PJSC "Magnit"

Consolidated financial statements

For the year ended 31 December 2014

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For the year ended 31 December 2014

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улучшаем мир

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Independent auditors' report

To the Shareholders of Public Joint Stock Company "Magnit"

We have audited the accompanying consolidated financial statements of Public Joint Stock Company "Magnit" and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2014, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

23 March 2015

Moscow, Russia

PJSC "Magnit"

Consolidated statement of financial position

as at 31 December 2014

(In thousands of US dollars)

	Notes	31 December 2014	31 December 2013
Assets			
Non-current assets			
Property, plant and equipment	6	4,141,049	5,962,817
Investment property		10,665	9,941
Land lease rights	7	54,645	99,573
Intangible assets	8	16,079	22,619
Goodwill	8	24,307	41,782
Long-term financial assets		1,733	2,148
		4,248,478	6,138,880
Current assets			
Inventories	9	1,448,240	1,713,925
Trade and other receivables		14,456	19,296
Advances paid	10	86,197	96,888
Taxes receivable		1,233	855
Prepaid expenses		4,311	7,704
Short-term financial assets	11	8,446	35,156
Income tax receivable		2,344	–
Cash and cash equivalents	12	314,469	181,218
		1,879,696	2,055,042
Total assets		6,128,174	8,193,922
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	13	34	34
Share premium	13	1,507,642	1,497,515
Treasury shares	13	(8,842)	(3,800)
Foreign currency translation reserve		(2,271,607)	(414,393)
Retained earnings		3,326,196	2,775,370
Total equity		2,553,423	3,854,726
Non-current liabilities			
Long-term borrowings and loans	15	789,396	1,143,981
Long-term advances received		3,591	8,846
Deferred tax liability	26	185,141	249,707
		978,128	1,402,534
Current liabilities			
Trade and other payables	16	1,187,282	1,471,796
Accrued expenses	17	145,482	202,032
Taxes payable	18	95,742	141,426
Dividends payable	14	255,465	1
Income tax payable		–	9,024
Short-term advances received		1,558	2,678
Short-term borrowings and loans	19	911,094	1,109,705
		2,596,623	2,936,662
Total liabilities		3,574,751	4,339,196
Total equity and liabilities		6,128,174	8,193,922

The accompanying notes on pages 6-43 are an integral part of these consolidated financial statements.

PJSC “Magnit”

Consolidated statement of comprehensive income

For the year ended 31 December 2014

(In thousands of US dollars)

	Notes	2014	2013
Revenue	20	19,872,292	18,201,924
Cost of sales	21	(14,132,806)	(13,012,807)
Gross profit		5,739,486	5,189,117
Selling expenses	22	(231,954)	(176,972)
General and administrative expenses	23	(3,716,842)	(3,462,342)
Investment income		9,695	5,859
Finance costs	24	(172,974)	(156,036)
Other income	25	75,257	59,785
Other expenses		(15,060)	(11,752)
Foreign exchange loss		(73,245)	(11,022)
Profit before income tax		1,614,363	1,436,637
Income tax expense	26	(373,245)	(318,189)
Profit for the year		1,241,118	1,118,448
Other comprehensive income			
Loss on translation to presentation currency		(1,855,795)	(256,395)
Other comprehensive loss for the year, net of tax		(1,855,795)	(256,395)
Total comprehensive (loss)/income for the year, net of tax		(614,677)	862,053
Profit for the year			
Attributable to:			
Equity holders of the Parent		1,241,118	1,118,448
		1,241,118	1,118,448
Total comprehensive (loss)/income for the year, net of tax			
Attributable to:			
Equity holders of the Parent		(614,677)	862,053
		(614,677)	862,053
Earnings per share (in US dollars per share)			
- basic and diluted, for profit for the year attributable to equity holders of the parent	27	13.13	11.83

The accompanying notes on pages 6-43 are an integral part of these consolidated financial statements.

PJSC "Magnit"

Consolidated cash flow statement

For the year ended 31 December 2014

(In thousands of US dollars)

	Notes	2014	2013
Cash flows from operating activities			
Profit before income tax		1,614,363	1,436,637
Adjustments for:			
Depreciation	6	449,337	436,149
Amortization	23	8,991	9,226
Loss from disposal of property, plant and equipment		11,351	6,636
Loss from disposal of investment property		–	104
Revaluation of investment property		(7,148)	–
Bad debt provision	23	2,947	2,230
Foreign exchange loss		73,245	11,022
Finance costs	24	172,974	156,036
Investment income		(9,695)	(5,859)
Operating cash flows before working capital changes		2,316,365	2,052,181
Decrease in trade and other receivables		6,074	3,178
Decrease/(increase) in advances paid		10,691	(8,743)
(Decrease)/increase in advances received		(6,375)	11,524
(Increase)/decrease in taxes receivable		(378)	2,561
Decrease/(increase) in prepaid expenses		3,393	(1,714)
Decrease/(increase) in inventories		265,685	(356,994)
(Decrease)/increase in trade and other payables		(357,667)	28,908
(Decrease)/increase in accrued expenses		(56,550)	36,259
(Decrease)/Increase in taxes payable		(45,684)	18,523
Cash generated from operations		2,135,554	1,785,683
Income tax paid		(326,233)	(252,238)
Interest paid		(177,177)	(149,417)
Interest received		9,767	6,567
Net cash from operating activities		1,641,911	1,390,595
Cash flows from investing activities			
Purchase of property, plant and equipment		(1,450,010)	(1,571,564)
Purchase of intangible assets		(12,000)	(13,872)
Purchase of land lease rights		(5,826)	(22,574)
Proceeds from disposal of subsidiary		2,855	7,143
Proceeds from sale of property, plant and equipment		14,480	20,319
Proceeds from sale of land lease rights		115	–
Acquisition of subsidiaries		–	(52,582)
Loans provided		(511,662)	(201,536)
Loans repaid		528,463	195,959
Net cash used in investing activities		(1,433,585)	(1,638,707)
Cash flows from financing activities			
Proceeds from loans and borrowings		9,166,521	8,062,402
Repayment of loans and borrowings		(8,594,681)	(7,755,075)
Dividends paid		(426,879)	(294,767)
Repayment of obligations under finance leases		(23)	(396)
Proceeds from sale of treasury shares		420,260	64,871
Purchase of treasury shares		(415,175)	(36,559)
Net cash from financing activities		150,023	40,476
Effect of foreign exchange rates on cash and cash equivalents		(225,098)	(21,139)
Net increase/(decrease) in cash and cash equivalents		133,251	(228,775)
Cash and cash equivalents at the beginning of the year	12	181,218	409,993
Cash and cash equivalents at the end of the year	12	314,469	181,218

The accompanying notes on pages 6-43 are an integral part of these consolidated financial statements.

