' insurance cover and establishing policies and rules relating to share-based incentive schemes. The Board also determines the remuneration policy for executive Directors and certain senior executives and approves the remuneration of non-executive Directors.

### Corporate governance
The Board reviews its own performance and that of its Committees and individual Directors. It is responsible for determining the risk appetite of the Group and ensuring maintenance of an effective system of internal control and risk management. It also approves and revises policies, including health, safety and environment policies, share dealing rules, code of conduct, anti-bribery and corruption policy and corporate governance arrangements.

The Board also calls any general meetings and approves documents sent to shareholders. It also recommends any changes to the Company's Memorandum and Articles of Association and considers material litigation or regulatory investigations affecting the Lenta Group. It is responsible for the approval of political donations and the appointment of key corporate advisors.

### Other
The Board also considers other matters of strategic or reputational importance likely to have a significant impact on the Company. When, exceptionally, decisions on matters specifically reserved for the Board are required to be taken urgently between Board meetings, such decisions shall be taken by a Directors' written resolution pursuant to Article 12.9 of the Articles of Association of the Company.

The Board is responsible for managing our business and may exercise all of the business's powers in doing so, except to the extent that any such power must be exercised by the shareholders in accordance with applicable BVI law or the Company's Memorandum and Articles ('M&A'). The Board also, by virtue of direct or indirect shareholdings in our consolidated subsidiaries, provides strategic management of our affairs and those of our consolidated subsidiaries. The day-to-day operations of our operating company, Lenta LLC, are managed by Senior Management as described below.

The Board currently consists of nine Directors, of which three: Michael Lynch-Bell, Anton Artemyev and Stephen Johnson are judged by the Board to be independent Directors according to the provisions of the UK Corporate Governance Code. None of the factors or circumstances set out in the Code as potential indicators of non-independence apply to Mr Lynch-Bell or Mr Artemyev.

While Mr Johnson carried out remunerated consultancy work for Lenta and one of its Major Shareholders, TPG Capital, prior to 2014, is remunerated as Chairman of another TPG Capital investee company and holds 80,000 Shares in Lenta Ltd subject to secured arrangements in favour of our pre-2014 Offering, the Board is satisfied that these have no effect on his independence. This is primarily because of his extensive experience in retail and the fact that his shareholding is subject to staggered release starting in 2014 and ending in 2018 – and is subject to his continued service on Lenta's Board.

Our CEO and CFO, who are also the General Director and Chief Financial Officer of Lenta LLC, are Directors, but are ineligible to serve on Board Committees. The remaining four Directors – including the Chairman – were elected by the shareholders pursuant to the nomination rights of the Major Shareholders.

### Board of Directors

| | | | | Committees | | | |
|---|---|---|---|---|---|---|---|
| Position | Name | Cat. | Director since | Nomination | Audit | Remuneration | Capex |
| Chairman | John Oliver | TPG | 2009 | ● | | ● | ● |
| Sen. INED | Stephen Johnson | INED | 2010 | © | ● | © | ● |
| Director | Michael Lynch-Bell | INED | 2013 | ● | © | ● | |
| Director | Anton Artemyev | INED | 2013 | ● | ● | ● | |
| Director | Dmitry Shvets | TPG | 2009 | ● | | ● | © |
| Director | Stephen Peel | TPG | 2011 | | | | |
| Director | Martin Elling | EBRD | 2011 | | | | ● |
| Director | Jan Dunning | CEO | 2013 | | | | |
| Director | Jago Lemmens | CFO | 2013 | | | | |

● Committee member © Chairman of Committee

● **Nomination Committee (five Directors)**
Read more on page 77

● **Audit Committee (three Directors)**
Read more on page 79

● **Remuneration Committee (five Directors)**
Read more on page 82

● **Capex Committee (four Directors)**
Read more on page 89

As provided under the M&A:

- the CEO and CFO hold office by virtue of their positions, and are appointed, and may be removed by the Board.
- the Major Shareholders may nominate Major Shareholder-nominated Directors (and remove such Directors), and shareholders are obliged to vote to approve the appointment or removal of such candidates, as follows:
  - TPG Capital: three Directors including the Chairman whilst it holds directly or indirectly an interest in 22.5% or more of the shares; two Directors including the Chairman whilst it holds directly or indirectly an interest in 15% or more of the shares; one Director whilst it holds directly or indirectly an interest in 5% or more of the shares;
  - EBRD: one Director whilst it holds an interest in 5% or more of the shares.

When a Major Shareholder's shareholding falls below a threshold listed above, one of the Directors nominated by that Major Shareholder must resign no later than the next general meeting, but may be renominated and re-elected by a simple majority resolution of the shareholders. These Directors may otherwise only be removed by their nominating Major Shareholder. The Major Shareholders may not assign or transfer these nomination rights to third parties.

As at the date of this report there are four Major Shareholder-nominated Directors on the Board. The Major Shareholder-nominated Directors have a fiduciary duty under the laws of the BVI to act in the best interests of our business. Under the M&A, a Director who has an interest in a transaction likely to give rise to a conflict of interest may not vote on any resolution relating to the transaction, unless fewer than three Directors are entitled to vote on such a resolution, in which case each interested Director may vote provided his interest is duly disclosed or certain other exceptions apply.

There should be at least three independent Directors at all times. Independent Directors are elected by a majority resolution of the Board from a list of candidates proposed by the Board and considered by the Board to be independent, taking into account the criteria for independence set forth in the Code. Each independent Director shall be deemed to resign at the first general meeting following their election by the Board, at which general meeting they shall be put forward for re-election. These Directors may be removed by a majority resolution of the Board or by a simple majority resolution of the shareholders upon a proposal made by shareholders holding more than 15% of the shares.

Each of the other Directors (if any) shall be elected by a simple majority resolution of the shareholders from a list of candidates. This will include those candidates proposed by the Board, retiring Directors consenting to being put forward for re-election and any candidates put forward for election by shareholders holding at least 15% of the shares within the timeframe stipulated in the M&A. These Directors may be removed in the same way as the independent Directors.

The Board may appoint a Director to fill a vacancy (subject to the rights of the Major Shareholders). In this case, that Director shall resign at the next general meeting and be put forward for re-election.

While the Board has overall accountability, in order to operate more effectively, responsibility for specific functions is delegated to four specialist Board Committees: Nomination, Audit, Remuneration and Capital Expenditure. The responsibility for formulating and, after approval, implementing strategic plans and the management of day-to-day operations is delegated to the Chief Executive Officer and the Senior Management team.

## BOARD FOCUS DURING THE YEAR

In 2016, the Board considered a wide range of matters, including:

- strategy
- budgets and long-term plans for the Company
- review of estimates of future cash flows, financing arrangements and fundraising
- industry and competitive environment
- responding to the changing dynamics of the Russian economy
- maintaining and increasing efficiency of the Company's rapid development
- individual business and overall Group performance and future capital expenditures
- the review and execution of M&A transactions
- development of the Company's corporate governance
- financial statements and announcements
- reviewing reports from its Committees
- shareholder feedback and reports from brokers and analysts
- risk management and risk oversight.

# Corporate governance continued

## Board and Committee attendance during the year

Normally the Board holds at least four meetings in person and a number of ad hoc meetings in person or via teleconference. We consider that any Director, participating via teleconference, videoconference or other electronic means shall be considered to be physically present, provided each Director is able to hear all other Directors and, in turn, be heard by all other Directors.

| Member | Board (5 meetings) | Audit Committee (10 meetings) | Capex Committee (4 meetings) | Nomination Committee (2 meetings) | Remuneration Committee (4 meetings) |
|---|---|---|---|---|---|
| John Oliver (Major Shareholder nominee) Chairman | 8 | – | 13 | 3 | 4 |
| Jan Dunning (CEO) | 8 | – | – | – | – |
| Stephen Johnson (Independent) | 7 | 11 | 11 | 3 | 4 |
| Michael Lynch-Bell (Independent) | 8 | 11 | – | 3 | 4 |
| Jago Lemmens (CFO) | 8 | – | – | – | – |
| Anton Artemyev (Independent) | 8 | 10 | – | 3 | 4 |
| Dmitry Shvets (Major Shareholder nominee) | 8 | – | 13 | 3 | 4 |
| Stephen Peel (Major Shareholder nominee) | 7 | – | – | – | – |
| Martin Elling (Major Shareholder nominee) | 8 | – | 12 | – | – |

A quorum for Board meetings consists of a minimum of five members of the Board.

## Changes to the Board in 2016

There were no changes to the Board in 2016.

## Length of service and independence of non-executive Directors

| | | |
|---|---|---|
| Stephen Johnson (Independent) | Since 2010 | Considered to be independent by the Board |
| Michael Lynch-Bell (Independent) | Since 2013 | Considered to be independent by the Board |
| Anton Artemyev (Independent) | Since 2013 | Considered to be independent by the Board |

There are seven Board meetings scheduled for 2017.

The terms of reference for Lenta's Board Committees were last revised and updated in November 2015. Details are set out in the Corporate Governance section of the Company website: http://www.lentainvestor.com/en/about/corporate-governance/internal-policies.

## BOARD COMMITTEES

### Effectiveness

The appointment of new Directors is led by the Nomination Committee, the majority of whose members are independent non-executive Directors. Details of the appointments process can be found on page 75.

All new Directors receive a personalised induction programme, tailored to their experience, background and particular area of focus. This is designed to develop their knowledge and understanding of the Company's culture and operations. The programme incorporates a wide-ranging schedule of meetings with Senior Management across the Company, comprehensive briefing materials and opportunities to visit the Company's operations, including spending time at new store openings, in store and in our distribution network.

All Directors have the opportunity to increase their knowledge of the Company through visits to the Company's operations and meetings with senior executives across the business.

The Board makes a careful assessment of the time commitments required from the Chairman and non-executive Directors to discharge their roles properly. This is discussed with candidates as part of the recruitment process and a commitment to the appropriate time requirements is included in engagement letters. Directors are expected to attend every Board meeting and every meeting of any Committee of which they are a member, unless there are exceptional circumstances preventing their attendance. Scheduled Board and Committee meetings are arranged at least a year in advance to allow Directors to manage other commitments.

The Chairman reviews each Director's development needs as part of the annual performance evaluation process and puts appropriate arrangements in place for specific training. The Nomination Committee reviews the Directors' skills and experience as a group against those needed to oversee and support the Company's future operations, and identifies any gaps. Training is arranged to develop the knowledge and skills of the Directors in a variety of areas relevant to Lenta's business.

Board papers are, ordinarily, circulated a week before each meeting to give the Directors and Committee members sufficient time to fully consider the information. All Directors have access to the Company Secretary and may take independent professional advice at the Company's expense in conducting their duties.

### Conflicts of interest

Directors have a statutory duty to avoid situations in which they have or could have a direct or indirect interest that conflicts or may conflict with the interests of the Company. A Director has a duty to disclose to the Board any transaction or arrangement under consideration by the Company in which he has a personal interest. The Board has a procedure for authorising conflicts or potential conflicts of interest. Under this procedure, Directors are required to declare all directorships or other appointments outside the Company that could give rise to a conflict or potential conflict of interest.

Early in 2016 the Senior Independent Director (also Chairman of the Nomination Committee) conducted an internal review of its performance and that of its Committees and individual Directors. The outcome of this review was encouraging, with the Directors (both non-executive and executive) confirming that Lenta has a high performing Board and rating most aspects of the Board's activities and governance very highly. As a result of the review, Lenta has made a small number of positive changes to its Board processes and will continue to keep its performance under both formal and informal review in order to ensure a process of continuous improvement.

## NOMINATION COMMITTEE REPORT

**Committee members:**

- Stephen Johnson (Independent, Chairman)
- Michael Lynch-Bell (Independent)
- Anton Artemyev (Independent)
- John Oliver (Major Shareholder nominee)
- Dmitry Shvets (Major Shareholder nominee)

The key roles and responsibilities of the Nomination Committee include:

- ensuring that proper procedures are established for the nomination, selection and training of the Company's Directors and Senior Management;
- keeping under review the size, structure, balance of skills, experience, independence, knowledge and general diversity of the Board to ensure the balance and composition of the Board and its Committees remains appropriate;
- making recommendations to the Board on Directors' conflicts of interest for authorisation, where appropriate;
- making recommendations to the Board regarding the appointment of new Directors, and identifying, interviewing, selecting, and determining the independence of candidates with suitable industry or key competency experience;
- reviewing Board level, Senior Management and Company-wide succession planning and other human resources-related matters;
- reviewing the leadership needs of the Company, both executive and non-executive, to ensure the continued ability of the organisation to compete in the marketplace.

A copy of the Committee's full terms of reference is available on the Company's website: http://www.lentainvestor.com/en/about/corporate-governance/internal-policies.

# Corporate governance continued

The Human Resources Director may be invited to attend any meeting of the Committee, except for portions of the meetings where their presence would be inappropriate, as determined by the Committee Chairman.

## Dear Shareholders

Looking forward to 2017, the Committee intends to continue its focus on the performance appraisal programme and the succession planning programme. We will also support management in the identification and recruitment of suitable candidates to support the Company's growth plans.

## Activities during the year

### Performance appraisal programme

Over the last few years, Lenta has developed and implemented a Company-wide performance appraisal programme. This process is used to assess the performance of every employee in the business, including the executive Directors. The findings from this programme are used to identify training and development needs, to pinpoint areas where investment in human resources is required and to identify high performance individuals at all levels. The Nomination Committee receives regular reports on the results and operation of the performance appraisal programme.

### Succession planning programme

The Company also operates an active succession planning programme. This is designed to identify possible successors for all management positions in the Company, to identify development needs for any potential successors, and to address any succession gaps. The performance appraisal programme is one of the key inputs in the succession planning process. During the year the Committee regularly reviewed the succession plan and worked with Company management to refine and develop it. Inevitably, this is an ongoing process.

Inevitably, not every role in a company can be adequately covered with a like-for-like successor. However, we remain confident that the Senior Management team and wider Board have the skills and experience necessary to seamlessly manage the business should any external recruitment be necessary.

**Stephen Johnson**
Chairman
Nomination Committee

## Accountability

The Board considers the Annual Report and Accounts, taken as a whole, to be fair, balanced and understandable and provide the necessary information required for shareholders to assess the Company's performance, business model and strategy – and that the business continues to operate as a going concern.

The Board assumes ultimate responsibility for ensuring the Company has appropriate risk management and internal controls in place – and has delegated responsibility to the Audit Committee to review their effectiveness. Successful management of risk is supported by controls, management oversight and sources of assurance. The Company maintains a comprehensive framework of internal controls addressing the key strategic, financial, legal, reputational and operational risks to the business. The accountability for operating these controls rests with Senior Management as a first line of defence.

Key elements of the Company's system of internal controls that operated throughout the year were:

- monitoring by the Board of a comprehensive reporting system including detailed monthly results, periodic short- and medium-term forecasts, annual budgets and medium-term plans;
- monitoring by the Board of the Company's liquidity, financing and borrowing requirements;
- well-defined procedures for assessment, approval, control and monitoring of major investment projects;
- a centrally coordinated internal audit programme to verify that policies and internal control procedures are being correctly implemented and identify any risks and potential areas for improvement at an early stage;
- financial, treasury, operating, compliance and administrative policies and procedures that incorporate statements of required behaviour;

- reviewing the speak-up policy and monitoring the operation of whistle-blowing facilities in place to allow staff and customers to raise concerns; and
- a remuneration policy for executives that motivates them appropriately, without encouraging excessive risk taking.

No significant internal control failings were identified during the year. The Group's approach to risk management, the risks identified and how it profiles these risks is set out on pages 40 to 47.

The Board commissioned a review of the effectiveness of the Company's risk management and internal controls in late 2015, assisted by external consultants. As a result, recommendations resulting from that review were considered and implementation commenced in 2016. This included the launch of a Risk Management Policy and Risk Matrix. A Head of Risk Management was also appointed during the year. Implementation of the recommendations will be completed during 2017.

Colleagues are required to confirm annually that they have complied with the Code of Business Conduct, which sets out individual obligations and responsibilities for everyone working at Lenta.

### Internal audit

Internal audit advises management on the extent to which systems of internal control are adequate and effective to manage business risk, safeguard the Company's resources and ensure compliance with the Company's policies and legal and regulatory requirements. It also advises on ways in which areas of risk can be addressed and provides objective assurance on risk and controls to Senior Management, the Audit Committee and the Board.

The mandate and programme of work of the internal audit department is considered and approved by the Audit Committee. Based on the approved internal audit plan, a number of internal audits took place across the Company's operations and functions to facilitate improvement of the Company's internal controls, with findings reported to the relevant operational management. Internal audit follows up on the implementation of recommendations and reports on progress to Senior Management and to the Audit Committee.

The Head of Internal Audit reports regularly to the Chairman of the Audit Committee and attends Audit Committee meetings to present the internal control findings from the internal audits performed. The Audit Committee reviews and discusses the effectiveness of internal audits on an annual basis with the Head of Internal Audit.

The Audit Committee plays a role in monitoring compliance with internal controls. In addition to receiving reports from Internal Audit, the Committee is responsible for monitoring legal compliance across the Company, including receiving reports from the Chief Legal Director. The Committee reports each year on its assessment of the effectiveness of the risk management and internal control systems. Throughout the year the Committee receives regular reports from the external auditor covering topics such as quality of earnings and technical accounting developments.

Whilst an internal control system cannot guarantee that losses will not occur, the Board is satisfied that management has remained diligent in its efforts to ensure an appropriate level of control remains in place. All Directors are covered by the Group's Directors' and Officers' insurance policy.

## AUDIT COMMITTEE REPORT

**Committee members:**

- Michael Lynch-Bell (Independent, Chairman)
- Anton Artemyev (Independent)
- Stephen Johnson (Independent)

The membership of the Committee is fully Code compliant and includes retail, liquidity, financial, risk management and geographic expertise. The Chairman is deemed to be the member with recent and relevant financial experience.

The Audit Committee supports the Board in its responsibilities with regard to corporate reporting and risk management and internal controls, and with maintaining a relationship with the Company's auditor. The Committee's activities include the review of internal control systems, compliance with financial reporting requirements and the scope, results and cost effectiveness of the external audit.

There are ten Committee meetings scheduled for 2017.

### Dear Shareholders

I am delighted to present the report of the Audit Committee. This report sets out the Committee's responsibilities, how it discharged its duties during the year and the key matters that were discussed at our meetings.

At the heart of the Audit Committee's remit is the need to provide confidence in the integrity of the Company's processes and procedures in relation to internal control, risk management and corporate reporting. In keeping with our commitment to good corporate governance, we seek to do this in line with international best practice. During 2016, the Committee reviewed the Company's financial results, including significant financial reporting estimates and judgements, as well as the financial disclosures in the interim management statements. It also monitored the Company's system of internal control and management of the Company's risks and oversaw the relationship with the external auditor

# Corporate governance continued

and with the internal audit function. We reviewed the implementation of the recommendations of the risk management function review and received reports from the newly appointed risk manager. As the Company has made its first long-term viability statement in this Annual Report, the Committee also considered management's assumptions and disclosures relating to it.

We are very grateful for the assistance of the Company's external auditor Ernst & Young ('EY') in this capacity. EY contributes a further independent perspective on certain aspects of the Company's financial control systems and reports both to the Audit Committee and directly to the Board.

Looking forward to the next 12 months, the Committee will continue to focus on the audit and assurance processes within the business, together with the monitoring of the key risks.

## Responsibilities

The primary responsibilities of the Audit Committee encompass overseeing, monitoring and reviewing the Company's financial reporting, internal control and assurance processes. Whilst the Committee has very specific duties set out in its terms of reference, it serves a much greater purpose in reassuring shareholders that their interests are properly protected in respect of the Company's financial management and reporting. The Committee regularly reports to the Board on matters discussed at its meetings. The Board has delegated responsibility to the Committee for reviewing the Company's procedures and system of internal control in relation to risk management, with a focus on the methodology used by Senior Management. It also oversees the internal and external audit processes that report to it.

The Chair, CEO and CFO are invited to attend all committee meetings. The Company Secretary, Head of Internal Audit, Chief Legal Counsel and the external auditor are also normally invited to attend Committee meetings, other than those that are called solely to approve the financial disclosures in the Company announcements made in respect of the March and September quarters. Other members of Senior Management are invited to attend to discuss any matters relevant to them. At the end of each meeting, where they are in attendance, the Committee offers both the external auditor and Head of Internal Audit the opportunity to meet with them without members of senior management being present.

