

Directors' remuneration report

The Board presents its Remuneration Report to the members of the Company. In preparing this report and establishing its policy the Board has given full consideration to, and follows the provisions of, the Combined Code, the Companies Act 2006 and the relevant parts of the Listing Rules of the UK Listing Authority.

In accordance with the Companies Act, the tables setting out Directors' remuneration, benefits under long-term incentive schemes, interests in the share incentive plan, pension arrangements and Directors' interests in share options of the Company on pages 29 to 32 have been audited. The information on pages 24 to 28, 33 and 34 the Directors' interests in shares on page 30 are not required to be audited.

Constitution of the Remuneration Committee

During the year under review, Roy Brown ceased to be the chairman of the Remuneration Committee on his retirement from the Board at the close of business on 22 April 2009 and Lesley Knox succeeded him as chairman of the Committee. The Remuneration Committee also comprises Christopher Rogers, Philip Rowley and Andy Duncan (all of whom the Board considers to be independent). The Committee meets as required (not normally fewer than three times a year) on behalf of the Board. Its remit is to determine the Company's policy for executive remuneration (having regard to pay and employment conditions elsewhere in the Group, especially when determining annual salary increases), to determine the remuneration packages of the Chairman, the Executive Directors, the Company Secretary and certain other senior executives that report to Board members, including pension rights and compensation payments, and to oversee the implementation and operation of share incentive schemes. The Committee's terms of reference are available on the Company's website, www.hmvgroup.com.

Advisers

The Remuneration Committee has appointed Towers Perrin as its advisers in respect of executive salaries, incentives and employee share schemes. Towers Perrin provides no other services to the Company. In addition, the Company appointed the following advisers:

- (a) Capita Share Plan Services and Simmons & Simmons, Solicitors on employee share schemes;
- (b) Watson Wyatt LLP and Bluefin Insurance Services Limited on pension matters; and
- (c) Reynolds Porter Chamberlain LLP, solicitors, on employment contracts and associated legal issues.

The Remuneration Committee also received advice from the Human Resources Director of HMV UK Limited, who assisted the Remuneration Committee by providing recommendations on the grants under the various incentive schemes and reviewing incentive arrangements.

The Chairman of the Board, the Chief Executive Officer and the Human Resources Director of HMV UK Limited are normally invited by the Remuneration Committee to attend meetings of the Committee but are not present for any discussion about their own remuneration.

General policy

The Company's remuneration policy aims to align the interests of Executive Directors and other senior executives with those of its shareholders. It is the Remuneration Committee's policy that variable performance-related pay and incentives should account for a significant proportion of the overall remuneration package of Executive Directors so that the remuneration of Executive Directors is aligned with the Group's performance. Generally, for target performance the performance-related element accounted for about half of the total package. For superior performance this would rise to almost three-quarters of the total package. These figures exclude pension values, which can vary significantly from person to person and from year to year. The Committee confirms that there are appropriate policies and procedures in place to monitor the size of potential awards.

In setting the Company's remuneration policy, therefore, the Remuneration Committee believes that the Company should provide:

- (a) competitive rewards, which will attract and retain high calibre management necessary to enable the Company to operate in the highly competitive retail sector and which reflect individual responsibilities and experience; and
- (b) incentive arrangements which are subject to challenging performance targets reflecting the Company's objectives and which motivate executives to focus on both annual and longer term performance.

Performance targets set for the incentive schemes are designed to provide maximum awards for exceptional performance and to place emphasis on the successful delivery of short-term performance goals as well as ensuring that the Company's long-term initiatives are less dependent on annual performance. The Remuneration Committee intends that Executive Directors' basic salaries should be positioned at or around the median level in the marketplace with the incentive arrangements (provided performance targets are met) set in order to bring overall remuneration into the upper quartile for the marketplace. When assessing the marketplace, the Remuneration Committee refers to survey data supplied by Towers Perrin, focusing on the companies in their database with broadly similar revenues. Salaries are however, currently below median. As described below, base salaries were frozen in the first year of the transformation plan and have been increased only modestly since then.

