Remuneration

This report outlines the remuneration policy of the Company's Management Board of as well as the actual remuneration of the Management Board for the 2017 financial year. This report also addresses the way in which the remuneration policy will be applied in the 2018 financial year and beyond. Further details of actual remuneration for the Management Board and Supervisory Board in 2017 can be found in notes 26 and 27 to the Consolidated Financial Statements.

Remuneration policy

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 qualified executives who will lead the Company on a sustainable basis in achieving its strategic objectives
- to balance short-term operational performance with the Company's long-term objectives 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. On a going-forward basis, the Committee takes into account pay ratios within the Company and in comparison with the peer group, whereby it is important to note that pay ratios across industries are impacted by the different mix of functions from one industry to another. Even within the same industry, comparing pay ratios is challenging due to different market conditions within the Company's geographical footprint.

Upon the 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

Benchmarking is applied to X5 base salaries and variable salary components. Executive Board remuneration is targeted at 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.

Total direct compensation

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

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

Base salary

Base salaries are specified in individual contracts with members of the Executive Board and reflect their respective qualifications, experience, expertise and responsibilities. The levels of base salaries are determined by (i) benchmarking with industry peers, as described above, and (ii) the specific responsibilities of the individual member of the Executive Board. The annual review date for base salaries is April 1.

Short-term incentive (STI)

The annual incentive for members of the Executive Board is predicated upon both quantitative financial indicators and individual targets. The on-target payout as a percentage of base salary is 100%, contingent on the objectives 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 annual incentive targets and their relative weight, 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 comprise components related to the Company's operational performance, including net revenue and return on invested capital (ROIC), as well as a profitability threshold as a condition for STI payout. The individual targets include leadership, 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 to be commercially sensitive.

Long-term incentive (LTI)

The LTI is a cash incentive programme in two stages over a five-year period from 1 January 2015 until 31 December 2019. The programme awards the Company's senior executives and other key employees for the achievement of ambitious goals during each applicable performance cycle. LTI targets have been structured to align the long-term interests of shareholders and management on a sustainable basis. The targets reflect the Company's strategic direction approved in 2014, a specific focus on net revenue and market share relative to the competition within each performance cycle, without sacrificing EBITDA margin or incurring undue risk. The second stage of the programme starts once the targets under the first stage 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. Specifically, the deferred components are conditional upon maintaining achieved targets, including leadership in net revenue terms, during an extended 12-month period, with final deferred payouts under the second stage in 2019. 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 level. For each LTI participant, total LTI payout may be adjusted downwards based on individual performance during the period of the programme.

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.

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 and guarantees to members of the Executive Board, nor does the Company provide pension arrangements for members of the Executive Board.

Contractual arrangements

Management Board members are appointed for a four-year term, to be extended upon reappointment by the Annual General Meeting of Shareholders. Members of the Management Board are engaged on the basis of a Management Services Agreement with a four-year term and, for the CEO based in Russia, a contract of employment with an operational subsidiary in Russia. The fixed and variable salary components stipulated in each contract reflect the responsibilities of the relevant Management Board member in the Netherlands and/or in Russia.

Clawback

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.

Severance arrangement

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

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.

2017 Management Board remuneration

The following table provides an overview of the Management Board's actual remuneration that became unconditional in 2017 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 pages 222-223.

Expenses recognised for remuneration of the members of the Management Board:

Name	Year	Base salary[1]	Short-term incentive[2]	Long-term incentive[3]	Share based compensation	Social security cost	Total
I. Shekhterman	2017	46	36	211	8	43	344
	2016	47	52	296	1	59	455
F. Lhoëst	2017	18	10	–	–	–	28
	2016	20	6	10	–	–	36
TOTAL	**2017**	**64**	**46**	**211**	**8**	**43**	**372**
	2016	**67**	**58**	**306**	**1**	**59**	**491**

Ad (1) - Base salary

In 2017, Mr. Shekhterman's annual base salary remained unchanged at the level of RUB 42 million. The table reflects actual base salary amounts, including adjustments based on number of days spent on vacation (as well as business trips in 2016), 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, thereby securing continuity. As such, Mr. Shekhterman's reward package does not include a severance entitlement and, instead, he will be entitled to a minimum annual compensation package of USD 4,000,000. Should, in a given year, the minimum compensation to which the CEO is entitled exceed the total annual remuneration based on fixed and variable components, Mr. Shekhterman will receive the difference upon completion of his full term as CEO.