## External auditor

The Committee approved the terms of engagement of the external auditor, the fees paid to it and the scope of work carried out by it, and reviewed the performance and effectiveness of the external auditor in respect of the year ended 31 December 2016. Consideration was given to the performance, objectivity, independence, resources and relevant experience of the external auditor. In this process, it reviewed a report from the external auditor on all relationships that might reasonably have a bearing on its independence and the audit partner and staff's objectivity, and the related safeguards and procedures. It also performed an annual review of the policies on the independence and objectivity of the external auditor, the use of the auditor for non-audit services and the employment of former employees of the external auditor. Following this review, the Committee recommended to the Board the re-appointment of EY as the Company's external auditor.

To safeguard auditor objectivity and independence, the Committee oversees the process for the approval of all non-audit services provided by EY. Consideration is given to whether it is in the best interests of the Company that the non-audit services are purchased from EY.

The Committee received reports on the findings of the external auditor during its half yearly review and annual audit. It reviewed the recommendations made to management by the external auditor and management's responses as well as the letters of representation to the external auditor.

Ernst & Young LLC was appointed as our external auditor in 2011. It is our policy to review its appointment annually and to re-tender the audit contract every seven years.

Ernst & Young LLC was reappointed as the Company's auditor by shareholders at the 2016 AGM. Professional fees billed by Ernst & Young LLC are shown in the table below.

| Auditor's (Ernst & Young LLC) fees, ('000 RUB) | 2016 | 2015 |
|---|---|---|
| Audit of consolidated financial statements | **25,186** | 29,565 |
| Consulting and other non-audit services | **20,725** | 5,699 |
| Total fees | **45,911** | 35,264 |

## Role of the Audit Committee

The key roles and responsibilities of the Audit Committee include:

- monitoring and challenging, where necessary, the integrity of the financial statements and half yearly results, interim management statements and any other formal announcement relating to financial performance;
- reviewing and challenging, where necessary, the actions and judgements of management, taking into account the views of the external auditor, in relation to the Company's financial statements, strategic review, financial review, governance statement and half-yearly reports, including the going concern assumption and the long-term viability statement;
- reviewing the Company's internal controls, including financial controls and updated risk management systems;
- reviewing the content of the Annual Report and Accounts when requested by the Board;
- reviewing reports on changes in tax legislation and management's proposed response;
- reviewing the Company's significant insurance arrangements;
- reviewing the Company's treasury policy;

- reviewing the Company's procedures for detecting and preventing bribery and fraud;
- reviewing the Company's compliance with the updated UK Corporate Governance Code;
- overseeing and reviewing the Internal Audit function, its terms of reference, effectiveness, plan, budget and reporting;
- reviewing the Company's speak-up policy and receiving reports on matters raised via the speak-up facilities;
- recommending the appointment of the external auditor and overseeing the relationship;
- reviewing the terms of reference of the Committee, the results of the performance evaluation and the training requirements of Committee members;
- reporting to the Board on how the Committee has discharged its responsibilities.

A copy of the Committee's full terms of reference is available on the Company's website: http://www.lentainvestor.com/en/about/corporate-governance/internal-policies.

The Audit Committee considered a number of issues during the year, taking into account the views of the Company's management, its tax advisors and the external auditor.

## Significant issues considered by the Audit Committee

The significant issues – and how they were addressed – are set out below.

### Suppliers' allowances

The Committee reviewed the accounting for and recognition of suppliers' allowances received for the provision of services. The review included consideration of the types of allowances received, the period of coverage and the timing of receipt. Based on this review, the Committee is satisfied that the allowances are recognised in the period in which they are earned and that appropriate disclosure has been made in the financial statements.

### Inventories and inventory allowances

The Committee reviewed the accounting for inventories and the recognition of write-downs during the period. The review took into consideration the calculation of the cost of inventories, the identification of slow-moving inventories and the reasons why shrinkage had occurred. Based on this review, the Committee agreed with the accounting treatment and disclosures adopted by management.

### Capital construction

The Committee examined the accounting for capital construction including the recognition of direct costs incurred, the allocation of directly attributable overheads and land lease expense. The review included a consideration of potential fraud risk, the construction tender process and the acquisition or leasing of land. The Committee agreed with the accounting treatment and disclosures adopted by management.

### Business combination

The Committee considered the key judgements made by management in accounting for the acquisition of the K-Ruoka stores. The Committee agreed with the accounting treatment and disclosures adopted by management.

### Ethics Committee

The Committee reviewed the work of the Ethics Committee; in particular its report on the Company hotline. The Audit Committee approved measures taken by management to mitigate risks of impropriety and hold culpable employees to account.

### Taxation

The Committee received regular updates on tax developments in Russia from management and the Company's advisors, together with management's interpretation of the impact of current tax legislation on the Company. The Committee concurred with management's judgement on the positions adopted and the related disclosures.

### Going concern

The Committee reviewed management's adoption of the going concern basis of accounting. Management had taken into account the Company's financial position, available borrowing facilities, loan covenant compliance, planned store opening programme and the anticipated cash flows and related expenditures from our retail stores. The Committee considered the position taken by management and, taking into account the external auditor's review, concluded that management's recommendation to prepare the financial statements on a going concern basis was appropriate.

The annual report also includes, for the first time, a long-term viability statement, which can be found on pages 46 to 47. The Committee considered the statement and approved management's disclosures.

### Share-based payments

The Committee reviewed the considerations made by management in relation to the accounting for remuneration received by certain employees in the form of share-based payments. In addition, management had evaluated the required disclosures for inclusion in the financial statements. Having challenged the appropriateness of key assumptions used by management, the Committee agreed with management's assessment and disclosures.

**Michael Lynch-Bell**
Chairman
Audit Committee

# Corporate governance continued

## Remuneration

The work of the Remuneration Committee, the interests in the Company's share capital held by Senior Management and the remuneration received by the Chairman and the non-executive Directors are set out on pages 85 to 88. The Directors' interests in the Company's share capital are set out on page 87.

## REMUNERATION COMMITTEE REPORT

**Committee members:**

- Stephen Johnson (Independent, Chairman)
- Michael Lynch-Bell (Independent)
- Anton Artemyev (Independent)
- John Oliver (Major Shareholder nominee)
- Dmitry Shvets (Major Shareholder nominee)

The Remuneration Committee held three meetings in 2016 and has five meetings scheduled for 2017.

The key roles and responsibilities of the Remuneration Committee include:

- determining and recommending the broad policy for executive remuneration within the Group;
- determining, on behalf of the Board, the remuneration of the executive Directors and senior management;
- approving the design of, and determining targets for any performance-related plans;
- making recommendations regarding employee equity participation schemes;
- determining the policy for and scope of service agreements and termination payments.

A copy of the Committee's full terms of reference is available on the Company's website: http://www.lentainvestor.com/en/about/corporate-governance/internal-policies.

### Dear Shareholders

2016 was another year of big challenges for Lenta – the challenge of managing the significant growth delivered by the business and the challenge of managing the business successfully in a difficult consumer and competitor environment. The senior management team and the wider management group within the business have remained very stable and committed to delivering its ambitious targets. Enabling the business to attract, retain and incentivise the best people remains central to our continuing ability to achieve our goals. The Remuneration Committee's primary focus is to ensure that Lenta has a remuneration framework that is highly competitive in the markets where we compete for talent, designed to support the long-term strategy of the business and aligned with the interests of our shareholders.

Having spent much of 2015 ensuring that the various elements of the management remuneration plans and policies were fit for purpose, in 2016 we were focused on reviewing and monitoring the changes that we made to ensure that they were functioning as desired. So far, we are content that this is the case. It is in part testament to the robustness of Lenta's approach to remuneration that we have managed to retain a very stable executive management team over the last four or five years in what has been a very challenging environment. The Committee is mindful of the need to be both active and flexible in keeping all aspects of the business's remuneration policies under review.

The Committee continues to be active in gathering external views in order to ensure that it remains aware of any significant changes in the area of remuneration both in Russia and more widely across Europe.

## Key activities of the Committee in 2016

### Long-Term Incentive Programme for Senior Management

The Board and Shareholders expressed concern about retention of the Senior Management team after the vesting date of the current Management Incentive Programme in 2018/19. The Remuneration Committee has addressed this concern by approving a new LTI programme for MIP participants that is targeted to assure retention of the Senior Management team after 2019. The programme operates according to the following rules:

- shares are granted annually with a vesting period of three years;
- the amount of shares depends on the job grade (percentage of annual salary), share price and individual performance evaluation of the manager;
- the final amount of vesting shares is subject to a financial performance co-efficient for three years preceding the vesting date;
- a manager's eligibility to receive shares is conditional on his or her employment with Lenta and compliance with certain covenants, including confidentiality, non-competition and non-solicitation covenants.

The LTIP 2016 with a vesting date in 2019 was approved, granting a total of 150,322 shares, which represents around 120% of the annual salary of this group (including Currency Adjustment Pay).

### Corrections to MIP

During the development of MIP corrections in 2015, it was concluded with PWC that some positions with MIP allocation did not deliver the market-level total cash reward for these senior managers in comparison to FTSE 25-75 companies. It was agreed to make additional allocations within the MIP for Herman Tinga. The Committee also approved a one-time LTIP allocation with vesting in 2018 in the amount equivalent to one year's salary to Maxim Schegolev, Sergey Prokofiev and Tatiana Yurkevich. Details are in the table on page 86.

### New LTIP allocation for middle managers

The Committee also approved a new annual long-term incentive plan with a vesting period of three years for 92 key middle managers. The total value of this award is 82,362 shares and represents around 44% of this group's annual salary. The allocation of the LTIP is linked to overall Company performance in the previous year and individual performance evaluation.

### 2016 Annual Bonus Scheme approval

The Committee approved the bonus KPIs, target and payout scales for 2016. The Committee was informed of the change in monthly bonus programme for store personnel, which was targeted to be linked more to store performance than individual contribution. The number of KPIs for the monthly bonus system has reduced by 40%. There was no financial impact on overall pay.

### Salary review in comparison to labour market

The Committee reviewed the labour market situation and salary dynamics in Russia, based on Mercer and Hay surveys. Based on this data and the company's experience and observations relating to staff turnover, motivation and recruitment it was decided not to make an overall salary revision, although salaries for some job positions were adjusted on an individual basis. The Committee will conduct a similar review to determine salary revisions required during 2017.

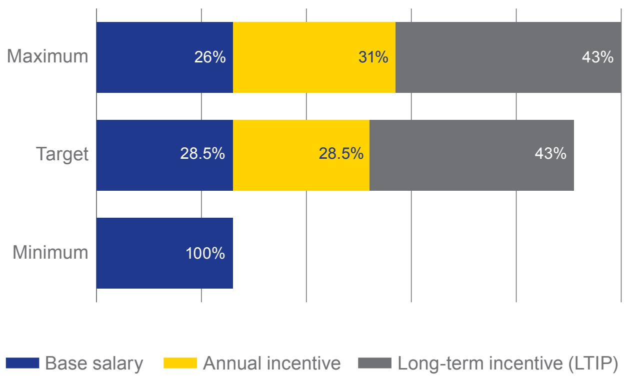
# Corporate governance continued

### Summary of executive Directors' remuneration policy

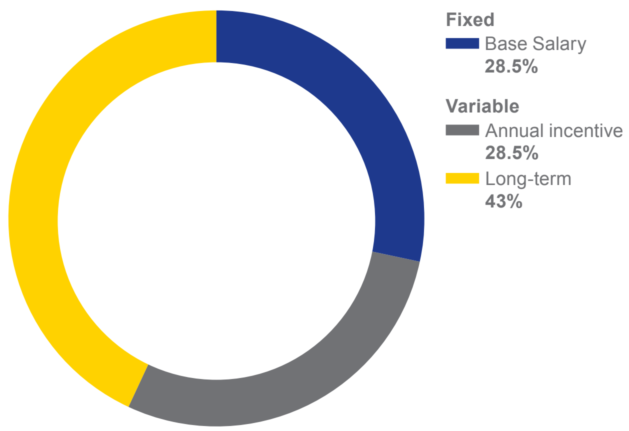
| Element | Principles | Opportunity |
|---|---|---|
| **Base pay** | Base pay is reviewed annually by the Remuneration Committee, considering a number of factors, including:<br>• Individual performance evaluation<br>• Salaries in comparable roles in the same industry and activities scope. | There is no set maximum or minimum, it is in line with labour market trends and/or individual role scope changes. |
| **Currency adjustment** | According to Russian legislation, base salaries are fixed in Roubles, which leads to a negative pay trend for executive Directors with a drop in the RUB/EUR rate. To maintain competitive pay levels, currency adjustment pay is used as decided by the Committee in 2013. | Currency adjustment pay is the difference between individual salary calculated in Euro at recruitment and current RUB salary expressed in Euro. For some executive Directors, only partial compensation is applied. |
| **Benefits** | • Company car, for some Directors with a driver<br>• Medical insurance with family coverage<br>• Relocation support<br>• Partial reimbursement of school fees for expatriates' children attending school in Russia. | There are maximums set for each compensation element depending on the job grade. |
| **Annual bonus** | All Directors are eligible for the annual bonus scheme, which is a discretionary, non-contractual scheme. Performance is measured against quantifiable financial targets, which are set at the start of the year and approved by the Remuneration Committee. | Total maximum annual bonus opportunity for each executive Director is 120% of annual base pay. |
| | In addition to financial targets, the bonus may be affected by the individual performance evaluation which may increase or decrease the payout. | |
| | Annual bonus is paid on the condition that a 'threshold' level of EBITDA is achieved. | |
| **Management incentive plan** | Eight executive Directors are eligible for the share-settled Management Incentive Plan (MIP). | There is no maximum set for the MIP; actual reward depends on the number of phantom shares allocated and share price development. |
| | Participating managers are allocated a specified number of phantom shares, in relation to which their entitlement under the MIP is calculated. | |
| | The plan is based on share price dynamics vs. IPO price in RUB and is subject to a hurdle reference price. | |
| | The plan has fixed vesting periods. | |
| | A Director's eligibility to receive shares is conditional on his or her employment with Lenta and compliance with certain covenants, including confidentiality, non-competition and non-solicitation covenants. | |
| **Long-term incentive plan** | All executive Directors are eligible for the share-based long-term incentive plan (LTIP) as decided by the Remuneration Committee. | Maximum LTIP annual value is 150% of annual salary; the actual amount varies between Directors based on their job grade and individual performance evaluation. |
| | LTIP is a conditional grant of shares depending on the job grade, base salary share price. Shares vesting depends on Company performance during the three years following the allocation. | |
| | Vesting period is three years from the grant date. | |
| | A Director's eligibility to receive shares is conditional on his or her employment with Lenta and compliance with certain covenants, including confidentiality, non-competition and non-solicitation covenants. | |

## Pay structure of CEO, CFO and all executive Directors

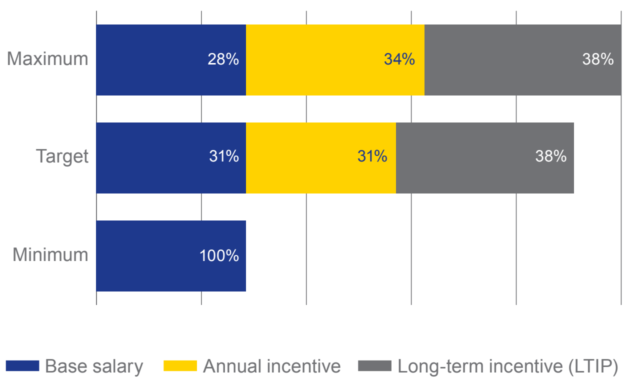
### Chief Executive Officer (Jan Dunning)



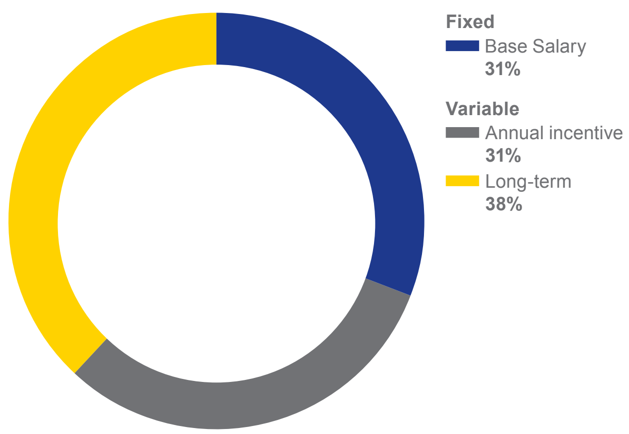

### CEO total cash reward (fixed vs. variable at target)



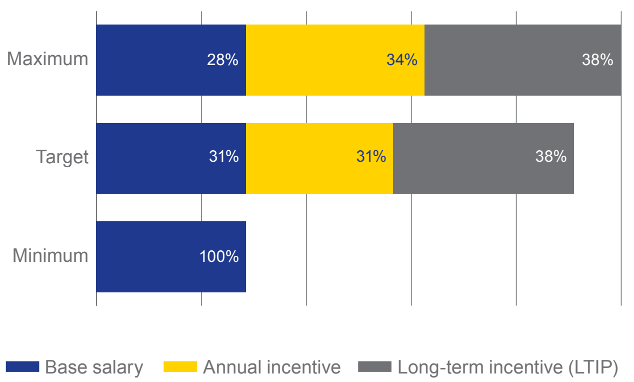

### Chief Financial Officer (Jago Lemmens)



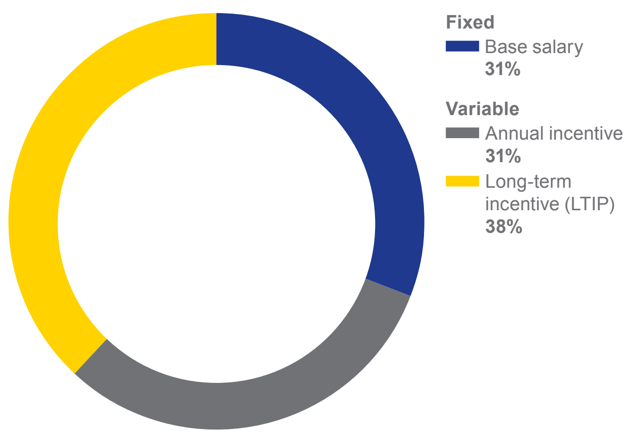

### CFO total cash reward (fixed vs. variable at target)




### Other Senior Management team members




### Other Senior Management team members total cash reward (fixed vs. variable at target)



# Corporate governance continued

## Pay structure of CEO, CFO and all executive Directors continued

The key terms of each member of Senior Management's participation in the MIP are set out below:

| Manager | Number of phantom shares | Base price (RUB) | Hurdle reference price (RUB) | Hurdle reference date | Vesting period commencement date |
|---|---|---|---|---|---|
| Jan Dunning | 205,646 | 1,516 | 764 | 23/09/2011 | 01/04/2012 |
| Jago Lemmens | 102,823 | 1,516 | 764 | 23/09/2011 | 01/04/2012 |
| Herman Tinga | | | | | |
| 1st grant | 102,823 | 1,516 | 1,375 | 01/04/2013 | 01/04/2013 |
| 2nd grant | 35,000 | 1,516 | 1,375 | 01/04/2013 | 01/04/2014 |
| 3rd grant | 42,000 | 2,214 | 1,375 | 01/04/2013 | 01/04/2019 |
| Edward Doeffinger | 102,823 | 1,516 | 764 | 23/09/2011 | 01/04/2012 |
| Joern Arnhold | 85,686 | 1,516 | 764 | 23/09/2011 | 01/04/2012 |
| Sergey Prokofiev | 35,988 | 1,516 | 1,375 | 01/04/2013 | 01/04/2013 |
| Maxim Shchegolev | 35,988 | 1,516 | 1,375 | 01/04/2013 | 01/04/2013 |
| Tatiana Yurkevich | 35,988 | 1,516 | 1,375 | 01/04/2013 | 01/04/2013 |

On 22 April 2014, as a result of the Settlement Event upon the 2014 Offering, we granted 399 new shares, (some in the form of GDRs), to Senior Management under the MIP. The details of the MIP issuance, the holdings of the recipients immediately following the issuance, and holdings of Senior Management as of 31 December 2016 are summarised below:

| Manager | Number of shares issued (including as GDRs) | Total holding after issuance (interests in shares) | Total holding as of Dec 31 2016 (interest in shares) | Approximate holding as of Dec 31 2016 (% of share capital) |
|---|---|---|---|---|
| Jan Dunning | 132 | 549,538 | 549,538 | 0.56% |
| Jago Lemmens | 66 | 104,697 | 105,737 | 0.11% |
| Edward Doeffinger | 66 | 95,557 | 95,557 | 0.10% |
| Joern Arnhold | 55 | 86,497 | 86,497 | 0.09% |
| Herman Tinga | 44 | 7,044 | 9,204 | 0.01% |
| Sergey Prokofiev | 12 | 12 | 12 | Less than 0.0001% |
| Maxim Shchegolev | 12 | 12 | 12 | Less than 0.0001% |
| Tatiana Yurkevich | 12 | 12 | 12 | Less than 0.0001% |

| | Number of phantom shares total | Vested shares | Base price (RUB) | Hurdle reference price (RUB) | Hurdle reference date | Vesting schedule | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | 2017 | 2018 | 2019 | 2020 | 2021 |
| Wave 1 | 496,978 | 99,396 | 1,516 | 764 | 23/09/2011 | 149,093 | 248,489 | | | |
| Wave 2 | 245,787 | 49,157 | 1,516 | 1,375 | 01/04/2013 | 63,236 | 105,394 | 10,500 | | 17,500 |
| Wave 2* | 42,000 | | 2,214 | 1,375 | 01/04/2013 | | | 21,000 | 21,000 | |

* Herman Tinga 2016 additional tranche.

