RISK AND OPPORTUNITY REPORT

Risk and opportunity management system

The demerger of METRO GROUP has resulted in numerous organisational changes. Against this background, CECONOMY has redesigned parts of its risk and opportunity management system to meet the requirements of the new organisation adequately. The new risk and opportunity management system of CECONOMY is presented and explained below. The risk and opportunity profile has also changed due to the demerger of METRO GROUP. The former top risks of METRO GROUP are no longer classified as the material risks for CECONOMY.

In a dynamic market environment, the early identification and systematic exploitation of opportunities is a fundamental entrepreneurial task. This is the prerequisite for our Company's long-term success. CECONOMY is continuously exposed to risks that can impede the realisation of our short-term and medium-term objectives or the implementation of long-term strategies. In some cases, however, we must consciously take controllable risks so as to be able to exploit opportunities in a targeted manner. We define risks as internal or external events resulting from uncertainty over future developments that can negatively impact the realisation of our corporate objectives. We define opportunities as possible successes that extend beyond the defined objectives and can thus positively impact our business development. We consider risks and opportunities as inextricably linked. For example, risks can emerge from missed or poorly exploited opportunities. Conversely, exploiting opportunities in dynamic growth markets or in new business areas always entails risks.

With this in mind, we regard our Company's risk and opportunity management system as a tool that helps us to realise our corporate goals. It is a systematic, Group-wide process. It helps the Company's management to identify, assess and control risks and opportunities. As such, risk and opportunity management is a uniform process. Risk management renders developments and events that could hinder us from reaching our business targets transparent at an early stage and analyses their implications. This allows us to put the necessary countermeasures and monitoring into place in a timely manner. At the same time, this forecasting process allows us to exploit emerging opportunities systematically.

CENTRALISED MANAGEMENT AND EFFICIENT ORGANISATION

Group-wide risk and opportunity management tasks and responsibilities are clearly defined and reflect our corporate structure. We combine centralised business management by the management holding company CECONOMY AG with the decentralised operating responsibility of our Group companies.

It is the responsibility and a legal requirement of the Management Board of CECONOMY AG to have an adequate governance system in place. This includes, in particular, the risk management, internal control and compliance management systems, as well as internal auditing as components of the governance, risk and compliance system (GRC system). This organisational structure is based on the governance elements identified in Section 107 Section 3 of the German Stock Corporation Act [AktG] as well as the German Corporate Governance Code [DCGK]. The goal of this guideline is to render structures and processes more transparent as well as provide for a uniform procedural-organisational framework for the subsystems. In this way, we aim to increase the transparency and efficiency of the GRC system within CECONOMY as a whole and continuously to improve its effectiveness.

CECONOMY AG's Group committee for governance, risk and compliance (GRC committee) regularly discusses ways to harmonise and refine the GRC subsystems. The committee also regularly discusses the current risk and opportunity situation. Permanent members are representatives of the Group divisions Accounting, Controlling & Reporting, Risk Management, Internal Control System, Treasury & Insurance, Group Corporate Legal, Group Compliance, Strategy & VCP, Mergers & Acquisitions, as well as representatives of the risk management of MediaMarktSaturn Retail Group.

RISK MANAGEMENT

The Management Board of CECONOMY AG assumes overall responsibility for the adequacy and effectiveness of the risk management system as part of the GRC system. Risks are identified, assessed, managed and monitored by the Group companies. Key elements of internal monitoring include effectiveness checks in the form of self-assessments by the management of the Group companies as well as internal audits.

The effectiveness of risk management is also monitored by the Supervisory Board of CECONOMY AG. In compliance with the provisions of the German Corporate Control and Transparency Act [Gesetz zur Kontrolle und Transparenz im Unternehmens-bereich, KonTraG], the external auditor submits the Company's early detection system as part of the risk management system to a periodic review. The results of this review are presented to the Management Board and Supervisory Board.

