Distribuidora Internacional de Alimentación, S.A.

Annual Accounts

31 December 2018

Directors' Report

2018

(With Independent Auditor's Report Thereon)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

KPMG Auditores, S.L.
Paseo de la Castellana, 259C
28046 Madrid

Independent Auditor's Report on the Annual Accounts

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

To the shareholders of Distribuidora Internacional de Alimentación, S.A.

REPORT ON THE ANNUAL ACCOUNTS

Opinion

We have audited the annual accounts of Distribuidora Internacional de Alimentación, S.A. (the "Company"), which comprise the balance sheet at 31 December 2018, and the income statement, statement of changes in equity and statement of cash flows for the year then ended, and notes.

In our opinion, the accompanying annual accounts give a true and fair view, in all material respects, of the equity and financial position of the Company at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with the applicable financial reporting framework (specified in note 2 a) to the accompanying annual accounts) and, in particular, with the accounting principles and criteria set forth therein.

Basis for Opinion

We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Annual Accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those regarding independence, that are relevant to our audit of the annual accounts in Spain pursuant to the legislation regulating the audit of accounts. We have not provided any non-audit services, nor have any situations or circumstances arisen which, under the aforementioned regulations, have affected the required independence such that this has been compromised.

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

Material Uncertainty Related to Going Concern

We draw attention to notes 1, 2b) and 2d) to the annual accounts which indicate that the Company’s equity at 31 December 2018 is negative in an amount of Euros 98,828 thousand and that at that date current assets less current liabilities are also negative in an amount of Euros 549,069 thousand, including financial debt totalling Euros 574,719 thousand falling due in the short term. These notes provide details of the circumstances under which the Company incurred significant losses in 2018, the measures that have been implemented with the aim of redressing the equity balance, as well as the process undertaken by the Company to reach a refinancing agreement with the main financial institutions which will enable the Company to have an adequate debt structure to meet the liquidity needs and payment commitments in its ordinary operations under the new business plan approved by the Board on 30 January 2019. These facts and conditions, together with other matters set out in the aforementioned notes, indicate the existence of a material uncertainty that could generate significant doubt as to the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In addition to the matter described in the *Material Uncertainty related to Going Concern* section, we have determined the matters described below as the key audit matters which should be communicated in our report.

Restatement of the comparative figures as a result of misstatements due to irregularities and errors **See note** 1 to the annual accounts.	
Key Audit Matter	*How the Matter was Addressed in Our Audit*
As specified in note 1 to the accompanying annual accounts, during the third quarter of 2018, following a review of the estimates for the financial close for that year, the Company and the Group of which it is the parent reduced their profit and loss forecasts for 2018 and identified misstatements in certain estimates made, associated mainly with the sales margin. In order to clarify the events that gave rise to these misstatements, the Group launched an investigation that brought to light the existence of irregular accounting practices carried out by certain employees and senior executives in Spain and Brazil by overriding the internal controls implemented by the Group. Note 1 provides details of the measures adopted by the Company's Board of Directors as well as the effects that the events described have had on the Company's financial and equity position which, inter alia, have led to the restatement of the comparative figures to correct the effects thereon of the misstatements identified. Consequently these figures differ from those included in the Company's approved annual accounts for 2017. Note 1 to the annual accounts provides details of the origin and nature of the adjustments made to the comparative figures. Given the relevance of the implications for the audit approach for 2018, this has been considered a key audit matter.	In the context of our audit, we performed, among others, the following procedures: – Understanding of the process followed by management to identify the misstatements that have led to the restatement of the comparative figures as well as the circumstances in which they took place, in particular those relating to irregular accounting practices with the effect of artificially increasing the sales margin. – Evaluation of the correct recognition of the restatement adjustments made by the Company to the comparative figures. – Analysis of the forensic investigation work performed in Spain by the external advisors engaged by the Company to assess the possible implications on our audit approach and on the analysis of our audit evidence. – Special attention to the affected areas, including increasing the tests of detail on the matters identified as presenting a greater risk of material misstatement, obtaining additional audit evidence through confirmations with third parties, increasing the involvement of highly experienced professionals in the audit, identifying those areas in which specialist knowledge is required in order to involve the specialists considered necessary so as to respond appropriately to the risk of misstatement, as well as using computer-assisted audit tools when performing certain audit tests. – Assessment of whether the information disclosed in the annual accounts in relation to the restatement of the comparative figures meets the requirements of the financial reporting framework applicable to the Company.