The total executive Director LTIP 2016 allocation is equal to 150,322 shares, which represents around 120% of the annual salary of this group.

## Summary of non-executive Directors' remuneration policy

| Element | Principles and opportunities |
|---|---|
| Letter of appointment | • The Chairman and other non-executive Directors of Lenta LLC each have a letter of appointment; they do not have service contracts.<br>• There is no notice period for termination. |
| Chairman and non-executive Director | • Fees are reviewed periodically by the Committee taking into consideration:<br>– Time commitment, demands and the responsibility of the role; and<br>– External market practice.<br>• There has been no increase in the level of fees paid to the Chairman and the non-executive Directors since the Company's IPO in February 2014. The Committee and Board have agreed that no increase will be payable for the coming year. |
| Additional fees | • Additional fees are paid for undertaking the extra responsibilities of<br>– Board Chairman<br>– Senior Independent Director<br>– Committee Chairman. |
| Other benefits | • The Chairman and the other non-executive Directors do not participate in any of our employee incentive arrangements, nor do they receive any pension provision.<br>• No further benefits are provided to the Chairman or non-executive Directors. |
| Recruitment | • Fees for the Chairman and the other non-executive Directors are determined by the Board as a whole, upon the recommendation of the Remuneration Committee.<br>• Fees are set at a level sufficient to attract, motivate and retain the world-class talent necessary to contribute to a high-performing board. |

## Non-executive Directors' Fees

| | Amount payable (USD) |
|---|---|
| Base fee for non-executive Directors | 165,000 |
| Additional fees: | |
| Chairman | 285,000 |
| Senior Independent Director | 25,000 |
| Chairman of the Audit Committee | 40,000 |
| Chairman of the Capital Expenditure Committee | 30,000 |
| Chairman of the Nomination and Remuneration Committee | 17,500 |
| Members of the Audit and Capital Expenditure Committees | 15,000 |
| Members of the Nomination and Remuneration Committees | 10,000 |

Interests of Directors in Lenta shares are summarised in the table below:

| Name of Director | Total holding as of 31 Dec 2016 (interest in shares) | Approximate holding as of 31 Dec 2016 (% of share capital) |
|---|---|---|
| John Oliver | 125,000 | 0.13% |
| Stephen Johnson | 80,000 | 0.08% |
| Martin Elling | 10,000 | 0.01% |
| Michael Lynch-Bell | 3,200 | less than 0.001% |

# Corporate governance continued

### Strategic alignment of pay

The table below shows the integration between Lenta's financial key performance indicators and the senior remuneration framework for 2015/16. This clearly demonstrates a clear linkage between performance metrics, payments to Directors and business performance over the short and long term.

| Financial objectives | KPI | Incentive scheme |
|---|---|---|
| Company revenue | Turnover | Annual Bonus Scheme<br>Performance coefficient for LTIP scheme |
| Increase earnings and returns | EBITDA | Annual Bonus Scheme<br>Performance coefficient for LTIP scheme |
| Increase shareholder value | Share price | MIP, LTIP |

| Non-financial objectives | KPI | Incentive scheme |
|---|---|---|
| Efficient operations | Productivity | Annual Bonus Scheme |
| Sales space growth | Number of stores opened and in pipeline | Annual Bonus Scheme |

### Annual bonus scheme

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Target bonus** (% of base salary) | X | **50% of Target bonus OEBITDA multiplier*** | X | **50% of Target bonus Sales multiplier** | X | **Individual performance coefficient** | X | **EUR/RUR base to actual rate adjustment** | = | **Bonus achieved** (as % of base salary) |

* Trigger for Annual Bonus

In April 2016, the 2015 annual bonus award was completed, with an overall award across the Company for those participating in the scheme of 92% of the maximum. Functional KPIs execution was on a high level, increasing the overall payout and the total bonus payout coefficient was higher than in 2014. The Committee and the Board felt that this accurately reflected the significant progress that the business made during 2015 despite the challenging external environment.

Within this overall award, the Senior Management team was awarded annual bonuses averaging 92% of the maximum, with the CEO achieving 97.6%. The Committee also agreed the annual bonus targets for 2016, providing for similarly stretching performance.

**Stephen Johnson**
Chairman
Remuneration Committee

# CAPITAL EXPENDITURE COMMITTEE REPORT

**Committee members:**

- Dmitry Shvets (Major Shareholder nominee, Chairman)
- Stephen Johnson (Independent)
- John Oliver (Major Shareholder nominee)
- Martin Elling (Major Shareholder nominee)

There are 12 Committee meetings scheduled for 2017; this number may be increased as necessary.

The key roles and responsibilities of the Capital Expenditure Committee include:

- advising the Board with regard to the overall capital expenditure strategy of the Group;
- reviewing the Company's processes for approving capital expenditure projects;
- setting the limits of authority for capex-related decisions;
- reviewing and approving all capex and M&A projects within the Committee's limits of authority;
- reviewing and making recommendations on how the overall capex plan aligns with the Company's strategy;
- endeavouring to ensure that improvement programmes relating to the design, construction and operation of new stores are defined and implemented in cooperation with management;
- monitoring capex projects' returns and making adjustments to the capex processes to reflect the lessons learned.

A copy of the Committee's full terms of reference is available on the Company's website: http://www.lentainvestor.com/en/about/corporate-governance/internal-policies.

## Dear Shareholders

2016 was another successful year for Lenta as it further accelerated its expansion – opening 41 hypermarkets (adding 40 hypermarkets net, as one was closed) and 17 supermarkets in Russia. We also completed a purchase of 11 well-located stores from Kesko which represented an excellent strategic fit for Lenta in the North-West region. This meant a lot of work for the Capital Expenditure Committee. In a growing economy, with the environment providing tailwinds for the business, our job would have been a very busy one. But with Russia's current financial uncertainties, a more stringent focus on how these could impact the business – and consequently any future capital expenditure planning – was required.

In a more challenging economic environment, the Committee applied a particularly keen focus on balancing the expenditure for land purchases and the construction and fitting-out of stores that will continue to feed Lenta's future growth plans with our commitment to deliver value for shareholders.

We will, as usual, be reviewing all opportunities as they present themselves. However, the Board and Senior Management agree that, in the present circumstances, it is particularly important to maintain an appropriate balance of prudent leverage levels, whilst also pursuing high growth and high investment project returns. We are confident of being able to continue to do so.

## Activities during the year

During 2016, the Capital Expenditure Committee focused on a number of issues on behalf of the Board. We considered more than 160 new investment proposals including new store projects and acquisitions (where investment proposals included more than one store), as well as supply chain and vertical integration projects.

We considered, reviewed and made recommendations to the Board on the Company's investment strategy, policy and risk management. We continued to improve the new form of investment proposal ('IP') with even higher standards to ensure the best overview and forecasts against the backdrop of the very large number of promising new store IPs that the expansion teams developed in 2016. We also worked together with management on improving the efficiency of the existing stores and maintaining their strict compliance with all applicable regulations.

The Capital Expenditure Committee also worked closely with management in reviewing potential acquisition opportunities. This cooperation enabled the smooth acquisition and integration of the new assets of Kesko.

We continued to refine the post-IP evaluation procedures to make sure that the capital expenditure process is in line with the Company strategy – and that the results are in line with our return requirements and high corporate standards. Post-IP evaluation continues to be refined to ensure future outcomes remain in line with our expectations. We also ensure that any lessons learned are applied in future store and other investment projects.

We also paid close attention to stores with weaker relative performance opened in previous years to ensure any specific lessons learned can be taken into account when reviewing, opening and operating new stores in the future.

**Dmitry Shvets**
Chairman
Capital Expenditure Committee

# Corporate governance continued

## RELATIONS WITH SHAREHOLDERS

We are committed to conducting constructive dialogue with shareholders to ensure that we understand what is important to them and enable clear communication of our position. The Chairman, CEO and CFO hold regular meetings with shareholders and update the Board on the outcomes of those meetings. Investor Relations keeps the Board informed of investor, broker and analyst views, and reports and presents formally to the Board at each scheduled Board meeting.

We support engagement with institutional shareholders as envisaged by the Stewardship Code and have a dedicated investor relations website.

At our AGM, all resolutions are proposed and voted upon individually by shareholders or their proxies. All votes taken during the AGM are by way of a poll. This follows best practice guidelines and allows the Company to count all votes, not just those of shareholders attending the meeting.

## RESPONSIBILITY STATEMENT

We, members of the Board, confirm that, to the best of our knowledge:

The consolidated financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit and loss of Lenta Ltd and its subsidiaries taken as a whole. This annual report includes a fair review of the development and performance of the business and the position of Lenta Ltd and its subsidiaries, taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board.

**John Oliver**
Chairman, Lenta Ltd
28 April 2017

### Schedule of investor calls in 2016

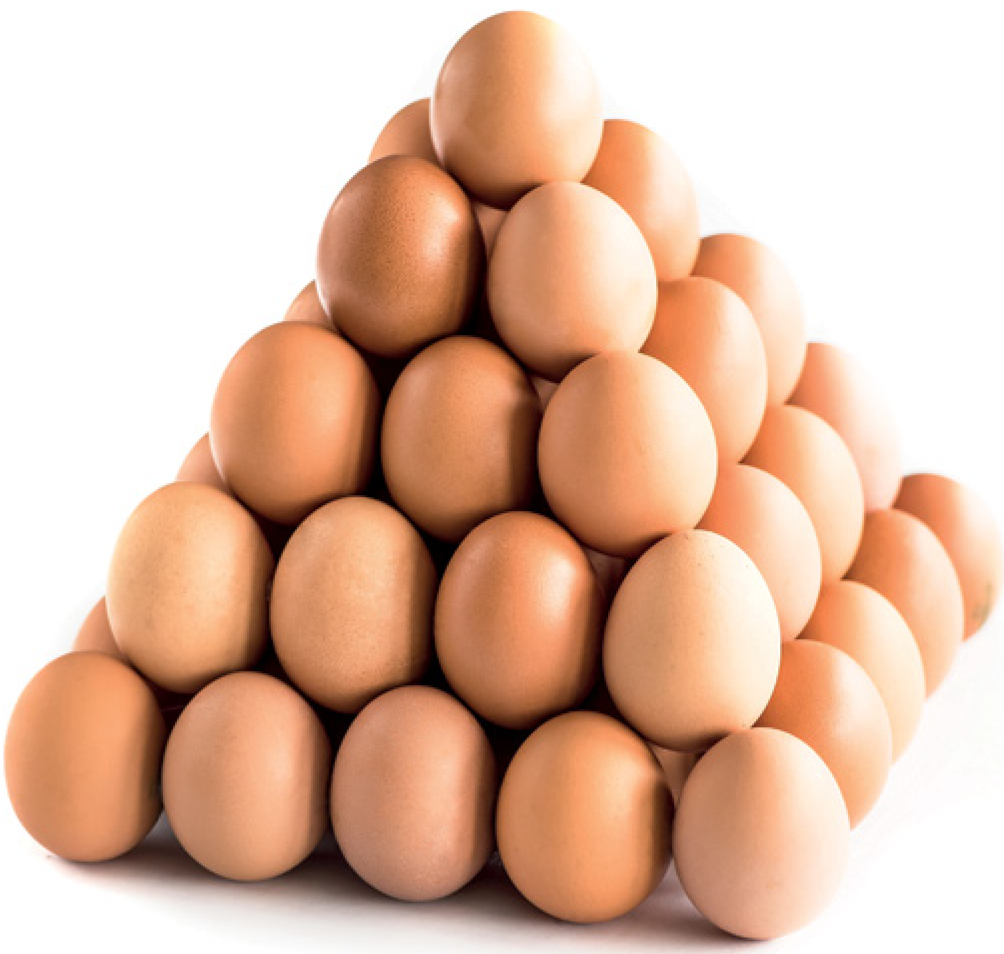
| | | | |
|---|---|---|---|
| January | 28 | Thursday | 5–6pm Moscow time |
| February | 18 | Thursday | 5–6pm Moscow time |
| April | 27 | Wednesday | 5–6pm Moscow time |
| July | 21 | Thursday | 5–6pm Moscow time |
| August | 25 | Thursday | 5–6pm Moscow time |
| October | 20 | Thursday | 5–6pm Moscow time |

### Schedule of investor calls in 2017

| | | | |
|---|---|---|---|
| January | 26 | Thursday | 5–6pm Moscow time |
| February | 16 | Thursday | 5–6pm Moscow time |
| April | 20 | Thursday | 5–6pm Moscow time |
| July | 20 | Thursday | 5–6pm Moscow time |
| August | 30 | Wednesday | 5–6pm Moscow time |
| October | 19 | Thursday | 5–6pm Moscow time |

# FINANCIAL STATEMENTS

**92** Statement of management's responsibilities for the preparation and approval of the consolidated financial statements
**93** Independent auditors' report
**96** Consolidated statement of financial position
**97** Consolidated statement of profit or loss and other comprehensive income
**98** Consolidated statement of cash flows
**99** Consolidated statement of changes in equity
**100** Notes to the consolidated financial statements



# Statement of management's responsibilities for the preparation and approval of the consolidated financial statements

for the year ended 31 December 2016

The following statement is made with a view to the respective responsibilities of management in relation to the consolidated financial statements of Lenta Limited and its subsidiaries ("the Group").

Management is responsible for the preparation of these consolidated financial statements that present fairly the financial position of Lenta Limited and its subsidiaries ("the Group") as at 31 December 2016 and the results of its operations, cash flows and changes in shareholders' equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements of IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended 31 December 2016 were approved by management on 15 February 2017.

On behalf of the Management as authorised by the Board of Directors.

**Jan Dunning**
CEO of Lenta Ltd

**Jago Lemmens**
CFO of Lenta Ltd

# Independent auditor's report

To the Shareholders and Board of Directors of Lenta Limited

## Opinion

We have audited the consolidated financial statements of Lenta Limited and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit and loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

## Capitalisation of construction costs

The Group incurs significant expenditures related to the construction of new retail stores, a part of which was capitalised under IAS 16 Property, Plant and Equipment. Capitalisation of construction costs was a matter of most significance in our audit because the balance of property, plant and equipment as of 31 December 2016 is significant to the consolidated financial statements. Information in respect of the balance of property, plant and equipment as of 31 December 2016 and additions for the year then ended is disclosed in Note 9 to the consolidated financial statements.

We obtained understanding of the Group's capitalisation policy and tested controls over authorisation, timeliness and accuracy of recording of property, plant and equipment additions. We compared the Group's investment budget with actual capital expenditures. On a sample basis we tested capital expenditures to supporting documents. We analysed aging of assets under construction.

## Recognition of suppliers' allowances

The Group receives various types of allowances from suppliers in connection with the purchase of goods for resale in the form of volume discounts and other payments. The recognition of allowances was a matter of most significance in our audit because of its material impact on trade and other receivables, cost of goods sold and inventories. In addition, management exercises judgement in determining the period over which these allowances should be recognised considering the nature and the level of fulfilment of the Group's obligations and estimates of purchase volumes. Information about suppliers' rebates receivable and accounts receivable on suppliers' advertising as of 31 December 2016 is disclosed in Note 14 to the consolidated financial statements.

We understood and tested the design and operating effectiveness of internal controls over the recognition of allowances from suppliers. We agreed performance obligations to supporting documents approved by individual suppliers. We analysed the assumptions underlying management estimates of amounts receivable. On a sample basis we received direct confirmations of outstanding balances from suppliers. We agreed the balances of suppliers' allowances receivables to the post year-end cash settlements.

## Other information included in the Group's 2016 annual report

Other information consists of the information included in the Annual report, other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Group's 2016 Annual report is expected to be made available to us after the date of this auditor's report.

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 identified above when it becomes available 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.

# Independent auditor's report (continued)

## Responsibilities of management and Board of Directors for the financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Board of Directors is responsible for overseeing the Group's financial reporting process.

## Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

From the matters communicated with Board of Directors, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Ilya Ananyev.

**Ilya Ananyev**
Partner
Ernst & Young LLC

15 February 2017

**Details of the audited entity**
**Name:** Lenta Ltd
Registered 16 July 2003
**Address:** Road Town, Tortola, BVI

**Details of the auditor**
**Name:** Ernst & Young LLC
Record made in the State Register of Legal Entities on 5 December 2002, State Registration Number 1027739707203.
**Address:** Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young LLC is a member of Self-regulated organization of auditors "Russian Union of auditors" (Association) ("SRO RUA"). Ernst & Young LLC is included in the control copy of the register of auditors and audit organizations, main registration number 11603050648.

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# Consolidated statement of financial position

as at 31 December 2016 (in thousands of Russian roubles)

| | Note | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets:** | | | |
| Property, plant and equipment | 9 | **147,812,289** | 104,016,458 |
| Prepayments for construction | 10 | **7,741,743** | 6,528,355 |
| Leasehold rights | 11 | **3,744,009** | 3,047,168 |
| Intangible assets other than leasehold rights | 12 | **1,890,176** | 1,092,329 |
| Long-term portion of cash flow hedging instruments | 31 | **62,618** | 355,414 |
| Deferred tax asset | 22 | **123,508** | – |
| Other non-current assets | | **199,131** | – |
| **Total non-current assets** | | **161,573,474** | 115,039,724 |
| | | | |
| **Current assets:** | | | |
| Inventories | 13 | **27,490,941** | 22,781,732 |
| Trade and other receivable | 14 | **17,035,789** | 13,646,894 |
| Advances paid | 15 | **2,669,761** | 2,264,911 |
| Taxes recoverable | 16 | **3,920,940** | 1,257,764 |
| Advance payments for income tax | | **–** | 288,119 |
| Prepaid expenses | | **131,932** | 217,711 |
| Short-term portion of cash flow hedging instruments | 31 | **309,592** | 439,050 |
| Cash and cash equivalents | 17 | **13,037,767** | 22,455,945 |
| **Total current assets** | | **64,596,722** | 63,352,126 |
| **Total assets** | | **226,170,196** | 178,391,850 |
| | | | |
| **Equity and liabilities** | | | |
| **Equity** | | | |
| Share capital | 18, 20 | **284** | 284 |
| Additional paid-in capital | 18 | **26,216,147** | 26,216,147 |
| Share options | 28 | **668,200** | 338,016 |
| Hedging reserve | 18 | **431,570** | 724,642 |
| Retained earnings | | **31,052,910** | 19,850,882 |
| **Total equity** | | **58,369,111** | 47,129,971 |
| | | | |
| **Liabilities** | | | |
| **Non-current liabilities:** | | | |
| Long-term borrowings | 21 | **66,955,931** | 65,149,097 |
| Deferred tax liabilities | 22 | **7,359,998** | 5,229,804 |
| Long-term portion of cash flow hedging instruments | 31 | **2,137** | 24,564 |
| **Total non-current liabilities** | | **74,318,066** | 70,403,465 |
| | | | |
| **Current liabilities:** | | | |
| Trade and other payables | 23 | **56,171,598** | 48,820,207 |
| Advances received | | **340,062** | 219,705 |
| Other taxes payable | 24 | **1,111,306** | 927,084 |
| Current income tax payable | | **568,345** | – |
| Short-term portion of cash flow hedging instruments | 31 | **46,588** | 99,564 |
| Short-term borrowings and short-term portion of long-term borrowings | 21 | **35,245,120** | 10,773,277 |
| Short-term obligations under finance leases | | **–** | 18,577 |
| **Total current liabilities** | | **93,483,019** | 60,858,414 |
| **Total liabilities** | | **167,801,085** | 131,261,879 |
| **Total equity and liabilities** | | **226,170,196** | 178,391,850 |

The accompanying notes on pages 100 to 140 are an integral part of these financial statements.

