

# Remuneration

This report outlines the remuneration policy of the Company's Management Board as well as the actual remuneration of the Management Board for the 2018 financial year. Further details of actual remuneration of the Management Board and Supervisory Board in 2018 can be found in notes 27 and 28 to the consolidated financial statements.

## Remuneration policy

The remuneration policy for members of the Management Board was adopted at the General Meeting of Shareholders on 7 May 2015. It aligns with the Company's strategy and supports the long-term development of the Company, while aiming to be effective, transparent and simple.

The Supervisory Board resolved that the remuneration policy for the Management Board will also apply to members of the Executive Board. In view of the relative size and composition of both boards, this policy refers to the Executive Board unless specific provisions apply to members of the Management Board only, which will be clearly indicated.

The objective of X5's remuneration policy is twofold:

- to create a remuneration structure that will support a healthy corporate culture and allow the Company to attract, reward and retain the best-qualified talent to lead the Company towards its strategic objectives;
- to balance short-term operational performance with the long-term objectives of the Company and sustainable value creation for its shareholders and stakeholders.

The Supervisory Board's Nomination and Remuneration Committee closely monitors developments in regional and local labour markets and takes these developments into account when making recommendations on Executive Board compensation to the Supervisory Board for consideration and approval. While developing the remuneration policy, the Nomination and Remuneration Committee carries out scenario analyses to determine the risks to which variable remuneration may expose the Company.

Upon a recommendation of 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 Board or when amending the remuneration package of a current member of the Executive Board. This discretion may be applied in the event of exceptional circumstances if clearly in the interest of the Company and its shareholders.

## Benchmarking with industry peers

The basic components of the total direct compensation provided to Executive Board members is benchmarked against the labour market peer group. As a company with operations mainly in Russia, the peer group created for the benchmarking is composed of Russian companies equivalent in terms of size of business, complexity of operations and corporate governance.

The composition (risk profile) of the levels of total direct compensation is also taken into account when benchmarking salary levels. The target total direct compensation level is typically around the median or 75th percentile, depending on the position of the relevant executive.

## Total direct compensation

The basic elements of the remuneration (total direct compensation) provided to Executive Board members are: a base salary, a performance-related annual cash incentive and a performance-related long-term cash incentive.

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

### Base salary

The level of each Executive Board member’s base salary is derived from the benchmarking of total direct compensation. Adjustment of the base salary is at the discretion of the Supervisory Board.

### Short-term incentive (STI)

The annual incentive for members of the Executive Board is predicated upon both quantitative financial and individual performance measures. The on-target payout as a percentage of base salary is 100%, contingent on the targets being fully achieved, with a cap at 140% of the base salary in the event of above-target performance.

At the beginning of each financial year, the Supervisory Board sets the performance measures and their relative weight, the targets to be achieved for each performance measure, 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. Financial performance measures comprise components related to the Company’s operational performance, particularly sales growth, operating margin and return on investment, with a profitability threshold as a condition for STI payout. Individual performance measures include divisional performance or key project-related targets.

Both financial and individual performance measures contribute to the Company’s success in the short term, while also securing the Company’s long-term objectives. X5 does not disclose the actual targets set, as they are considered commercially sensitive.

### Long-term incentive (LTI)

In 2018, the General Meeting of Shareholders approved a new LTI programme that was developed by the Supervisory Board since targets under the previous programme were achieved in 2017. Whereas the 2015-2018 LTI programme was specifically designed to support the Company’s ambitious transition to accelerated growth and expansion in line with long-term strategic targets, the Supervisory Board recognised that the Company is entering a new stage with enhanced focus on sustainability and strategic objectives that contribute to long-term value creation for the Company. The new LTI is a cash incentive programme over a three-year period until 31 December 2020, with an extension component of deferred, conditional payouts in order to maintain the focus on long-term goals and to provide for an effective retention mechanism. In comparison to the 2015-2018 LTI programme, it is designed for a wider group of participants within the Company and aims to create greater balance between short- and long-term compensation of the programme participants.

Targets under the LTI are structured to align the long-term interests of shareholders and management, with a focus on maintaining leadership in terms of revenue and enterprise value multiple relative to competition. Additionally, the LTI includes thresholds related to (i) the EBITDA margin to ensure that profitability is not sacrificed and (ii) the net debt/EBITDA ratio to retain focus on prudent financial and balance sheet management. Under the programme, 50% of the total award is paid in 2021 subject to maintaining achieved targets until the end of 2020, while the other 50% is deferred to 2022 subject to maintaining achieved targets in 2021 with a profitability threshold

as a condition for deferred payout. This creates a focus on long-term goals throughout the programme and provides an effective mechanism for motivating and retaining executives who are critical to the Company's continued success.

The size of each individual cash award is based on the participant's annual base salary and LTI scale, reflecting his/her role and contribution to meeting the LTI targets at both individual and team levels, with a maximum of 133% per year of the participant's base salary during the three-year programme. The total available fund for all payouts under the LTI programme is capped at 5% of average EBITDA during the three-year period of the programme.

## Contractual arrangements

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. The CEO, as a Russia-based member of the Management Board, also has an employment contract 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.

## Clawback

The Supervisory Board may recover from members of the Management Board 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.

## Other remuneration components

Members of the Executive Board may be offered a number of other arrangements, such as an expense allowance, medical insurance, accident insurance and life insurance, in accordance with Company policy. The Company's policy does not allow personal loans or guarantees to members of the Executive Board, nor does the Company provide pension arrangements for members of the Executive Board.