Trade discounts with suppliers See notes 3l) and 24b) to the annual accounts	
Key Audit Matter	*How the Matter was Addressed in Our Audit*
The Company's cost of merchandise used is reduced due to different discounts based on the trade terms and conditions agreed with suppliers. Certain discounts are fixed and others are variable, and their application is subject to the cumulative volume of consumables during a contractually established period or the volume of sales of items from the corresponding suppliers by the Company at its establishments. During 2018 the Company recognised a Euros 1,012,893 thousand reduction in cost of merchandise used due to trade discounts applied, and discounts amounting to Euros 67,732 thousand are pending issue at the reporting date. Furthermore, mainly as a result of the trade discounts issued at year end, at 31 December 2018 there is a balance of Euros 45,234 thousand receivable from suppliers. Furthermore, as indicated in note 1 to the accompanying annual accounts, during 2018 the Company identified irregular accounting practices that have led to a review of the amount of discounts that had been applied. As a result of this review, equity for 2017 has been reduced by Euros 27.6 million, and the cost of merchandise used for 2018 has been reduced by this amount. There is a risk of misstatement in the amount of the net cost of merchandise used recognised in the event that the discount applied does not reflect the terms and conditions actually agreed with the supplier. In these circumstances, the correct recognition of the aforementioned cost requires that the Company reliably estimates the level of compliance of the terms and conditions that give entitlement to the discount. As a result of the irregularities identified and their effect on the estimate of the trade discounts, in the audit of 2018 we have increased the assessment of the risk of material misstatement and this has therefore been considered a key matter of our audit of the current year.	In the context of our audit, we performed, among others, the following procedures: – Understanding of the process followed by the Company to determine and recognise the discounts to be applied for each supplier based on the terms and conditions agreed. – Selection of a sample of suppliers from which confirmation has been requested of the trade terms and conditions agreed with the Company, as well as confirmation of the invoices issued and balance receivable at the reporting date. – Recalculation, for a sample of suppliers, of the reduction in the cost of merchandise used recognised in respect of the trade discounts applied, considering the trade terms and conditions agreed with these suppliers. – Tests of details for the purposes of concluding on the reasonableness and recoverability of the balances receivable from suppliers recognised under assets on the balance sheet. Furthermore, for a selected sample, we verified the subsequent collection or, where appropriate, offset of the balance with subsequent purchases. – Verification of the correct recognition of the restatement adjustments made by the Company to the comparative figures. – Assessment of whether the information disclosed in the annual accounts in relation to the trade discounts meets the requirements of the financial reporting framework applicable to the Company.

Recoverability of deferred tax assets

See notes 4r) and 21 to the annual accounts

Key Audit Matter	*How the Matter was Addressed in Our Audit*
As mentioned in note 21 to the accompanying annual accounts, the Company, together with its subsidiaries, files consolidated tax returns and at 31 December 2018 the tax loss carryforwards pending offset generated by this tax group amount to Euros 102,834 thousand, which have not been recognised by the Company as deferred tax assets on the balance sheet. Furthermore, the Company has deferred tax assets, net of deferred tax liabilities, derived from temporary differences amounting to Euros 20,688 thousand. As a result of the reduction in the future profit and loss forecast in the new business plan (see note 1), the Company has assessed the amount of deferred tax assets whose recovery is probable, considering the reviewed tax projections, over a maximum of ten years. As a result of this assessment, the Company derecognised deferred tax assets amounting to Euros 95,251 thousand during 2018, taking into account the order in which the tax bases will be offset, as established by the tax group. Due to the uncertainty associated with the recoverability of the amounts recognised as deferred tax assets and the expected recovery period, as well as the judgement required of the Directors in interpreting the criteria set out in prevailing tax legislation and the risks that could derive from a different interpretation of the aforementioned legislation, we consider this to be a key matter in our audit of the current year.	In the context of our audit, we performed, among others, the following procedures: – Understanding of the analysis and evaluation process carried out by the Company, in the current situation, in order to consider whether or not the recovery of the deferred tax assets recognised at 31 December 2018 is probable. – Assessment of the reasonableness of the criteria and the main assumptions considered by the tax group in estimating the future taxable profits necessary for offset. – Contrasting of the consistency of the profit and loss forecasts used as a basis for the analysis of the recoverability of the deferred tax assets with the business plan approved by the Board of Directors on 30 January 2019 and evaluation of the reasonableness of the time period in which the Company expects to offset these assets. – Request of the opinion of the Company's tax advisors on the criteria followed to determine the tax bases of the Spanish tax group on the basis of the binding rulings received by the Company from the Spanish Directorate-General of Taxes, and analysis of their reasonableness with the assistance of our tax specialists. – Assessment of whether the information disclosed in the annual accounts in relation to the aforementioned deferred tax assets meets the requirements of the financial reporting framework applicable to the Company.

<table>
<tr><th colspan="2">Recoverable amount of non-current assets subject to amortisation or depreciation and investments in Group companies
See notes 4e), 4g), 6 and 11 to the annual accounts</th></tr>
<tr><td>Key Audit Matter</td><td>How the Matter was Addressed in Our Audit</td></tr>
<tr><td>At 31 December 2018 the Company has recognised property, plant and equipment amounting to Euros 508,224 thousand, goodwill amounting to Euros 35,689 thousand and investments in Group companies amounting to Euros 728,331 thousand. At each reporting date, the Company estimates the recoverable amount of the property, plant and equipment associated with stores, including the goodwill of those stores for which there are indications of impairment.