CECONOMY AG Corporate Risk Management is responsible for the management and development of our risk management system. The approach, methods and standards of risk management are determined for the Group in coordination with the GRC Committee and, as a current material investment, the MediaMarktSaturn Retail Group. CECONOMY AG Corporate Risk Management informs the Management Board of CECONOMY AG promptly and continuously about significant developments in risk management, ensures the exchange of information within our Company and supports the further development of risk management in the Group companies.

OPPORTUNITY MANAGEMENT

Systematically identifying and communicating opportunities is an integral part of the management and controlling system of CECONOMY. Opportunities may refer to internal or external events and developments that can have a positive impact on our business development. As a matter of principle, we strive to ensure that CECONOMY's main opportunities compensate for the identified risks and that there is at least a balanced relationship between opportunities and risks for the Company.

We conduct macroeconomic analyses, study relevant trends and evaluate market, competition and location analyses. In addition, we analyse the critical success factors of our business models and relevant cost drivers of our Company. The Management Board of CECONOMY AG specifies the derived market and business opportunities as well as efficiency enhancement potential in the context of strategic as well as short-term and medium-term planning. To this end, it seeks close communication with the heads of the Group divisions and the management of the Group companies. As a Company, we focus primarily on business approaches driven by the market and by customers. We continuously review the various elements of our sustainable long-term growth strategy.

REPORTING

Group reporting is the central element of internal risk and opportunity communication. It is complemented by risk and opportunity management reporting. The aim is to allow for the structured and continuous monitoring of risks and opportunities and document this in line with legal and regulatory stipulations. In this way, the Management Board receives regular information on the risk situation and ensures that negative trends are identified in good time and appropriate countermeasures can be taken.

We conduct an annual risk inventory to systematically map and assess all material Group-wide risks based on quantitative and qualitative indicators and uniform criteria relating to loss potential and the probability of occurrence. The results of the risk inventory and the risk portfolio are updated on a regular basis.

From a functional point of view, the risk managers at Group level validate the results reported by the Group companies for their area of responsibility. In a second step, they summarise these in a functional risk profile coupled with a detailed description of material individual risks. In a third step, risk profiles for selective categories are validated in direct interaction between the risk managers at Group level and the GRC committee, and specific steps to improve risk management are devised.

In addition, we consider the results of the analyses of strengths, weaknesses, opportunities and threats carried out as part of the strategic planning process. We also consider analyses and reports that we compile as part of our medium-term planning and projections. Furthermore, we examine relevant results from the internal control system, the compliance management system, the opportunity management system, and internal auditing.

The overarching risk and opportunity portfolio at CECONOMY that emerges from these findings enables us to gain a very good understanding of the Company's risk and opportunity situation. The GRC report describes the status quo and contains recommendations for risk management. In addition, the main features of the GRC subsystems are presented, including planned measures to improve the effectiveness of the GRC subsystems.

The Management Board of CECONOMY AG informs the Supervisory Board and in particular the Audit Committee on an ongoing basis about risk and opportunity management. Once a year, the Supervisory Board receives a comprehensive written report informing it about the organisation and alignment of risk and opportunity management as well as the current risk and opportunity situation.

When preparing the half-year financial report, we regularly review and update the overarching risk and opportunity portfolio for CECONOMY compiled in the previous year.

Furthermore, an emergency notification system takes effect if serious risks to our asset, financial and earnings position arise. In this case, the Management Board of CECONOMY AG directly and promptly receives the necessary information.

Strict risk policy principles

In principle, METRO GROUP takes entrepreneurial risks only if they are manageable and if the associated opportunities promise reasonable added value. Business interests and risk management aspects are therefore carefully weighed up and harmonised to the extent possible.

We bear the risks associated with core retail processes ourselves. The core processes include the development and implementation of business models, decisions about store locations, and the procurement and sale of merchandise and services. Risks from support processes are reduced within the Group or, where this appears sensible, transferred to third parties. In principle, we do not assume risks that are not related to core processes or support processes.

