

5 / REMUNERATION

This chapter outlines the remuneration policy for the Management Board and the Supervisory Board, as approved by the General Meeting of Shareholders. Details of actual remuneration in 2015 can be found in notes 26 and 27 of the Consolidated Financial Statements.

Since members of the Management Board are also members of the Executive Committee and the Supervisory Board resolved that the remuneration policy shall equally apply to all members of the Executive Committee, this section will refer to the Executive Committee, unless specific provisions apply to members of the Management Board only which will be indicated.

The objective of X5's remuneration policy is twofold:

- ▶ to create a remuneration structure that will allow the Company to attract, reward and retain qualified executives who will lead the Company in achieving its strategic objectives and
- ▶ to balance short-term operational performance with the long-term objectives of the Company and value creation for its shareholders and stakeholders, with due regard for the risks to which variable remuneration may expose the Company.

In response to proposal from the Nomination and Remuneration Committee, and if in the interest of the Company, the Supervisory Board may at its discretion deviate from the remuneration policy when offering a remuneration package to a newly appointed member of the Executive Committee. This discretion may be applied in the event of exceptional circumstances or if deemed appropriate and if in the interest of the company and its shareholders.

Adjustments to remuneration policy in 2015

The Annual General Meeting of Shareholders of 7 May 2015 approved an amendment of the remuneration policy, substituting the deferred cash incentive plan launched in 2013 with a short-term incentive and a long-term incentive, both cash based. These changes were aimed at:

- ▶ Improving the balance between short-term operational performance and the medium and long-term objective of creating sustainable value for all stakeholders thereby following good practice;
- ▶ Enhanced alignment of the remuneration policy with the Company's targets and strategic objectives defined in 2014, with specific incentives for profitable growth and increasing market share.

All other features of the remuneration policy remained unchanged.

Benchmarking with industry peers

As a company with operations mainly in Russia, with international exposure due to its governance structure and listing on the London Stock Exchange, distinct bench-

marking is applied to X5 base salaries as well as variable salary components. Base salaries are benchmarked against mainly Russian peers while variable salary components, including long term incentive elements, are benchmarked against relevant western peers as well. The peer group applied to the benchmarking of base salaries is currently composed of Russian companies equivalent in terms of size of business, complexity of operations, growth dynamics and corporate governance.

Total direct compensation

The total direct compensation consists of the following components: base salary, performance related short-term incentive (STI) and performance-related long-term incentive (LTI).

In addition to this total direct compensation, members of the Executive Committee are entitled to other benefits, such as described below under 'Other remuneration components'.

Base salary

Base salaries are specified in the individual contracts with members of the Executive Committee and reflect their qualifications, experience, expertise and responsibilities.

The levels of base salaries are determined by:

- ▶ Benchmarking with industry peers, as described above;
- ▶ the specific responsibilities of the individual member of the Executive Committee.

The annual review date for the base salaries is April 1.

Short-term incentive (STI)

The annual incentive for members of the Executive Committee is predicated upon both quantitative financial indicators and individual targets. The on-target pay-out as a percentage of base salary is 100%, contingent on full achievement of the objectives, with a cap at 140% in case of exceptional performance.

The Supervisory Board sets the annual incentive targets -and their weight- at the beginning of each financial year, as well as performance ranges, i.e. the value below which no pay-out will be made (the threshold), the on-target value and the maximum pay-out level. The financial targets consist of elements related to the Company's operational performance, including net sales, with an EBITDA threshold as a condition for STI pay-out. The individual targets include targets related to divisional performance, mission-re-

lated or key project-related targets, as well as qualitative cultural and behavioral targets.

Both the financial and individual performance measures contribute to the Company's success in the short term, while also securing the long-term objectives of the Company. X5 does not disclose the targets for the STI programme which represent commercially sensitive information.

Long-term incentive (LTI)

The LTI is a programme in two stages which runs until 31 December 2019. LTI targets have been structured to align the long term interests of shareholders and management. The targets represent the Company's long-term ambitions, with a specific focus on net revenue and market share relative to the competition, without sacrificing EBITDA. The total available fund for all payouts under the LTI programme is capped at 12% of EBITDA in the year that the final stage performance targets are achieved.

The size of each individual cash award is based on a pre-determined score, reflecting the participant's role and function within the Company and his or her contribution to meeting the LTI targets, both at individual and team level. The LTI includes an award for non-financial individual targets with a weight up to 20% of the total incentive opportunity, determined at the discretion of the Supervisory Board.

Other remuneration components

A number of other arrangements may be offered to members of the Executive Committee, such as expense allowance, medical insurance, accident insurance and life insurance, in accordance with general policies approved by the Supervisory Board. The Company's policy does not allow personal loans and guarantees to members of the Executive Committee. The Company does not provide for pension arrangements for members of the Executive Committee.