# Consolidated statement of profit or loss and other comprehensive income

for the year ended 31 December 2016 (in thousands of Russian roubles)

| | Note | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|---|
| Sales | | **306,352,092** | 252,763,075 |
| Cost of sales | 25 | **(238,584,029)** | (196,457,910) |
| **Gross profit** | | **67,768,063** | 56,305,165 |
| | | | |
| Selling, general and administrative expenses | 26 | **(46,442,510)** | (36,044,771) |
| Other operating income | 27 | **3,086,079** | 2,584,310 |
| Other operating expense | 27 | **(716,375)** | (512,533) |
| **Operating profit** | | **23,695,257** | 22,332,171 |
| | | | |
| Interest expense | | **(10,084,573)** | (10,044,858) |
| Interest income | | **851,813** | 767,905 |
| Ineffective portion of change in fair value of cash flow hedging instruments | 31 | **–** | 6,308 |
| Foreign exchange gains/(losses) | | **90,751** | (189,423) |
| **Profit before income tax** | | **14,553,248** | 12,872,103 |
| | | | |
| Income tax expense | 22 | **(3,351,220)** | (2,584,010) |
| **Profit for the year** | | **11,202,028** | 10,288,093 |
| | | | |
| **Other comprehensive income** | | | |
| **Other comprehensive income to be reclassified to profit or loss in subsequent periods** | | | |
| Net loss from cash flow hedges | 19 | **(366,340)** | (2,326,519) |
| Income tax relating to the components of OCI | 22 | **73,268** | 465,304 |
| **Other comprehensive loss for the year, net of tax** | | **(293,072)** | (1,861,215) |
| **Total comprehensive income for the year, net of tax** | | **10,908,956** | 8,426,878 |
| | | | |
| **Earnings per share (in thousands of Russian roubles per share) (Note 20)** | | | |
| – basic and diluted, for profit for the year attributable to equity holders of the parent | | **0.115** | 0.112 |

The accompanying notes on pages 100 to 140 are an integral part of these financial statements.

# Consolidated statement of cash flows

for the year ended 31 December 2016 (in thousands of Russian roubles)

| | Note | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| **Profit before income tax** | | **14,553,248** | 12,872,103 |
| | | | |
| Adjustments for: | | | |
| Net loss on disposal of property, plant and equipment | | **262,048** | 53,596 |
| Net loss on disposal of intangible assets | | **–** | 6,486 |
| Net loss on disposal of leasehold rights | | **1,279** | 59,235 |
| Interest expense | | **10,084,573** | 10,044,858 |
| Interest income | | **(851,813)** | (767,905) |
| Inventory write-down/(reversal of write-down) to NRV | 13 | **325,443** | (38,710) |
| Change in bad debt allowance and impairment of advances and prepayments for construction | 10, 14, 27 | **178,504** | 194,665 |
| Depreciation and amortisation | 9, 26 | **7,694,569** | 5,686,264 |
| Share options expense | 28 | **330,184** | 184,124 |
| Ineffective portion of change in fair value of cash flow hedging instruments | 31 | **–** | (6,308) |
| | | **32,578,035** | 28,288,408 |
| Movements in working capital | | | |
| Increase in trade and other receivables | | **(3,399,994)** | (2,120,455) |
| (Increase)/decrease in advances paid | 15 | **(406,727)** | 486,213 |
| Increase in prepaid expenses | | **(33,427)** | (52,232) |
| Increase in inventories | 13 | **(4,821,288)** | (3,113,641) |
| Increase in trade and other payables | 23 | **5,159,820** | 1,228,784 |
| Increase in advances received | | **115,017** | 5,754 |
| (Decrease)/increase in net other taxes payable | 16, 24 | **(1,281,209)** | 1,187,747 |
| **Cash from operating activities** | | **27,910,227** | 25,910,578 |
| | | | |
| Income taxes paid | | **(289,411)** | (896,352) |
| Interest received | | **942,997** | 656,052 |
| Interest paid | | **(8,845,027)** | (9,745,887) |
| **Net cash generated from operating activities** | | **19,718,786** | 15,924,391 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchases of property, plant and equipment | | **(41,688,957)** | (30,434,839) |
| Acquisition of subsidiaries, net of cash acquired | | **(11,100,481)** | – |
| Purchases of intangible assets other than leasehold rights | | **(1,088,745)** | (486,224) |
| Purchases of leasehold rights | | **(630,989)** | (557,827) |
| Proceeds from sale of property, plant and equipment | | **251,937** | 109,264 |
| **Net cash used in investing activities** | | **(54,257,235)** | (31,369,626) |
| | | | |
| **Cash flows from financing activities** | | | |
| Proceeds from borrowings | | **65,422,079** | 89,717,940 |
| Repayments of borrowings | | **(40,283,231)** | (85,565,000) |
| Repayments of obligations under financial lease | | **(18,577)** | (16,888) |
| Proceeds from issue of new shares | 18 | **–** | 21,788,593 |
| Payment of loan commission | | **–** | (59,250) |
| **Net cash generated from financing activities** | | **25,120,271** | 25,865,395 |
| | | | |
| **Net (decrease)/increase in cash and cash equivalents** | | **(9,418,178)** | 10,420,160 |
| | | | |
| Cash and cash equivalents at the beginning of the period | 17 | **22,455,945** | 12,035,785 |
| Cash and cash equivalents at the end of the period | 17 | **13,037,767** | 22,455,945 |

The accompanying notes on pages 100 to 140 are an integral part of these financial statements.

# Consolidated statement of changes in equity

for the year ended 31 December 2016 (in thousands of Russian roubles)

| | Share capital | Additional paid-in capital | Hedging reserve | Share options reserve | Retained earnings | Total equity |
|---|---|---|---|---|---|---|
| **Balance at 1 January 2016** | **284** | **26,216,147** | **724,642** | **338,016** | **19,850,882** | **47,129,971** |
| Profit for the period | **–** | **–** | **–** | **–** | **11,202,028** | **11,202,028** |
| Other comprehensive income/(loss) | **–** | **–** | **(293,072)** | **–** | **–** | **(293,072)** |
| **Total comprehensive income/(loss)** | **–** | **–** | **(293,072)** | **–** | **11,202,028** | **10,908,956** |
| | | | | | | |
| Share-based payments (Note 28) | **–** | **–** | **–** | **330,184** | **–** | **330,184** |
| **Balance at 31 December 2016** | **284** | **26,216,147** | **431,570** | **668,200** | **31,052,910** | **58,369,111** |
| | | | | | | |
| **Balance at 1 January 2015** | 284 | 4,427,554 | 2,585,857 | 153,892 | 9,562,789 | 16,730,376 |
| Profit for the period | – | – | – | – | 10,288,093 | 10,288,093 |
| Other comprehensive income/(loss) | – | – | (1,861,215) | – | – | (1,861,215) |
| **Total comprehensive income/(loss)** | – | – | (1,861,215) | – | 10,288,093 | 8,426,878 |
| | | | | | | |
| Share-based payments (Note 28) | – | – | – | 184,124 | – | 184,124 |
| Issue of shares (Note 18, 28) | – | 21,788,593 | – | – | – | 21,788,593 |
| **Balance at 31 December 2015** | 284 | 26,216,147 | 724,642 | 338,016 | 19,850,882 | 47,129,971 |

**Notes**

Additional paid-in capital: Additional paid-in capital is the difference between the fair value of consideration received and nominal value of the issued shares.

The accompanying notes on pages 100 to 140 are an integral part of these financial statements.

# Notes to the consolidated financial statements

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 1. THE LENTA GROUP AND ITS OPERATIONS

The Lenta Group (the "Group") comprises Lenta Limited ("the Company") and its subsidiaries. The Group's principal business activity is the development and operation of hypermarket and supermarket stores in Russia.

The Company was incorporated as a company limited by shares under the laws of the British Virgin Islands (BVI) on 16 July 2003. The Company's registered address is at Road Town, Tortola, BVI. The registered office of the Group's main operating entity, Lenta LLC, is located at 112, Savushkina Street, 197374, Saint Petersburg, Russia.

Starting from March 2014 the Company's shares were listed on the London Stock Exchange and Moscow Exchange in the form of Global Depositary Receipts (GDR). In 2015 two more public offerings took place at the London Stock Exchange and Moscow Exchange in the form of GDRs.

At 31 December 2015 and 2016 the Group has one main operational fully owned subsidiary, Lenta LLC, a legal entity registered under the laws of the Russian Federation. The principal activity of Lenta LLC is retail trade. Other subsidiaries including newly acquired (see Note 7) are property or investment holding companies by its nature.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

### Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (IASB).

### 2.1 Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for as described in accounting policies below. The consolidated financial statements are presented in Russian roubles and all values are rounded to the nearest thousand (RUB 000), except when otherwise indicated.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented unless otherwise stated.

Management has considered the Group's cash flow forecasts for the period ending 31 March 2018, which take into account the current and expected economic situation in Russia, the Group's financial position, available borrowing facilities, and loan covenant compliance, planned store opening program and the anticipated cash flows and related expenditures from retail stores.

Accordingly, management is satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the consolidated financial information for these consolidated financial statements.

At 31 December 2016, the Group had net current liabilities of RUB 28,886,297 thousand (net current assets at 31 December 2015: 2,493,712 thousand).

Unused credit facilities available as of 31 December 2016 were RUB 44,150,000 thousand. Management believes that operating cash flows and available borrowing capacity will provide it adequate resources to fund its liabilities for the next year.

### 2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and other entities controlled by the Company (its subsidiaries) as at 31 December 2016. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights result in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee;
- Rights arising from other contractual arrangements;
- The Group's voting rights and potential voting rights.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the statement of comprehensive income from the date the Group gains control until the date the Group ceases to control the subsidiary.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.2 Basis of consolidation (continued)

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

Subsidiaries are those companies (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits and which are neither associates nor joint ventures. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

### 2.3 Summary of significant accounting policies

#### Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interest in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognised in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Subsequently contingent consideration classified as an asset or liability is measured at fair value with changes in fair value recognised either in profit or loss. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted for within equity.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest over the net identifiable assets acquired and liabilities assumed.

If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the gain is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss from disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

#### Current versus non-current classification

The Group presents assets and liabilities in statement of financial position based on current/non-current classification. An asset is current when it is:

- Expected to be realised or intended to sold or consumed in normal operating cycle;
- Held primarily for the purpose of trading;
- Expected to be realised within twelve months after the reporting period; or
- Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

All other assets are classified as non-current. A liability is current when:

- It is expected to be settled in normal operating cycle;
- It is held primarily for the purpose of trading;
- It is due to be settled within twelve months after the reporting period; or
- There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

The Group classifies all other liabilities as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

#### Fair value measurement

The Group measures financial instruments, such as derivatives at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 30.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

#### Functional and presentation currency

The presentation and functional currency of all Group entities is the Russian rouble ("RUB"), the national currency of the Russian Federation, the primary economic environment in which operating entities function.

Transactions in foreign currencies are initially recorded by the Group's entities at the functional currency spot rates at the date the transaction first qualifies for recognition.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of gain or loss from change in fair value of the item.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

#### Property, plant and equipment

Property, plant and equipment are initially recorded at purchase or construction cost. Cost of replacing major parts or components of property, plant and equipment items is capitalised and the replaced part is retired. All other repair and maintenance costs are expensed as incurred.

Property, plant and equipment are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any.

Gains and losses on disposals determined by comparing net proceeds with the respective carrying amount are recognised in profit or loss.

Construction in progress comprises costs directly related to the construction of property, plant and equipment including an appropriate allocation of directly attributable variable overheads that are incurred in construction. Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Construction in progress is reviewed regularly to determine whether its carrying value is recoverable and whether appropriate impairment loss has been recognised.

Properties in the course of construction for production, rental or administrative purposes, or for purposes not yet determined, are carried at cost, less any recognised impairment loss. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

#### Depreciation

Depreciation of property, plant and equipment is calculated using the straight-line method to write off their cost to their residual values over their estimated useful lives:

| | Useful lives in years |
|---|---|
| Buildings | 30 |
| Land improvements | 30 |
| Machinery and equipment | 5 to 15 |
| Other | 3 to 5 |

#### Leasehold rights

Leasehold rights acquired as part of hypermarket development projects are separately reported at cost less accumulated amortisation and accumulated impairment losses. These leasehold rights are amortised to profit or loss over the term of the lease, which is 49 years. If the Group further purchases the land plot previously leased, the carrying amount of the related leasehold right as of the date of purchase transaction is reclassified to the cost of land plot purchased.

#### Finance leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the profit and loss, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

#### Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is reflected in profit and loss in the period in which the expenditure is incurred.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life (which is from 3 to 7 years) using a straight-line method to write off their cost to their residual values and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of profit or loss and other comprehensive income as the expense category that is consistent with the function of the intangible assets or included into the carrying amount of an asset as appropriate.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

Intangible assets with indefinite useful lives are not amortised, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the profit or loss when the asset is derecognised.

**Impairment of non-financial assets**

At each reporting date, the Group reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating unit, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and value in use. 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 for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or a cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (the cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (the cash generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (the cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

**Income taxes**

Income taxes have been provided for in the consolidated financial statements in accordance with management's interpretation of the relevant legislation enacted or substantively enacted as at the reporting date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated statement of profit or loss and other comprehensive income unless it relates to transactions that are recognised, in the same or a different period, directly in equity. In the case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost of consideration paid.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Deferred income tax is recorded using the balance sheet liability method for tax loss carry-forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the reporting date, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry-forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry-forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

Deferred tax assets are recognised for all deductible temporary differences, the carry-forward of unused tax credits and any unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

#### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses. Cost comprises the direct cost of goods, transportation and handling costs. Cost of sales comprises only cost of inventories sold through retail stores and inventory write-downs made during the period.

#### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets are capitalised as part of the cost of that asset, other borrowing costs are recognised in profit or loss in the period in which they are incurred. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. For the purposes of borrowing costs recognition, a substantial period of time is considered to be a period of twelve months or more.

To the extent that the Group borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Group determines the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

#### Revenue recognition

The sole source of revenue is retail sales. Revenue from the sale of goods is recognised at the point of sale.

The Group generates and recognises sales to retail customers in its stores at the point of sale. Retail sales are in cash and through bank cards. Revenues are measured at the fair value of the consideration received or receivable, recognised net of value added tax and are reduced for estimated customer returns. Historical information in relation to the timing and frequency of customer returns is used to estimate and provide for such returns at the time of sale.

Income generated from rental of spaces for small trading outlets within the Group's stores is recognised in the end of each month on a straight-line basis over the period of the lease, in accordance with the terms of the relevant lease agreements.

Interest income is recognised on a time-proportion basis using the effective interest rate method. Interest income is included into the Interest income line in the statement of comprehensive income.

#### Suppliers' allowances

The Group receives various types of allowances from vendors in the form of volume discounts and other forms of payments that effectively reduce the cost of goods purchased from the vendor. These allowances received from suppliers are recorded as a reduction in the price paid for the products and reduce cost of goods sold in the period the products are sold. Where a rebate agreement with a supplier covers more than one year, the rebates are recognised in the period in which they are earned.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

#### Employee benefits

The Group is subject to mandatory contributions to the Russian Federation defined contribution state pension benefit fund. Wages, salaries, contributions to the state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Group.

#### Share-based payments

Certain employees (including senior executives) of the Group receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments (equity-settled transactions).

The cost of equity-settled transactions is determined by the fair value at the date when the grant is made using an appropriate valuation model.

That cost is recognised, together with a corresponding increase in share options reserve in equity, over the period in which the performance and/or service conditions are fulfilled in employee benefits expense (Note 28). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The statement of profit or loss expense or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period and is recognised in employee benefits expense (Note 28).

No expense is recognised for awards that do not ultimately vest, except for equity-settled transactions for which vesting is conditional upon a market or non-vesting condition. These are treated as vested irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

When the terms of an equity-settled award are modified, the minimum expense recognised is the expense had the terms had not been modified, if the original terms of the award are met. An additional expense is recognised for any modification that increases the total fair value of the share-based payment transaction, or is otherwise beneficial to the employee as measured at the date of modification.

#### Pre-opening costs

Operating expenses incurred during the process of opening of new stores were recorded in the Group's consolidated statement of profit or loss and other comprehensive income. These expenses do not meet capitalisation criteria under IAS 16 Property, Plant and Equipment and include rent, utilities and other operating expenses.

#### Segment reporting

The Group's business operations are located in the Russian Federation and relate primarily to retail sales of consumer goods. Although the Group operates through different stores and in various regions within the Russian Federation, the Group's chief operating decision maker reviews the Group's operations and allocates resources on an individual store-by-store basis. The Group has assessed the economic characteristics of the individual stores and determined that the stores have similar margins, similar products, similar types of customers and similar methods of distributing such products. Therefore, the Group considers that it only has one reportable segment under IFRS 8. Segment performance is evaluated based on a measure of revenue and earnings before interest, tax, depreciation and amortisation (EBITDA). EBITDA is non-IFRS measure. Other information is measured in a manner consistent with that in the consolidated financial statements.

#### Seasonality

The Group's business operations are stable during the year with limited seasonal impact, except for a significant increase of business activities in December.

#### Financial assets

**General description**

Financial assets are classified into the following specified categories: at fair value through profit or loss ("FVTPL"); held-to-maturity investments, "available-for-sale" ("AFS") financial assets and "loans and receivables". The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

All financial assets are recognised initially at fair value plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

**Loans and receivables**

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest rate method.

**Cash and cash equivalents**

Cash and short-term deposits in the statement of financial position comprise cash at banks and on hand and short-term deposits with a maturity of three months or less.

**Impairment of financial assets**

Financial assets are assessed for indicators of impairment at each reporting date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial asset have been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

**Derecognition of financial assets**

A financial asset is derecognised when:

- The rights to receive cash flows from the asset have expired;
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

#### Financial liabilities and equity instruments issued by the Group

**Treasury shares**

Own equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in the statement of profit or loss and other comprehensive income on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised in additional paid-in capital. Voting rights related to treasury shares are nullified for the Group and no dividends are allocated to them. Share options exercised during the reporting period are satisfied with treasury shares.

**Share capital**

Ordinary shares are classified as equity. Transaction costs of a share issue are shown within equity as a deduction from the equity.

**Additional paid-in capital**

Additional paid-in capital represents the difference between the fair value of consideration received and the nominal value of the issued shares.

**Earnings per share**

Basic earnings per share amounts are calculated by dividing the net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to ordinary equity holders of the parent (after adjusting for interest on the convertible preference shares) by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares into ordinary shares.

**Classification as debt or equity**

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement. An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments are recorded at the proceeds received, net of transaction costs.

#### Financial liabilities

Financial liabilities of the Group, including borrowings and trade and other payables, are initially recognised at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest rate method.

**Derecognition of financial liabilities**

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.3 Summary of significant accounting policies (continued)

**Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

**Derivative financial instruments and hedge accounting**

**Initial recognition and subsequent measurement**

The Group uses derivative financial instruments, such as interest rate swaps and caps, to hedge its interest rate risks. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

Any gains or losses arising from changes in the fair value of derivatives are taken directly to profit or loss, except for the effective portion of cash flow hedges, which is recognised in OCI and later reclassified to profit or loss when the hedge item affects profit or loss.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Swaps and caps used by the Group that meet the strict criteria for hedge accounting are accounted for as cash flow hedges. The effective portion of the gain or loss from the hedging instrument is recognised in other comprehensive income in the cash flow hedge reserve, while any ineffective portion is recognised immediately in profit or loss as other operating expenses.

Designation of a hedge relationship takes effect prospectively from the date all of the criteria are met. In particular, hedge accounting can be applied only from the date all of the necessary documentation is completed. Therefore, hedge relationships cannot be designated retrospectively.

Amounts recognised as OCI are transferred to profit or loss when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognised or when a forecast sale occurs.

When the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recognised as OCI are transferred to the initial carrying amount of the non-financial asset or liability.

If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover (as part of the hedging strategy), or if its designation as a hedge is revoked, or when the hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss previously recognised in OCI remains separately in equity until the forecast transaction occurs or the foreign currency firm commitment is met.

**Current versus non-current classification**

Derivative instruments are classified as current or non-current or separated into current and non current portions based on an assessment of the facts and circumstances (i.e., the underlying contracted cash flows):

- When the Group expects to hold a derivative as an economic hedge for a period beyond 12 months after the reporting date, the derivative is classified as non-current (or separated into current and non-current portions) consistent with the classification of the underlying item.

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

In the application of the Group's accounting policies, which are described in Note 2 above, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments that have the most significant effect on the amounts recognised in these 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:

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (CONTINUED)

### Judgments

#### Operating lease commitments – Group as lessor

The Group has entered into premises leases. The Group has determined, based on an evaluation of the terms and conditions of the arrangements, such as the lease term not constituting a substantial portion of the economic life of the commercial property, that it retains all the significant risks and rewards of ownership of these properties and accounts for the contracts as operating leases.

