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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 2016 can be found in notes 26 and 27 to 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 apply equally 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, in which case that 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 on a sustainable basis in achieving its strategic objectives; and
- to balance short-term operational performance with the long-term objectives of the Company and sustainable value creation for its shareholders and stakeholders, with due regard for the risks to which variable remuneration may expose the Company.

In response to a 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 or when amending the remuneration package of a current member of the Executive Committee. This discretion may be applied in the event of exceptional circumstances if it is clearly in the interest of the Company and its shareholders.

Benchmarking with industry peers

As a company with operations mainly in Russia and with international exposure due to its governance structure and listing on the London Stock Exchange, the most relevant benchmarking is applied to X5 base salaries as well as variable salary components. Therefore, base salaries are benchmarked mainly against Russian peers, while variable salary components, including long-term incentive elements, are benchmarked against the appropriate Western peer group as well. The peer group applied to the benchmarking of base salaries is composed of Russian companies equivalent in terms of size of business, complexity of operations, growth dynamics and corporate governance.

Total direct compensation

Total direct compensation consists of the following components: base salary, performance-related short-term incentives (STI) and performance-related long-term incentives (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 respective qualifications, experience, expertise and responsibilities. The levels of base salaries are determined by (1) benchmarking with industry peers, as described above; and (2) the specific responsibilities of the individual member of the Executive Committee. The annual review date for base salaries is 1 April.

Based on the salary benchmarking review conducted in 2015, no adjustments were made to the 2016 base salaries of Executive Committee members.

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 at the beginning of each financial year, as well as performance ranges, i.e. the value below which no payout will be made (the threshold), the on-target value and the maximum payout 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 payout. Individual targets include targets related to divisional performance, mission-related or key project-related targets, as well as qualitative cultural and behavioural targets.

Both 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 targets for the STI programme, which represent commercially sensitive information.

Long-term incentive (LTI)

The LTI programme is divided into two stages, and runs until 31 December 2019. LTI targets have been structured to align the long-term interests of shareholders and management on a sustainable basis. The targets represent the Group's long-term ambitions, with a specific focus on net revenue and market share relative to the competition without sacrificing EBITDA margin or incurring undue risk. 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.

Each stage of the programme includes a deferred component of conditional payouts in order to maintain the focus on long-term goals throughout the programme and to provide for an effective retention mechanism. The size of each individual cash award is based on a predetermined score reflecting the participant's role and contribution to meeting the LTI targets, at both the individual and team levels. For each LTI participant, the total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

After meeting the targets for the first stage of the LTI programme in 2015, the targets set for the deferred payout under the first stage of the LTI were achieved as of 31 December 2016, as specific performance indicators were met in line with the strategic objectives set by the Supervisory Board, and (additionally) EBITDA exceeded the target threshold.

Other remuneration components

A number of other arrangements may be offered to members of the Executive Committee, such as an 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 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 upon 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 on 1 January 2014 strengthens the Company's ability to revise and claw back a director's variable pay components if they are excessive or wrongly awarded. Under the new rules, the Supervisory Board may recover from Management Board members all or part of a paid bonus if such bonus is based on the basis of 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, in the case of a change-of-control event, a related increase in the value of the securities that have been granted to a board member as part of his or 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 or 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 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 and the Supervisory Board, as well as certain senior management members, are insured under X5's Directors and Officers Insurance Policy.

Although the insurance policy provides 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, wilful

misconduct or intentional misrepresentation by such director or officer. Similar indemnities granted by the Company to members of the Supervisory Board were approved by 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, and other members draw 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 30% of the voting rights in the Company shall waive his or 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 award of Restricted Stock Units (RSUs). The number of RSUs awarded 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 award date.

RSU awards are subject to a three-year vesting period. Provided that the Supervisory Board member still holds office when the 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. RSU awards to members of the Supervisory Board are not subject to performance criteria, as determined by the General Meeting of Shareholders.

Adjustments to remuneration policy in 2016

The Annual General Meeting of Shareholders of 10 May 2016 approved two amendments to the remuneration policy for members of the Supervisory Board.

Under the adjusted remuneration principles, Board members are entitled to additional compensation for time and expertise dedicated to specific strategic projects for X5, provided that such compensation (1) relates to work of a temporary, one-off nature, performed as an extension of the statutory non-executive duties of the relevant Board member; and (2) is approved in advance by the Supervisory Board – upon recommendation of the Nomination and Remuneration Committee, which will ensure, on a case-by-case basis, that any such engagement shall under no circumstances compromise the independence of the relevant Board member or the Board collectively.

Secondly, effective May 2016, the General Meeting approved a simplified award mechanism for RSUs under the Restricted Stock Unit Plan, while safeguarding the existing terms and conditions for vesting and lock-up under the plan. As such, the "conditional grant" under the plan was substituted by an award, followed by a three-year vesting period and a subsequent two-year lock-up period.

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."

Remuneration Policy in 2017 and beyond

In 2016, the Remuneration Policy as described in this report was applied. It is the intention that the current policy, with its focus on aligning the interests of shareholders and management on a sustainable basis, will be continued in the next financial year and beyond.

Under the Company's long-term incentive programme (LTI), targets have been structured to ensure that the long-term interests of shareholders and management are aligned and to achieve the strategic objectives of the Company. The targets represent the Group's long-term ambitions for sustainable and profitable growth with a specific focus on net revenue and market share relative to the competition without sacrificing EBITDA margin or incurring undue risk.

In 2015 and 2016, X5 made significant progress in achieving the long-term strategic goals set by the Supervisory Board, including becoming the largest food retailer in Russia by revenue as of 31 December 2016. Accordingly, and underpinning this progress, the targets under the first stage of the LTI were achieved in 2015 and 2016 consecutively.

Building on this achievement, and subject to meeting the sustainability criteria set out in the LTI programme, management expects that the targets under the second stage of the LTI programme are likely to be met in 2017. Pay-outs will take place in subsequent years. Similar to the first stage, the second stage of the programme includes a deferred component of conditional payouts, the purpose of which is to maintain the focus on long-term, sustainable goals throughout the life of the programme, and also to create an effective mechanism for motivating and retaining members of management who are critical to the ongoing success of the Company.

The Supervisory Board

24 March 2017