

DIRECTORS' REPORT ON THE PROPOSALS ON THE AGENDA OF THE ORDINARY GENERAL MEETING OF THE SHAREHOLDERS (17TH APRIL 2013 SINGLE CALL)

Report on item 2 on the agenda

2. Remuneration policies in accordance with article 123-ter of Legislative Decree No. 58/98; relative and consequent resolutions.

To Our Shareholders,

In compliance with article 123-ter of Legislative Decree No. 58/1998 (Consolidated Finance Act) and article 84-*quater* of the Issuers' Regulations issued by the Consob with Resolution No. 11971 of 14th May 1999 and subsequent amendments (hereinafter the "Issuer's Regulations"), Section I of the Report on Remuneration is given below, approved by the Board of Directors on 7th March 2013, on the recommendation of the Remuneration Committee.

In accordance with article 123-ter, paragraph 6, of Legislative Decree No. 58/1998, the Shareholders' Meeting convened pursuant to paragraph two of article 2364, and that is to approve the separate annual financial statements, shall vote either in favour or against the section on the remuneration report required by paragraph three of that article, which is to say on the first section of the remuneration report.

That section illustrates the following:

- a) the policies of the company on the remuneration of members of management bodies, general managers and senior executives with key responsibilities with reference to at least the subsequent financial year;
- b) the procedures used to set and implement that policy.

That vote is not binding. The result of the vote shall be disclosed to the public in accordance with Art. 125-*quater*, paragraph 2 of Legislative Decree No. 58/1998.

In consideration of the foregoing, the shareholders are invited to vote on the section of the Report on Remuneration specified in paragraph 3 of Art. 123-ter of Legislative Decree No. 58/1998.

The Report on Remuneration will be made available to the public within the legal time limits and may be consulted on the company website at www.recordati.it.

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2013 REMUNERATION POLICY

Procedures used for the adoption and implementation of the Remuneration Policy: bodies and persons involved to formulate and approve the Remuneration Policy and the bodies and persons responsible for the proper implementation of that policy.

The Remuneration Policy is approved by the Board of Directors of the Company on the basis of a recommendation made by the Remuneration Committee, the composition, responsibilities and functioning of which are described in detail in the following sub-section.

After approval by the Board of Directors, the Remuneration Policy is subject to a non binding vote by the Shareholders' Meeting held to approve the annual report.

The Remuneration Committee is supported by the Head of the Human Resources Department of the Group and by the General Manager for the Co-ordination of Operations in the formulation of a proposal on the Remuneration Policy to be submitted to the Board.

While no specific intervention by independent experts occurred in the formulation of the Remuneration Policy, account was taken in its formulation of the salary policies pursued by other companies in the sector as constantly monitored by benchmarking salary surveys and by annual reports on executive remuneration and corporate governance such as the annual report developed by leading consultant firms.

The Remuneration Policy may be updated if necessary or appropriate by the Board of Directors, on the basis of a recommendation by the Remuneration Committee, which is responsible for periodic assessment of its appropriateness, overall consistency and concrete application, as described in detail below.

The Board of Directors complies with the Remuneration Policy, which takes into consideration the conditions and practices for similar markets in defining the remuneration of: the Chairman and Chief Executive Officer, inclusive of the remuneration received as General Manager; the other Directors occupying specific positions; the non executive directors.

The Chairman and Chief Executive Officer refers to the Remuneration Policy in setting the remuneration of key management personnel and other senior managers in the Recordati Group.

Without prejudice to the responsibilities of the Remuneration Committee, the Board of Directors is responsible for the following: (i) deciding the remuneration of directors occupying specific positions pursuant to article 2389, paragraph 3 or the Italian Civil Code; (ii) the allocation of the total remuneration for directors set by shareholders, if they have not done so; (iii) the examination of stock option plans to be submitted for shareholder approval and deciding the grant of options in implementation of those plans.

Furthermore, the Board of Directors, supported by the Remuneration Committee, oversees the implementation of the remuneration policy.

The Remuneration Committee

As indicated above, a proposal to the Board of Directors on Remuneration Policy was formulated by the Remuneration Committee.

The Company created a Remuneration Committee in 2001, in compliance with corporate governance code recommendations. Furthermore, when the Related Party Transaction Regulations were approved, the Board assigned responsibility to the Remuneration Committee for the formulation of an opinion (non binding or binding according to the case) on related-party transactions concerning the remuneration of the members of the management and supervisory bodies and key management personnel, without prejudice to the provisions of Art. 2.01 f) of the aforementioned Regulations.