Risk management details clearly defined

The coordinated and efficient implementation of measures within risk management is guaranteed by the fact that all relevant facts are compiled in sets of rules based on the internationally recognised standards COSO II and IDW PS 981.

Our Group-wide risk management system thus records all strategic, operational, financial and compliance risks.

In principle, we consider all external and internal risks for prospective one- and three-year periods.

RISK CLASSIFICATION

All risks identified are classified based on uniform standards and quantitative and qualitative indicators with respect to loss potential (negative effects on our corporate objectives and key performance indicators EBIT and EBITDA) and probability of occurrence (in per cent). In assessing the extent of damage, we distinguish between five classes of Group risks in particular: < €5 million, ≥ €5 million, ≥ €25 million, ≥ €50 million, ≥ €150 million. The probability of occurrence for Group risks is also divided into five classes: unlikely (≤ 5 per cent), low (> 5 to 25 per cent), possible (> 25 to 50 per cent), likely (> 50 to 90 per cent), high (> 90 per cent). All risks are assessed on the basis of their potential impact at the time of the risk analysis and before potential risk-minimising measures (presentation of gross risks, that is, before the implementation of risk-limitation measures, but taking into account measures that have already been effectively implemented). In principle, but at least from a probability of occurrence of 25 to 50 per cent, concrete measures are defined and implemented for each risk in order to control or avoid the risk or to mitigate the effects associated with it.

Presentation of the risk situation

In addition to the general risks, the Management Board of CECONOMY AG has identified and evaluated the following risks (gross risks) for the reporting period, which are material for CECONOMY.

CECONOMY's risks are classified into three categories – high, medium and low – on the basis of the loss potential and the probability of occurrence:

		E ≤ 5% - Unlikely	D > 5-25% - Minor	C > 25-50% - Possible	B > 50-90% - Likely	A > 90% - High
≥ 150 million Critical	1	M	H	H	H	H
≥ 50 million Considerable	2	M	M	H	H	H
≥ 25 million Significant	3	L	M	M	M	H
≥ 5 million Moderate	4	L	L	L	M	M
< 5 million Marginal	5	L	L	L	L	L

The risks classified as high (H) are considered material for CECONOMY and are described in detail below. The sequence does not reflect the significance of the risks. Risks that we classify as medium (M) or low (L) are not presented separately in the risk and opportunity report unless we expect the risk to become particularly relevant for the Group or our shareholders in the future.

No.	Material risks 2016/17	Risk group	Risk assessment
1	Significant intensification of competition in the transformation to digital	Risks related to the retail business	high
2	Default of receivables due to insolvency of business partners	Risks related to the retail business	high
3	Rating downgrade of CECONOMY AG	Financial risks	high
4	Budget and forecast deviations due to increasingly dynamic customer behaviour and against the background of macroeconomic developments (including the reduction in the value of goodwill and assets as a result of the deviation)	Financial risks	high

In the following, we explain the material risks, classified into various risk groups and the corresponding control measures.

RISKS RELATED TO THE RETAIL BUSINESS

Particularly in the saturated markets of Western Europe and against the backdrop of digital change, the retail industry is characterised by a high rate of change and intense competition. The resulting conditions can influence business development and represent natural business risks. A major business risk is a significant intensification of competition in the transformation to digital, especially from online retailers such as Amazon (risk no. 1). The intense competition for market share in saturated markets and, during the consolidation phase against competitors that price aggressively, can lead to increasing pressure on margins and the loss of market share. In order to mitigate this risk, we continuously monitor the market and our competitors and play an active role in market consolidation.

We also regularly evaluate internal and external information so that we can identify market trends and the changing needs of our customers at an early stage.

In addition, the default of receivables due to the insolvency of important suppliers, in particular mobile communications providers, is also a risk that we continuously monitor and control (risk no. 2). To this end, we regularly analyse information about our suppliers in order to be able to take early protective measures with regard to outstanding receivables if necessary. This naturally also includes an examination of the creditworthiness of our contractual partners. We grant higher receivables only to business partners with good credit ratings. In addition, regular checks are carried out to determine whether, for example, an adjustment of existing contracts with mobile phone providers can contribute to a reduction in the risk of default.