It is the Company's policy that no Executive Director should have a fixed term service contract or notice period exceeding one year, and that no Non-Executive Director should have a letter of appointment for a term of more than three years. All the current Directors' service contracts or letters of appointment comply with this policy. Further details are found on page 33.

Changes to remuneration policy

The Remuneration Committee intends that remuneration policy should be, as far as possible, enduring, but also believes that it is appropriate to keep it under review. The 2009/10 financial year is the last year of HMV's three-year transformation plan. The structural changes in the entertainment markets in which the Group operates have meant the Group needs both to deliver operational excellence in the short term but also to develop new products and activities to drive the growth of the Group over the medium and longer term. Following consultation with our major shareholders, the Remuneration Committee has decided to make some interim changes to the Executive Directors' remuneration for the 2009/10 financial year only. The Remuneration Committee believes the combination of the changes described below balance the need to deliver the operational improvements for the final year of the transformation plan (which should be reflected through the PANI target) with the development of new streams of future activities (which should be reflected in share price growth and performance against other retailers). In relation to the short-term bonus scheme, the increased deferral of bonus into shares together with the existing equity holdings of Executive Directors, clearly align the interest of Executive Directors with those of shareholders.

Details of the changes are given on pages 26 and 27 and can be found in the accompanying letter to shareholders.

The Remuneration Committee will during the course of the year revisit the Company's incentive arrangements for the Executive Directors and senior employees and will seek shareholder approval for any proposed changes at the 2010 Annual General Meeting.

Components of the Executive Directors' remuneration

Executive Directors' remuneration is provided in the form of a combination of basic salary, an annual cash bonus, a proportion of which is deferred for three years and paid in shares, and an award of shares under the HMV Performance Share Plan (further details of each are given on page 26).

The main components of the Executive Directors' remuneration for the financial year under review were as follows:

Salary

The Remuneration Committee, taking into account each Executive Director's performance, experience and responsibilities, determines the basic salary for each Executive Director. Salaries are usually reviewed with effect from 1 July each year. During the three-year transformation plan, Executive Directors' salaries were frozen in 2007, and with effect from 1 July 2008 their salaries were increased by 3%, which was in line with other Group employees. With effect from 1 July 2009 salaries are expected to increase by 2%, again in line with other Group employees.

Benefits in kind

Benefits in kind include provision of a car allowance, pension, medical and life insurance, permanent health insurance and staff discount.

HMV Group plc Incentive Plan for Senior Executives (the 'HIPS')

The HIPS comprises two elements – (i) an annual non-pensionable performance-related cash bonus, a proportion of which is deferred and paid in shares; and (ii) an award of shares under The HMV Performance Share Plan. The HIPS is designed to provide an incentive for senior management to achieve and exceed targets set by the Remuneration Committee.

Annual bonus The annual bonus (the 'annual award') awarded to each Executive Director is equivalent to 60% of base salary for on target performance and 120% at maximum, dependent on the performance of the Group and the achievement of key business objectives ('KBOs'). The annual award comprises a payment in cash of two-thirds of the earned bonus, which is paid after the end of the financial year to which the performance relates, with the remaining one-third payable in shares, the vesting of which is deferred for three years provided that the Executive Director remains in the employ of the Group.

The performance targets are determined each year by the Remuneration Committee. For the year under review the performance targets were profit after notional interest ('PANI'), which for Simon Fox and Neil Bright is Group profit before interest and tax and for Gerry Johnson is a combination of HMV Group and Waterstone's profit before interest and tax, each reduced by a 10% notional interest rate applied to the Group's average capital employed, as well as the achievement of KBOs. These performance targets were chosen because the Remuneration Committee believe they bring incentive levels closer to market norms and place greater emphasis on short-term operating performance which will grow shareholder value in the long term.