The current committee was appointed by the Board on 13th April 2011 and is composed of *Prof. Silvano Corbella*, the Chairman, *Dr. Germano Giuliani* and *Dr. Umberto Mortari*, all non executive, independent directors. The Chairman *Prof. Corbella* has specific expertise on financial matters.

The functions currently assigned to the Committee are as follows:

- to formulate proposals to the Board on policies for the remuneration of directors, key management personnel and other senior managers of the Recordati Group;

- to periodically assess the appropriateness, overall consistency and concrete implementation of the policy for the remuneration of directors, key management personnel and other senior managers in the Recordati Group, making use with regard to the latter of information supplied by the CEO;
- to submit proposals or express opinions to the Board of Directors on the remuneration of executive directors and other directors who occupy specific positions and on the setting of performance objectives in relation to the variable component of that remuneration;
- to monitor the implementation of decisions made by the Board itself, verifying the actual achievement of the performance objectives;
- to perform the functions assigned by the Board of Directors in relation to the administration of plans for the grant to employees and/or Directors of the Company and its subsidiaries of shares of the Company or options on them (stock options), without prejudice to the general responsibility of the Board itself for the supervision also of this matter;
- to express an opinion, either binding or not binding, on related-party transactions of major importance and on related-party transactions of minor importance respectively, regarding remuneration, in compliance with the Related-Party Transaction Regulations.

The proceedings of meetings of the Remuneration Committee are governed by the following rules (contained in the Committee's regulations approved by the Board of Directors):

1. Committee meetings are chaired by the chairman or, in the event of his absence or impediment, by the most senior member of the Committee in terms of length of service on the Board of Directors, or in the case of equal length of service, the most senior by age;
2. responsibility for preparing minutes of meetings lies with the chairman, who shall appoint a secretary from time to time, who may also not be a member of the Committee and who is called upon to minute the meeting;
3. the Committee meets having been convened by notice in writing which indicates the place, day and time and agenda of the meeting to be given by the chairman of the Committee (or in the event of his absence or impediment by the most senior member of the Committee in terms of length of service on the Board of Directors, or in the case of equal length of service, the most senior by age) at least two days prior to the date set for the meeting to be held either at the registered offices of the Company or elsewhere in Italy, as indicated in the notice to convene the meeting;
4. remote participation in meetings of the Committee is also admissible by means of appropriate audio-video, teleconference or telephone links, on condition that all participants can be identified and that they are able to speak and at the same time examine the agenda and the related documents and pass resolutions on them. In these cases the meeting is considered as held in the place where the chairman and secretary are present;
5. the Committee is constituted and passes resolutions with the attendance and vote in favour respectively of the majority of the members in office;
6. the Chairman of the Board of Statutory Auditors or in the event of his absence or impediment another statutory auditor designated by him takes part in the proceedings of the Remuneration Committee in the capacity of a permanent guest. Other statutory auditors may in any case participate;
7. also the CEO and other corporate functions whose participation in meetings is necessary or appropriate in relation to the duties of the committee may be invited to participate from time to time on invitation of the committee and with reference to individual items on the agenda.

The Remuneration Committee has the right to access the corporate information and functions needed to perform its duties and also to make use of external consultants, under the terms and conditions laid down by the Board of Directors. The Company allocates funds to the Committee that are adequate for it to perform its duties, within the limits of the budget approved by the Board of Directors.

Objectives

The objectives pursued with the Remuneration Policy are to set remuneration which meets the following requirements:

- to be sufficient to attract, keep and motivate managers with the professional abilities required to successfully manage the organisational and operational complexity of the Company and the Group;
- to align their interests with the pursuit of the primary objective of creating wealth for shareholders over a medium to long-term time horizon;
- to leave a significant proportion of total remuneration linked to the achievement of specific performance objectives, both qualitative and quantitative, set in advance, consistent with the lines of development of the Company and the Group.

Principles and criteria

The underlying principles and governing criteria of the Remuneration Policy are as follows:

- to balance the fixed and variable components of remuneration appropriately in accordance with the strategic objectives of the Company and the Group;
- to provide a fixed component of overall remuneration that is sufficient and appropriate to remunerate services in the event that the variable component is not paid, because of the failure to achieve performance objectives;
- to set maximum limits to variable components, by linking them to qualitative and quantitative performance objectives, set in advance, that are measurable and linked to the creation of wealth for shareholders in both the short and long term;
- to encourage the fidelity of key Group personnel with incentives to remain with the Group.