PJSC "Magnit"

Consolidated statement of changes in equity

For the year ended 31 December 2014

(In thousands of US dollars)

	Attributable to equity holders of the parent					
	Share capital	Share premium	Treasury shares	Foreign currency translation reserve	Retained earnings	Equity attributable to equity holders of the parent
Balance at 1 January 2013	34	1,484,255	(18,852)	(156,537)	1,958,364	3,267,264
Profit for the period	–	–	–	–	1,118,448	1,118,448
Other comprehensive income	–	–	–	(256,395)	–	(256,395)
Total comprehensive income for the period	–	–	–	(256,395)	1,118,448	862,053
Dividends declared (Note 14)	–	–	–	–	(301,442)	(301,442)
Share-buyback	–	–	(36,559)	–	–	(36,559)
Sale of treasury shares	–	13,260	51,611	(1,461)	–	63,410
Balance at 31 December 2013	34	1,497,515	(3,800)	(414,393)	2,775,370	3,854,726
Balance at 1 January 2014	34	1,497,515	(3,800)	(414,393)	2,775,370	3,854,726
Profit for the period	–	–	–	–	1,241,118	1,241,118
Other comprehensive income	–	–	–	(1,855,795)	–	(1,855,795)
Total comprehensive income for the period	–	–	–	(1,855,795)	1,241,118	(614,677)
Dividends declared (Note 14)	–	–	–	–	(690,292)	(690,292)
Share-buyback	–	–	(415,175)	–	–	(415,175)
Sale of treasury shares	–	10,127	410,133	(1,419)	–	418,841
Balance at 31 December 2014	34	1,507,642	(8,842)	(2,271,607)	3,326,196	2,553,423

The accompanying notes on pages 6-43 are an integral part of these consolidated financial statements.

(All amounts are in thousands of US dollars if not otherwise indicated)

1. Corporate information

The consolidated financial statements of the Group for the year ended 31 December 2014 were authorised for release by the Chief Executive Officer of PJSC “Magnit” on 23 March 2015.

Close Joint Stock Company “Magnit” (“Magnit”) was incorporated in Krasnodar, the Russian Federation, in November 2003.

In January 2006, Magnit changed its legal form to Open Joint Stock Company “Magnit”. There was no change in the principal activities or shareholders as a result of the change to an Open Joint Stock Company. In 2014 Magnit changed its legal form to Public Joint Stock Company (the ”Company” or PJSC “Magnit”) in accordance with changes in legislation.

PJSC “Magnit” and its subsidiaries (the “Group”) operate in the retail and distribution of consumer goods under the “Magnit” name. The Group’s retail operations are operated through convenience stores, cosmetic stores, hypermarkets and other.

All of the Group’s operational activities are conducted in the Russian Federation. The principal operating office of the Group is situated at 15/5 Solnechnaya St., 350072 Krasnodar, the Russian Federation.

The principal activities of the Group’s subsidiaries all of which are incorporated in the Russian Federation, and the effective ownership percentages are as follows:

Company name	Principal activity	Ownership Interest 2014	Ownership Interest 2013
CJSC “Tander”	Food retail and wholesale	100%	100%
LLC “Retail Import”	Import operations	100%	100%
LLC “BestTorg”	Food retail in Moscow and the Moscow region	100%	100%
LLC “Tander-Magnit”	Food retail in the Moscow region	100%	100%
LLC “Selta”	Transportation services for the Group	100%	100%
LLC “TK Zelenaya Liniya”	Greenhouse complex	100%	100%
LLC “Tandem”	Rent operations	100%	100%
LLC “Alkotrading”	Other operations	100%	100%
LLC “Logistika Alternativa”	Import operations	100%	100%
LLC “Zvezda”	Assets holder, maintenance services for the Group	100%	100%
LLC “ITM”	IT operations	100%	–
LLC “UK Premier-Liga”	Managing company of the employee`s pension fund	–	100%
“TD-holding” company limited	Production and processing of food for the Group	100%	100%
LLC “MagnitEnergo”	Buyer of electric power for the Group	100%	100%

The 100% ownership in LLC “UK Premier-Liga” was sold to a third party.

In February 2014, the Group established LLC “ITM” with 100% ownership. The company provides IT services for the Group.

1. Corporate information (continued)

At 31 December 2014 and 2013, the shareholding structure of the Company was as follows:

	2014		2013	
Shareholder	Number of shares	Ownership interest, %	Number of shares	Ownership interest, %
Galitskiy S.N.	35,538,021	37.58%	36,563,000	38.67%
Shares controlled by Lavreno Ltd. (Cyprus)	4,276,445	4.52%	3,251,466	3.44%
Gordeichuk V.E.	2,624,692	2.78%	2,622,677	2.77%
Shares controlled by the Group’s Management	462,847	0.49%	533,503	0.56%
Treasury shares	48,527	0.05%	16,141	0.02%
Free float	51,610,823	54.58%	51,574,568	54.54%
	94,561,355	100%	94,561,355	100%

2. Basis of preparation of the financial statements

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

Basis of accounting

The Group’s entities maintain their accounting records in Russian roubles (“RUB”) and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The statutory financial statements have been adjusted to present these consolidated financial statements in accordance with IFRS.

The financial statements have been prepared on a historical cost basis except for the use of fair value as deemed cost for certain property, plant and equipment as of the date of transition to IFRS and investment property at fair value.

The functional currency of each of the Group’s entities is the Russian rouble (“RUB”).

The presentation currency of the consolidated financial statements is the United States of America dollar (“USD”) as it is considered by management a more relevant presentation currency for international users of the consolidated financial statements of the Group.

2. Basis of preparation of the financial statements (continued)

Basis of accounting (continued)

The translation from functional currency into presentation currency is made as follows:

- Assets and liabilities for each consolidated statement of financial position presented are translated at the closing rate at the date of that consolidated statement of financial position;
- Income and expenses for each consolidated statement of comprehensive income presented are translated at the average exchange rates for the periods presented (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions);
- All resulting exchange differences are recognized in other comprehensive income;
- All items included in the consolidated statement of changes in equity, other than net profit for the period, are translated at historical exchange rates;
- In the consolidated cash flow statement, cash balances at the beginning and end of each period presented are translated at exchange rates at the respective dates of the beginning and end of each period. All cash flows are translated at the average exchange rates for the periods presented.

The RUB is not a freely convertible currency outside the Russian Federation and, accordingly, any translation of RUB denominated assets and liabilities into USD for the purpose of these consolidated financial statements does not imply that the Group could or will in the future realise or settle in USD the translated values of these assets and liabilities.

The following USD/RUB ex-rates were used during preparation of the consolidated financial statements:

	2014	2013
As of 31 December	56.2584	32.7292
Average for the year	38.4217	31.8480

3. Summary of significant accounting policies

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and other entities controlled by the Company (its subsidiaries). 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.

3. Summary of significant accounting policies (continued)

Basis of consolidation (continued)

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 re-assesses 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.

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 in 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.

The financial statements of subsidiaries are prepared for the same reporting period as those of the holding company; where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used by them into line with those of the Group.

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 assets (including goodwill) and liabilities of the subsidiary;
- Derecognises the carrying amount of any non-controlling interest;
- Derecognises the cumulative translation differences, recorded in equity;
- Recognises the fair value of the consideration received;
- Recognises the fair value of any investment retained;
- Recognises any surplus or deficit in profit or loss;
- Reclassifies the parent’s share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

3. Summary of significant accounting policies (continued)

Business combinations

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 acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree’s identifiable net assets. Acquisition costs incurred are expensed 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 acquirer’s previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it should not be remeasured until it is finally settled within equity. In instances where the contingent consideration does not fall within the scope of IAS 39, it is measured in accordance with the appropriate IFRS.