FINANCIAL RISKS

The risk of price changes (interest rate risks, currency risks, share price risks), liquidity risks, credit risks in dealings with counterparties in the context of financial transactions and risks arising from cash flow fluctuations may have a significant negative impact on our financial result. CECONOMY's financial risks are therefore managed centrally.

Ensuring CECONOMY AG's unlimited access to the capital markets is integral to the management of financial risks. A downgrading of our rating to a non-investment grade below Baa3/BBB- would have a negative impact on our liquidity and Group financing (risk no. 3). In addition, negative effects on net working capital cannot be ruled out. In principle, a deterioration in net working capital would trigger additional financing requirements. For this reason, we continuously optimise and monitor ratings-relevant key figures to allow us to initiate countermeasures at short notice. In order to counteract this risk, our strategy focuses on optimising our net working capital and funds for investment.

In addition, we have identified unexpected deviations from the budget or forecast as a further risk (risk no. 4), particularly in view of increasingly dynamic customer behaviour and macroeconomic developments. Such discrepancies could cause us to fail to meet our targets or to make business decisions based on incorrect assumptions. This might necessitate a revaluation of assets, including goodwill, which would have a negative impact on our assets and results of operations (EBIT). Deviations from our forecasts could also lead to a loss of confidence on the capital market. For this reason, we attach high priority to measures designed to limit these risks. In this context, we consistently implement strategic and organisational measures aimed at improving the quality of data and forecasts and at improving earnings. Special emphasis is placed on countries for which there is an impairment risk.

In addition, the steps we take to counter these risks include careful monitoring as well as effective internal controls for the budget and forecast process. We also continue to intensify the planning process and the related internal information flow and coordination processes. Closer integration of strategic planning and the budgeting process as well as a stronger involvement of the supervisory bodies in the strategy and budgeting process contribute to this. We also support the proactive implementation of CECONOMY's strategy by developing and implementing value creation plans at the country level. Finally, the outlook offers insights into the Group's expectations for business development during the coming financial year.

RISKS RELATED TO BUSINESS PERFORMANCE

The online business is a strong growth driver for CECONOMY. We are therefore constantly pushing ahead with the expansion of our online activities. The resulting increase in complexity presents additional challenges and risks, which we counteract by working closely with the relevant departments. A delay in online expansion due to the intensification of competition, especially from online retailers such as Amazon, could lead to a weakening of CECONOMY's competitive position and thus dampen sales growth.

In addition, significantly slower growth than forecast in the Services & Solutions division may result in a loss of market share to our competitors. In addition to negative effects on sales and EBITDA/EBIT, the relevance of the Services & Solutions division for our business model and for communications with the capital market could have capital market-related effects.

In addition to the material risks for CECONOMY described above, there are also risks resulting from the demerger of METRO GROUP, for example tax risks. These were continuously monitored and evaluated prior to and after the demerger. For CECONOMY, however, we estimate the probability of occurrence to be less than 5 per cent and therefore do not consider the risks to be material for the Group.

The following risks are continuously analysed in the context of risk management due to their general significance, but from today's perspective they are not material for CECONOMY.

One risk that is not considered material to CECONOMY relates to the macroeconomic and political situation in the countries in which we operate. The uneven development of the global economy with solid growth in Western and Central Europe and weaker development in the Eastern European markets presents challenges for CECONOMY. In addition, the constantly changing basic conditions in these countries as well as unrest, changes in political leadership and attacks represent risks for CECONOMY. In this context, Turkey stands out during the reporting period, as the domestic political situation remains tense. However, our international presence provides us with the opportunity to offset economic, legal and political risks as well as fluctuations in demand between individual countries.