Components of remuneration

With regard to members of the Board of Directors, the total remuneration set for directors by shareholders is allocated among them by the Board of Directors on the basis of the following criteria: all directors are paid a basic fee, plus an extra amount for non executive directors in relation to their appointment to each committee, with a further extra amount for non executive directors who occupy the position of chairman on those committees.

Non executive directors receive no other remuneration except for that described above and they are not therefore recipients of the benefits of the stock option plans in force.

The Chairman and Chief Executive Officer and the Vice Chairman receive an additional fee set by the Board pursuant to Art. 2389, paragraph 3 of the Italian Civil Code, in addition to the basic fee paid to each director.

The executive directors of the company (Ing. Giovanni Recordati, Dr. Alberto Recordati and Dr. Andrea Recordati) are also employees of the Company. Like other key management personnel, they therefore also receive as part of their employee relationship a total fixed salary and, if the conditions are met, short term variable remuneration based on an MBO (Management by Objectives) scheme, along with a medium to long-term variable component of remuneration, based on stock option plans.

As part of the process of appointing key management personnel or senior managers, these persons may be paid a recruitment bonus in order to attract particularly high quality human resources.

Further details are given below of the components of total remuneration for key management personnel (including the three executive directors) and other senior management figures of the Company and its subsidiaries.

- **Fixed remuneration**

The fixed component of remuneration, the gross annual salary, which is to say the contractually guaranteed annual remuneration is monitored for all top management positions by sector salary surveys and the amount is set, in order to meet the criteria of retention and adequate remuneration, in a competitive market level.

The percentage of the fixed component of remuneration as part of the overall remuneration varies from year to year depending on changes in the other components of remuneration: the amount of the short-term remuneration linked to the MBO scheme varies from year to year depending on the degree to which the company objective and individual objectives are achieved as described below. The amount of the medium to long-term variable remuneration resulting from the stock option plans is determined by the performance of the shares of the Company.

- **Short-term variable remuneration (MBO scheme)**

The variable component of salaries for key management personnel (including executive directors) and senior managers is linked to the inclusion of these roles in a management by objectives (MBO) incentive scheme.

On the basis of this scheme, a bonus is paid on the achievement of annual results defined with the Company and measured according to parameters and weightings set in advance. Bonuses are payable for individuals in amounts proportionate to the achievement of the results for the year in question and with a maximum ceiling equal to 30% of gross annual salary (GAS) excluded as established below for the Chairman and CEO.

The MBO scheme involves the assignment of three individual objectives for each person, each of which is associated with a measurement indicator: this indicator represents the reference parameter which, if reached, determines the percentage achievement of the objective to which it is related.

One objective (Group operating income budgeted) is common to all key management personnel and senior managers to which the self-financing principle of the MBO scheme applies. According to that principle, no expenses are budgeted for the variable component of salaries, which is therefore only paid if the Group objective for operating income is exceeded by at least an amount, based on actual results, equal to the variable remuneration to be paid to those persons.

The measurement indicator consists of a progressive scale, the lower end of which corresponds to 100% achievement of the objective and the upper end of which corresponds to 110% achievement of the objective, the ceiling for each objective.

A value is associated to the measurement indicator along a predetermined progressive scale for each percentage level of achievement of the objective between 100% and 110%.

Different progressive scales of the measurement indicator are possible depending on the objective. Finally the measurement indicator is descriptive for qualitative objectives (not associated with quantitative measurement indicators, such as projects of particular importance to the Company).

Each objective is also assigned a percentage of importance (or weighting ratio, which represents the proportion of the objective out of a total of 100%). The weighted average (according to the percentage weightings assigned) of the percentage achievement of the three objectives assigned gives the percentage achievement of the MBO objective of the person concerned.

The threshold to pass to receive a bonus consists of exceeding the weighted average of 100% (no bonus is paid on a weighted average of less than or equal to 100%), while for the maximum weighted average (110%) the maximum bonus of 30% of GAS is paid.

It is clear, with regard to the above, that by including the important Group operating income objective among the individual objectives of each individual, Recordati's MBO scheme tends not to reward individual performance in itself so much, but rather individual performance in a context of operating results which will allow the bonus to be paid, in line with the principle of aligning management interests with shareholder interests with a view to pursuing the long term interests of the Company.

For the Chairman and Chief Executive Officer only, by virtue of his specific and particular role, the maximum bonus is 40% of GAS. This role is also assigned two "additional" objectives for which a supplementary fixed amount bonus is paid. These are "on/off" type objectives associated with the achievement of key objectives for the development of the Group (e.g. the conclusion of an acquisition or obtaining a product license).