Ad (2) – Short-term incentive

Short-term incentives are based on results achieved in 2017 and payable in 2018. For 2017, the Supervisory Board determined in advance that the achievement of Company performance targets represented an 80% weighting of the total on-target bonus opportunity for the CEO, while his individual performance targets had a weighting of 20%. Group targets consist of elements related to the Company's operational performance, including net revenue and return on invested capital (ROIC), with a profitability threshold as a condition for STI payout. For the Company Secretary, the STI is based on achievement of individual targets, 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. With regard to financial targets, the Group achieved EBITDA above the target threshold. Other group targets, including the net revenue target, were partially met, albeit within the target range set by the Supervisory Board. The achievement of performance targets was assessed and determined by the Supervisory Board, resulting in payouts of 85% of base salary for Mr. Shekhterman and 55% of base salary for Mr. Lhoëst.

The Supervisory Board

28 March 2018

Ad (3) – Long-term incentive

The targets set for the first payout under the second stage of the LTI were achieved as per 31 March 2017, as specific comparative performance indicators were met, and EBITDA also exceeded the target threshold. Pursuant to the rules of the LTI programme, 50% of the achievement award is payable in 2018, and 50% is deferred to 2019, subject to maintaining the comparative performance against the competition in 2018. For Mr. Shekhterman, the expense recognised for the long-term incentive reward is composed of two elements: (i) accrual for 2017 with respect to the first payout under the second stage of the LTI programme, and (ii) accrual based on the probability of achieving the targets under the second stage of the LTI programme as per 31 December 2018.

Internal pay ratio

The pay ratio of CEO compensation compared to the average employee compensation during 2017 is 161:1. This pay ratio is obtained by dividing the 2017 remuneration for the CEO by the 2017 average remuneration per employee of X5. The pay ratio was calculated based on following methodology: annual remuneration of the CEO (base salary and short-term incentive) compared with total annual remuneration of X5 employees, divided by the number of employees on a FTE basis. Awards under the long-term incentive programme are not included in the pay ratio.

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 from compensation levels of Management Board members. For companies in other industries, this will be different. Furthermore, pay ratios can be volatile over time, as they can depend heavily on the Company's annual performance since that performance impacts the remuneration of the Management Board (and Executive Board) much more than all other employees.

Pay ratio between	Year	Ratio
X5 CEO and X5 employees	2017	161:1
	2016	198:1
Company Secretary and X5 employees	2017	61:1
	2016	53:1

Remuneration policy in 2018 and beyond

As described in this remuneration report, the targets under the second stage of the LTI programme were achieved in 2017. Since the launch of the programme, X5 has made significant progress in achieving the long-term strategic targets set by the Supervisory Board in 2014, including becoming the largest food retailer in Russia by revenue. Building on this achievement, the targets under the second stage of the LTI programme were achieved in 2017, as described in this remuneration report. Subject to meeting the sustainability criteria set out in the LTI programme, management expects that the targets for the deferred component under the second stage of the LTI programme are likely to be met at the end of 2018, with payouts to take place in 2019.

Whereas the LTI 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 recognises 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.

In view of this transition, the Supervisory Board developed in 2017 a new LTI programme that will be submitted for approval to the 2018 Annual General Meeting of Shareholders. The new programme is specifically designed for a wider group of participants within the Company and is aimed at creating greater balance between the short- and long-term compensation of the programme participants.

The new LTI targets are structured to align the long-term interests of shareholders and management, with a continued focus on revenue and, as an additional long-term objective, leadership in terms of enterprise value multiple, relative to competition. Additionally, the new LTI includes triggers relating 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. Consistent with the current LTI programme, the new programme is designed with a conditional payout as a deferred component subject to continued achievement of targets beyond the end date of the programme. This creates a focus on long-term goals throughout the programme and provides an effective mechanism for motivating and retaining members of management who are critical to the Company's ongoing success.