If the target PANI is reached then, for the Executive Directors, a sum equivalent to 45% of their salary is awarded and a further 15% of salary is awarded if the KBOs are met. No KBO payment can be made to an Executive if the PANI performance is less than 90% of target. The Remuneration Committee has carried out the assessment of whether these performance targets have been met by reference to the audited accounts for the 52 weeks to 25 April 2009. The bonus threshold of 90% of PANI had been exceeded so that the bonus associated with KBO achievement could be awarded. As the PANI target was not met, no other bonus was payable. Annual bonuses for Executive Directors, therefore, ranged from nil to 15% of salary.

Performance share awards At the 2006 Annual General Meeting, the shareholders approved The HMV Performance Share Plan (the 'Plan'). Awards under the Plan are usually made in August each year. Apart from exceptional circumstances, the Executive Directors are granted an award of shares under the Plan at a level no greater than 200% of base salary as at the date of the award. The awards vest after three years provided that the preset performance criteria are met. The Remuneration Committee sets the performance criteria each year. For the awards made in July 2008, an award will vest on the satisfaction of a target based on basic adjusted earnings per share ('EPS'). If the EPS in the financial year 2010/11 is less than 15.3p the award will not vest. Mid point EPS is 17.0p at which point 65% of the award will vest. If EPS is above 19.6p the award will vest in full. The award will vest on a straight-line basis from 15.3p to 17.0p and then from 17.0p to 19.6p, with 30% of the award vesting on the achievement of the minimum target. These performance targets were selected because the Remuneration Committee believes they align the interests of the Executive Directors with those of the Company's shareholders and place emphasis on the successful delivery of short-term performance goals, as well as ensuring that the Company's long-term initiatives are less dependent on annual performance.

Details of the awards made to the Executive Directors appear on page 31.

Share options No options were granted during the year under review and the outstanding options held by the Executive Directors are set out on page 32.

Re-balancing changes for 2009/10

The Remuneration Committee has, after consultation with major shareholders, decided to make some changes to the structure of remuneration for 2009/10. The overriding objective of these changes is to support the delivery of improvements over the next 12 months and the development of new streams of activities to drive growth thereafter. The changes are as follows:

- the maximum annual bonus opportunity will be increased from 120% to 150% of salary and the on-target bonus opportunity will increase from 60% to 70% of salary. However, the proportion of bonus compulsorily deferred into shares for three years will increase from the present one third to 43%. The cash amount which can be received at target thus remains the same under both the old and the new schemes;
- bonus payments will be based exclusively on PANI performance in 2009/10;
- annual awards under the HMV Performance Share Plan will be reduced from 150% to 120% of salary, with the proportion of the award vesting on minimum target performance reduced from 30% to 25%;
- the Remuneration Committee has selected a new performance measure to determine the vesting of shares under the HMV Performance Share Plan ('PSP'). It has chosen HMV's relative Total Shareholder Return. Shares will only vest if HMV's TSR is relatively strong against a basket of competitors and other retailers. TSR reflects the development of the Group's longer term initiatives and balances the PANI target used for the annual bonus. HMV's relative TSR will be measured against an industry peer group of UK-listed companies. Some shareholders have requested the Committee to consider an appropriate underpinning measure to support the TSR measure. The Committee understands this concern and will ensure that when assessing the Company's relative performance and deciding on the proportion of awards that should vest at the end of the performance period, the Group's absolute performance over the period will also be taken into account.

- The peer group companies, in alphabetical order, are:
 Arriva plc
 Carpetright plc
 Debenhams plc
 Domino's Pizza UK & IRL plc
 DSG international plc
 Dunelm Group plc
 Enterprise Inns plc
 GAME Group plc
 Greene King plc
 Halfords Group plc
 Home Retail Group Plc
 J D Wetherspoon plc
 Kesa Electricals plc
 Kingfisher plc
 Marks and Spencer Group plc
 Marston's PLC
 Millenium & Copthorne Hotels plc
 Mothercare plc
 N Brown Group plc
 Next plc
 Sports Direct International plc
 The Carphone Warehouse Group PLC
 The Go-Ahead Group plc
 The Restaurant Group plc
 Whitbread PLC
 WH Smith PLC
- Threshold or median performance will trigger the vesting of 25% of the PSP award, rising to full vesting at upper quartile and above on a straight-line basis. No award will vest for TSR performance below the median or threshold.

