Remuneration Committee Report

> *The revised Directors' Remuneration Policy that we will be submitting for shareholder approval at this year's AGM builds to the changes we made last year to comply with the UK Corporate Governance Code and to further align with best practice.*

Jill Caseberry
Chair of the Remuneration Committee

CHAIR'S LETTER

Dear Shareholder

On behalf of the Remuneration Committee, I am pleased to present the Remuneration Report for the financial period ended 3 April 2020.

The Report consists of three sections:

- A summary of the pay outcomes for FY20, and our approach for FY21;
- The 2020 Directors' Remuneration Policy – in accordance with the Directors' Remuneration Reporting Regulations, Halfords is bringing a revised Directors' Remuneration Policy to the Annual General Meeting ("AGM") in September 2020 for shareholder approval; and
- The annual Directors' Remuneration Report – this summarises the remuneration outcomes for FY20 and explains how we intend to apply the Remuneration Policy in FY21.

2020 Directors' Remuneration Policy

For Executive Directors, Halfords operates an annual bonus with deferral plus a performance share plan. The Committee believes that this framework remains appropriate to support the Company's execution of the strategy and long-term shareholder value creation. The 2020 Directors' Remuneration Policy (the "Policy") that we are putting forward for shareholder approval at the 2020 AGM is therefore largely the same as the 2017 Directors' Remuneration Policy. The Committee has, however, made a number of changes to the Policy to reflect the introduction of the 2018 UK Corporate Governance Code (the "Code") and to align with best practice.

Key Area for FY21
Continuing to keep our approach to Directors' remuneration under review to ensure that it supports the business as we recover from the impact of COVID-19 and as we continue to execute our Strategy and our focus on service-related revenue increases.

6 **Remuneration Committee meetings held**

In last year's Directors' Remuneration Report I outlined a number of changes to our approach which have now been formalised as part of the 2020 Policy. These changes included:

- **Pensions** – for any new Executive Directors appointed to the Board the pension opportunity will be in line with the maximum employer contribution available for the majority of the workforce. In addition, mindful of shareholder guidance the Executive Directors have, however, agreed to reduce their pension in line with the rate available for the wider workforce from 1 April 2023.
- **Malus and clawback** – malus and clawback provisions have been expanded to include a broader range of circumstances, including a material failure of risk management, corporate failure and serious reputational damage.
- **Discretion** – incentive arrangements include the ability to exercise discretion to adjust incentive pay-outs (both upwards and downwards) if the original outcome is not considered to reflect the underlying financial or non-financial performance of the business or where the outcome is not considered appropriate in the context of the experience of shareholders or other stakeholders over the performance period.

In light of the Code and evolving market practice, as part of the policy review, the Committee has also introduced a post-employment shareholding guideline to support the alignment of interests between Executive Directors and shareholders following an Executive Director's departure from the Board. Under this guideline, Executive Directors will be expected to retain their shareholding guideline (200% of salary) for a period of two years post stepping down as an Executive Director. This guideline will apply to any performance incentive shares that vest from 1 April 2020.

Implementation of Remuneration Policy for FY21

Base Salary

Base salaries for Executive Directors were increased by 1.8% with effect from 1 October 2019 in line with the rate of increase received throughout the workforce. Salaries from 1 October 2019 are therefore £555,523 for the Chief Executive Officer ("CEO") and £365,300 for the Chief Financial Office ("CFO").

Pension

Executive Directors currently receive a pension allowance of 15% of base salary. The Committee carefully considered the level of pension allowance for Executive Directors and no changes have been made to this allowance for FY21. Whilst the Committee acknowledges that this level of pension is above the rate that is available to the wider workforce in the UK, the Committee did not consider that it was appropriate to lower the pension allowance for Executive Directors at this stage, given their existing contractual entitlements and short period of tenure. However, mindful of shareholder guidance that pensions for Executive Directors should be aligned with the pension provision available for the wider workforce, the Executive Directors have, however, agreed to reduce their pension to be in line with the rate available for the wider workforce from 1 April 2023.

Performance Based Incentives

On 7 November 2019 we set out our intention to accelerate the growth of the motoring services business, to generate higher and more sustainable financial returns for shareholders. The Committee has therefore reviewed performance measures for the annual bonus plan and performance share plan to ensure that they are appropriate in the context of our evolving strategy, current economic climate and the steps the business needs to take over the short and medium term to ensure we continue to recover from the impact of COVID-19.