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 Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the re-assessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then 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 forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

3. Summary of significant accounting policies (continued)

Current versus non-current classification

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

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 non-financial assets such as investment properties, at fair value at each balance sheet date. Fair values of financial instruments measured at amortised cost are disclosed in Note 29.

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.

3. Summary of significant accounting policies (continued)

Fair value measurement (continued)

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 re-assessing 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.

External valuers are involved for valuation of investment properties. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained.

Revenue recognition

The Group generates and recognizes sales to retail customers at the point of sale in its stores and to wholesale customers upon title transfer to customers. Retail sales are in cash and through bank cards. Revenues are measured at the fair value of the consideration received or receivable, recognized 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.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment.

Historical cost information was not available in relation to buildings purchased prior to transition date to IFRS (1 January 2004). Therefore, management has used valuations performed by independent professionally qualified appraisers to arrive at the fair value as of the date of transition to IFRS and deemed those values as cost.

Cost includes major expenditures for improvements and replacements, which extend the useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statement of comprehensive income as incurred.

3. Summary of significant accounting policies (continued)

Property, plant and equipment (continued)

Depreciation is charged so as to write off the cost or valuation of assets, other than land and properties under construction, over their estimated useful lives, using the straight-line method. The estimated useful economic lives of the related assets are as follows:

	Useful life in years
Buildings	30
Machinery and equipment	3-14
Other fixed assets	3-10

Other fixed assets consist of vehicles and other relatively small groups of fixed assets.

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 provision for impairment is made.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the statement of comprehensive income.

Investment property

Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment property are included in the income statement in the period in which they arise. Fair values are evaluated annually by an accredited external, independent valuer, applying a valuation model recommended by the International Valuation Standards Committee.

Investment property is derecognised when either it has been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in the income statement in the period of derecognition.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

3. Summary of significant accounting policies (continued)

Land lease rights

Land lease rights acquired as part of hypermarket development projects are separately reported at cost less accumulated amortization and accumulated impairment losses. Amortization is charged on a straight-line basis over their estimated useful lives. The useful life is estimated to be 49 years.

When the Group constructs a building on land that is leased under an operating lease, the operating lease costs (including amortization of land lease rights) that are incurred during the construction are capitalised as part of the construction cost of the building.

Intangible assets

Intangible assets acquired separately are reported at cost less accumulated amortization and accumulated impairment losses. Amortization is charged on a straight-line basis over their estimated useful lives.

Lease rights and other intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair values can be measured reliably. The cost of such intangible assets is their fair value at the acquisition date.

Subsequent to initial recognition, lease rights and other intangible assets acquired in a business combination are reported at cost less accumulated amortization and accumulated impairment losses, on the same basis as intangible assets acquired separately.

The following useful lives are used in the calculation of amortization:

Description	Useful life in years
Licenses	1-25
Lease rights (convenience stores)	1-21
Software	1-25
Trade marks	1-10
Other	1-7

Impairment of non-current assets

At each reporting date, the Group reviews the carrying amounts of its tangible and intangible 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 CGU to which the asset belongs.

Recoverable amount is the higher of 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 estimates of future cash flows have not been adjusted.

3. Summary of significant accounting policies (continued)

Impairment of non-current assets (continued)

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (CGU) is reduced to its recoverable amount. An impairment loss is recognised immediately in the profit and loss. Where an impairment loss subsequently reverses, the carrying amount of the asset (CGU) 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 (CGU) in prior years. A reversal of an impairment loss is recognised immediately in the profit and loss.

The following asset has specific characteristics for impairment testing:

Goodwill

Goodwill is tested for impairment annually as at 31 December and when circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of each CGU (or group of CGUs) to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

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.

3. Summary of significant accounting policies (continued)

Inventory

Inventory is stated at the lower of cost and net realizable value. Cost comprises the direct cost of goods, transportation and handling costs. Cost of goods for resale is calculated using the weighted average method, cost of materials and supplies is calculated using cost per unit method, cost of fuel and lubricants calculated using the average cost method. Net realizable value represents the estimated selling price less all estimated costs necessary to make the sale.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation.

Vendor 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. Volume-related rebates and other payments 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.

Income taxes

Income tax expense represents the sum of the tax currently payable and deferred tax. Income taxes are computed in accordance with Russian law.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. Current income tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method.

3. Summary of significant accounting policies (continued)

Income taxes (continued)

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

- Where the deferred tax liability arises from the initial recognition of goodwill or 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 taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where 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.

Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised, except:

- Where 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.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. 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.

Current and deferred taxes are recognised as an expense or income in the consolidated profit and loss, except when they relate to items credited or debited outside profit or loss, either in other comprehensive income or directly in equity, in which case the tax is also recognised outside profit or loss, either in other comprehensive income or directly in equity, or where they arise from the initial accounting for a business combination. 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.

3. Summary of significant accounting policies (continued)

Retirement benefit costs

The operating entities of the Group contribute to the state pension, medical and social insurance funds on behalf of all its current employees. Any related expenses are recognized in the profit and loss as incurred.

Bonus plan

Under the bonus program the Group has agreed to pay, at its discretion, cash bonuses to key management personnel. The amount of the cash bonus, if paid, will be based on the market price of the Group's shares on that date times a fixed number of shares as indicated in the employment contract of each individual. The compensation expense is recognized over the one-year service period based on its assessment that it is probable the amounts will be paid. The liability will be remeasured at the date of settlement, with any changes recognised in profit or loss.

The fair value of the liability is determined based on the market value of shares at the end of each reporting period adjusted for expected employee turnover.

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 types of stores and in various states 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, including both convenience stores, cosmetic stores, hypermarkets and others, 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 profit or loss and is measured consistently with profit or loss in the consolidated financial statements.

Seasonality

The Group's business operations are not influenced by seasonality factors, except for the increase of business activities before the New Year holidays.

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.

To the extent that the Group borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity 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 entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

All other borrowing costs are expensed in the period they occur.

3. Summary of significant accounting policies (continued)

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 investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

Effective interest rate method

The effective interest rate method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount of the financial asset.

For all financial instruments measured at amortised cost and interest bearing financial assets classified as available for sale, interest income is recorded using the effective interest rate. Interest income is included in investment income in the statement of comprehensive income.

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 investment 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.

3. Summary of significant accounting policies (continued)

Impairment of financial assets (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 the profit and 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 the profit and 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

If the Group reacquires its own equity instruments, those instruments (“treasury shares”) are recognised as a deduction to equity at cost, being the consideration paid to reacquire the shares. No gain and loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group’s own equity instruments. On disposal the cost of treasury shares is written off using weighted average method. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

3. Summary of significant accounting policies (continued)

Financial liabilities and equity instruments issued by the Group (continued)

Share premium

Share premium represents the difference between the fair value of consideration received and nominal value of the issued shares.

Earnings per share

Earnings per share have been determined using the weighted average number of the Group's shares outstanding during the years ended 31 December 2014 and 31 December 2013. The Group does not have any potentially dilutive equity instruments.

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.

Equity instruments

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 direct issue costs.