The maximum incentive opportunity, when short-term and long-term incentives are taken together, for Executive Directors will, therefore, remain the same. These interim changes will provide additional focus on operational performance over the next 12 months and at the same time reflect the development of new streams of business to drive growth in the longer term.

Share Incentive Plan

The HMV Group plc Share Incentive Plan (the 'SIP') is intended to allow the Company to align the interests of its UK employees (including the Executive Directors, all of whom are eligible to participate) more closely with the interests of shareholders.

Under the SIP, UK employees may acquire Ordinary Shares in three ways. Firstly, the Company can use the SIP as part of its broad incentive arrangements by awarding free shares to employees; in this regard an award of 120 free shares was made to every eligible employee, including Mr Bright, on the Initial Public Offering. There have not been any further awards of free shares and there are no plans to award further free shares to any employees. The free shares are held by a UK employee benefit trust (the 'Trust'), subject to the rules of the SIP. Secondly, the Company may invite UK employees to purchase Ordinary Shares, known as Partnership Shares, and thirdly, the Company may, if it wishes, agree to match the shares purchased with additional shares, known as Matching Shares. The Company has matched on a one-for-one basis since the inception of the SIP and these Matching Shares do not vest until the employee has completed one year's service from the date of the award. All shares held in the Trust attract dividend shares which, except in exceptional circumstances, are retained in the Trust for a period of three years. With effect from the next financial year dividends will be paid in cash to members of the SIP rather than by way of further shares.

All Executive Directors participate in the SIP and their awards are set out on page 31.

The Company reviews the awards of shares made under the various all-employee and executive share plans in terms of their effect on dilution limits and seeks to comply with the dilution limits recommended by the Association of British Insurers. At the end of the financial year under review, the Company was within the dilution limits for the issue of new shares for all of its share plans, as set out in the rules of those share plans.

The Company operates a shareholding policy which requires the Executive Directors, and other senior executives, to build and retain a shareholding in HMV Group plc equivalent in value to 100% of their salary.