In addition, we have identified new and increasingly complex regulations on data protection, such as the processing of personal data or the use of customer-specific information, as a risk to our Company. We are therefore actively preparing for the implementation of the new general data protection regulation. This includes a large number of strategic and organisational measures, including strengthening awareness of the requirements of data protection at all levels in the Group, as well as anchoring the obligation to comply with data protection regulations in the employment contracts in accordance with the German Federal Data Protection Act [Bundesdatenschutz-gesetz, BDSG]. In particular, employees of Company units who have access to and work with sensitive data are given intensive training on the subject of data protection and data security.

We have also identified disruptions of important business processes, such as downtimes of IT systems or cyber attacks, as a non-material risk for CECONOMY. Systems for online retailing must be continuously available, as these systems are a prerequisite for unlimited access outside normal store hours. Systems that are essential for business operations in the stores, especially checkouts, are largely self-contained and can continue to be used for some time even during events such as network failures or the failure of central systems. In the event of partial network failures, they can automatically reroute shipments or switch to redundant routes. Modern technologies such as remote server management and cloud computing allow us to use our hardware efficiently. In addition, in the event of one or more server failures, centralised IT systems can be quickly restored.

In addition, other non-material risks may arise from the various legal regulations and self-imposed standards of conduct to which CECONOMY is subject. For example, in CECONOMY's business relationships with suppliers, antitrust law risks may arise, for example, in areas such as the resale prices for merchandise. Appropriate risk provisions were created for pending antitrust proceedings where liability is sufficiently substantiated. Employees in sensitive business areas receive intensive training as part of the antitrust programme. As a matter of principle, legal requirements in the various jurisdictions, as well as the expectations of our customers and the public regarding corporate compliance, have continued to increase and become more complex. In response to these requirements, CECONOMY has established a Group-wide compliance system that it continuously refines. The aim of this system is to systematically and sustainably prevent regulatory infringements within the Company.

Presentation of opportunities

CECONOMY has numerous opportunities to ensure long-term positive business developments. Above all, these are due to the fact that we respond in a rigorous manner and at an early stage to the needs of our customers. Our main goal is to create added value for our customers and to provide support to them in the digital world. To this end, we are constantly developing new business models, solutions and formats and making use of the opportunities arising from digitalisation.

We also take into account demographic developments, increasing differentiation in the mature markets of Western Europe and population growth in developing and emerging countries. We analyse the relevant global and national trends and take decisions aimed at systematically exploiting opportunities of the future and creating competitive edges.

We have identified the following opportunities that may have a positive impact on our ability to meet our corporate goals over the next five years as material for CECONOMY.

OPPORTUNITIES FROM THE DEVELOPMENT OF BUSINESS CONDITIONS

During financial year 2017/18, we expect a slight improvement in business conditions for retail, which, however, could support our sales and earnings development.

STRATEGIC BUSINESS OPPORTUNITIES

CECONOMY is very well known in the countries in which it operates. We have assumed leading positions in many markets. We must further strengthen and expand these. Weaker market participants have withdrawn, especially in countries with challenging basic conditions. We are working to fill these gaps or, when reasonable, to take over individual locations and plan to actively move pan-European market consolidation forward. Market exits of competitors would create additional opportunities for market share gains. To this end, we continuously analyse competitors and other potential acquisition candidates. We also see additional potential in the successful repositioning of national and subsidiary companies operating in a difficult economic environment (e.g. Russia, Italy). Ongoing transformation, repositioning and restructuring measures aim to improve the market position and boost its profitability, particularly with respect to focal topics such as the consolidation of procurement activities, logistics and the country portfolio.

Another important opportunity for the future success of our Company is a significantly faster than expected expansion of the online business. The online business in retailing is experiencing high growth rates and the online market share could start to come close to that of the brick-and-mortar business. We believe that the positive development in the online business will continue and create continued competitive momentum both in the store-based business and in online retail over the medium term. As a result, it is imperative for CECONOMY to further develop its internet sales channel. Our internet presence has already intensified in recent years and we are continuously optimising our online shops. In financial year 2016/17, we made further progress in the transformation from a purely brick-and-mortar store to a multi-channel distribution channel, combining the advantages of the physical and digital world. Unlike pure online providers, we create real added value for customers this way. In order to ensure further online expansion, we invest not only in technical resources but also in our employees, who bring the necessary expertise to our companies.