#### Assets versus business acquisition

From time to time in the normal course of business the Group acquires the companies that are a party to a lease contract, own the land plot or store in which the Group is interested. If at the date of acquisition by the Group, the company does not constitute an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investor, the Group treats such acquisitions as a purchase of assets (a leasehold right, land plot or store) in the consolidated financial statements. The exercise of judgment determines whether a particular transaction is treated as a business combination or as a purchase of assets.

### Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

#### Leases renewal assumption

It is presumed that the initial land leases contracted for short terms will be renewed for 49 years at completion of construction of department stores. Thus, any long-term prepayments at the inception of the leases are presumed to have a 49-year useful life. Should the Group fail to renew the land lease contracts for a 49-year period, leasehold rights would have to be written off at the end of the initial lease term.

#### Inventory valuation

Management reviews the inventory balances to determine if inventories can be sold at amounts greater than or equal to their carrying amounts plus costs to sell. This review also includes the identification of slow moving inventories, which are written down based on inventories ageing and write down rates. The write down rates are determined by management following the experience of sales of such items.

#### Tax legislation

Russian tax, currency and customs legislation is subject to frequent changes and varying interpretations. Management's interpretation of such legislation in applying it to business transactions of the Group may be challenged by the relevant regional and federal authorities enabled by law to impose fines and penalties. Recent events in the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that the transactions that have not been challenged in the past may be challenged. Fiscal periods remain open to review by the tax authorities in respect of taxes for the three calendar years preceding the year of tax review. Under certain circumstances reviews may cover longer periods. While the Group believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation, the above facts may create additional financial risks for the Group.

#### Fair value measurement of financial instruments

When the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. See Note 30 for further discussion.

#### Impairment of non-financial assets

The Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets are impaired. Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use.

The fair value less costs to sell calculation is based on available data from binding sales transactions, conducted at arm's length, for similar assets or observable market prices less incremental costs for disposing of the asset.

Due to their subjective nature, these estimates will likely differ from future actual results of operations and cash flows, and it is possible that these differences could be material.

The value in use calculation is based on a discounted cash flow model. In determining the value in use calculation, future cash flows are estimated from each store based on cash flows projection utilising the latest budget information available. The discounted cash flow model requires numerous estimates and assumptions regarding the future rates of market growth, market demand for the products and the future profitability of products.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (CONTINUED)

### Estimates and assumptions (continued)

**Share-based payments**

The Group measures the cost of equity-settled transactions by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payment transactions are disclosed in Note 28.

## 4. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The accounting policies adopted in the preparation of the consolidated financial statements are consistent with those followed in the preparation of the Group's annual consolidated financial statements for the year ended 31 December 2015, except for the adoption of new or revised standards and interpretations effective as of 1 January 2016.

The nature and the impact of each new standard and amendment are described below:

**IFRS 14 Regulatory Deferral Accounts**

IFRS 14 is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of IFRS. Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and OCI. The standard requires disclosure of the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements.

Since the Group is an existing IFRS preparer and is not involved in any rate-regulated activities, this standard does not apply.

**Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests**

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 *Business Combinations* principles for business combination accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation if joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party. The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are applied prospectively. These amendments do not have any impact on the Group as there has been no interest acquired in a joint operation during the period.

**Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation**

The amendments clarify the principle in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is a part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are applied prospectively and do not have any impact on the Group, given that it has not used a revenue-based method to depreciate its non-current assets.

**Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants**

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of IAS 41 *Agriculture*. Instead, IAS 16 will apply. After initial recognition, bearer plants will be measured under IAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of IAS 41 measured at fair value less costs to sell. For government grants related to bearer plants, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* will apply. The amendments are applied retrospectively and do not have any impact on the Group as it does not have any bearer plants.

**Amendments to IAS 27: Equity Method in Separate Financial Statements**

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in their separate financial statements have to apply that change retrospectively.

These amendments do not have any impact on the Group's consolidated financial statements.

## 4. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS (CONTINUED)

### Annual improvements 2012–2014 cycle

These improvements include:

**IFRS 5 Non-current Assets Held for Sale and Discontinued Operations**
Assets (or disposal groups) are generally disposed of either through sale or distribution to the owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment is applied prospectively.

**IFRS 7 Financial Instruments: Disclosures**
**(i) Servicing contracts**
The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be made retrospectively. However, the required disclosures need not be provided for any period beginning before the annual period in which the entity first applies the amendments.

**(ii) Applicability of the amendments to IFRS 7 to condensed interim financial statements**
The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. This amendment is applied retrospectively.

**IAS 19 Employee Benefits**
The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment is applied prospectively.

**IAS 34 Interim Financial Reporting**
The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment is applied retrospectively.

These amendments do not have any impact on the Group.

**Amendments to IAS 1 Disclosure Initiative**
The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments do not have any impact on the Group.

**Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception**
The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value. Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

These amendments are applied retrospectively and do not have any impact on the Group as the Group does not apply the consolidation exception.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 5. STANDARDS ISSUED BUT NOT YET EFFECTIVE

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

**IFRS 9 Financial Instruments**
In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for the financial instruments project: classification and measurement; impairment; and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required, but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Group plans to adopt the new standard on the required effective date. During 2016, the Group has performed a high-level impact assessment of all three aspects of IFRS 9. This preliminary assessment is based on currently available information and may be subject to changes arising from further detailed analyses or additional reasonable and supportable information being made available to the Group in the future. The Group does not expect a significant impact on its balance sheet or equity on applying the classification and measurement requirements of IFRS 9.

IFRS 9 requires the Group to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Group will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

The Group believes that all existing hedge relationships that are currently designated in effective hedging relationships will still qualify for hedge accounting under IFRS 9. As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, the Group does not expect a significant impact as a result of applying IFRS 9.

**IFRS 15 Revenue from Contracts with Customers**
IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

**Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture**
The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

**IAS 7 Disclosure Initiative – Amendments to IAS 7**
The amendments to IAS 7 Statement of Cash Flows are part of the IASB's Disclosure Initiative and require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. On initial application of the amendment, entities are not required to provide comparative information for preceding periods. These amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. Application of the amendments will result in additional disclosures provided by the Group.

**IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12**
The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in the opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact. These amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. If an entity applies the amendments for an earlier period, it must disclose that fact. These amendments are not expected to have any impact on the Group.

## 5. STANDARDS ISSUED BUT NOT YET EFFECTIVE (CONTINUED)

**IFRS 2 Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2**
The IASB issued amendments to IFRS 2 *Share-based Payment* that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The Group is assessing the potential effect of the amendments on its consolidated financial statements.

**IFRS 16 Leases**
IFRS 16 was issued in January 2016 and it replaces 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*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

The Group is assessing the potential effect of the amendments on its consolidated financial statements.

**IFRS 1 First-time Adoption of International Financial Reporting Standards – Amendments to IFRS 1**
The amendment repeals short-term exemptions for first-time adopters. The amendment is effective from 1 January 2018. These amendments are not expected to have any impact on the Group.

**IAS 28 Investments in Associates and Joint Ventures – Amendments to IAS 28**
The amendments clarifies that an entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss. If an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. The amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted. If an entity applies those amendments for an earlier period, it must disclose that fact. These amendments are not expected to have any impact on the Group.

**IFRS 12 Disclosure of Interests in Other Entities – Amendments to IFRS 12**
The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10-B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. The amendments are effective from 1 January 2017 and must be applied retrospectively. These amendments are not expected to have any impact on the Group.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 5. STANDARDS ISSUED BUT NOT YET EFFECTIVE (CONTINUED)

**IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration**

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration.

Entities may apply the amendments on a fully retrospective basis. Alternatively, an entity may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognised on or after: (i) the beginning of the reporting period in which the entity first applies the interpretation or (ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation. Early application of interpretation is permitted and must be disclosed. First-time adopters of IFRS are also permitted to apply the interpretation prospectively to all assets, expenses and income initially recognised on or after the date of transition to IFRS.

The amendments are intended to eliminate diversity in practice, when recognising the related asset, expense or income (or part of it) on the derecognition of a nonmonetary asset or non-monetary liability relating to advance consideration received or paid in foreign currency.

The amendments are effective for annual periods beginning on or after 1 January 2018.

These amendments are not expected to have any impact on the Group.

**IAS 40 Investment property – Amendments to IAS 40**

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if that is possible without the use of hindsight. Early application of the amendments is permitted and must be disclosed. The amendments will eliminate diversity in practice. The amendments are effective for annual periods beginning on or after 1 January 2018.

These amendments are not expected to have any impact on the Group.

**Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Amendments to IFRS 4**

The amendments address concerns arising from implementing the new financial instruments Standard, IFRS 9, before implementing the new insurance contracts standard that the Board is developing to replace IFRS 4. The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach.

These amendments are not expected to have any impact on the Group.

**Temporary exemption from IFRS 9**

The optional temporary exemption from IFRS 9 is available to entities whose activities are predominantly connected with insurance. The temporary exemption permits such entities to continue to apply IAS 39 *Financial Instruments: Recognition and Measurement* while they defer the application of IFRS 9 until 1 January 2021 at the latest. Predominance must be initially assessed at the annual reporting date that immediately precedes 1 April 2016 and before IFRS 9 is implemented. Also the evaluation of predominance can only be reassessed in rare cases. Entities applying the temporary exemption will be required to make additional disclosures.

**The overlay approach**

The overlay approach is an option for entities that adopt IFRS 9 and issue insurance contracts, to adjust profit or loss for eligible financial assets; effectively resulting in IAS 39 accounting for those designated financial assets. The adjustment eliminates accounting volatility that may arise from applying IFRS 9 without the new insurance contracts standard. Under this approach, an entity is permitted to reclassify amounts between profit or loss and other comprehensive income (OCI) for designated financial assets. An entity must present a separate line item for the amount of the overlay adjustment in profit or loss, as well as a separate line item for the corresponding adjustment in OCI.

## 5. STANDARDS ISSUED BUT NOT YET EFFECTIVE (CONTINUED)

The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The entity restates comparative information reflecting the overlay approach if, and only if, the entity restates comparative information when applying IFRS 9.

The overlay approach requires an entity to remove from profit or loss additional volatility that may arise if IFRS 9 is applied with IFRS 4. When applying the temporary exemption, entities must still provide extensive disclosure that require the application of some aspects of IFRS 9.

The amendments are effective for annual periods beginning on or after 1 January 2018

These amendments are not expected to have any impact on the Group.

## 6. OPERATING SEGMENTS

The Group's principal business activity is the development and operation of food retail stores located in Russia. Risks and returns are affected primarily by economic development in Russia and by the development of Russian food retail industry.

The Group has no significant assets outside the Russian Federation (excluding investments in its foreign wholly owned intermediate holding subsidiary Zoronvo Holdings Limited, which is eliminated on consolidation). Due to the similar economic characteristics of food retail stores, the Group's management has aggregated its operating segments represented by stores into one reportable operating segment. Within the segment all business components are similar in respect of:

- The products;
- The customers;
- Centralised Group structure (commercial, operational, logistic, finance, HR and IT functions are centralised).

The Group's operations are regularly reviewed by the chief operating decision maker, represented by the CEO, to analyse performance and allocate resources within the Group. The CEO assesses the performance of operating segments based on the dynamics of revenue and earnings before interest, tax, depreciation, amortisation (EBITDA).

The accounting policies used for the operating segment are the same as accounting policies applied for the consolidated financial statements.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 6. OPERATING SEGMENTS (CONTINUED)

The segment information for the year ended 31 December 2016 and 2015 is as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Sales | **306,352,092** | 252,763,075 |
| EBITDA | **31,389,826** | 28,018,435 |

Reconciliation of EBITDA to IFRS profit for the year is as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **EBITDA** | **31,389,826** | 28,018,435 |
| Interest expense | **(10,084,573)** | (10,044,858) |
| Interest income | **851,813** | 767,905 |
| Income tax expense (see Note 22) | **(3,351,220)** | (2,584,010) |
| Depreciation/amortisation (see Note 9, 11, 12, 26) | **(7,694,569)** | (5,686,264) |
| Ineffective portion of the change in fair value of cash flow hedging instruments (see Note 31) | **–** | 6,308 |
| Foreign exchange gain/(loss) | **90,751** | (189,423) |
| **Profit for the year** | **11,202,028** | 10,288,093 |

## 7. ACQUISITION OF SUBSIDIARIES

On 30 November 2016 the Group purchased the Kesko food retail business in Russia (“KFR”), operating under the K-Ruoka brand. The Group became the owner of 100% participatory interests in six KFR companies registered in Russia and dealing in food and non-food retail business through a chain of 11 hypermarkets. As a result, cost of acquisition of all of the participatory interests in six KFR companies for the Group amounted to RUB 11,296,152, including cash consideration paid of RUB 11,414,113, less adjustment for working capital of RUB 117,961 at acquisition date.

The financial position and results of operations of KFR were included in the Group’s consolidated financial statements beginning from 30 November 2016. As of the date of issuance of these consolidated financial statements, the Group and Kesko Food Russia Holding Oy (the seller) have not finalised the working capital adjustment of the acquired entities and the Group has not completed its purchase price allocation in accordance with IFRS 3 *Business Combinations*. Accordingly, the acquisition of KFR has been accounted for based on provisional values.

The Group assigned provisional values to net assets acquired based on estimates of an independent appraiser. The Group will finalise the purchase price allocation within 12 months from the acquisition date.

## 7. ACQUISITION OF SUBSIDIARIES (CONTINUED)

Provisional fair values of the identifiable assets and liabilities of KFR at the date of acquisition were:

| | Provisional values at the acquisition date |
|---|---|
| Property, plant and equipment (Note 9) | **9,992,668** |
| Prepayments for construction | **10,590** |
| Leasehold rights (Note 11) | **751,919** |
| Deferred tax asset (Note 22) | **208,137** |
| Inventories | **213,364** |
| Trade and other receivable | **123,296** |
| Advances paid | **47,398** |
| VAT and other taxes recoverable | **312,766** |
| Cash and cash equivalents | **313,632** |
| Deferred tax liability (Note 22) | **(74,296)** |
| Trade and other payables | **(589,532)** |
| Advances received | **(5,340)** |
| Current income tax payable | **(8,450)** |
| **Fair value of the identifiable net assets** | **11,296,152** |
| **Total acquisition cost** | **11,296,152** |

The fair value of the trade and other receivables amounts to RUB 123,296. The gross amount of trade receivables is RUB 126,096, of which RUB 2,800 have been impaired. It is expected that the rest contractual amounts can be collected.

During the year ended 31 December 2016 cash flow of acquisition was as follows:

| | Cash flow of acquisition |
|---|---|
| Cash paid | **11,414,113** |
| Less cash acquired with subsidiaries | **(313,632)** |
| **Net cash flow on acquisition** | **11,100,481** |

From the date of acquisition the contribution to revenue and profit before tax of KFR was RUB 1,053,797 and RUB 19,252 respectively. It is not practicable to determine contribution to revenue and profit before tax of KFR if it had been acquired at the beginning of the year ended 31 December 2016 due to different management and operational styles of acquired business and the Group.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 8. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

The transactions with related parties are made on terms equivalent to those that prevail in arm's length transactions.

The consolidated financial statements include the following balances with related parties:

Entities with significant influence over the Group:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| **EBRD** | | |
| Long-term loans payable | **–** | 4,520,527 |
| Accrued liabilities | **75** | 6,559 |
| Interest accrued | **–** | 1,691 |
| | | |
| **TPG Capital** | | |
| Accrued liabilities | **3,260** | 13,848 |

The following transactions were carried out with related parties:

Entities with significant influence over the Group:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| **EBRD** | | |
| Repayments of borrowings | **(4,554,240)** | – |
| Interest expense | **340,077** | 833,200 |
| Directors fee | **–** | 25,483 |
| Business trip expenses | **155** | 323 |
| Consulting services | **75** | – |
| | | |
| **TPG Capital** | | |
| Directors fee | **28,784** | 23,642 |
| Business trip expenses | **1,214** | 19,919 |
| Consulting services | **–** | 2,807 |

Remuneration to the members of the Board of Directors and key management personnel is as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Short-term benefits | **666,246** | 682,421 |
| Long-term benefits (share-based payments, Note 28) | **280,693** | 158,645 |
| **Total remuneration** | **946,939** | 841,066 |

## 9. PROPERTY, PLANT AND EQUIPMENT

| | Land | Land improvements | Buildings | Machinery and equipment | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **Balance at 1 January 2016** | **12,582,774** | **7,116,578** | **71,205,405** | **29,434,011** | **3,564,759** | **123,903,527** |
| Additions | **19,046** | **–** | **–** | **66** | **41,041,432** | **41,060,544** |
| Transfers from construction in progress | **3,397,951** | **2,642,680** | **23,360,680** | **11,769,060** | **(41,170,371)** | **–** |
| Transfers from leasehold rights | **618,314** | **–** | **–** | **–** | **–** | **618,314** |
| Acquisition of subsidiaries (Note 7) | **1,253,373** | **309,987** | **6,089,079** | **2,323,192** | **17,037** | **9,992,668** |
| Disposals | **(857)** | **(5,420)** | **(163,705)** | **(565,266)** | **(164,791)** | **(900,039)** |
| **Balance at 31 December 2016** | **17,870,601** | **10,063,825** | **100,491,459** | **42,961,063** | **3,288,066** | **174,675,014** |
| **Accumulated depreciation and impairment** | | | | | | |
| **Balance at 1 January 2016** | **–** | **1,041,933** | **8,647,931** | **10,197,205** | **–** | **19,887,069** |
| Charge for the year | **–** | **258,724** | **2,702,141** | **4,376,332** | **–** | **7,337,197** |
| Disposals | **–** | **(529)** | **(24,140)** | **(336,872)** | **–** | **(361,541)** |
| **Balance at 31 December 2016** | **–** | **1,300,128** | **11,325,932** | **14,236,665** | **–** | **26,862,725** |
| **Net book value** | | | | | | |
| **Balance at 1 January 2016** | **12,582,774** | **6,074,645** | **62,557,474** | **19,236,806** | **3,564,759** | **104,016,458** |
| **Balance at 31 December 2016** | **17,870,601** | **8,763,697** | **89,165,527** | **28,724,398** | **3,288,066** | **147,812,289** |

| | Land | Land improvements | Buildings | Machinery and equipment | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **Balance at 1 January 2015** | 9,971,338 | 5,488,814 | 54,610,275 | 21,331,730 | 4,542,748 | 95,944,905 |
| Additions | – | – | 87,269 | 611 | 27,642,190 | 27,730,070 |
| Transfers from construction in progress | 2,035,686 | 1,650,598 | 16,510,017 | 8,370,416 | (28,566,717) | – |
| Transfers from leasehold rights | 655,359 | – | – | – | – | 655,359 |
| Disposals | (79,609) | (22,834) | (2,156) | (268,746) | (53,462) | (426,807) |
| **Balance at 31 December 2015** | 12,582,774 | 7,116,578 | 71,205,405 | 29,434,011 | 3,564,759 | 123,903,527 |
| **Accumulated depreciation and impairment** | | | | | | |
| **Balance at 1 January 2015** | – | 848,274 | 6,621,417 | 7,257,007 | – | 14,726,698 |
| Charge for the year | – | 193,659 | 2,028,335 | 3,138,721 | – | 5,360,715 |
| Disposals | – | – | (1,821) | (198,523) | – | (200,344) |
| **Balance at 31 December 2015** | – | 1,041,933 | 8,647,931 | 10,197,205 | – | 19,887,069 |
| **Net book value** | | | | | | |
| **Balance at 1 January 2015** | 9,971,338 | 4,640,540 | 47,988,858 | 14,074,723 | 4,542,748 | 81,218,207 |
| **Balance at 31 December 2015** | 12,582,774 | 6,074,645 | 62,557,474 | 19,236,806 | 3,564,759 | 104,016,458 |

During the year ended 31 December 2016 and the year ended 31 December 2015 the Group is not involved in acquisition of any assets that would satisfy the definition of qualifying assets for the purposes of borrowing costs capitalisation. Thus, no borrowings costs were capitalised during those periods.

Land and buildings with a carrying amount of RUB 3,956,848 thousand were pledged under secured loan agreement with EBRD as at 31 December 2015. All pledged assets were released upon termination of the loan agreement with EBRD on 30 June 2016 (see Note 21).

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 9. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

No property, plant and equipment is held by the Group under finance leases at 31 December 2016.

At 31 December 2015 the carrying amount of property, plant and equipment held under finance leases is RUB 37,532 thousand.