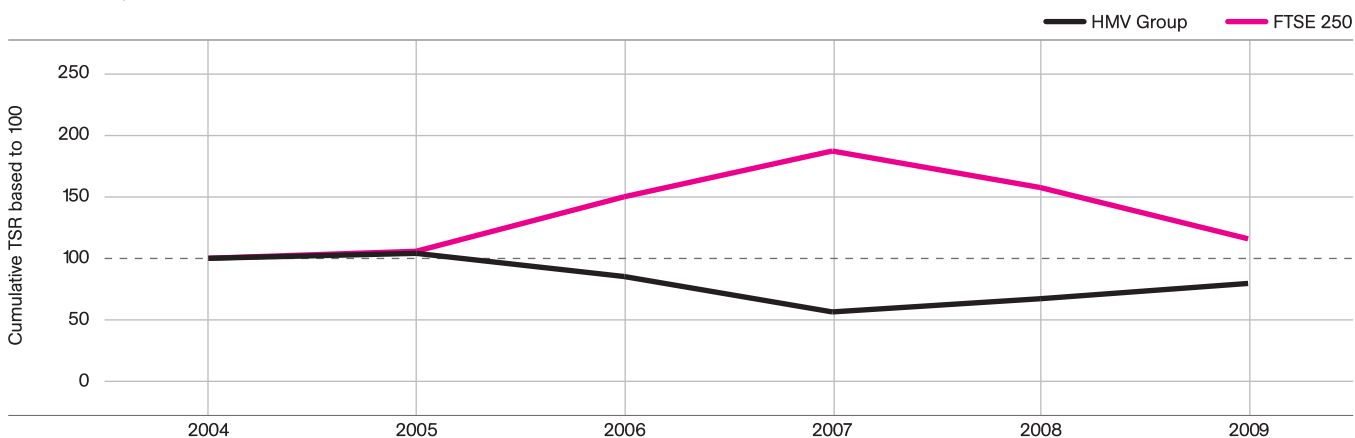
Performance graphs

The graphs below show the percentage change in the total shareholder return from 24 April 2004 to the end of the financial year against both the FTSE 250 and the FTSE General Retailers Index, both of which the Board considers to be appropriate peer groups for the Company as the Company is a constituent member of both these indices.

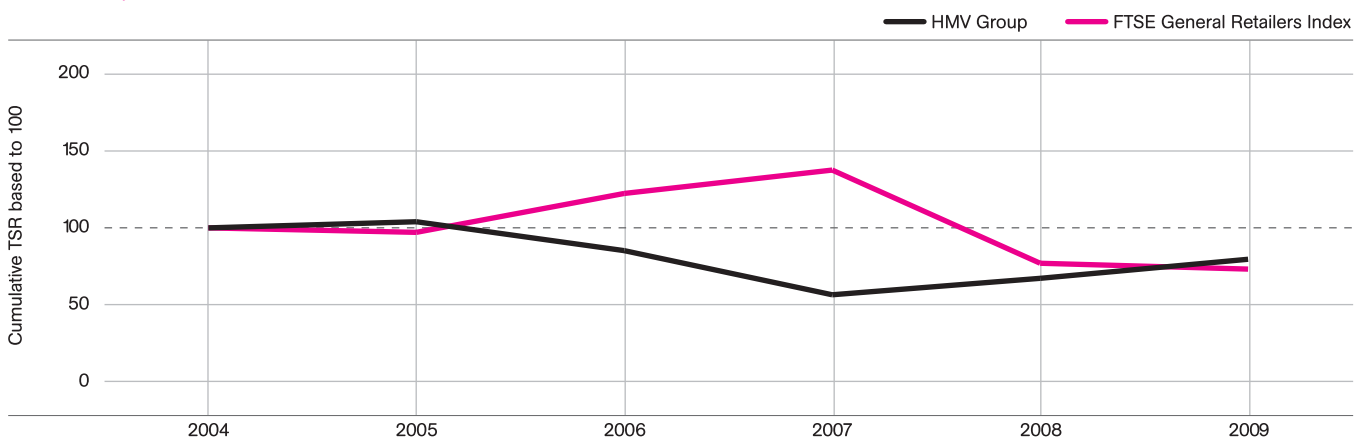
Total Shareholder Return Graphs

For the period 24 April 2004 to 25 April 2009

HMV Group v FTSE 250 Index



HMV Group v FTSE General Retailers Index



Pension arrangements

For each Executive Director, only basic salary is pensionable. Simon Fox, Neil Bright and Gerry Johnson are members of the HMV Group Pension Scheme, which is a contracted-out defined benefit scheme, providing them with benefits of up to one-thirtieth of final pensionable pay for each year of service. They are subject to the Company's salary 'capping' which was introduced in April 2006, which is currently £117,600. The HMV Group Pension

Scheme, therefore, provides Mr Fox, Mr Bright and Mr Johnson with benefits of up to one-thirtieth of their respective 'capped' salaries for each year of service.

The Company made a contribution to a Self Invested Pension Plan ("SIPP") for each Executive Director in lieu of pension contribution above the cap.

In the event of death during employment, the dependants of the Executive Directors would receive a pension and a lump sum.