We also see an important opportunity in the further expansion of our service offering. The focus of these efforts is on the customer and his or her needs, for example in providing support for increasingly complex products. To this end, we have set up smart bars at our stores to carry out repairs on site and assist customers in the event of problems. In order to support our customers in technical matters at home, we cooperate with DTB Deutsche Technikberatung GmbH, in particular. Against this backdrop, we are constantly reviewing possible acquisitions that will further enhance our range of services. In addition, we develop and implement new service concepts that extend and complement our range of services.

We see a further opportunity in our strategic investment in Fnac Darty S.A., in which we acquired a stake of around 24.33 per cent in July 2017.

We also see opportunities in intensified cooperation with our strategic partners. For example, we are already testing our shop-in-shop concepts, which include the electronics departments of METRO Cash & Carry, in Russia.

We believe that the application of innovative ideas relating to progressing digitalisation will increasingly shape the future of retail and drive the development of new business models. Digitalisation also influences the behaviour of our customers. In our Group, we see potential for those new business models which offer excellent added value to our customers, in line with our strategy and building on existing strengths of our operating processes. We therefore continually review new concepts and maintain an intensive exchange with startups that are relevant to us, in some cases through direct investments in startups, in order to gain insight into new business areas and develop innovative ideas. In the past, the Spacelab Accelerator programme has been mainly used for this. In the future, CECONOMY will be supported by the newly founded “Retailtech Hub”.

BUSINESS PERFORMANCE OPPORTUNITIES

In addition to systematically tapping cost-cutting potential, productivity increases, especially through process optimisation, and the centralisation of core functions across the entire organisation create the basis for sustainable success. This effort includes a number of projects that we have already initiated and will systematically continue to pursue. These include, for example, centralising our purchasing and optimising the supply chain. Should we make more progress in implementing further productivity enhancements than we currently expect, this could have a positive impact on our business development.

Sustainability is important to us and we believe that it will continue to grow in importance globally. Expectations of customers, employees, investors, policymakers and society will increase, and we want to live up to them. To this end, we are developing a holistic sustainability strategy that we are systematically implementing. In addition to increasing the attractiveness of our brand, the range of products and our own brands, we see in the area of sustainability an abundance of new business models that we are currently analysing in detail with regard to their potential. In addition, we continually review further opportunities and initiatives in sustainability. These include developing a more sustainable range of products and services as well as taking measures to reduce CO_2 emissions. These opportunities and our social commitment can have a positive impact on our reputation. This will help us to grow our sales over the medium term. We also believe that a stronger focus on sustainability can have a positive impact on our shares. This will make us more attractive, especially to investors with a sustainable outlook, and we will be able to gain access to better conditions.

Overall assessment of the risk situation by the Company’s management

The Management Board and the Supervisory Board of METRO AG are regularly informed about the Company’s risk and opportunities situation. The demerger of METRO GROUP has changed the overall risk and opportunity profile, meaning that it is no longer comparable with the previous year. To evaluate the present risk situation, we not only analysed individual risks and opportunities: the interdependencies between risks were also analysed and rated according to their probability and impact. The assessment has shown that the overall risks are manageable. The individual and cumulative risks identified do not represent risks that jeopardise the continuity of CECONOMY AG due to illiquidity or over-indebtedness over a period of at least one year. We are confident that CECONOMY’s earnings strength provides a solid foundation for sustained positive business developments and the exploitation of numerous opportunities. This assessment is mirrored by the rating of the internationally leading, independent rating agency Moody’s, whom we commissioned. CECONOMY has an investment grade credit rating of Baa3 – with a stable outlook. The Management Board of CECONOMY AG does not currently expect any fundamental change in the risk and opportunities situation.