Financial liabilities

Financial liabilities of the Group, including borrowings and trade and other payables, are initially measured at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest rate method, with interest expense recognised using an 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.

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.

Fair value of financial instruments

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

3. Summary of significant accounting policies (continued)

Fair value of financial instruments (continued)

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm’s length market transactions; reference to the current fair value of another instrument that is substantially the same; a discounted cash flow analysis or other valuation models.

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted the following new and amended IFRS and IFRIC interpretations as at 1 January 2014.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10 *Consolidated Financial Statements* and must be applied retrospectively, subject to certain transition relief. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. These amendments have no impact on the Group, since none of the entities in the Group qualifies to be an investment entity under IFRS 10.

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32

These amendments clarify the meaning of ’currently has a legally enforceable right to set-off’ and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting and is applied retrospectively. These amendments have no impact on the Group.

Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria and retrospective application is required. These amendments have no impact on the Group as the Group does not have derivatives.

IFRIC 21 Levies

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. Retrospective application is required for IFRIC 21. This interpretation has no impact on the Group.

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

Annual Improvements 2010-2012 Cycle

In the 2010-2012 annual improvements cycle, the IASB issued seven amendments to six standards, which included an amendment to IFRS 13 *Fair Value Measurement*. The amendment to IFRS 13 is effective immediately and, thus, for periods beginning at 1 January 2014, and it clarifies in the Basis for Conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This amendment to IFRS 13 has no impact on the Group.

Annual Improvements 2011-2013 Cycle

In the 2011-2013 annual improvements cycle, the IASB issued four amendments to four standards, which included an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The amendment to IFRS 1 is effective immediately and, thus, for periods beginning at 1 January 2014, and clarifies in the Basis for Conclusions that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but permits early application, provided either standard is applied consistently throughout the periods presented in the entity’s first IFRS financial statements. This amendment to IFRS 1 has no impact on the Group, since the Group is an existing IFRS preparer.

The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

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.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 establishes a single framework for revenue recognition and contains requirements for related disclosures. The new standard replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and the related interpretations on Revenue recognition. The standard is effective for annual periods beginning on or after 1 January 2017, with earlier application permitted.

In May 2014, the IASB issued an amendment to IFRS 11 *Joint Arrangements, entitled Accounting for Acquisitions of Interests in Joint Operations*. The amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business and requires the application of IFRS 3 *Business Combinations*, for such acquisitions. The amendment is effective for annual periods beginning on or after 1 January 2016, with earlier application permitted.

3. Summary of significant accounting policies (continued)

Standards issued but not yet effective (continued)

In May 2014, the IASB issued amendments to IAS 16 *Property, Plant and Equipment*, and IAS 38 *Intangible Assets, entitled Clarification of Acceptable Methods of Depreciation and Amortization*. Amendments clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate, because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. These amendments are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted.

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*. The final version of IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and all previous versions of IFRS 9. IFRS 9 brings together the requirements for the classification and measurement, impairment and hedge accounting of financial instruments. In respect of impairment IFRS 9 replaces the ‘incurred loss’ model used in IAS 39, with a new ‘expected credit loss’ model that will require a more timely recognition of expected credit losses. The standard is effective for annual periods beginning on or after 1 January 2018, with earlier application permitted.

In September 2014, the IASB issued amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures entitled Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*. These narrow scope amendments clarify, that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not), and a partial gain or loss is recognized when a transaction involves assets that do not constitute a business. The amendments are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted.

In November 2013, the IASB issued amendments to IAS 19 *Employee Benefits, entitled Defined Benefit Plans: Employee Contributions*. The narrow-scope amendments apply to contributions from employees or third parties to defined benefit plans. The objective of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of salary. The amendments are effective for annual periods beginning on or after 1 July 2014 with earlier application permitted.

The impact of adoption of these Standards and Interpretations in the preparation of consolidated financial statements in the future periods is currently being assessed by the Group’s management.

4. Significant accounting judgements and estimates

In the application of the Group’s accounting policies, 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.

4. Significant accounting judgements and estimates (continued)

Estimates and assumptions

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.

The most significant areas requiring the use of management estimates and assumptions relate to useful economic lives of property, plant and equipment; impairment of assets and taxation.

Impairment of assets

The Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets are impaired. In making the assessment for impairment, assets that do not generate independent cash flows are allocated to an appropriate CGU.

Management necessarily applies its judgment in allocating assets that do not generate independent cash flows to appropriate cash-generating units and also in estimating the timing and value of underlying cash flows within the value in use calculation. 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.

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.

Useful economic life of property, plant and equipment

The Group’s property, plant and equipment are depreciated using the straight-line method over their estimated useful lives which are determined based on the Group’s management business plans and operational estimates, related to those assets.

The Group’s management periodically reviews the appropriateness of the useful economic lives. The review is based on the current condition of the assets, the estimated period during which they will continue to bring economic benefit to the Group, historic information on similar assets and industry trends.

Useful life of leasehold improvements

The Group’s leasehold improvements in convenience stores used under operating leases are depreciated using the straight-line method over their estimated useful life beyond the legal expiry dates of operating lease agreements assuming leases will be renewed. Based on the history of the successful renewals of these agreements (all agreements that management wanted to prolong were successfully prolonged) and pre-emptive rights for the prolongation of the lease agreements, the Group’s management assumes a thirty year depreciation period for these leasehold improvements.

4. Significant accounting judgements and estimates (continued)

Taxation

The Group is subject to income tax and other taxes. Significant judgment is required in determining the provision for income tax and other taxes due to the complexity of the Russian Federation tax legislation. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether it is probable additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the amount of tax and tax provisions in the period in which such determination is made.

5. Balances and transactions with related parties

The Group enters into transactions with related parties in the ordinary course of business. The Group purchases food products, materials for construction and equipment from related parties, issues loans, obtains loans and acquires construction services and provides rental services. Related parties of the Group are represented by counterparties that are allied with the Group through key management and their relatives. Transactions with related parties are made on terms not necessarily available to third parties.

No guarantees have been given or received.

No expense has been recognized in the period for bad or doubtful debts in respect of the amounts owed by related parties.

Related party balances as at 31 December 2014 and 2013 consisted of the following:

	Other related parties	
	2014	2013
Long-term loans receivable	711	–
Short-term loans receivable (Note 11)	7,412	35,125
Advances paid (Note 10)	2,465	18
Other receivables	409	1,414
Trade payables (Note 16)	436	759
Other payables (Note 16)	13	1,263
Advances received	103	–

The Group’s transactions with related parties for the years ended at 31 December 2014 and 2013 consisted of the following:

	Shareholders		Other related parties	
	2014	2013	2014	2013
Wholesale	–	–	105	–
Rent income	–	–	1,043	116
Rent expense	–	–	44	26
Other income	–	–	3,965	5,008
Interest income	18	2	5,292	3,912
Interest expense	3	–	–	–
Purchases of property, plant and equipment	–	–	11,966	4,486
Purchases of inventory	–	–	181,702	300,831
Loans given	9,708	5,338	366,054	183,556
Loans given repayment	9,727	5,340	390,417	182,593
Loans received	6,981	–	–	–
Loans received repayment	6,984	–	–	–

Short-term employee benefits of Group management and members of the Board of Directors of the Group for 2014 were USD 17,516 thousand (2013: USD 14,522 thousand).