Name	Simon Fox	Neil Bright	Gerry Johnson
Age as at 25 April 2009	48	46	48
Accrued pension at 25 April 2009 – £000 pa	10	39	14
Increase in accrued pension during the period or from date of appointment – £000 pa	4	4	4
Increase in accrued pension during the period or from date of appointment (net of inflation) – £000 pa	4	4	4
Transfer value of accrued pension at 25 April 2009 – £000	78	305	129
Transfer value of accrued pension at 26 April 2008 or date of appointment – £000	46	195	61
Directors' contributions during the period or from date of appointment – £000	9	9	9
Increase (decrease) in transfer value over the year or from date of appointment (net of Directors' contributions) – £000	23	101	59
Transfer value of increase in accrued pension during the period or from the date of appointment (net of inflation and Directors' contributions) – £000	22	20	30

Notes:

- (i) Pension accruals shown are the amounts which would be paid annually on retirement based on service to the end of the year.
- (ii) Transfer values have been calculated in accordance with guidance note GN11 issued by the Institute of Actuaries.
- (iii) The value of the net increase or decrease represents the incremental value to the Director of his service during the year or from the date of his appointment, as appropriate, calculated on the assumption that service is terminated at the year end. It is based on the accrued pension increase or decrease after an adjustment for inflation.
- (iv) The change in the transfer value includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Directors' contributions.
- (v) Voluntary contributions paid by Directors and resulting benefits are not shown.
- (vi) The figures above exclude contributions of £48,483 paid into Mr Bright's SIPP, £92,519 paid into Mr Fox's SIPP and £45,113 paid into Mr Johnson's SIPP.

Details of Directors' remuneration

	Base salary, benefits in kind and fees 2009 £000	Annual bonus 2009 £000	Total remuneration 2009 £000	Total remuneration 2008 £000
Executive Directors				
Simon Fox	506	73	579	992
Neil Bright	326	23	349	717
Gerry Johnson	312	–	312	595
Non-Executive Directors				
Carl Symon	67	–	67	190
Robert Swannell	50	–	50	–
Roy Brown	49	–	49	65
Andy Duncan	5	–	5	–
Lesley Knox	97	–	97	40
Christopher Rogers	45	–	45	45
Philip Rowley	40	–	40	23
Total	1,497	96	1,593	2,667

Notes:

- (i) Taxable benefits in kind consist of private healthcare during the financial year under review.
(ii) At the end of the period under review the base salary for the Executive Directors was Simon Fox £489,250, Neil Bright £309,000 and Gerry Johnson £298,700.
(iii) Carl Symon, Andy Duncan and Robert Swannell did not serve as Directors for the full 2008/09 financial year and their remuneration above reflects this accordingly.
(iv) One-third of the annual bonus earned in the year is deferred for three years and will be payable in shares. See deferred annual bonus table on page 32.
(v) The fees earned by Andy Duncan in respect of his Non-Executive directorship are waived by Mr Duncan and paid direct to charity. The amount paid to charity for the year under review was £5,334.
(vi) £76,487 of the fees noted above for Mrs Knox relate to Mrs Knox's Chairmanship of the Board for the period from 5 September 2008 to 1 February 2009 inclusive.

Directors' interests in shares

The Directors who held office at the end of the financial period had the following interests (beneficial and non-beneficial) in the share capital of the Company in addition to the interests in executive share options and other employee share schemes set out on page 31 and 32:

	25 April 2009	Ordinary Shares 26 April 2008 or as at the date of appointment
Executive Directors		
Simon Fox	432,819	340,152
Neil Bright	314,368	307,800
Gerry Johnson	38,000	38,000
Non-Executive Directors		
Robert Swannell	70,000	40,000
Andy Duncan	–	–
Lesley Knox	32,312	32,312
Christopher Rogers	5,580	5,580
Philip Rowley	17,150	17,150

For those Directors who served at the end of the financial year there have been no changes to the shareholdings since 25 April 2009 subject only to the participation by the Executive Directors in the SIP, details of which can be found on page 31.

