Remuneration Committee Report

Jill Caseberry

Chair of the Remuneration Committee

The Committee has carefully considered recent developments in corporate governance, particularly the publication of the new UK Corporate Governance Code and agreed changes in a number of areas to reflect best practice.

Chair's Letter

Dear Shareholder

On behalf of the Remuneration Committee, I am pleased to present the Remuneration Report for the financial period ended 29 March 2019.

Claudia Arney stepped down from the Board on 1 March 2019 having served nine years on the board as an independent Non-Executive Director. I replaced Claudia as Chair of the Remuneration Committee from this date and I would like to thank her for both her contribution to the Remuneration Committee over the years and her support during the handover.

The Report consists of three sections:

- Annual Statement – A summary of the key messages on pay for FY19, and our approach for FY20;
- Summary Remuneration Policy Report – The Company's Remuneration Policy (the "Policy") was approved at the 2017 AGM. No changes have been made to the Policy and accordingly, we are not seeking approval for a new Policy this year. A copy of our full Policy is available on our website; and
- Annual Directors' Remuneration Report – This summarises the remuneration outcomes for FY19 and explains how we intend to apply the Remuneration Policy in FY20.

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4 Remuneration Commitee meetings held

Key Areas for 2018/19

- Reviewing the new UK Corporate Governance Code and other developments in shareholder guidance and considering the Company's response
- Determining remuneration packages for joining and departing executive directors
- Setting performance targets for 2019/20 bonus and PSP awards which are appropriately stretching in the context of the business' evolving strategy and business circumstances

FY19 Business Context

Despite a challenging UK consumer environment the group delivered like-for-like sales growth of +1.1%. Underlying Profit Before Tax of £58.8m was disappointing down £12.8m, this was primarily driven by a lower motoring mix year-on-year due to mild winter temperatures, weakened consumer confidence in the run up to Christmas, retail cost inflation and investment in strategic projects. Cash generation remains strong, and despite unseasonal weather and Brexit related challenges, the Group reduced stock holding through effective inventory management. Services-related sales represent 24% of the overall Group sales, this is an improvement year-on-year and supports our credentials as a service-led retailer.

Remuneration Outcomes for FY19

Annual bonuses for FY19 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. Group PBT targets were not met and therefore no bonuses were paid in respect of FY19.

The current Executive Directors were not in the business when PSP awards were granted in 2016. Other Senior Executives within the business, however, received awards based 75% on EBITDA performance and 25% on revenue growth performance. Performance targets were not met and therefore no portion of these award shall vest.

Remuneration Policy Implementation

2018 PSP awards

In September 2018 the Chief Executive Officer, Graham Stapleton, set out a new vision for Halfords which focused on investing in our offering to create an even more specialist, unique and differentiated shopping experience for customers, to fully leverage the combined strength of the Retail services and Autocentres businesses and to harness the power of data to build lifelong relationships with customers. Further details of this strategy are set out on pages 24 to 25.

In light of the ongoing review and development of our strategy, the PSP award for 2018 was delayed until October to ensure that the performance measures and targets fully aligned with our ongoing strategy. At the September Capital Markets Day, Graham set out the Group's ambition to deliver improved Free Cash Flow through a combination of: (i) improved operating cash flows as a result of our customer strategy; (ii) a disciplined approach to capital expenditure; and (iii) improvements in working capital though a focus on stock and creditors. Given this strategic focus, it was announced at the Capital Markets Day that the Committee determined that it was important that Free Cash Flow was included as a performance measure for the 2018 PSP in respect of 25% of the award to support management in achieving these objectives. The performance targets for 2018 PSP awards are set out on page 102.

Remuneration for FY20

The CEO's salary was reviewed and increased by 2% to £545,700 with effect from 1 October 2018. This increase is in line with the increases awarded across the wider workforce. Loraine Woodhouse joined the Board on 1 November 2018 in the role of CFO. Her salary was set at £350,000 per annum.

The maximum annual bonus opportunity remains at 150% of base salary. Annual bonuses continue to be based 80% on Group PBT performance and 20% on strategic objectives. For 2019/20 the strategic measures for the annual bonus will be based on NPS, employee engagement, Group services-related revenue and Operating Cash Flow. Given the broadening of the strategic focus set out at the Capital Markets Day and the strategic importance of delivering strong cash flow the Committee considered that these metrics are appropriate.

The maximum PSP awards will continue to be 200% of base salary. Performance measures will be the same as for 2018 awards – 50% based on EPS growth, 25% based on revenue growth and 25% based on free cash flow. Performance targets have been set to be challenging but realistic taking into account expected performance over the next three years. Targets are set out on page 107.

The Committee carefully considered whether it would be appropriate to reduce the level of PSP awards for FY20 in light of the share price which has fallen by around 25% since the FY19 awards were granted. However, given the increase in the stretch of the targets for FY20 awards and the fact that management are relatively new in role, the Committee considered that it was appropriate to maintain the current award level to ensure that management are fully incentivised to drive performance and deliver value for shareholders over the next three years.

Changes to Reflect the Code

During the year the Committee has been carefully considering recent developments in corporate governance, particularly the publication of the new UK Corporate Governance Code.

In response to the new Code, the Committee has determined that for any new Executive Directors appointed to the Board from 1 April 2019, the pension opportunity will be reduced from 15% of salary to 3% of base salary, in line with the policy for the majority of the workforce.

Taking into account shareholder guidance we have expanded our malus and clawback provisions to reflect a broader range of circumstances including a material failure of risk management, corporate failure and serious reputational damage. We have also taken steps to ensure that the Committee has the ability to exercise discretion if appropriate. If a situation arises where the Committee could exercise its discretion it will only do so in compliance with the principles set out in the Code.

Remuneration Review

During 2019/20, the Committee will be undertaking a thorough review of our Remuneration Policy in advance of submitting a new Policy to shareholders at the AGM in 2020 in accordance with the DRR reporting regulations. The focus of this review will be on ensuring that our remuneration arrangements remain appropriate in the context of our evolving strategy and business circumstances and the approach taken for the wider workforce. As part of this review we will also consider our approach to post-employment shareholding guidelines.

Executive Director Changes

During the year, Jonny Mason left the Board and Loraine Woodhouse joined in the role of CFO. In considering the appointment and departure terms for these individuals, we have sought to act fairly and not pay any more than is necessary, while wishing to ensure a successful transition between individuals for the benefit of Halfords and our shareholders.

Loraine Woodhouse

Loraine Woodhouse joined the Board on 1 November 2018. Her remuneration arrangements are in line with our Remuneration Policy.

In April 2019, Loraine was made a payment of £7,909 to reflect the pro-rated bonus she forfeited on leaving her previous employer Waitrose. This amount was of equivalent value to the payment she would have received in her previous role, taking into account performance achieved. This amount was paid at a similar time to the forfeited payment.

Leaving Arrangements for Jonny Mason

In March 2018, it was announced that Jonny Mason had resigned from his role as CFO and he left the business on 31 July 2018. As set out in last year's report, Jonny received the cash element of his FY18 bonus. On cessation of employment, Jonny forfeited the deferred element of his FY18 annual bonus, together with all other unvested Deferred Bonus Plan, Performance Share Plan, and Sharesave awards.

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 at the Company's Annual General Meeting.

Jill Caseberry

Chair of the Remuneration Committee

21 May 2019