Annual Bonus

The normal maximum annual bonus opportunity is 150% of base salary.

For FY21 the annual bonus performance will be based 77.5% on financial measures (Net Debt 30%, Cost Reduction 25%, Underlying Group PBT (post exceptions) 15%, Operating Cashflow 7.5%) and 22.5% on strategic measures. The strategic measures for FY21 are NPS, Employee Engagement and Digital Sales to incentivise management to drive sales in key strategic segments while improving the customer experience.

The Committee retains the discretion to adjust the annual bonus outcome if it is not considered to be reflective of underlying financial or non-financial performance of the business, the performance of the individual or where the outcome is not considered appropriate in the context of the experience of shareholders or other stakeholders.

Performance Share Plan ("PSP")

The normal PSP award is 200% of base salary. The Committee is mindful of shareholder guidance that award levels should be adjusted where the share price has fallen significantly compared to prior years. The Committee will take this into account when determining award levels in September.

2020 PSP awards will be based on the following performance measures (in 2019 awards were based 50% on EPS growth, 25% on Group Revenue Growth and 25% on Free Cash Flow):

- 20% based on EPS growth
- 10% based on Group Services-Related Revenue
- 30% based on Free Cash Flow
- 40% based on relative Total Shareholder Return vs. the constituents of the FTSE All-Share General Retailers Index at the share of the performance period.

The vesting of awards is subject to the achievement of a net debt underpin.

Given our strategic focus on increasing services-related revenue the Committee considered that it was appropriate to replace Group revenue with a more focused services-related revenue metric to incentivise and reward management for delivering against the Strategy. Vesting in respect of this portion will also be subject to the Company maintaining an appropriate margin on services revenue.

Group revenue will not be included as a performance measure for 2020. Whilst, growing Group revenue continues to remain an important strategic objective for the Company, the Committee wanted to incentivise a clear focus on growth in Group Services-Related Revenue over the next three years given the criticality of this to future shareholder value creation. Relative Total Shareholder Return has also been introduced as a performance measure to ensure that PSP outcomes are aligned with the value we have returned to our shareholders relative to our key retail peers. Free Cash Flow continues to be included as performance measures for the PSP reflecting our ongoing focus on earnings growth and our objective to increase free cash flow outlined at the capital markets day in September 2018 to strengthen the business over the longer term, as does EPS growth which the Committee considers incentivises management to both grow revenue and manage cost in a balanced way.

Our normal practice is to grant awards in September. In light of this and the continuing economic and business uncertainty facing the Company the Committee has not set financial targets for the 2020 PSP at this time. The Committee intends to set targets in advance of award and targets will be disclosed as part of the RNS at the time of award. In line with prior years the Committee will set targets which are considered to be appropriately stretching in the context of the business' evolving strategy and business circumstances.

As with the annual bonus, the Committee retains the discretion to adjust the PSP vesting outcome if it is not considered to be reflective of underlying financial or non-financial performance of the business or the performance of the individual or where the outcome is not considered appropriate in the context of the experience of shareholders or other stakeholders.

FY20 Performance Share Plan awards

In last years' Directors' Remuneration Report we indicated our intention to grant PSP awards of 200% of base salary to Executive Directors. The Committee continued to monitor the Company's share price performance prior to the grant of awards in September 2019. The Committee determined that taking into account the Company's share price at that time compared to the share price used to determine the 2018 PSP award, it was appropriate to reduce the PSP awards granted to 175% of salary.

Remuneration Outcomes for FY20

Annual bonuses for FY20 were based 80% on Group PBT performance and 20% on Strategic KPIs. Any payment under the strategic element of the bonus is subject to the threshold PBT target being met. The threshold target was not met and the Committee did not therefore award any payments to Directors under the scheme. Whilst the Committee concluded that the threshold would have been achieved and payments triggered, had the business not experienced the impact of widespread store closures in the final week of the financial year, arising from the COVID-19 pandemic, the Committee concluded the proposed incentive outcomes are appropriate in the context of the shareholder experience.