### Depreciation and amortisation expense

The amount of depreciation charged during the year ended 31 December 2016 and year ended 31 December 2015 is presented within depreciation and amortisation in the Group's consolidated statement of profit or loss and other comprehensive income and statement of cash flows as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Depreciation of property, plant and equipment (Note 9) | **7,337,197** | 5,360,715 |
| Amortisation of intangible assets (Note 12) | **290,898** | 257,940 |
| Leasehold rights amortisation (Note 11) | **66,474** | 67,609 |
| **Total depreciation and amortisation** | **7,694,569** | 5,686,264 |

See Note 29 for capital commitments.

## 10. PREPAYMENTS FOR CONSTRUCTION

Prepayments for construction are represented by advances given to the constructors for the building of the stores and to suppliers.

Prepayments are regularly monitored on the subject of impairment. An impairment analysis is performed at each reporting date on an individual basis for counterparties. A provision for impairment is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of prepayments. As at 31 December 2016 the Group impaired RUB 378,672 of prepayments (31 December 2015: RUB 235,995).

## 11. LEASEHOLD RIGHTS

Leasehold rights as at 31 December 2016 consist of the following:

| | Leasehold rights |
|---|---|
| **Cost** | |
| **At 1 January 2016** | **3,255,655** |
| Additions | **630,989** |
| Acquisition of subsidiaries (Note 7) | **751,919** |
| Disposals | **(1,279)** |
| Transfer to PPE | **(657,637)** |
| **At 31 December 2016** | **3,979,647** |
| | |
| **Accumulated amortisation** | |
| **At 1 January 2016** | **208,487** |
| Charge for the year | **66,474** |
| Transfer to PPE | **(39,323)** |
| **At 31 December 2016** | **235,638** |
| | |
| **Net book value** | |
| **At 1 January 2016** | **3,047,168** |
| **At 31 December 2016** | **3,744,009** |

Leasehold rights as at 31 December 2015 consisted of the following:

| | Leasehold rights |
|---|---|
| **Cost** | |
| **At 1 January 2015** | 3,486,162 |
| Additions | 557,827 |
| Disposals | (63,559) |
| Transfer to PPE | (724,775) |
| **At 31 December 2015** | 3,255,655 |
| | |
| **Accumulated amortisation** | |
| **At 1 January 2015** | 214,618 |
| Charge for the year | 67,609 |
| Disposals | (4,324) |
| Transfer to PPE | (69,416) |
| **At 31 December 2016** | 208,487 |
| | |
| **Net book value** | |
| **At 1 January 2015** | 3,271,544 |
| **At 31 December 2015** | 3,047,168 |

Amortisation expense is included in selling, general and administrative expenses (Note 26).

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 12. INTANGIBLE ASSETS OTHER THAN LEASEHOLD RIGHTS

Intangible assets other than leasehold rights as at 31 December 2016 consist of the following:

| | Software | Trade marks | Total |
|---|---|---|---|
| **Cost** | | | |
| **At 1 January 2016** | **2,078,687** | **549** | **2,079,236** |
| Additions | **1,088,745** | **–** | **1,088,745** |
| **At 31 December 2016** | **3,167,432** | **549** | **3,167,981** |
| | | | |
| **Accumulated amortisation** | | | |
| **At 1 January 2016** | **986,358** | **549** | **986,907** |
| Amortisation for the period | **290,898** | **–** | **290,898** |
| **At 31 December 2016** | **1,277,256** | **549** | **1,277,805** |
| | | | |
| **Net book value** | | | |
| **At 1 January 2016** | **1,092,329** | **–** | **1,092,329** |
| **At 31 December 2016** | **1,890,176** | **–** | **1,890,176** |

Intangible assets other than leasehold rights as at 31 December 2015 consisted of the following:

| | Software | Trade marks | Total |
|---|---|---|---|
| **Cost** | | | |
| **At 1 January 2015** | 1,603,385 | 549 | 1,603,934 |
| Additions | 486,224 | – | 486,224 |
| Disposals | (10,922) | – | (10,922) |
| **At 31 December 2015** | 2,078,687 | 549 | 2,079,236 |
| | | | |
| **Accumulated amortisation** | | | |
| **At 1 January 2015** | 732,870 | 533 | 733,403 |
| Amortisation for the period | 257,924 | 16 | 257,940 |
| Disposals | (4,436) | – | (4,436) |
| **At 31 December 2015** | 986,358 | 549 | 986,907 |
| | | | |
| **Net book value** | | | |
| **At 1 January 2015** | 870,515 | 16 | 870,531 |
| **At 31 December 2015** | 1,092,329 | – | 1,092,329 |

Amortisation expense is included in selling, general and administrative expenses (Note 26).

## 13. INVENTORIES

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Goods for resale (at lower of cost and net realisable value) | **26,191,962** | 21,809,738 |
| Raw materials | **1,298,979** | 971,994 |
| **Total inventories** | **27,490,941** | 22,781,732 |

Raw materials are represented by inventories used in own production process in butchery, bakery and culinary.

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Goods for resale (at cost) | **27,437,087** | 22,729,419 |
| Write down to net realisable value | **(1,245,125)** | (919,681) |
| **Goods for resale (at lower of cost and net realisable value)** | **26,191,962** | 21,809,738 |

## 13. INVENTORIES (CONTINUED)

During the reporting period the Group wrote down inventories to their net realisable value, which resulted in recognition of expenses within cost of sales in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2016 in the amount of RUB 325,443 thousand (compared to RUB 38,710 thousand of expense reversal recognised in the year ended 31 December 2015).

## 14. TRADE AND OTHER RECEIVABLES

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Accounts receivable on rental and other services and on suppliers' advertising | **12,892,578** | 9,727,574 |
| Suppliers' rebates receivable | **3,858,738** | 3,643,232 |
| Other receivables | **352,258** | 307,105 |
| Bad debt allowance | **(67,785)** | (31,017) |
| **Total trade and other receivables** | **17,035,789** | 13,646,894 |

Receivables are due normally within 25 days according to the terms of standard contracts. Outstanding receivables are regularly monitored. An impairment analysis is performed at each reporting date on an individual basis for counterparties. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Usually for receivables over 365 days the allowance for doubtful debts is 100%, unless there are strong indications from the nature of the agreement underlying the debt that no allowance is needed as the long term of the receivable is in line with the agreement. Allowances for doubtful debts are recognised against receivables of under 365 days based on estimated irrecoverable amounts determined by reference to past default experience of each particular counterparty and an analysis of the counterparty's current financial position.

Amounts receivable from suppliers and accounts receivable on rental and other services disclosed above include amounts (see below for ageing analysis) that are past due at the end of the reporting period for which the Group has not recognised an allowance for doubtful debts because there has not been a significant change in credit quality and the amounts are still considered recoverable. The Group does not hold any collateral or other credit enhancements over these balances.

Ageing of trade and other receivables that are past due but not impaired as at 31 December 2016:

| | 0–60 days overdue | 60–120 days overdue | 120–365 days overdue | Neither past due nor impaired | Total |
|---|---|---|---|---|---|
| Suppliers' volume rebates receivable | **322,208** | **5,613** | **22,260** | **3,486,694** | **3,836,775** |
| Accounts receivable on rental and other services | **758,337** | **53,411** | **60,141** | **11,975,546** | **12,847,435** |
| Other receivables | **64,594** | **9,814** | **20,689** | **256,482** | **351,579** |
| **Total** | **1,145,139** | **68,838** | **103,090** | **15,718,722** | **17,035,789** |

Ageing of trade and other receivables that were past due but not impaired as at 31 December 2015:

| | 0–60 days overdue | 60–120 days overdue | 120–365 days overdue | Neither past due nor impaired | Total |
|---|---|---|---|---|---|
| Suppliers' volume rebates receivable | 87,469 | 8,326 | 30,827 | 3,513,960 | 3,640,582 |
| Accounts receivable on rental and other services | 1,206,134 | 45,621 | 43,801 | 8,406,211 | 9,701,767 |
| Other receivables | 80,450 | 4,157 | 1,376 | 218,562 | 304,545 |
| **Total** | 1,374,053 | 58,104 | 76,004 | 12,138,733 | 13,646,894 |

## 15. ADVANCES PAID

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Advances to suppliers of goods | **1,162,541** | 788,124 |
| Advances for services | **1,109,412** | 1,066,570 |
| Guarantee payments under lease contracts | **397,808** | 410,217 |
| **Total advances paid** | **2,669,761** | 2,264,911 |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 16. TAXES RECOVERABLE

Taxes recoverable as at 31 December 2016 are represented by a VAT recoverable of RUB 3,920,940 thousand (31 December 2015: RUB 1,257,764 thousand).

## 17. CASH AND CASH EQUIVALENTS

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Rouble short-term deposits | **5,669,714** | 16,612,228 |
| Rouble denominated cash in transit | **5,272,838** | 2,258,241 |
| Rouble denominated cash on hand and balances with banks | **2,062,814** | 3,556,009 |
| Foreign currency denominated cash on hand and balances with banks | **32,401** | 29,467 |
| **Total cash and cash equivalents** | **13,037,767** | 22,455,945 |

Cash in transit represents cash receipts made during the last day of the reporting period (29–31 December), which were sent to banks but not deposited into the respective bank accounts until the next reporting period.

Significant rouble denominated cash in transit results from the business seasonality, indicating higher levels of retail sales in holiday periods such as New Year's Eve as well as the closing day in relation to the official banking days in Russia. If the closing day is on non-banking days, the amount of cash in transit increases.

Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates.

## 18. ISSUED CAPITAL AND RESERVES

### Issued capital

As at 31 December 2016 the Company's share capital is comprised of 97,318,746 authorised and issued ordinary shares (as at 31 December 2015: 97,318,746) with equal voting rights. The shares have no par value.

All outstanding ordinary shares are entitled to an equal share in any dividend declared by the Company. According to the BVI Business Companies Act No. 16 of 2004, no dividends can be declared and paid unless the Board of Directors determines that immediately after the payment of the dividend the Group will be able to satisfy its liabilities as they become due in the ordinary course of its business and the realisable value of the assets of the Group will not be less than the sum of its total liabilities, other than deferred taxes, as shown in the books of account, and its capital. In accordance with Russian legislation, Lenta LLC, the Company's primary operating subsidiary registered under the laws of the Russian Federation, may distribute profits as dividends or transfer them to reserves (fund accounts) limited to the retained earnings recorded in its financial statements prepared in accordance with Russian Accounting Rules. No dividends to holders of ordinary shares are declared for the year ended 31 December 2016 and for the year ended 31 December 2015.

The movements in the number of shares for the year ended 31 December 2016 and for the year ended 31 December 2015 are as follows.

| | 31 December 2016 No. | 31 December 2015 No. |
|---|---|---|
| Authorised share capital (ordinary shares with no par value) | **unlimited** | unlimited |
| Issued and fully paid (no par value) | **97,318,746** | 97,318,746 |

| | 31 December 2016 No. | 31 December 2015 No. |
|---|---|---|
| **Balance of shares outstanding at beginning of financial year** | **97,318,746** | 86,053,394 |
| Additional issue of shares | **–** | 11,265,352 |
| **Balance of shares outstanding at the end of financial year** | **97,318,746** | 97,318,746 |

In year 2015 11,265,352 ordinary shares were issued by the Group for a cash consideration of RUB 21,788,593 thousand net of directly attributable issuance costs. The whole amount of the consideration received was recorded as increase in additional paid-in capital, as the shares have no par value.

## 18. ISSUED CAPITAL AND RESERVES (CONTINUED)

### Share options reserve

The share options reserve is used to recognise the value of equity-settled share-based payments provided to employees, including key management personnel, as part of their remuneration. Refer to Note 28 for further details of these plans.

### Hedging reserve

The hedging reserve is used to recognise the effective portion of the gain or loss from the hedging instrument and later reclassified to profit or loss when the hedge item affects profit or loss.

## 19. COMPONENTS OF OTHER COMPREHENSIVE INCOME (OCI)

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **Cash flow hedges** | | |
| Reclassification during the year to profit or loss | **(410,581)** | (1,800,556) |
| Related tax effect | **82,116** | 360,111 |
| Gain/(loss) arising during the year | **44,241** | (525,963) |
| Related tax effect | **(8,848)** | 105,193 |
| **Net loss during the year** | **(293,072)** | (1,861,215) |

## 20. EARNINGS PER SHARE

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **Earnings per share (in thousands of Russian roubles per share)** | | |
| Reclassification during the year to profit or loss | **0.115** | 0.112 |

The calculation of basic earnings per share for reporting periods is based on the profit attributable to shareholders (for the year ended 31 December 2016: RUB 11,202,028 thousand, for the year ended 31 December 2015: RUB 10,288,093 thousand) and a weighted average number of ordinary shares outstanding during the respective periods, calculated as shown below.

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **Number of issued shares at the beginning of period** | **97,318,746** | 86,053,394 |
| Number of shares issued in October 2015 | **–** | 4,225,352 |
| Number of shares issued in March 2015 | **–** | 7,040,000 |
| **Number of shares at the end of reporting period** | **97,318,746** | 97,318,746 |
| Weighted average number of shares | **97,318,746** | 92,252,707 |

The Group has issued share-based payments' (Note 28) instruments that could potentially dilute basic earnings per share in the future. These instruments have no material effect on dilution of earnings per share for the periods presented.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 21. BORROWINGS

Short-term borrowings:

| | Currency | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| Fixed rate bonds (liability for interests) | RUB | **713,803** | 760,097 |
| Fixed rate long-term bank loans (liability for interests) | RUB | **32,612** | 30,138 |
| Floating rate long-term bank loans (liability for interests) | RUB | **803,918** | 14,575 |
| Floating rate short-term bank loans (liability for interests) | RUB | **3,266** | – |
| Fixed rate short-term bank loans (liability for interests) | RUB | **82,853** | – |
| Short-term portion of floating rate long-term bank loans | RUB | **3,270,650** | – |
| Short-term portion of fixed rate long-term bank loans | RUB | **11,400,000** | – |
| Fixed rate short-term bank loans | RUB | **18,938,018** | – |
| Fixed rate bonds | RUB | **–** | 9,968,467 |
| **Total short-term borrowings and short-term portion of long-term borrowings** | | **35,245,120** | 10,773,277 |

Long-term borrowings:

| | Currency | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| Fixed rate bonds | RUB | **16,958,600** | 9,973,156 |
| Fixed rate long-term bank loans | RUB | **16,931,549** | 9,951,940 |
| Floating rate long-term bank loans | RUB | **33,065,782** | 45,224,001 |
| **Total long-term borrowings** | | **66,955,931** | 65,149,097 |

The Group's borrowings as at 31 December 2016 and 31 December 2015 are denominated in Russian roubles.

On 27 January 2016 the Group received RUB 7,000,000 thousand under non-revolving credit line agreement with PJSC Rosbank with maturity period of 3 years. The loan bears financial covenants.

On 18 February 2016 coupons 7-11 on 03 series bonds issued in March 2013 were reset at 11.75% per annum, put option right on early redemption after 2.5 years (August 2018). On 3 March 2016 the Group executed an offer of 03 series bonds with total nominal value of RUB 586,583 thousand, and completed book building for the offering on the same day at price amounting to 100.75% of nominal value.

On 24 February 2016 coupons 7-11 on 01 series bonds issued in March 2013 were reset at 11.75% per annum, put option right on early redemption after 2.5 years (September 2018). On 10 March 2016 right on early redemption of 01 series bonds was not exercised by the holders.

On 24 February 2016 coupons 7-12 on 02 series bonds issued in March 2013 were reset at 11% per annum, put option right on early redemption after 3 years (March 2019). On 10 March 2016 the Group executed an offer of 02 series bonds with total nominal value of RUB 2,999,979 thousand.

The funds raised from the issue of the bonds are used on business expansion.

On 9 June 2016 the Group signed revolving credit line of RUB 5,000,000 thousand with PJSC Bank Saint-Petersburg.

On 21 June 2016 revolving credit line of RUB 5,000,000 thousand was agreed with JSC Rosselkhozbank. The credit line has financial covenants.

On 30 June 2016 termination of loan agreement with EBRD was signed upon the prepayment of the entire outstanding principal amount of RUB 4,554,240 thousand.

On 03 November 2016 the Group received RUB 10,000,000 thousand under non-revolving credit line agreement with PJSC Sberbank. The loan bears financial covenants.

On 9 November 2016 the Group signed revolving credit line of RUB 3,000,000 thousand with PJSC Rosbank. The credit line bears financial covenants. At the reporting date the Group draw down RUB 1,000,000 thousand.

## 21. BORROWINGS (CONTINUED)

On 18 November 2016 the Group signed revolving credit line of RUB 15,000,000 thousand with PJSC Sberbank. At the reporting date the Group draws down RUB 6,400,000 thousand. The loan bears a financial covenant.

On 15 December 2016 the Group signed 5 year loan agreement of RUB 8,500,000 thousand with JSC UniCredit Bank. The loan bears financial covenants.

On 22 December 2016 the Group signed 4 year non-revolving credit line of RUB 4,000,000 thousand with JSC Raiffeisenbank. The loan bears financial covenants.

During the year ended 31 December 2016 the Group received RUB 28,600,000 thousand under credit agreements concluded before 1 January 2016 and repaid RUB 29,775,669 thousand.

As at 31 December 2016 the Group had RUB 44,150,000 thousand of unused credit facilities (as at 31 December 2015: RUB 45,300,000 thousand).

As at 31 December 2016 the Group is in compliance with all financial covenants of loan agreements.

## 22. INCOME TAXES

The Group's income tax expense for the year ended 31 December 2016 and 31 December 2015 is as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Current tax expense | **1,137,425** | 632,900 |
| Deferred tax expense | **2,213,795** | 1,944,919 |
| Adjustments in respect of current income tax of previous year | **–** | 6,191 |
| **Income tax expense recognised in profit for the year** | **3,351,220** | 2,584,010 |

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Tax effect related to effective portion of change in the fair value of cash flow hedging instruments | **(73,268)** | (465,304) |
| **Income tax (benefit)/expense recognised in OCI** | **(73,268)** | (465,304) |

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **Profit before tax** | **14,553,248** | 12,872,103 |
| **Theoretical tax charge at 20%** | **(2,910,649)** | (2,574,421) |
| | | |
| Difference in tax rates for foreign companies and specific tax regime in Russia | **(101,269)** | 157,125 |
| Add tax effect of non-deductible expenses | **(339,302)** | (160,523) |
| – share option expenses | **(66,037)** | (36,825) |
| – others | **(273,265)** | (123,698) |
| Adjustments in respect of current income tax of previous years | **–** | (6,191) |
| **Income tax expense** | **3,351,220** | 2,584,010 |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 22. INCOME TAXES (CONTINUED)

Differences between IFRS and Russian statutory tax regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences, recorded at the rate of 20% is detailed below.

| | 1 January 2016 | Differences in recognition and reversals recognised in profit or loss | Differences in recognition and reversals recognised in other comprehensive income | Deferred tax on acquisition of subsidiaries (Note 7) | 31 December 2016 |
|---|---|---|---|---|---|
| **Tax effect of (taxable)/ deductible temporary differences** | | | | | |
| Property, plant and equipment | – | (68,668) | – | 199,467 | 130,799 |
| Consulting and other accruals | – | (8,529) | – | 8,529 | – |
| Other | – | (7,432) | – | 141 | (7,291) |
| **Total deferred assets** | – | (84,629) | – | 208,137 | 123,508 |

| | 1 January 2016 | Differences in recognition and reversals recognised in profit or loss | Differences in recognition and reversals recognised in other comprehensive income | Deferred tax on acquisition of subsidiaries (Note 7) | 31 December 2016 |
|---|---|---|---|---|---|
| **Tax effect of (taxable)/deductible temporary differences** | | | | | |
| Property, plant and equipment | (5,116,612) | (2,360,501) | – | (142,047) | (7,619,160) |
| Leasehold rights | (428,445) | (2,382) | – | – | (430,827) |
| Unused vacation and employee bonuses accrual | 257,209 | 4,462 | – | – | 261,671 |
| Suppliers' bonuses | (70,733) | 69,859 | – | – | (874) |
| Borrowings | (194,331) | 65,058 | – | – | (129,273) |
| Intangible assets other than leasehold rights | (20,769) | (3,307) | – | – | (24,076) |
| Inventory | 415,175 | 96,393 | – | 58,712 | 570,280 |
| Bad debt allowance | 48,059 | 30,029 | – | 1,861 | 79,949 |
| Finance leasing | 3,418 | (3,418) | – | – | – |
| Consulting and other accruals | 65,920 | 48,061 | – | 7,558 | 121,539 |
| Customs duty payable | 37,618 | (37,618) | – | – | – |
| Cash flow hedging instruments | (227,606) | (3,898) | 73,268 | – | (158,236) |
| Other | 1,293 | (31,904) | – | (380) | (30,991) |
| **Total deferred tax liabilities** | (5,229,804) | (2,129,166) | 73,268 | (74,296) | (7,359,998) |

Strategic report
Corporate governance
Financial statements
Appendices

## 22. INCOME TAXES (CONTINUED)

| | 1 January 2015 | Differences in recognition and reversals recognised in profit or loss | Differences in recognition and reversals recognised in other comprehensive income | 31 December 2015 |
|---|---|---|---|---|
| **Tax effect of (taxable)/deductible temporary differences** | | | | |
| Property, plant and equipment | (3,241,091) | (1,875,521) | – | (5,116,612) |
| Leasehold rights | (450,356) | 21,911 | – | (428,445) |
| Unused vacation and employee bonuses accrual | 144,820 | 112,389 | – | 257,209 |
| Suppliers' bonuses | (157,358) | 86,625 | – | (70,733) |
| Borrowings | (79,040) | (115,291) | – | (194,331) |
| Intangible assets other than leasehold rights | (17,386) | (3,383) | – | (20,769) |
| Inventory | 586,189 | (171,014) | – | 415,175 |
| Bad debt allowance | 13,236 | 34,823 | – | 48,059 |
| Finance leasing | 6,947 | (3,529) | – | 3,418 |
| Consulting and other accruals | 46,769 | 19,151 | – | 65,920 |
| Customs duty payable | 30,677 | 6,941 | – | 37,618 |
| Cash flow hedging instruments | (634,903) | (58,007) | 465,304 | (227,606) |
| Other | 1,307 | (14) | – | 1,293 |
| **Total deferred tax (liabilities)/assets** | (3,750,189) | (1,944,919) | 465,304 | (5,229,804) |

The temporary taxable differences associates with undistributed earnings of subsidiaries amount to RUB 59,399,304 thousand and RUB 54,229,761 thousand as of 31 December 2016 and 2015, respectively. A deferred tax liability on these temporary differences was not recognised, because management believed that it was in a position to control the timing of reversal of such differences and has no intention to reverse them in the foreseeable future.