Share Incentive Plan

The Directors who served as Directors at the end of the year under review and who held shares under the SIP as at 25 April 2009 are as follows:

	Total SIP shares held at 26 April 2008	Partnership Shares purchased by participants on a monthly basis at prices between 110p–144p	Matching Shares awarded on a monthly basis at prices between 110p–144p which will vest one year after the date of purchase	Dividend Shares purchased using dividends paid on Free, Partnership and Matching Shares	Total SIP shares held at 25 April 2009
Simon Fox	3,202	1,180	1,180	240	5,802
Neil Bright	11,733	1,180	1,180	730	14,823
Gerry Johnson	5,074	1,180	1,180	347	7,781

Notes:

- (i) Simon Fox, Neil Bright and Gerry Johnson have continued to acquire Partnership Shares and be awarded Matching Shares on a monthly basis between 25 April 2009 and 29 June 2009 in accordance with the terms of the SIP. These total 200 Partnership Shares and 200 Matching Shares each for Mr Fox and Mr Bright and 201 Partnership Shares and 201 Matching Shares for Mr Johnson.

Performance Share Plan

The following Performance Share Plan awards are being held for the following Directors:

Executive Directors	Interests in shares as at 26 April 2008	Date of award	Number of shares conditionally awarded	Market price of shares at award	Performance period ending	Interests in shares as at 25 April 2009
Simon Fox	586,419	6 October 2006	586,419	162.25p	25 April 2009	586,419
	2,060,737	7 August 2007	2,060,737	115.25p	24 April 2010	2,060,737
	–	8 July 2008	678,571	108.15p	30 April 2011	678,571
Neil Bright	277,777	6 October 2006	277,777	162.25p	25 April 2009	277,777
	520,607	7 August 2007	520,607	115.25p	24 April 2010	520,607
	–	8 July 2008	428,571	108.15p	30 April 2011	428,571
Gerry Johnson	163,580	6 October 2006	163,580	162.25p	25 April 2009	163,580
	503,253	7 August 2007	503,253	115.25p	24 April 2010	503,253
	–	8 July 2008	414,285	108.15p	30 April 2011	414,285

Notes:

- (i) The 2006 awards were subject to performance conditions based on the achievement of EPS and e-commerce revenue targets in 2008/09. Neither of these targets have been met and therefore the awards will not vest.
- (ii) For the awards made in August 2007, an award will vest on the satisfaction of a target based on adjusted earnings per share ('EPS'). The EPS targets were set based on the Group's performance without the contribution of HMV Japan, which was sold during the 2007/08 financial year. If the EPS in the financial year 2009/10 is less than 14.4p the award will not vest. Mid point EPS is 16.0p at which point 65% of the award will vest. If EPS is above 18.4p the award will vest in full. The award will vest on a straight-line basis from 14.4p to 16.0p and then from 16.0p to 18.4p with 30% of the award vesting on the achievement of the minimum target, except where an award exceeds 150% of base salary, when only 25% of the award will vest on achieving the minimum target and 62.5% of the award will vest on the achievement of the mid point. Following the share placing and the acquisition of 50% of Mean Fiddler Group which took place in the financial period under review, the minimum, mid point and maximum vesting EPS targets were amended to 14.1p, 15.6p and 18.0p respectively.
- (iii) To support the three-year transformation plan launched in March 2007, the Committee, on a one-off basis for 2007, made some changes to the way in which remuneration arrangements were applied. The changes required Mr Fox to purchase shares to the value of one times' salary. After three years, he may receive up to five shares for every one share purchased dependent on the achievement of the EPS performance target. Mr Fox's co-investment arrangement was made under the rules of the Plan and replaced the regular 2007 Plan award. As part of these arrangements, the share options granted to Mr Fox shortly after his appointment in September 2006 lapsed. In addition, the Committee made an enhanced award under the Plan of 200% of base salary, this being within the limits of the Plan, to Mr Bright, Mr Johnson and other senior management to emphasise the importance of, and to further support the delivery of, the three-year transformation plan.
- (iv) No shares vested in the year under review.
- (v) The performance conditions for the 2008 awards are set out on page 26.