The recoverable amount of the assets of the stores, including goodwill, has been determined using the discounted cash flow method, considering the reduction in profit and loss and the other assumptions foreseen in the new business plan. As a result of the valuation carried out, impairment totalling Euros 57,468 thousand was recognised on property, plant and equipment in 2018, of which Euros 18,556 thousand relates to stores that are expected to close in the context of the new business plan, and impairment of Euros 10,780 thousand was recognised on goodwill assigned to stores.

In the case of investments in Group companies, impairment is assessed for each individual subsidiary, taking into consideration the balances receivable from Group companies, and is calculated considering the future cash flows of each subsidiary as a cash-generating unit. In 2018 the Company recognised impairment of Euros 51,372 thousand on investments in Group companies in respect of the investment in the subsidiary Beauty by DIA, S.A. (Clarel).

To estimate the recoverable amount of the cash-generating units, the Company uses valuation techniques that require the Directors to exercise judgement and make assumptions and estimates. Due to the judgement required and the uncertainty associated with these estimates, this has been considered a key audit matter of the current period.</td><td>In the context of our audit, we performed, among others, the following procedures:

– Understanding of the analysis and evaluation process carried out by the Company, in the current situation, in order to identify the stores with indications of impairment and, therefore, to calculate their recoverable amount.

– Assessment, with the involvement of our valuation specialists, of the reasonableness of the methodology used to calculate the recoverable amount of store assets as well as the recoverable amount of investments in Group companies, and the reasonableness of the main assumptions considered.

– Contrasting of the consistency of the future profit and loss forecasts used as a basis for the calculation of the recoverable amount of the stores and the investments in Group companies with the business plan approved by the Board of Directors on 30 January 2019, questioning the main assumptions therein.

– Sensitivity analysis of certain assumptions in the model to changes that are considered reasonable.

– Assessment of whether the information disclosed in the annual accounts in relation to the impairment of non-current assets meets the requirements of the financial reporting framework applicable to the Company.</td></tr>
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Other Information: Directors' Report

Other information solely comprises the 2018 directors' report, the preparation of which is the responsibility of the Company's Directors and which does not form an integral part of the annual accounts.

Our audit opinion on the annual accounts does not encompass the directors' report. Our responsibility as regards the content of the directors' report is defined in the legislation regulating the audit of accounts, which establishes two different levels:

a) A specific level applicable to the non-financial information statement and to certain information included in the Annual Corporate Governance Report, as defined in article 35.2. b) of Audit Law 22/2015, which consists solely of verifying that this information has been provided in the directors' report, or where applicable, that the directors' report makes reference to the separate report on non-financial information, as provided for in legislation, and if not, to report on this matter.
b) A general level applicable to the rest of the information included in the directors' report, which consists of assessing and reporting on the consistency of this information with the annual accounts, based on knowledge of the entity obtained during the audit of the aforementioned accounts and without including any information other than that obtained as evidence during the audit. Also, assessing and reporting on whether the content and presentation of this part of the directors' report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.

Based on the work carried out, as described above, we have verified that the information mentioned in a) above has been provided in the directors' report and that the rest of the information contained in the directors' report is consistent with that disclosed in the annual accounts for 2018 and the content and presentation of the report are in accordance with applicable legislation.

Directors' and Audit Committee's Responsibility for the Annual Accounts

The Directors are responsible for the preparation of the accompanying annual accounts in such a way that they give a true and fair view of the equity, financial position and financial performance of the Company in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit committee is responsible for overseeing the preparation and presentation of the annual accounts.

Auditor's Responsibilities for the Audit of the Annual Accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with prevailing legislation regulating the audit of accounts in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with prevailing legislation regulating the audit of accounts in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

– Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

– Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

– Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

– Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves a true and fair view.

We communicate with the audit committee of Distribuidora Internacional de Alimentación S.A. regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the entity's audit committee with a statement that we have complied with the applicable ethical requirements, including those regarding independence, and to communicate with them all matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the audit committee of the entity, we determine those that were of most significance in the audit of the annual accounts of the current period and which are therefore the key audit matters.

We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Report to the Audit Committee

The opinion expressed in this report is consistent with our additional report to the Company's audit committee dated 7 February 2019.

Contract Period

We were appointed as auditor of the Company by the shareholders at the general meeting on 20 April 2018 for a period of three years, for the years ending 31 December 2018, 2019 and 2020. Previously, we were appointed as auditor from 2011 onwards, by consensus of the shareholders at their general meeting, and have been auditing the consolidated annual accounts of the Group since 1995.

KPMG Auditores, S.L.
On the Spanish Official Register of
Auditors (“ROAC”) with No. S0702

(*Signed on original in Spanish*)

Maria Lacarra
On the Spanish Official Register of Auditors (“ROAC”) with No. 20411

7 February 2019