Contractual arrangements

Management Board members appointed prior to 1 January 2013 are engaged on the basis of an employment agreement for an indefinite period of time. Russia-based members of the Management Board are engaged on the basis of a Management Services Agreement with a four-year term, to be extended at reappointment by the Annual General Meeting of Shareholders, and a contract of employment with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract

reflect the relevant responsibilities of each member of the Management Board in the Netherlands and in Russia.

Claw-back / change-of control

New claw-back legislation introduced in the Netherlands as per 1 January 2014 strengthens the Company's ability to revise and claw back director's variable pay components if they are excessive or wrongly awarded. Under the new rules the Supervisory Board may recover from the Management Board members all or part of a paid bonus if such bonus is based on incorrect information regarding the targets or the conditions of the bonus. Furthermore, the Supervisory Board has the discretionary authority to adjust an unpaid bonus to an appropriate amount if payment of the bonus is considered unreasonable or unfair. In addition, it is enacted that in the case of a change-of-control event a related increase in value of the securities that have been granted to a board member as part of his/her remuneration will be deducted from the remuneration to be paid to the board member at the time of selling these securities or when his/her board membership ends.

Severance arrangement

The severance payment is in principle limited to a maximum of one year's base salary for members of the Management Board, and a six months' base salary for Executive Committee members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances.

Loans

X5 does not provide any loans or guarantees to members of the Executive Committee.

Insurance and indemnity arrangements

Members of the Management Board, as well as certain senior management members, are insured under X5's Directors and Officers Insurance Policy.

Although the insurance policy provides for a wide coverage, X5's directors and officers may incur uninsured liabilities. Members of the Management Board may be indemnified by the Company against any claims arising out of or in connection with the general performance of their duties, provided that such claim is not attributable to gross negligence, willful misconduct or intentional misrepresentation by such director or officer. Similar indemnities to be granted by the Company to members of the Supervisory Board shall be submitted to the 2016 Annual General Meeting of Shareholders.

Supervisory Board Remuneration

The remuneration principles for the Supervisory Board, adopted by the General Meeting of Shareholders in 2013 are as follows: the Chairman receives a fee of EUR 250,000 members chairing a committee receive a fee of EUR 200,000 with other members drawing a fee of EUR 100,000.

Any non-independent member of the Supervisory Board who is -either directly or indirectly- affiliated with, engaged or employed by a legal entity or person holding at least thirty per cent of the voting rights in the Company, shall waive his/her entitlement to remuneration for acting as a member of the Supervisory Board.

X5 believes it is necessary to allow members of the Supervisory Board to align their interests with those of shareholders and strengthen their commitment and confidence in the future of the Company. Therefore, members of the Supervisory Board are entitled to an annual grant of Restricted Stock Units (RSUs), with award date on 19 May of the subsequent year, subject to the relevant Supervisory Board member holding office during the period until the award date. The number of Restricted Stock Units (RSUs) granted in each given year is based on 100% of the Board member's fixed annual remuneration, divided by the average market value¹ of a GDR on the relevant grant date.

RSU awards are subject to a two-year vesting period. Provided that the Supervisory Board member still holds office when RSUs vest, the RSUs will be converted into an equal number of GDRs which cannot be traded during a further two-year lock-in period. RSUs awards to members of the Supervisory Board are not subject to performance criteria, and determined by the General Meeting of Shareholders.

Remuneration Policy in 2016 and beyond

As described in Note 26 'Staff Costs' to the Consolidated Financial Statements, the targets set for the first stage of the LTI were achieved as per 31 December 2015, as specific comparative performance indicators were met, and also the profitability threshold was exceeded. In order to ensure continued executive alignment and motivation, the Supervisory Board reserved a discretionary part of the first stage bonus fund for deferred, conditional payouts during the remainder of the period covered by the first stage of the LTI, in accordance with the programme rules.

During the course of 2016 the Nomination and Remuneration Committee will continue to reflect on the current policy and the balance between short and long term compensation and the Company's targets, taking into account the Company's strategic plan defined during the year.

Furthermore, the Board will propose to the General Meeting of Shareholders an amendment of the remuneration principles for members of the Supervisory Board, aimed at (i) introducing a compensation policy for extraordinary assignments of a non-executive nature, performed by members of the Supervisory Board and (ii) simplifying the RSU award mechanism, while safeguarding the existing terms and conditions for vesting and lock-up under the RSU plan. Further details of the proposed amendments will be submitted to the 2016 Annual General Meeting of Shareholders.

The Supervisory Board
17 March 2016

¹ The Average Market Value is defined as "on any particular day the volume weighted average price of a GDR over the thirty immediately preceding calendar days. The volume weighted average price is calculated using the closing price of a GDR taken from the Official List of the London Stock Exchange".