The right to the receipt of a bonus is acquired when the Board of Directors approves the consolidated financial statements from which achievement of the Group operating income objective set when the objective was decided is seen. The bonus is paid in the year in which the consolidated financial statements mentioned are approved. No reason has arisen, at present, to defer payment of the bonus to any significant degree with respect to the time when the right to receive it is acquired because it forms part of an MBO scheme which, with a view to continuity, lends itself to setting the same objectives each year. Furthermore, the main objective for key management personnel and senior managers, Group operating income, is an objective to which all the above persons contribute to achieving, without any single individual being able to influence that achievement exclusively. This all puts a considerable limit on the risk that short-term results will be pursued at the expense of medium to long-term results.

The objectives set for the head of the internal audit function and for the financial reporting officer are consistent with the duties assigned to them.

• **Medium to long-term variable remuneration**

The medium to long-term incentive scheme adopted by the Company is based on granting stock option rights. The stock option plans adopted by the Company are available in the relative section of the Company website on the following page http://www.recordati.it/rec_it/investors/regulated_information/stock_options.

As is typical of these types of incentive tools, the beneficiaries are granted the right to purchase a certain number of shares of the company at a set price (the exercise price), once a certain period of time has passed (the vesting period) and the condition for the achievement of the performance objective mentioned below has been satisfied. The right must be exercised before a specified expiration date (the end of the fifth or eighth year following that on which the options are granted for the 2006-2009 and 2010-2013 stock option plans respectively).

The number of options granted to each beneficiary correlates with the importance of their position occupied in the organisation chart among the various senior management figures.

On the basis of the current stock option plans, options are generally granted on a two yearly basis and according to the plans, the exercise price is established on the basis of a fair market value calculation (the arithmetic average of the share prices quoted on the stock market in the period running from the grant date of the options and the same date of the previous calendar month). The total options granted to each beneficiary are divided into four equal tranches with four different successive vesting periods: the first

tranche can be exercised (if the other conditions set by plans are satisfied) in the second year following that on which the options were granted; the second, third and fourth tranches may be exercised in the third, fourth and fifth years respectively following that in which the options were granted.

It is felt that the “staggered” vesting period described above puts a strong limitation on the likelihood that the beneficiaries of stock option plans will behave in a manner designed to increase the market value of shares in the short-term, at the expense of the creation of value over a medium to long-term time horizon.

An indispensable condition for the exercise of each tranche of options granted is the achievement of a performance objective which is that of a net consolidated income parameter.

The existence of a performance clause in the stock option plan regulations also complies with the principle whereby the Remuneration Policy is consistent with the pursuit of the interests of the Company and its shareholders, which must coincide with the interests of the management.

The current stock option plans do not require the beneficiaries to continue to hold a portion of the shares purchased following the exercise of stock options. This is because it is considered that the structure of the stock option plans as described above, with a “staggered” vesting period and expiration of the options in the fifth or eighth year following that on which they are granted, is sufficient to ensure that priority is given to the creation of wealth for shareholders over a medium to long-term time horizon.

- ***Extra performance clause***

In compliance with the underlying principles of the Remuneration Policy and in line with the objectives to attract, motivate and retain key personnel, it is also possible to pay bonuses on a one-off basis, with a maximum ceiling of 100% of Gross Annual Salary for the services of key management personnel (including the executive directors) defined as “extra performance”, which is to say performance significantly higher than the base parameters set for the assignment of both short and medium to long-term variable remuneration.

Non monetary benefits

The Remuneration Policy does not contemplate particular non monetary benefits besides those defined as standard for senior management (e.g. company car).

End of contract indemnity

The Remuneration Policy of the Company does not normally involve agreements which provide for the payment of an indemnity if a director leaves office or employment is terminated. Should an employment relationship terminate early for reasons other than just cause, key management personnel and other senior managers are paid an indemnity in accordance with the provisions of the law and of the national labour contract for the senior management of industrial companies and in some cases together with an additional amount calculated on a fair pay basis in line with practices in the sector.

Additional insurance, social security and pension cover

No additional cover with respect to that which is compulsory by law or provided under labour contracts is provided by the company except for supplementary F.A.S.I. insurance to cover medical expenses and, for the Chairman and Chief Executive Officer, to provide a life insurance policy.

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on behalf of the Board of Directors
the Chairman and Chief Executive Officer

Ing. Giovanni Recordati