## 23. TRADE AND OTHER PAYABLES

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Trade payables | **46,612,578** | 42,002,004 |
| Accrued liabilities and other creditors | **4,437,082** | 3,586,669 |
| Payables for purchases of property, plant and equipment | **5,121,938** | 3,231,534 |
| **Total trade and other payables** | **56,171,598** | 48,820,207 |

The trade and other payables are denominated in:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Russian roubles | **55,569,398** | 48,601,870 |
| USD | **418,393** | 122,582 |
| EUR | **165,950** | 94,991 |
| GBP | **17,857** | 764 |
| **Total trade and other payables** | **56,171,598** | 48,820,207 |

## 24. OTHER TAXES PAYABLE

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Social taxes | **559,625** | 490,231 |
| Property tax | **381,379** | 270,774 |
| Personal income tax | **157,637** | 134,089 |
| Other taxes | **12,665** | 31,990 |
| **Total other taxes payable** | **1,111,306** | 927,084 |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 25. COST OF SALES

Cost of sales for the years ended 31 December 2016 and 31 December 2015 consists of the following:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Cost of goods sold | **204,373,681** | 167,408,885 |
| Cost of own production | **24,810,938** | 21,710,294 |
| Supply chain cost | **3,795,679** | 3,185,448 |
| Losses due to inventory shortages and write down to net realisable value | **5,603,731** | 4,153,283 |
| **Total cost of sales** | **238,584,029** | 196,457,910 |

Cost of goods sold is reduced by rebates and promotional bonuses received from suppliers.

The cost of own production consists of the following:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Raw materials | **20,497,106** | 17,925,511 |
| Labour costs | **3,492,856** | 2,947,684 |
| Utilities | **700,859** | 752,180 |
| Repairs and maintenance | **120,117** | 84,919 |
| **Total cost of own production** | **24,810,938** | 21,710,294 |

Cost of sales for the year ended 31 December 2016 includes employee benefits expense of RUB 3,492,856 thousand (year ended 31 December 2015: RUB 4,092,406 thousand) of which contributions to state pension fund are comprised of RUB 499,517 thousand (year ended 31 December 2015: RUB 609,388 thousand).

## 26. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Employee benefits | **17,522,506** | 14,558,823 |
| Depreciation and amortisation (Note 9, 11, 12) | **7,694,569** | 5,671,219 |
| Advertising | **3,324,415** | 2,313,536 |
| Premises lease | **3,167,843** | 2,349,035 |
| Utilities and communal payments | **2,959,131** | 1,964,640 |
| Professional fees | **2,615,199** | 1,822,108 |
| Cleaning | **1,789,987** | 1,432,304 |
| Repairs and maintenance | **1,636,793** | 1,264,894 |
| Security services | **1,300,135** | 973,180 |
| Taxes other than income tax | **1,263,223** | 1,096,846 |
| Land and equipment lease | **267,793** | 323,045 |
| Pre-opening costs | **743,348** | 640,596 |
| Other | **2,157,568** | 1,634,545 |
| **Total selling, general and administrative expenses** | **46,442,510** | 36,044,771 |

Employee benefits for the year ended 31 December 2016 include contributions to state pension fund of RUB 2,234,917 thousand (year ended 31 December 2015: RUB 1,844,088 thousand).

Pre-opening costs for the year ended 31 December 2016 include employee benefits of RUB 414,530 thousand (year ended 31 December 2015: RUB 360,904 thousand) of which contributions to state pension fund are comprised RUB 46,496 thousand (year ended 31 December 2015: RUB 39,742 thousand).

Professional fees for the year ended 31 December 2016 include fees billed by Ernst & Young LLC: for the audit of the consolidated financial statements in the amount of RUB 25,186 thousand (for the year ended 31 December 2015: RUB 29,565 thousand) and for consulting and other non audit services in the amount of RUB 20,725 thousand (for the year ended 31 December 2015: RUB 5,699 thousand).

## 27. OTHER OPERATING INCOME AND EXPENSES

Other operating income is comprised of the following:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Rental income | **973,959** | 752,755 |
| Penalties due by suppliers | **788,786** | 904,528 |
| Sale of secondary materials | **497,245** | 295,743 |
| Advertising income | **488,599** | 422,002 |
| Amounts received from lawsuit settlement | **188,089** | – |
| Gain on property, plant and equipment disposal | **17,165** | 62,250 |
| Other | **132,236** | 147,032 |
| **Total other operating income** | **3,086,079** | 2,584,310 |

Other operating expenses are comprised of the following:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Loss from fixed assets and leasehold rights disposal | **280,492** | 181,567 |
| Change in bad debt allowance and impairment of advances and prepayments for construction (Note 10, 14) | **178,504** | 194,665 |
| Amounts paid in settlement of lawsuit | **125,870** | – |
| Penalties for breach of a contracts with suppliers | **61,653** | 1,311 |
| Penalties from government authorities | **18,185** | 65,351 |
| Other | **51,671** | 69,639 |
| **Total other operating expenses** | **716,375** | 512,533 |

## 28. SHARE-BASED PAYMENTS

### Long-term incentive plan

During the year 2014 the Group approved a long-term incentive plan (LTIP) to certain members of management, according to which the Company granted award shares in 2014, 2015 and 2016 along with the communication of the terms of award to participants.

The monetary amount of the award to be granted to the participants of the plan was calculated based on the annual base salary on the grant date, target award interest, business results co efficient and individual performance rating co-efficient.

Under terms of Tranche 2014 the shares are to be released in phases:

- 1st 25% on the first anniversary of the award (1 April 2015);
- 2nd 25% on the second anniversary of the award (1 April 2016);
- 50% on the third anniversary of the award (1 April 2017), provided that employment conditions are met.

With respect to the first phase no shares were issued in April 2015 and April 2016, the Group plans to release shares till the end of 2017.

The vesting date of 100% of Tranche 2015 is 1 April 2018. The vesting dates of awards granted during 2016 year are 31 December 2018 and 1 April 2019.

The fair value of the award shares was estimated based on the GDR price on Moscow Exchange on the award grant date.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 28. SHARE-BASED PAYMENTS (CONTINUED)

### Long-term incentive plan (continued)

Total expense recognised for the services received from the employees covered by long-term incentive plan for the year ended 31 December 2016 and the year ended 31 December 2015 is shown in the following table:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Expense arising from the equity-settled long-term incentive plan payments | **139,355** | 28,925 |

### Share value appreciation rights

During the 2013 the Group granted share value appreciation rights (SVARs) to certain members of top management as part of management long-term incentive plan. Each SVAR entitles the holder to a quantity of ordinary shares in Lenta Ltd based on an increase in the share price over a predetermined exercise price subject to meeting the performance conditions.

### Movements during the year

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, SVARs:

| | 2016 Number | 2016 WAEP | 2015 Number | 2015 WAEP |
|---|---|---|---|---|
| **Outstanding at 1 January** | **594,211** | **RUB 1,516** | 594,211 | USD 49.84 |
| Granted during the year | **42,000** | **RUB 2,214** | – | – |
| Forfeited during the year | **–** | **–** | – | – |
| Exercised during the year | **–** | **–** | – | – |
| Expired during the year | **–** | **–** | – | – |
| **Outstanding at 31 December** | **636,211** | **RUB 1,562** | 594,211 | RUB 1,516 |
| **Exercisable at 31 December** | **–** | **–** | – | – |

In March 2015 modifications to the SVARs were agreed including deferral of exercise date of SVARs that are to be vested in April 2015 by one year.

On 17 July 2015 the Remuneration Committee of Lenta Ltd agreed on certain changes in the management long-term incentive plan, which is based on share value appreciation rights. Whereas the plan has been set up using financial parameters denominated in USD, all financial parameters are now changed into Russian roubles using the exchange rate on the date of the grant (1 April 2013). As a result, the exercise price for the remaining outstanding options will be changed from USD 49.84 to RUB 1,516 per share. The vesting schedule has been revised and fixed, as a result of which the remaining 80% of the initial grant will now vest in 2 stages: 30% on 1 April 2017 and the remaining 50% on 1 April 2018.

During the year ended 31 December 2016 additional tranche of share value appreciation rights (SVARs) was granted to certain members of top management as part of management long-term incentive plan.

The weighted average remaining contractual life for the SVARs outstanding as at 31 December 2016 was 1.76 years (31 December 2015: 2.3 years).

The weighted average exercise price for options outstanding as at 31 December 2016 is RUB 1,562 thousand (31 December 2015: RUB 1,516 thousand).

The weighted average fair value of options outstanding as at 31 December 2016 is RUB 0.89 thousand (year ended 31 December 2015: RUB 0.86 thousand).

The expense recognised for the services received from the employees covered by SVARs plan during the year is shown in the following table:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| Expense arising from the equity-settled SVARs transaction | **190,828** | 155,199 |

The fair value of the management SVARs is estimated at the grant date using the Black Scholes option pricing model, taking into account the terms and conditions upon which the SVARs were granted.

## 29. COMMITMENTS

### Capital expenditure commitments

At 31 December 2016 the Group has contractual capital expenditure commitments in respect of property, plant and equipment and intangible assets totalling RUB 21,055,701 thousand net of VAT (31 December 2015: RUB 19,370,442 thousand net of VAT).

### Operating lease commitments

Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Not later than 1 year | **4,353,739** | 3,786,074 |
| Later than 1 year and not later than 5 years | **17,616,198** | 14,664,366 |
| Later than 5 years | **32,311,175** | 33,247,702 |
| **Total operating lease commitments** | **54,281,112** | 51,698,142 |

## 30. FINANCIAL INSTRUMENTS

### Categories of financial instruments

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| **Financial assets** | | |
| Cash | **13,037,767** | 22,455,945 |
| Trade and other receivables | **17,035,789** | 13,646,894 |
| Cash flow hedging instruments | **372,210** | 794,464 |
| | | |
| **Financial liabilities** | | |
| Cash flow hedging instruments | **48,725** | 124,128 |
| | | |
| **At amortised cost** | | |
| Floating rate long-term borrowings | **33,869,700** | 45,238,576 |
| Fixed rate long-term borrowings and bonds | **34,636,564** | 20,395,179 |
| Fixed rate short-term borrowings | **30,420,871** | 10,288,619 |
| Floating rate short-term borrowings | **3,273,916** | – |
| Trade and other payables | **56,171,598** | 47,058,158 |
| Obligations under finance leases | **–** | 18,577 |
| **Total financial liabilities at amortised cost** | **158,372,649** | 122,999,109 |

### Fair values

The following table provides the fair value measurement hierarchy of the Group's financial assets and liabilities. Quantitative disclosures of fair value measurement hierarchy for financial assets and financial liabilities as at 31 December 2016:

| | 31 December 2016 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Financial assets measured at fair value** | | | | |
| Cash flow hedging instruments | **372,210** | **–** | **372,210** | – |
| | | | | |
| **Financial liabilities measured at fair value** | | | | |
| Cash flow hedging instruments | **48,725** | **–** | **48,725** | – |
| | | | | |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Fixed rate bonds | **18,260,825** | **18,260,825** | **–** | – |
| Floating rate borrowings | **37,143,616** | **–** | **37,143,616** | – |
| Fixed rate borrowings | **47,002,207** | **–** | **47,002,207** | – |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 30. FINANCIAL INSTRUMENTS (CONTINUED)

### Fair values (continued)

| | 31 December 2015 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Financial assets measured at fair value** | | | | |
| Cash flow hedging instruments | **794,464** | – | 794,464 | – |
| **Financial liabilities measured at fair value** | | | | |
| Cash flow hedging instruments | **124,128** | – | 124,128 | – |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Fixed rate bonds | **20,632,997** | 20,632,997 | – | – |
| Floating rate borrowings | **45,238,576** | – | 45,238,576 | – |
| Fixed rate borrowings | **9,479,907** | – | 9,479,907 | – |
| Obligations under finance leases | **18,577** | – | 18,577 | – |

During the year ending 31 December 2016 and 31 December 2015, there are no transfers between Level 1, Level 2 and Level 3 of fair value measurements.

Set out below, is a comparison by class of the carrying amounts and fair value of the Group's financial instruments, other than those with carrying amounts are reasonable approximations of fair values:

| | 31 December 2016 | | 31 December 2015 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| **Financial assets** | | | | |
| Cash flow hedging instruments | **372,210** | **372,210** | 794,464 | 794,464 |
| **Financial liabilities** | | | | |
| **Interest-bearing loans and borrowings** | | | | |
| Obligations under finance leases | **–** | **–** | 18,577 | 18,577 |
| Floating rate borrowings | **37,143,616** | **37,143,616** | 45,238,576 | 45,238,576 |
| Fixed rate borrowings and bonds | **65,057,435** | **65,263,032** | 30,683,798 | 30,112,904 |
| **Derivative liabilities** | | | | |
| Cash flow hedging instruments | **48,725** | **48,725** | 124,128 | 124,128 |
| **Total financial liabilities** | **102,249,776** | **102,455,373** | 76,065,079 | 75,494,185 |

The management assessed that the carrying amounts of cash and short-term deposits, trade receivables, trade payables and other current liabilities approximate their fair values largely due to the short-term maturities of these instruments.

The fair value of the financial assets and liabilities is included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

## 30. FINANCIAL INSTRUMENTS (CONTINUED)

### Fair values (continued)

The following methods and assumptions are used to estimate the fair values:

- Fair values of the Group's interest-bearing borrowings and loans are determined by using DCF method using discount rate that reflects the issuer's borrowing rate as at the end of the reporting period. The own non-performance risk as at 31 December 2016 and 31 December 2015 is assessed to be insignificant.
- The fair value of bonds is based on the price quotations at the reporting date at Moscow exchange where transactions with bonds take place with sufficient frequency and volume.
- The Group enters into derivative financial instruments with financial institutions with investment grade credit ratings. Derivatives valued using valuation techniques with market observable inputs are interest rate swaps and caps. The most frequently applied valuation techniques include swap models, using present value calculations, and option pricing model for caps. The models incorporate various inputs including the credit quality of counterparties and interest rate curves. As at 31 December 2016 and 31 December 2015, the marked-to-market value of derivative positions is net of a credit valuation adjustment attributable to derivative counterparty default risk. The changes in counterparty credit risk had no material effect on the hedge effectiveness assessment for derivatives designated in hedge relationships and other financial instruments recognised at fair value.

## 31. HEDGE AND HEDGING INSTRUMENTS

The Group entered into interest rate swaps and caps provided by VTB Bank PJSC to mitigate the risk of a rising MosPrime interest rate. Caps provide security for 4 quarters during the full periods of the agreement, so the termination date would the earlier of the expiry date or the fourth settlement date for the floating amounts paid by VTB Bank PJSC to the Group.

As at period end the Group had the following interest rate financial instruments:

| Type of instrument | Notional amount 2016 | Notional amount 2015 | Fixed interest rate | Fixed commission | Effective date | Expiry date |
|---|---|---|---|---|---|---|
| Interest rate swap | 12,500,000 | 12,500,000 | 7.64% | n/a | 31 March 2015 | 12 April 2018 |
| Interest rate swap | 900,000 | 900,000 | 7.54% | n/a | 31 December 2013 | 12 November 2018 |
| Interest rate swap | – | 1,000,000 | 15.35% | n/a | 31 December 2014 | 31 December 2016 |
| Interest rate cap | 10,000,000 | 10,000,000 | 12.00% | 0.54% | 31 December 2014 | 12 April 2018 |
| Interest rate cap | 900,000 | 900,000 | 12.00% | 0.45% | 31 December 2013 | 12 November 2018 |

Derivative financial instruments are classified in the statement of financial position as follows:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Non-current asset | **62,618** | 355,414 |
| Current assets | **309,592** | 439,050 |
| Non-current liability | **(2,137)** | (24,564) |
| Current liability | **(46,588)** | (99,564) |
| **Net derivative asset** | **323,485** | 670,336 |

The Group performs fair value assessment of the fair values of swaps and caps at the reporting date:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Swaps | **372,210** | 755,481 |
| Caps | **(48,725)** | (85,145) |
| **Net derivative asset** | **323,485** | 670,336 |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 31. HEDGE AND HEDGING INSTRUMENTS (CONTINUED)

Starting 1 July 2013 the Group applied cash flow hedge accounting of swaps and caps that meet prescribed criteria, including preparation of all necessary documentation. Hedge accounting was applied prospectively from designation.

Retrospective and prospective effectiveness of cash flow hedges (swaps and caps) was measured by the Group using the "dollar offset" method. The effective portion of the gain on or loss from the hedging instrument was recognised in other comprehensive income in hedging reserve.

The effect from changes in fair value of financial instruments is recognised as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| **Profit or loss** | | |
| Ineffective portion of the change in the fair value of cash flow hedging instruments | **–** | 6,308 |
| Reclassification from hedge reserve into interest expense | **410,581** | 1,800,556 |
| | **410,581** | 1,806,864 |
| | | |
| **Other comprehensive income** | | |
| Effective portion of the change in the fair value of cash flow hedging instruments | **44,241** | (525,963) |
| Reclassification from hedge reserve into interest expense | **(410,581)** | (1,800,556) |
| | **(366,340)** | (2,326,519) |

## 32. FINANCIAL RISK MANAGEMENT

The Group's principal financial liabilities, other than derivatives, comprise of loans and borrowings, trade and other payables. The main purpose of these financial liabilities is to finance the Group's operations and to provide guarantees to support its operations. The Group's principal financial assets include loans, trade and other receivables, and cash and short-term deposits that derive directly from its operations. The Group also enters into derivative transactions.

The Group is exposed to market risk, credit risk and liquidity risk. The Group's senior management oversees the management of these risks. The Group's financial risk activities are governed by appropriate policies and procedures and financial risks are identified, measured and managed in accordance with the Group's policies and risk objectives. All derivative activities for risk management purposes are carried out by specialists that have the appropriate skills, experience and supervision. It is the Group's policy that no trading in derivatives for speculative purposes may be undertaken.

The Board of Directors reviews and agrees policies for managing each of these risks, which are summarised below.

### Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises the following types of risk: interest rate risk, currency risk, and other price risk, such as equity price risk. Financial instruments affected by market risk include loans and borrowings, cash equivalents and derivative financial instruments.

### Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

During the year ended 31 December 2016 and year ended 31 December 2015, the Group does not attract any amounts of foreign currency denominated borrowings, and as a consequence is not materially exposed to foreign currency risk. The only balances that are exposed to foreign currency risk are accounts payable to several foreign suppliers.

At 31 December 2016 and at 31 December 2015 there are no significant amounts in foreign currencies.

Whenever possible, the Group tries to mitigate the exposure to foreign currency risk by matching the statement of financial position, and revenue and expense items in the relevant currency.