6. Property, plant and equipment

Property, plant and equipment as at 31 December 2014 consisted of the following:

	Land	Buildings	Machinery and equipment	Other assets	Assets under construc-tion	Total
Cost						
At 1 January 2014	264,963	3,951,997	1,480,759	938,088	613,175	7,248,982
Additions	70,432	–	300,688	134,197	945,177	1,450,494
Transfers	–	903,089		–	(903,089)	–
Disposals	(573)	(11,485)	(26,797)	(21,194)	(2,605)	(62,654)
Transfer from land lease right	8,767	–	–	–	–	8,767
Translation difference	(135,746)	(1,935,543)	(706,140)	(428,168)	(268,969)	(3,474,566)
At 31 December 2014	207,843	2,908,058	1,048,510	622,923	383,689	5,171,023
Accumulated depreciation and impairment						
At 1 January 2014	–	(364,081)	(662,943)	(259,141)	–	(1,286,165)
Charge for the year	–	(138,239)	(229,771)	(81,327)	–	(449,337)
Disposals	–	834	20,490	15,499	–	36,823
Translation difference	–	195,835	343,617	129,253	–	668,705
At 31 December 2014	–	(305,651)	(528,607)	(195,716)	–	(1,029,974)
Net book value						
At 1 January 2014	264,963	3,587,916	817,816	678,947	613,175	5,962,817
At 31 December 2014	207,843	2,602,407	519,903	427,207	383,689	4,141,049

Property, plant and equipment as at 31 December 2013 consisted of the following:

	Land	Buildings	Machinery and equipment	Other assets	Assets under construc-tion	Total
Cost						
At 1 January 2013	223,323	3,314,397	1,246,233	746,893	669,176	6,200,022
Additions	45,444	–	362,277	257,516	907,043	1,572,280
Acquisition of subsidiary	6,314	7,558	10,109	387	104	24,472
Transfers	–	912,386	–	–	(912,386)	–
Disposals	(1,899)	(19,463)	(39,159)	(6,154)	(2,798)	(69,473)
Transfer from land lease right	9,456	–	–	–	–	9,456
Translation difference	(17,675)	(262,881)	(98,701)	(60,554)	(47,964)	(487,775)
At 31 December 2013	264,963	3,951,997	1,480,759	938,088	613,175	7,248,982
Accumulated depreciation and impairment						
At 1 January 2013	–	(255,928)	(512,137)	(205,139)	–	(973,204)
Charge for the year	–	(132,026)	(229,449)	(74,674)	–	(436,149)
Disposals	–	1,943	36,574	4,001	–	42,518
Translation difference	–	21,930	42,069	16,671	–	80,670
At 31 December 2013	–	(364,081)	(662,943)	(259,141)	–	(1,286,165)
Net book value						
At 1 January 2013	223,323	3,058,469	734,096	541,754	669,176	5,226,818
At 31 December 2013	264,963	3,587,916	817,816	678,947	613,175	5,962,817

In 2014, the weighted average capitalisation rate on funds borrowed is 9.07% per annum (2013: 8.43%).

7. Land lease rights

Land lease rights as at 31 December 2014 consisted of the following:

	Land lease rights
Cost	
At 1 January 2014	105,920
Additions	5,826
Disposals	(130)
Transfer to PPE	(8,767)
Translation difference	(43,326)
At 31 December 2014	59,523
Accumulated amortization and impairment	
At 1 January 2014	(6,347)
Charge for the year	(1,751)
Disposals	15
Translation difference	3,205
At 31 December 2014	(4,878)
Net book value	
At 1 January 2014	99,573
At 31 December 2014	54,645

Land lease rights as at 31 December 2013 consisted of the following:

	Land lease rights
Cost	
At 1 January 2013	100,383
Additions	22,574
Transfer to PPE	(9,456)
Translation difference	(7,581)
At 31 December 2013	105,920
Accumulated amortization and impairment	
At 1 January 2013	(4,650)
Charge for the year	(2,088)
Translation difference	391
At 31 December 2013	(6,347)
Net book value	
At 1 January 2013	95,733
At 31 December 2013	99,573

In 2014, amortization charge of land lease rights was capitalised to cost of property, plant and equipment in the amount of USD 484 thousand (2013: USD 716 thousand).

8. Intangible assets

Intangible assets as at 31 December 2014 consisted of the following:

	Licenses	Lease rights	Software	Trade mark	Other	Total
Cost						
At 1 January 2014	2,954	4,804	20,878	674	1,569	30,879
Additions	1,572	117	8,555	31	1,725	12,000
Disposals	(430)	(86)	(1,845)	(36)	(597)	(2,994)
Translation difference	(1,597)	(2,019)	(10,859)	(280)	(1,014)	(15,769)
At 31 December 2014	2,499	2,816	16,729	389	1,683	24,116
Accumulated amortization and impairment						
At 1 January 2014	(1,042)	(717)	(5,578)	(298)	(625)	(8,260)
Charge for the year	(792)	(502)	(5,175)	(122)	(1,133)	(7,724)
Disposals	430	86	1,844	36	596	2,992
Translation difference	550	432	3,389	152	432	4,955
At 31 December 2014	(854)	(701)	(5,520)	(232)	(730)	(8,037)
Net book value						
At 1 January 2014	1,912	4,087	15,300	376	944	22,619
At 31 December 2014	1,645	2,115	11,209	157	953	16,079

Intangible assets as at 31 December 2013 consisted of the following:

	Licenses	Lease rights	Software	Trade mark	Other	Total
Cost						
At 1 January 2013	2,281	4,356	17,355	711	902	25,605
Additions	1,290	587	10,736	48	1,211	13,872
Acquisition of subsidiary	–	804	–	–	–	804
Disposals	(429)	(607)	(5,832)	(34)	(459)	(7,361)
Translation difference	(188)	(336)	(1,381)	(51)	(85)	(2,041)
At 31 December 2013	2,954	4,804	20,878	674	1,569	30,879
Accumulated amortization and impairment						
At 1 January 2013	(775)	(829)	(6,247)	(205)	(326)	(8,382)
Charge for the year	(761)	(553)	(5,606)	(143)	(791)	(7,854)
Disposals	429	607	5,832	33	459	7,360
Translation difference	65	58	443	17	33	616
At 31 December 2013	(1,042)	(717)	(5,578)	(298)	(625)	(8,260)
Net book value						
At 1 January 2013	1,506	3,527	11,108	506	576	17,223
At 31 December 2013	1,912	4,087	15,300	376	944	22,619

Amortization expense is included in general and administrative expenses (Note 23).

8. Intangible assets (continued)

Goodwill as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Goodwill as at beginning of the year	41,782	–
Goodwill arising on acquisition, as at the date of acquisition	–	41,868
Goodwill impairment	–	–
Translation difference	(17,475)	(86)
Goodwill as at the end of the year	24,307	41,782

9. Inventories

Inventory as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Goods for resale	1,366,965	1,627,700
Raw materials	81,275	86,225
	1,448,240	1,713,925

Raw materials are represented by spare parts, packaging materials and other materials used in shops and warehouses.