Our CEO, Graham Stapleton, received a PSP award upon appointment in January 2018, based 75% on EPS performance and 25% on Group Revenue performance. This award was made in line with the PSP awards made to other Group senior executives in September 2017. The EPS and Revenue performance targets for these PSP awards have not been met and therefore no portion of these awards shall vest.

Concluding Remarks

I hope that you find the Report clear, transparent and informative. The Committee has sought to promote a remuneration environment that strongly aligns the commercial direction of the Group with the interests of shareholders, whilst reflecting best practice developments and market trends. I look forward to your support on both the 2020 Directors' Remuneration Policy and the 2019/20 annual Directors' Remuneration Report at the Company's Annual General Meeting.

Jill Caseberry
Chair of the Remuneration Committee
6 July 2020

Directors’ Remuneration Policy

2020 Directors’ Remuneration Policy – Key Principles

The Committee seeks to support the delivery of the Group’s strategy through establishing appropriate remuneration arrangements. Our goal is to build a strong long-term sustainable business by delivering ongoing sales growth and shareholder returns through an enhanced focus on services-related revenue alongside our traditional authoritative ranges of products, colleague and service excellence, digital participation and helpful retail and service environments.

The overall Remuneration Policy of the Committee, and of the Board, has been developed taking into account the following principles:

- **Simple, clear and aligned with our culture and purpose** – the remuneration framework has been designed to be simple and transparent to ensure that it is clear to shareholders, participants and other stakeholders. Our Policy is that Executive Directors only participate in an annual bonus and the performance share plan to ensure this simplicity. Incentive opportunities are capped so that the maximum potential pay-out under each scheme is clear. This simple reward framework is aligned with Halfords’ culture and purpose of working together to achieve our strategic goals.
- **Attract and retain whilst remaining appropriate, taking into account external and internal comparisons** – enable the Group to attract and retain management of a high calibre with the necessary retail, customer service, financial, digital and service-industry skills and credentials required to deliver a sustainable business model and drive shareholder returns. Remuneration arrangements are set at levels appropriate to achieving this goal without paying more than is considered necessary. The Committee considers external and internal reference and ratios when determining the reward framework for Executive Directors. External market data is reviewed at appropriate intervals to inform the positioning of Executive Directors’ pay relative to the companies of a similar size and in similar sectors, without seeking to ‘match the median’, to identify and mitigate the risk of losing strong performers. The Committee also regularly reviews remuneration arrangements for the wider workforce population to ensure that Executive Director’s pay structure and levels are appropriate in this context.
- **Link variable pay to performance and the delivery of the agreed Strategy** – provide management with the opportunity to earn competitive remuneration through annual and long-term variable pay arrangements that are designed to support delivery against key financial, strategic and shareholder value creation objectives. Performance measures are aligned with strategic goals so that remuneration arrangements are transparent to executives, shareholders and other stakeholders. Different elements of Executive Directors’ pay are delivered over the short and longer term and are designed to ensure that a substantial proportion of the Executive Directors’ remuneration is variable and performance-related.
- **Align Executive Directors with shareholders** – ensure management’s interests are aligned with those of shareholders by incentivising management to deliver the Group’s long-term strategy of a sustainable, growing business and thus enhance shareholder value. A significant portion of reward is delivered in shares to create alignment of interests. Executive Directors are required to build up a shareholding in Halfords which they are expected to maintain whilst in employment and post-employment to provide an extended period of alignment with shareholders.
- **Drive sustainable performance** – remuneration arrangements are designed to support the sustainable delivery of performance and to prevent excessive risk-taking. We carry out a robust target-setting process each year taking into account our strategic plan as well as external expectations of performance. Targets are set to ensure that the maximum remuneration can only be earned for delivering exceptional performance whilst not encouraging excessive risk-taking. Our Policy includes provisions which enable the Committee to exercise discretion to ensure that incentive outcomes are appropriate and which allow for the application of clawback and/or malus in specific negative circumstances.

2020 Directors’ Remuneration Policy

Pages 123 to 131 of this report sets out the Directors’ Remuneration Policy (the “Policy”) that the Company intends to apply, subject to shareholder approval, with effect from 15 September 2020 (the date of the (“AGM”)). It is intended that this Policy will apply until the 2023 AGM, unless the Company seeks shareholder approval for a revised Policy which comes into force before this date.