## 32. FINANCIAL RISK MANAGEMENT (CONTINUED)

### Foreign currency sensitivity

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant.

| | Change in USD rate | Effect on profit before tax |
|---|---|---|
| Year ended 2016 | **20.00%** | **(83,682)** |
| | **-20.00%** | **83,682** |
| Year ended 2015 | 40.00% | (49,033) |
| | -13.00% | 15,936 |

The following table demonstrates the sensitivity to a reasonably possible change in the EUR exchange rate, with all other variables held constant.

| | Change in EUR rate | Effect on profit before tax |
|---|---|---|
| Year ended 2016 | **20.00%** | **(33,195)** |
| | **-20.00%** | **33,195** |
| Year ended 2015 | 43.00% | (40,846) |
| | -15.00% | 14,249 |

Foreign currency exchange rate reasonable possible change range was prepared for the purpose of market risk disclosures in accordance with IFRS 7 and is derived from statistical data, in particular time series analysis.

### Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of the financial instrument will fluctuate because of changes in market interest rates.

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates. As at 31 December 2016 these obligations are represented with long-term borrowing (Note 21), which bears interest of MosPrime 1-3m plus margin. In order to hedge the risk of rising MosPrime interest rate, the Group entered into interest rate swaps and caps (Note 31).

### Interest rate sensitivity

The following tables demonstrate the sensitivity to a reasonably possible change in MosPrime rates, on that portion of loans and borrowings affected, after the impact of hedge accounting. With all other variables held constant, the Group's profit before tax and OCI are affected through the impact on floating rate borrowings, as follows:

| | Profit or loss | | OCI | |
|---|---|---|---|---|
| | 200 bp increase | 400 bp decrease | 200 bp increase | 400 bp decrease |
| **2016** | | | | |
| Variable rate instruments | **(775,287)** | **1,550,574** | **–** | **–** |
| Interest rate swaps and caps | **337,619** | **(576,600)** | **313,312** | **(647,145)** |
| **Cash flow sensitivity (net)** | **(437,668)** | **973,974** | **313,312** | **(647,145)** |

| | Profit or loss | | OCI | |
|---|---|---|---|---|
| | 600 bp increase | 500 bp decrease | 600 bp increase | 500 bp decrease |
| **2015** | | | | |
| Variable rate instruments | (2,647,200) | 2,647,200 | – | – |
| Interest rate swaps and caps | 1,519,500 | (855,009) | 1,761,327 | (1,358,130) |
| **Cash flow sensitivity (net)** | (1,127,700) | 1,792,191 | 1,761,327 | (1,358,130) |

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 32. FINANCIAL RISK MANAGEMENT (CONTINUED)

### Interest rate sensitivity (continued)

The range of reasonable possible changes in MosPrime rate was prepared for the purpose of market risk disclosures in accordance with IFRS 7 and is based on risk metrics that are derived from statistical data, in particular time series analysis.

The Group is exposed to cash flow interest rate risk as it borrows funds at floating interest rates. During the year ended 31 December 2016 all of the Group's borrowings are denominated in Russian roubles. The Group evaluates its interest rate exposure and hedging activities on a regular basis and acts accordingly in order to align with the defined risk limits set by the executive board. To ensure optimal hedging strategies various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and financial hedging instruments.

The Group manages its cash flow interest rate risk by the use of floating to fixed interest rate swaps and caps. Such financial instruments have the economic benefit of converting borrowings issued at variable rates to fixed interest rates. The Group's hedging instruments as at the reporting date are detailed in Note 30 of these financial statements. The sensitivity analyses below have been determined based on the net exposure of interest bearing borrowings. The net exposure of the Group to interest rate fluctuations as at 31 December 2016 is as follows:

| | 31 December 2016 |
|---|---|
| Total floating rate borrowings (gross of direct issue costs) | **36,928,571** |
| Less notional amount of interest rate financial instruments (Note 32) | **(24,300,000)** |
| **Net exposure to interest rate fluctuations** | **12,628,571** |
| % of floating rate borrowings exposed to interest rate fluctuations | **34%** |

### Credit risk

Credit risk is the risk that a counterparty may default or not meet its obligations to the Group on a timely basis, leading to financial loss to the Group. Financial assets, which are potentially subject to credit risk, consist principally of cash in bank accounts and cash in transit, loans and receivables.

In determining the recoverability of receivables the Group performs a risk analysis considering the credit quality of the counterparty, the ageing of the outstanding amount and any past default experience.

### Trade receivables

The Group has no significant concentrations of credit risk. Concentration of credit risk with respect to receivables is limited due to the Company's customer and vendor base being large and unrelated. Credit is only extended to counterparties subject to strict approval procedures. The Group trades only with recognised, creditworthy third parties who are registered in the Russian Federation. It is the Group's policy that all customers who are granted credit terms have a history of purchases from the Group. The Group also requires these customers to provide certain documents such as incorporation documents and financial statements. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. Sales to retail customers are made in cash, debit cards or via major credit cards.

### Cash and cash equivalents

Credit risk from investing activities is managed by the Group's treasury department in accordance with the Group's policy. Investments of surplus funds are made only with approved counterparties. Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

The maximum exposure to credit risk at the reporting date of trade receivables is the carrying value as presented in the statement of financial position. The maximum exposure to credit risk at the reporting date of cash and cash equivalents is RUB 12,853,791 thousand (31 December 2015: RUB 22,317,167 thousand).

## 32. FINANCIAL RISK MANAGEMENT (CONTINUED)

### Liquidity risk

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of its financial assets and liabilities and projected cash flows from operations. The Group objective is to maintain a continuity of funding and flexibility through the use of bank overdrafts and bank loans. Each year the Group analyses its funding needs and anticipated cash flows, so that it can determine its funding needs.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2016, 31 December 2015 bases on contractual undiscounted cash flows of the financial liabilities based on the earliest date on which the Group is required to pay. The table includes both interest and principal cash flows. When the amount payable is not fixed for the entire term of the instrument, such as variable rate interest payments, the amount disclosed in the table is determined by reference to the conditions (e.g. MosPrime index) existing at the reporting date:

**31 December 2016**

| | Less than 12 months | 1–5 years | Over 5 years | Total |
|---|---|---|---|---|
| Borrowings | **43,797,302** | **68,974,211** | **14,415,411** | **127,186,924** |
| Trade and other payables | **56,171,598** | **–** | **–** | **56,171,598** |
| Amounts payable under swaps and caps | **58,106** | **16,238** | **–** | **74,344** |
| **Total** | **100,027,006** | **68,990,449** | **14,415,411** | **183,432,866** |

**31 December 2015**

| | Less than 12 months | 1–5 years | Over 5 years | Total |
|---|---|---|---|---|
| Borrowings | 19,945,156 | 72,189,546 | 15,328,782 | 107,463,484 |
| Trade and other payables | 47,058,158 | – | – | 47,058,158 |
| Amounts payable under swaps and caps | 100,216 | 74,344 | – | 174,560 |
| Finance leasing | 19,850 | – | – | 19,850 |
| **Total** | 67,123,380 | 72,263,890 | 15,328,782 | 154,716,052 |

### Capital management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The Group reviews its capital needs periodically to determine actions to balance its overall capital structure through shareholders' capital contributions or new share issues, return of capital to shareholders as well as the issue of new debt or the redemption of existing debt. The Group is guided in its decisions by an established financing policy, which stipulates leverage ratios, interest coverage, covenants compliance, appropriateness of balance between long-term and short-term debt, requirements to diversification of funding sources. Dividends are to be declared based on the capital requirements of the business and with reference to continuing compliance with the financial policy.

The capital structure of the Group consists of debt, which includes the borrowings disclosed in Note 21, obligations under finance leases less cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in Note 18.

Net debt of the Group is comprised of the following:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| Borrowings | **102,201,051** | 75,922,374 |
| Obligations under finance leases | **–** | 18,577 |
| Cash and cash equivalents (Note 17) | **(13,037,767)** | (22,455,945) |
| **Net debt** | **89,163,284** | 53,485,006 |

Net debt is a non-IFRS indicator and, therefore, its calculation may differ between companies, however it is one of the key indicators that are commonly used by investors and other users of financial statements in order to evaluate the financial condition of the Group.

# Notes to the consolidated financial statements (continued)

for the year ended 31 December 2016 (in thousands of Russian roubles)

## 33. CONTINGENCIES

### Operating environment of the Group

The Group sells products that are sensitive to changes in general economic conditions that impact consumer spending. Future economic conditions and other factors, including sanctions imposed, consumer confidence, employment levels, interest rates, consumer debt levels and availability of consumer credit could reduce consumer spending or change consumer purchasing habits. A general slowdown in the Russian economy or in the global economy, or an uncertain economic outlook, could adversely affect consumer spending habits and the Group's operating results.

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy has been negatively impacted by a decline in oil prices and sanctions imposed on Russia by a number of countries. The rouble interest rates remained high. The combination of the above resulted in reduced access to capital, a higher cost of capital and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

### Legal contingencies

Group companies are involved in a number of lawsuits and disputes that arise in the normal course of business. Management assesses the maximum exposure relating to such lawsuits and disputes to be RUB 511,656 thousand as at 31 December 2016 (31 December 2015: RUB 6,449 thousand). Management believes there is no exceptional event or litigation likely to affect materially the business, financial performance, net assets or financial position of the Group, which have not been disclosed in these consolidated financial statements.

### Russian Federation tax and regulatory environment

The government of the Russian Federation continues to reform the business and commercial infrastructure in its transition to a market economy. As a result the laws and regulations affecting businesses continue to change rapidly. These changes are characterised by poor drafting, different interpretations and arbitrary application by the authorities. In particular taxes are subject to review and investigation by a number of authorities who are enabled by law to impose fines and penalties. While the Group believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation, the above facts may create tax risks for the Group. Management also assesses the maximum exposure from possible tax risks to be RUB 288,582 thousand (31 December 2015: RUB 126,793 thousand). No tax provisions are recorded as at 31 December 2016 and 31 December 2015. Management continues to monitor closely any developments related to these risks and regularly reassesses the risk and related liabilities, provisions and disclosures.

### Land leases

Certain lease agreements for land plots containing a short lease term expired prior to the date of these financial statements. The Group initiated the process of renewal of the lease agreements for 49 years and believes that the risks relating to the operations of the respective stores are insignificant. No provisions in this respect are accrued as at 31 December 2016 and 31 December 2015.

### Environmental matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

## 34. EVENTS OCCURRING AFTER THE REPORTING PERIOD

There were no significant events after the reporting date other than disclosed elsewhere in the consolidated financial statements.

# APPENDICES

**142** List of cities as of 31 December, 2016
**144** Glossary
**145** Further information
**146** Cautionary statements

# List of cities as of 31 December 2016

| Number on the map | Cities[1] | Number of hypermarkets | Number of supermarkets | Number of distribution centres |
|---|---|---|---|---|
| 1 | Almetyevsk | 1 | | |
| 2 | Armavir | 1 | | |
| 3 | Astrakhan | 1 | | |
| 4 | Balakovo | 1 | | |
| 5 | Barnaul | 3 | | |
| 6 | Belgorod | 2 | | |
| 7 | Biysk | 1 | | |
| 8 | Bryansk | 1 | | |
| 9 | Cheboksary | 1 | | |
| 10 | Chelyabinsk | 5 | | |
| 11 | Cherepovets | 2 | | |
| 12 | Dimitrovgrad | 1 | | |
| 13 | Ekaterinburg | 2 | | 1 |
| 14 | Engels | 1 | | |
| 15 | Grozny | 1 | | |
| 16 | Irkutsk | 2 | | |
| 17 | Ivanovo | 3 | | |
| 18 | Izhevsk | 1 | | |
| 19 | Kaluga | 1 | 3 | |
| 20 | Kazan | 1 | | |
| 21 | Kemerovo | 3 | | |
| 22 | Khanty-Mansiysk | 1 | | |
| 23 | Kostroma | 1 | | |
| 24 | Krasnodar | 3 | | |
| 25 | Krasnoyarsk | 4 | | |
| 26 | Kursk | 1 | | |
| 27 | Lipetsk | 1 | | |
| 28 | Magnitogorsk | 2 | | |
| 29 | Moscow | 13 | 34 | 2 |
| 30 | Murmansk | 1 | | |
| 31 | Naberezhnye Chelny | 1 | | |
| 32 | Nizhnekamsk | 1 | | |
| 33 | Nizhniy Novgorod | 3 | | |
| 34 | Nizhniy Tagil | 2 | | |
| 35 | Novocherkassk | 1 | | |
| 36 | Novokuznetsk | 5 | | |
| 37 | Novorossiysk | 2 | | |
| 38 | Novoshakhtinsk | 1 | | |
| 39 | Novosibirsk | 7 | | 1 |

| Number on the map | Cities[1] | Number of hypermarkets | Number of supermarkets | Number of distribution centres |
|---|---|---|---|---|
| 40 | Omsk | 6 | | |
| 41 | Orel | 1 | | |
| 42 | Orenburg | 2 | | |
| 43 | Orsk | 1 | | |
| 44 | Penza | 2 | | |
| 45 | Perm | 1 | | |
| 46 | Petrozavodsk | 2 | | |
| 47 | Prokopievsk | 1 | | |
| 48 | Pskov | 1 | | |
| 49 | Rostov-on-Don | 3 | | 1 |
| 50 | Ryazan | 2 | | |
| 51 | Samara | 2 | | |
| 52 | Saransk | 1 | | |
| 53 | Saratov | 2 | | |
| 54 | Smolensk | 1 | | |
| 55 | St. Petersburg | 35 | 12 | 2 |
| 56 | Stavropol | 2 | | |
| 57 | Surgut | 2 | | |
| 58 | Syktyvkar | 2 | | |
| 59 | Taganrog | 2 | | |
| 60 | Tobolsk | 1 | | |
| 61 | Togliatti | 2 | | 1 |
| 62 | Tomsk | 3 | | |
| 63 | Tula | 1 | | |
| 64 | Tver | 1 | | |
| 65 | Tyumen | 4 | | |
| 66 | Ufa | 4 | | |
| 67 | Ulyanovsk | 2 | | |
| 68 | Velikiy Novgorod | 2 | | |
| 69 | Vladimir | 1 | | |
| 70 | Volgograd | 4 | | |
| 71 | Vologda | 1 | | |
| 72 | Volzhskiy | 1 | | |
| 73 | Voronezh | 2 | | |
| 74 | Yaroslavl | 3 | | |
| 75 | Yoshkar Ola | 1 | | |
| 76 | Yurga | 1 | | |
| 77 | Zheleznovodsk | 1 | | |

1 From 1 May 2015, all stores located in Moscow city and the Moscow Region are shown as ‘Moscow’; all stores located in the Leningrad Region and St. Petersburg are shown as ‘St. Petersburg’.

# Glossary

Unless otherwise specified, the terms ‘we’, ‘us’, and ‘our’ refer to Lenta Ltd., or where the context allows, to the Lenta business more generally.

| | |
|---|---|
| **the 2014 Offering** | the initial public offering of our Shares, in the form of GDRs, admitted to trading on the London Stock Exchange and the Moscow Stock Exchange on 5 March 2014 |
| **active cardholder** | a customer who has purchased goods at one of our stores at least twice in the past 12 months using our loyalty card |
| **average sales density** | total sales during the relevant year divided by the average selling space for that year |
| **average ticket** | the figure calculated by dividing total sales, net of VAT, at all stores during the relevant year by the number of tickets in that year |
| **the Board** | the board of directors of Lenta Ltd |
| **BVI** | the British Virgin Islands |
| **Capex** | capital expenditure |
| **CAGR** | Compounded annual rate of growth |
| **EGAIS** | national automated information system for the control of alcohol production and distribution |
| **FMCG** | fast-moving consumer goods – products that are sold quickly and at relatively low cost |
| **gamification** | the application of game-design elements and game principles in non-game contexts. Gamification commonly employs game design elements which are used in non-game contexts to improve user engagement, organisational productivity, flow, learning, crowdsourcing, employee recruitment and evaluation, ease of use, usefulness of systems, physical exercise, traffic violations, voter apathy, and more. |
| **GDRs** | global depositary receipts |
| **in-store availability** | the number of SKUs in-store with a positive stock value as a proportion of the total number of active SKUs for sale, calculated based on the average daily in-store availability of all open stores |
| **LFL** | like-for-like |
| **P&L** | profit and loss statement |
| **SG&A** | Selling, General and Administrative Expenses, which is a major non-production cost presented in the Income statement |
| **Shares** | our ordinary shares |
| **SKU** | a ‘stock keeping unit’, or a number assigned to a particular product to identify the price, product options and manufacturer of the merchandise |
| **sq.m** | square metre(s) |
| **ticket** | the receipt issued to a customer for his/her basket (the amount spent by a customer on a shopping trip) |
| **total selling space** | the area inside our stores used to sell products, excluding areas rented out to third parties, own-production areas, storage areas and the space between store entry and the cash desk line |
| **traffic** | the number of tickets issued for the period under review |

# Further information

In this annual report, we present certain operating and financial information regarding our hypermarkets and supermarkets, which we define as follows:

| | |
|---|---|
| **Adjusted EBITDA** | EBITDA adjusted for non-recurring one-off items such as changes in accounting estimates and one-off non-operating costs |
| **Adjusted EBITDA margin** | Adjusted EBITDA as a percentage of sales |
| **Adjusted EBITDAR** | Adjusted EBITDA before rent paid on land, equipment and premises leases |
| **Adjusted EBITDAR margin** | Adjusted EBITDAR as a percentage of sales |
| **EBITDA** | Profit for the period before foreign exchange gains/losses, revaluation of financial instruments at fair value through profit or loss, reversal of impairment of non-financial assets, other expenses, depreciation and amortisation, interest and tax. The reconciliation of EBITDA to IFRS profit is presented in tabular format in note 6 to the Consolidated Financial Statements. |
| **like-for-like sales** | We distinguish between sales attributable to new stores and sales attributable to existing stores. We consider the sales generated by stores until the end of the 12th full calendar month of their operation to be sales attributable to new stores. Accordingly, like-for-like sales begin with the comparison of the 13th full calendar month of operations of a store to its first full calendar month of operations, assuming the store has not subsequently closed, expanded or down sized. The number of stores in our like-for-like panel as of 31 December 2016 and 2015 was 152 (125 hypermarkets and 27 supermarkets) and 109 (91 hypermarkets and 18 supermarkets) respectively. 'Like-for-like average ticket growth', 'like-for-like average price growth per article', 'like-for-like traffic growth', and 'like-for-like average sales density' are calculated using the same methodology as like-for-like sales. |
| **Other metrics** | Net debt is calculated as the sum of short-term and long-term debt (including borrowings and obligations under finance leases, capitalised fees and accrued interest) minus cash and cash equivalents. The ratio of net debt to Adjusted EBITDA is net debt divided by Adjusted EBITDA. The ratio of Adjusted EBITDA to net interest expense is Adjusted EBITDA divided by net interest expense, which is calculated as interest expense less interest income. The ratio of Adjusted EBITDAR to net interest expense plus rental expense ratio is Adjusted EBITDAR divided by the sum of net interest expense and rental expenses. CROCI is defined as Adjusted EBITDA over average capital invested. Average capital invested is the average of the book value of gross non-current assets plus net working capital as of the beginning of the year and the book value of gross non-current assets plus net working capital as of the end of the year. Adjusted SG&A/Sales is SG&A, excluding expenses on land and equipment leases, premises leases, depreciation and amortisation and one-off expenses as a proportion of sales. |

# Cautionary statements

## Forward-looking statements

This document contains certain ‘forward-looking statements’ which include all statements other than those of historical facts that relate to our plans, financial position, objectives, goals, strategies, future operations and performance, together with the assumptions underlying such matters.

We generally use words such as ‘estimates’, ‘expects’, ‘believes’, ‘intends’, ‘plans’, ‘may’, ‘will’, ‘should’, ‘projects’, ‘anticipates’, ‘targets’, ‘aims’, ‘would’, ‘could’, ‘continues’ and other similar expressions to identify forward-looking statements. We have based these forward-looking statements on the current views of our management with regard to future events and performance. These views reflect management’s best judgement, but involve uncertainties and are subject to certain known and unknown risks together with other important factors outside our control, the occurrence of which could cause actual results to differ materially from those expressed in our forward-looking statements.

## Market and industry data

Statements referring to our competitive position and the Russian retail food sector reflect our beliefs and, in some cases, private and publicly available information and statistics, including annual reports, industry publications, market research, press releases, filings under various securities laws, official data published by Russian governmental entities and data published by international organisations and other third-party sources.

## Rounding

Certain figures in this document have been subject to rounding adjustments. Accordingly, figures shown for the same category presented in different tables may vary slightly, and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

# Notes

# Notes

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