10. Advances paid

Advances paid as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Advances to third party suppliers	55,348	68,307
Advances for customs duties	27,317	26,941
Advances to employees	1,067	1,622
Advances to related party suppliers (Note 5)	2,465	18
	86,197	96,888

11. Short-term financial assets

Short-term financial assets as at 31 December 2014 and 2013 consisted of the following:

	Weighted average interest rate	2014	Weighted average interest rate	2013
Short-term loans to related parties (Note 5)	19.13%	7,412	9.23%	35,032
Short-term loans to third parties	16.61%	468	9.63%	31
Financial assets at fair value through profit and loss	–	566	–	–
Other short-term loans to related parties	–	–	9.85%	93
		8,446		35,156

11. Short-term financial assets (continued)

In 2014 the Group issued short-term loans to a number of related parties in amount of RUB 416,990 thousand (USD 7,412 thousand). Interest outstanding as at 31 December 2014 is RUB 2,575 thousand (USD 46 thousand). Loans maturing in May-October 2015 bear fixed interest rates of 11.50-21.20% per annum (2013: 9.20-9.25% per annum). Loans are unsecured as at 31 December 2014.

12. Cash and cash equivalents

Cash and cash equivalents as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Petty cash, in RUB	31,065	43,836
Cash in banks, in RUB	1,748	11,671
Cash in banks, in foreign currency	285	113
Cash in transit, in RUB	103,515	125,598
Short-term deposits	177,856	–
	314,469	181,218

Cash in transit represents cash collected by banks from the Group's stores and not deposited in bank accounts and bank card payments being processed as at 31 December.

Short-term deposits were placed on accounts in following banks:

Sberbank of Russia:

The Group placed deposits in amount of RUB 10,000,000 thousand (USD 177,751 thousand) plus accrued interest of RUB 5,893 thousand (USD 105 thousand) maturing in January 2015.

13. Share capital, share premium and treasury shares

	2014 No. ('000)	2013 No. ('000)
Authorized share capital (ordinary shares with a par value of RUB 0.01)	200,850	200,850
Issued and fully paid (par value of RUB 0.01)	94,561	94,561
Treasury shares	(48)	(16)

	2014 No. ('000)	2013 No. ('000)
Balance of shares outstanding at beginning of financial year	94,545	94,435
Sale of treasury shares	1,750	262
Share-buyback	(1,782)	(152)
Balance of shares outstanding at the end of financial year	94,513	94,545

13. Share capital, share premium and treasury shares (continued)

In 2014 1,750,278 treasury shares were sold by the Group for a total cash consideration of RUB 16,057,361 thousand (USD 410,075 thousand at exchange rate at the date of transactions). The difference between cash received and the carrying value of shares was recorded as increase of share premium in the amount of USD 10,127 thousand and decrease of foreign currency translation reserve in the amount of USD 1,419 thousand.

During 2014 the Group purchased 1,782,664 of own ordinary shares from the open market.

14. Dividends declared

During the year ended 31 December 2014 the Group declared dividends to shareholders relating to 2013, the first half of 2014 and first 9 months of 2014:

	2014
Dividends declared for 2013 (2.57 USD for 1 share)	243,166
Dividends declared for the first half of 2014 (2.04 USD for 1 share)	192,750
Dividends declared for the first 9 months of 2014 (2.69 USD for 1 share)	254,376

During the year ended 31 December 2013 the Group declared dividends to shareholders relating to 2012 and the first half of 2013:

	2013
Dividends declared for 2012 (1.75 USD for 1 share)	165,149
Dividends declared for the first half of 2013 (1.44 USD for 1 share)	136,293

As at 31 December 2014 the amount of liability for unpaid dividends is USD 255,465 thousand (at 31 December 2013: USD 1 thousand).

15. Long-term borrowings and loans

Long-term borrowings and loans as at 31 December 2014 and 2013 consisted of the following:

	31 December 2014		31 December 2013	
	Weighted average interest rate	Amount	Weighted average interest rate	Amount
Sberbank of Russia	9.62%	523,276	7.92%	884,779
Bonds issued in April 2013	8.41%	181,413	8.41%	311,623
Bonds issued in February 2013	8.52%	91,417	8.52%	156,968
Bonds issued in 2012	–	–	8.93%	156,230
Less: current portion (Note 19)	–	(6,710)	–	(365,619)
		789,396		1,143,981

15. Long-term borrowings and loans (continued)

Sberbank of Russia: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 29,500,000 thousand (USD 524,366 thousand) maturing in October 2016 – August 2017. The amount outstanding as at 31 December 2014 is RUB 29,420,766 thousand (USD 522,958 thousand) plus accrued interest of RUB 17,903 thousand (USD 318 thousand). The credit lines were unsecured as at 31 December 2014.

Bonds: In April 2013 the Group issued bonds of RUB 10,000,000 thousand net of direct issue costs of RUB 13,680 thousand, maturing in March 2016. The total amount outstanding as at 31 December 2014 is RUB 10,000,000 thousand (USD 177,751 thousand) net of RUB 5,675 thousand (USD 101 thousand) of direct issue costs plus accrued interest of RUB 211,700 thousand (USD 3,763 thousand).

In February 2013 the Group issued bonds of RUB 5,000,000 thousand net of direct issue costs of RUB 12,890 thousand, maturing in February 2016. The total amount outstanding as at 31 December 2014 is RUB 5,000,000 thousand (USD 88,876 thousand) net of RUB 4,956 thousand (USD 88 thousand) of direct issue costs plus accrued interest of RUB 147,900 thousand (USD 2,629 thousand).

The bonds are listed at the Moscow Exchange MICEX-RTS.

The current portion of long-term borrowings and loans outstanding as at 31 December 2013 and 31 December 2014 represented by accrued interest on borrowings and bonds.

16. Trade and other payables

Trade and other payables as at 31 December 2014 and 2013 consisted of the following:

	31 December 2014	31 December 2013
Trade payables to third parties	1,173,162	1,451,638
Trade payables to related parties (Note 5)	436	759
Other payables to third parties	13,671	18,136
Other payables to related parties (Note 5)	13	1,263
	1,187,282	1,471,796

The average credit period for purchases was 36 days in 2014 and 43 days in 2013. Interest may be charged on the outstanding balance based on market rates in accordance with certain agreements with vendors, however no significant amounts of interest were charged to the Group during the years presented. The Group has financial risk management policies in place to help ensure that all payables are paid within the credit timeframe.