## Severance arrangement

The severance payment is limited to a maximum of six months' base salary for Management Board members. The Supervisory Board reserves the right to agree to a different amount if required under individual circumstances. No severance pay is awarded if the agreement is terminated at the initiative of the Executive Board member or in the event of seriously culpable or negligent behaviour on his/her part.

## Insurance and indemnity arrangements

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

Although the insurance policy provides broad 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 the director or officer in question. Similar indemnities granted by the Company to members of the Supervisory Board were approved by the 2016 Annual General Meeting of Shareholders.

# 2018 Management Board Remuneration

The Management Board remuneration for 2018 is in accordance with the remuneration policy for members of the Management and Executive Board adopted at the General Meeting of shareholders on 7 May 2015.

The following table provides an overview of the Management Board's actual remuneration that became unconditional in 2018 or at year end (in millions of Russian roubles). For disclosures in line with IFRS reporting requirements, which are accrual-based over earning/performance periods and partly depend on estimations/assumptions, see note 8 "Related-party transactions" on page 254.

Name	Year	Base salary	Short-term incentive	Long-term incentive	Share based compensation	Social security cost	Total
I. Shekhterman	2018	60	59	183	1	44	347
	2017	46	36	211	8	43	344
F. Lhoëst	2018	20	13	-	-	-	33
	2017	18	10	-	-	-	28
<b>TOTAL</b>	<b>2018</b>	<b>80</b>	<b>72</b>	<b>183</b>	<b>1</b>	<b>44</b>	<b>380</b>
	<b>2017</b>	<b>64</b>	<b>46</b>	<b>211</b>	<b>8</b>	<b>43</b>	<b>372</b>

## Ad (1) – Base salary

In 2018, the Supervisory Board reviewed and approved an adjustment within the total remuneration package for the members of the Executive Board, based on a base salary benchmarking analysis in combination with the introduction of a new long-term incentive plan designed to create greater balance between short- and long-term compensation. Accordingly, in line with compensation levels in peer group companies, Mr. Shekhterman's annual base salary was increased to RUB 70,000,000 (2017: RUB 42,000,000). The table reflects actual base salary amounts, including adjustments based on the number of days spent on vacation and business trips in 2018, in accordance with Russian labour law.

For Mr Shekhterman, the Supervisory Board has applied its discretionary authority to deviate from the remuneration policy in the same way that it had previously done for Mr DuCharme when in office as CEO specifically for hiring and retention purposes and to safeguard continuity in the interest of the Company and its shareholders, as Mr Shekhterman's leadership and skills are considered to be crucial for the continuity of the Company's growth and success. As disclosed when Mr Shekhterman took office in 2015, his reward package does not include a severance entitlement; instead, he will be entitled to a minimum annual compensation package of USD 4,000,000. Should the minimum annual compensation exceed the total annual remuneration

based on fixed and variable components, Mr Shekhterman will be entitled to the difference upon completion of his full term as CEO.

## Ad (2) – Short-term incentive

Short-term incentives are based on results achieved in 2018 and payable in 2019. For 2018, the Supervisory Board determined that 50% of the total on-target bonus opportunity for the CEO depends on achieving quantitative financial performance measures, and 50% on individual performance measures. Financial performance measures consist of elements related to the Company's operational performance, including EBITDA and return on investment, with a profitability threshold as a condition for STI payout. For the Company Secretary, the STI is based on achievement of individual performance measures, also with a profitability threshold as a condition for STI payout. The on-target payout as a percentage of base salary is set at a level of 100% for the CEO and 60% for the Company Secretary. The achievement of all performance targets was assessed and determined by the Supervisory Board for each Management Board member individually. As of 31 December 2018, all financial targets set for the CEO by the Supervisory Board, in particular operating margin and return on investment, were achieved above target within a 110% outperformance range. Taking into account achievement levels of individual performance measures, this resulted in payouts of 103% of base salary for Mr Shekhterman and 58% of base salary for Mr Lhoëst.

### Ad (3) – Long-term incentive

The 2015-2018 LTI programme came to an end when targets under the second stage of the programme were achieved in 2017. Under the programme’s deferred payout mechanism, 50% of the total award under the second stage of the programme was paid to Mr Shekhterman in 2018, with a final 50% deferred payout in 2019.

## Internal pay ratio

The ratio of the total salary expense of the Management Board vs. total average salary expense per employee (excluding LTI) is presented in the table below:

Pay ratio between	Year	Ratio
X5 CEO vs. X5 employees	2018	209:1
	2017	174:1
Company Secretary vs. X5 employees	2018	58:1
	2017	61:1

The pay ratio is calculated by dividing the total remuneration of the respective Management Board members by the average remuneration of all X5 employees over 2017 and 2018 to convey the year-on-year changes. The average remuneration per employee is calculated as the total labour costs derived from note 27 on page 268 divided by the number of employees on an FTE basis. Given the irregular nature of awards under the LTI programme and the fact that not every member of the Management Board participates in the LTI programme, LTI awards are not included in the pay ratio for fair and consistent presentation purposes.

As is commonly understood, pay ratios are specific to the company’s industry, geographical footprint and organisational model. As a major food retail company, the relatively small number of executive staff vs. operational staff in stores and warehouses across seven federal districts in Russia adds to the variety of pay within the Company and substantially differentiates the average employee compensation with compensation levels of Executive Board members. For companies in other industries, this will be different. Furthermore, pay ratios can be volatile over time, as they can greatly depend on the Company’s annual performance since that performance impacts the remuneration of the Executive Board much more than of all other employees.

## Remuneration policy in 2019 and beyond

In 2018, the remuneration policy as described in this report was applied. It is the intention that the current policy will in principle be continued in the next financial year and beyond.

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### The Supervisory Board

19 March 2019