17. Accrued expenses

Accrued expenses as at 31 December 2014 and 2013 consisted of the following:

	31 December 2014	31 December 2013
Accrued salaries and wages	90,781	128,421
Other accrued expenses	54,701	73,611
	145,482	202,032

18. Taxes payables

Taxes payables as at 31 December 2014 and 2013 consisted of the following:

	31 December 2014	31 December 2013
Value added tax	37,896	55,081
Social insurance contributions	30,759	44,377
Employee income tax withholding	14,182	19,366
Property tax	11,585	20,917
Other taxes	1,320	1,685
	95,742	141,426

19. Short-term borrowings and loans

Short-term loans as at 31 December 2014 and 2013 consisted of the following:

	Weighted average interest rate	2014	Weighted average interest rate	2013
Sberbank of Russia	8.38%	378,942	7.34%	159,843
Rosbank	17.80%	181,808	7.10%	213,876
Alfa-Bank, Rostov branch	13.01%	152,866	–	–
Bond issued in September 2012	8.93%	90,988	–	–
Bank of Moscow, Krasnodar branch	16.44%	83,543	7.12%	61,108
VTB Bank, Krasnodar branch	12.33%	16,214	–	–
Other	14.50%	23	–	–
Bonds issued in April 2011	–	–	7.77%	154,998
Bonds issued in March 2011	–	–	8.02%	154,261
Current portion of long-term loans (Note 15)	–	6,710	–	365,619
		911,094		1,109,705

Sberbank of Russia: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 20,000,000 thousand (USD 355,502 thousand) and overdraft contract allowing borrowings of up to RUB 7,000,000 thousand (USD 124,426 thousand) effective till July-December 2015. The amount outstanding as at 31 December 2014 is RUB 21,276,581 thousand (USD 378,194 thousand) plus interest accrued of RUB 42,109 thousand (USD 748 thousand) maturing in July-December 2015. The credit lines were unsecured as at 31 December 2014.

19. Short-term borrowings and loans (continued)

Rosbank: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 10,575,000 thousand (USD 187,972 thousand) effective till May 2015 – February 2016. The amount outstanding as at 31 December 2014 is RUB 10,225,000 thousand (USD 181,751 thousand) plus accrued interest of RUB 3,179 thousand (USD 57 thousand) maturing in January-July 2015. The credit lines were unsecured as at 31 December 2014.

Alfa-bank, Rostov branch: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 10,000,000 thousand (USD 177,751 thousand) effective till April 2017. The amount outstanding as at 31 December 2014 is RUB 8,600,000 thousand (USD 152,866 thousand) maturing in January-February 2015. The credit lines were unsecured as at 31 December 2014.

Bonds: In September 2012 the Group issued bonds of RUB 5,000,000 thousand net of direct issue costs of RUB 12,922 thousand, maturing in September 2015. The total amount outstanding as at 31 December 2014 is RUB 5,000,000 thousand (USD 88,876 thousand) net of RUB 3,117 thousand (USD 55 thousand) of direct issue costs plus accrued interest of RUB 121,900 thousand (USD 2,167 thousand). The bonds are listed at the Moscow Exchange MICEX-RTS.

Bank of Moscow, Krasnodar branch: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 7,000,000 thousand (USD 124,426 thousand) effective till April 2016. The amount outstanding as at 31 December 2014 is RUB 4,700,000 thousand (USD 83,543 thousand) maturing in February-March 2015. The credit lines were unsecured as at 31 December 2014.

VTB Bank, Krasnodar branch: The Group entered into a number of credit line agreements allowing borrowings of up to RUB 9,000,000 thousand (USD 159,976 thousand) effective till March 2015. The amount outstanding as at 31 December 2014 is RUB 900,000 thousand (USD 15,998 thousand) plus accrued interest of RUB 12,161 thousand (USD 216 thousand) maturing in February 2015. The credit lines were unsecured as at 31 December 2014.

20. Revenue

Revenue for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Retail	19,851,316	18,196,699
Wholesale	20,976	5,225
	19,872,292	18,201,924

21. Cost of sales

Cost of sales for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Cost of goods sold	13,279,203	12,186,691
Transportation expenses	539,540	552,371
Losses due to inventory shortages	314,063	273,745
	14,132,806	13,012,807

Cost of goods sold is reduced by rebates and promotional bonuses received from suppliers.

In 2014, payroll in amount of USD 147,303 thousand (2013: USD 158,557 thousand) was included in transportation expenses within cost of sales.

In 2014, depreciation of production fixed assets in amount of USD 1,565 thousand (2013: USD 290 thousand) was included in cost of goods sold.

22. Selling expenses

Selling expenses for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Advertising	90,435	31,697
Packaging and raw materials	72,540	75,235
Depreciation	68,979	70,040
	231,954	176,972

23. General and administrative expenses

General and administrative expenses for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Payroll	1,690,523	1,588,385
Rent and utilities	814,217	726,217
Payroll related taxes	481,899	454,316
Depreciation	378,793	365,819
Repair and maintenance	87,906	61,116
Taxes, other than income tax	76,400	84,185
Bank services	49,213	42,661
Security	16,484	19,731
Provision for unused vacation	15,109	16,546
Bad debt provision	2,947	2,230
Other expenses	103,351	101,136
	3,716,842	3,462,342

"Other expenses" line includes amortization charge for the year ended 31 December 2014 in the amount of USD 8,991 thousand (2013: USD 9,226 thousand).

24. Finance costs

Finance costs for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Interest on loans	133,391	87,005
Interest on bonds	49,602	80,163
Interest on finance leases	–	6
Total interest expense for financial liabilities	182,993	167,174
Less: amounts included in the cost of qualifying assets	(10,019)	(11,138)
	172,974	156,036

25. Other income

Other income for the years ended 31 December 2014 and 2013 consisted of the following:

	2014	2013
Sale of packing	46,125	36,626
Advertising income	9,790	6,263
Penalties	7,091	11,975
Other	12,251	4,921
	75,257	59,785

26. Income tax

The Group's income tax expense for the years ended 31 December 2014 and 2013 is as follows:

	2014	2013
Consolidated statement of comprehensive income		
Current tax	314,865	258,252
Deferred tax	58,380	59,937
Income tax expense reported in the consolidated statement of comprehensive income	373,245	318,189

The movements for the years ended 2014 and 2013 in the Group's deferred tax position are as follows:

	2014	2013
Liability at the beginning of the year	249,707	202,784
Charge for the year	58,380	59,937
Deferred taxes acquired in business combination	–	3,121
Translation difference	(122,946)	(16,135)
Deferred tax liability at the end of the year	185,141	249,707

26. Income tax (continued)

The tax effect of the major temporary differences that give rise to the deferred tax assets and liabilities as at 31 December 2014 and 2013 is as follows:

		Consolidated statement of financial position		Consolidated statement of comprehensive income	
	As at 31 December 2014	As at 31 December 2013	As at 1 January 2013	2014	2013
Deferred tax assets					
Accrued expenses	(628)	(1,155)	(103)	65	(1,089)
Inventories	(17,342)	(16,386)	(6,502)	(11,434)	(10,638)
Other	(9,609)	(15,267)	(5,845)	(1,065)	(10,114)
Deferred tax liabilities					
Property, plant and equipment	200,131	268,933	209,036	63,951	73,900
Other	12,589	13,582	6,198	6,863	7,878
Net deferred tax liability	185,141	249,707	202,784	58,380	59,937

The taxation charge for the year is different from that which would be obtained by applying the statutory income tax rate to the profit before income tax. Below is a reconciliation of theoretical income tax at 20% to the actual expense recorded in the Group's profit and loss:

	2014	2013
Profit before tax	1,614,363	1,436,637
Theoretical income tax expense at 20%	(322,873)	(287,327)
Adjustments due to:		
Tax effect of losses due to inventory shortages not deductible in determining taxable profit	(35,488)	(27,060)
Tax effect of other expenses that are not deductible in determining taxable profit	(14,884)	(3,802)
Income tax expense	(373,245)	(318,189)

27. Earnings per share

Earnings per share for the years ended 31 December 2014 and 2013 have been calculated on the basis of the net profit for the year and the weighted average number of common shares outstanding during the year.

The calculation of earnings per common share for the years ended 31 December 2014 and 2013 is as follows:

	2014	2013
Profit for the year attributable to equity holders of the parent	1,241,118	1,118,448
Weighted average number of shares (in thousands of shares)	94,561	94,561
Basic and diluted earnings per share (in US dollars)	13.13	11.83

The Group does not have any potentially dilutive equity instruments.

28. Contingencies, commitments and operating risks

Operating environment

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.

In 2014, the Russian economy was negatively impacted by a significant drop in crude oil prices and a significant devaluation of the Russian rouble, as well as sanctions imposed on Russia by several countries. In December 2014, the rouble interest rates have increased significantly after the Central Bank of Russia raised its key rate to 17%.The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation 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.

By the Executive Order of the President of Russia “On Special Economic Measures to Protect the Russian Federation’s Security” signed on August 6, 2014 it was prohibited to import into the territory of the Russian Federation certain agricultural products, raw materials and foodstuffs originating in countries, that have decided to impose economic sanctions on Russian legal entities and (or) individuals, or have joined such decision. The following countries are under embargo: EU countries, USA, Australia, Canada and Norway. A specific list of goods in respect of which the restrictions are imposed, was determined by the Russian Government. The list includes meat and dairy products, fish, vegetables, fruits, nuts and other.

The Group’s Management believes that these changes do not have material impact on the Group’s operation.

Litigation

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time, none of which has had, individually or in aggregate, a material adverse impact on the Group. Management believes that the resolution of all business matters will not have a material impact on the Group’s financial position, operating results and cash flows.

Insurance

The insurance industry in the Russian Federation is in the process of development and many forms of insurance protection common in developed markets are not yet generally available in Russia. The Group does not fully cover many risks that a group of a similar size and nature operating in a more economically developed country would insure. Management understands that until the Group obtains adequate insurance coverage there is a risk that the loss or destruction of certain assets could have an adverse effect on the Group’s operations and financial position.

28. Contingencies, commitments and operating risks (continued)

Capital and rent commitments

As at 31 December 2014 and 2013, the Group entered in a number of agreements related to the acquisition of property, plant and equipment:

	2014	2013
Within one year	191,226	295,923
In the second to fifth years inclusive	4,856	18,849
	196,082	314,772

The Group entered in a number of cancellable short-term and long-term rental agreements. The Group plans to prolong these agreements in the future. The expected annual lease payments under these agreements amount to approximately USD 457 million (2013: USD 574 million).

29. Financial risk management objectives and policies

Capital risk 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 debt and equity ratios.

The capital structure of the Group consists of debt, which includes the borrowings disclosed in Notes 15 and 19, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in Note 13.

Gearing ratio

Management reviews the Group’s capital structure on an annual basis. As part of this review, management considers the cost of capital and the risks associated with each class of capital. The Group has a target gearing ratio in 2014 of up to 54% determined as the proportion of net debt to equity.

The gearing ratio as at 31 December 2014 and 2013 was as follows:

	2014	2013
Debt	1,700,490	2,253,686
Cash and cash equivalents	(314,469)	(181,218)
Net debt	1,386,021	2,072,468
Equity	2,553,423	3,854,726
Net debt to equity ratio	54%	54%

Debt is defined as long-term and short-term borrowings. Equity includes all capital and reserves of the Group.

29. Financial risk management objectives and policies (continued)

Fair values

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the financial statements.

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.

	Carrying amount		Fair value	
	2014	2013	2014	2013
Long-term borrowings and loans	522,958	533,728	438,066	527,577
Bonds	363,818	934,077	349,077	922,568

The fair value of loans from banks is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities. Long-term borrowing and loans are categorized as Level 2 within the fair value hierarchy. For quoted bonds (Level 1) the fair value was determined based on quoted market prices. No transfers occurred between levels in the hierarchy during the reporting period.

Fair values of financial instruments of the Group other than disclosed above approximate to their carrying amounts as at 31 December 2014 and 2013.

Foreign currency risk management

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. The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's operating activities (when purchase is denominated in a different currency from the Group's functional currency).

Foreign currency sensitivity

The following tables demonstrate the sensitivity to a reasonably possible change in the US dollar and euro exchange rate, with all other variables held constant. The impact on the Group's profit before tax is due to changes in the fair value of monetary assets and liabilities. The Group's exposure to foreign currency changes for all other currencies is not material.

The Group manages its foreign currency risk by scheduling payments to foreign suppliers close to the date of transfer of ownership over goods to the Group.

	Change in USD rate	Effect on profit before tax	Change in EUR rate	Effect on profit before tax
2014	28.54%	37,913	29.58%	13,846
	-28.54%	(37,913)	-29.58%	(13,846)
2013	10.21%	6,489	8.63%	4,453
	-10.21%	(6,489)	-8.63%	(4,453)

29. Financial risk management objectives and policies (continued)

Interest rate risk management

The Group is not exposed to interest rate risk as entities in the Group borrow funds on fixed rates.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group's exposure to credit risk arises with respect to operating activities (primarily for trade and other receivables) and investing activities (cash, short term loans).

Customer credit risk is managed by the Group by dealing with creditworthy counterparties, who have a good long term credit history. The Group's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties. Credit exposure is controlled by counterparty limits that are reviewed and approved by management.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The Group defines counterparties as having similar characteristics if they are related entities. Concentration of credit risk did not exceed 5% of gross monetary assets at any time during the years presented.

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. The short term loans are secured with the Groups' shares. 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 is the carrying value of each class of financial assets as presented in the statement of financial position.

Offsetting of financial assets and liabilities

The Group offsets its financial assets and financial liabilities when all the conditions for offset are met. The effect of offsetting is the following:

	Gross amount			Net amount	
	Trade and other receivables	Trade and other payables	Amount of offset	Trade and other receivables	Trade and other payables
2014	321,196	(1,494,022)	306,740	14,456	(1,187,282)
2013	367,828	(1,820,328)	348,532	19,296	(1,471,796)

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the board of directors, which has built a liquidity risk management framework for management of the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

29. Financial risk management objectives and policies (continued)

Liquidity risk tables

The following tables summarise the maturity profile of the Group’s financial liabilities based on contractual undiscounted payments. The table includes both interest and principal cash flows.

	Weighted average effective interest rate, %	Less than 1 month	1-3 month	3 month to 1 year	1-5 years	Total
2014						
Trade and other payables	–	1,059,056	128,226	–	–	1,187,282
Fixed interest rate instruments	10.66	204,290	269,804	539,467	869,250	1,882,811
		1,263,346	398,030	539,467	869,250	3,070,093
2013						
Trade and other payables	–	1,318,679	153,106	11	–	1,471,796
Fixed interest rate instruments	7.94	434,350	185,745	597,250	1,259,137	2,476,482
		1,753,029	338,851	597,261	1,259,137	3,948,278

The Group has access to financing facilities of RUB 126,275,000 thousand (USD 2,244,554 thousand) of which RUB 51,066,737 thousand (USD 907,718 thousand) remains unused at 31 December 2014. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

30. Subsequent events

There were no significant events after the reporting date.