Deferred annual bonus

The following deferred bonus awards held by each person who was a Director of the Company at the end of the financial year under review are as follows:

Executive Directors	Number of shares held conditionally as at 26 April 2008	Number of shares conditionally awarded	Date of award	Market price of shares at award	Performance period ending	Number of shares vested in the year and market price on vesting date	Number of shares lapsed in the year	Number of shares held conditionally as at 25 April 2009
Simon Fox	–	153,721	8 July 2008	106.25p	30 April 2011	–	–	153,721
Neil Bright	44,677	–	8 July 2005	242p	26 April 2008	11,169 112.5p	33,508	–
	–	110,957	8 July 2008	106.25p	30 April 2011	–	–	110,957
Gerry Johnson	–	80,443	8 July 2008	106.25p	30 April 2011	–	–	80,443

Notes:

- (i) These awards are linked to the annual bonus award which operated prior to the annual bonus award which was implemented during the previous financial year. The deferred share awards usually vest three years following their grant, subject to the achievement of cumulative budgeted profit before interest and tax, after notional interest charged over capital employed over the three-year period and the performance of the individual over the same three-year period.
- (ii) The release of shares to Mr Bright was made in accordance with the rules of the plan.

Executive share options

The share options held by each person who was a Director of the Company as at the end of the financial year under review are as follows:

	Date of grant	Exercise price	Number of options at 26 April 2008 or date of appointment	Granted in year	Lapsed in year	Exercised in year	Number of options at 25 April 2009	Exercisable from	Exercisable to
Neil Bright	22 May 2002	167p	485,030	–	–	–	485,030	22 May 2005	22 May 2012
	8 July 2005	242p	179,752	–	179,752	–	–	8 July 2008	8 July 2015
Gerry Johnson	5 October 2005	242p	154,958	–	154,958	–	–	5 October 2008	5 October 2015

Notes:

- (i) Options to acquire shares under the HMV Group plc 2002 Executive Share Option Scheme (the '2002 Scheme') were previously granted on an annual basis, thus ensuring reward was spread over a number of years and was allied to the long-term growth in shareholder value. The rules of the 2002 Scheme permit the granting of options to Executive Directors to a maximum of 300% of basic salary per annum. Options were granted at the five-day average of the market value of the Company's shares on the date of grant. Options granted under the 2002 Scheme can normally only be exercised after three years and then subject to the achievement of EPS targets imposed by the Remuneration Committee at the date of grant. 40% of the option shall be exercisable if the Company's adjusted basic EPS exceeds the growth in the Retail Prices Index by at least 3% per annum. 100% of the option shall be exercisable if the Company's adjusted basic EPS growth exceeds the growth in the Retail Prices Index by at least 7% per annum. For all options granted to date, EPS was assessed on an adjusted UK GAAP basis. Vesting will occur on a straight-line basis between these two points. EPS was determined by the Remuneration Committee to be the appropriate criterion given its clear linkage with shareholder value as well as providing a clearly definable target for executives. The Remuneration Committee assesses whether these performance conditions have been met by reference to the audited accounts. There is no Remuneration Committee discretion to re-test the performance criteria in the event that they are not met.
- (ii) No share options have been exercised in the year ended 25 April 2009 or between that date and the date of this report by any of the Directors who served at the end of the year under review.
- (iii) The options granted in 2005 lapsed during the financial year.
- (iv) The market price of an Ordinary Share as at 25 April 2009 was 144.5p, the highest market price for the year under review being 149.25p and the lowest market price being 86.25p.

Service agreements

No Executive Director has a service agreement containing a notice period exceeding one year.

The Remuneration Committee has considered the notice periods and termination arrangements set out below in light of the Combined Code, and continues to believe they are appropriate for the Executive Directors given their seniority and value to the Company.

The service contracts in respect of the Executive Directors who served at any time during the period under review are summarised below:

	Date of service contract	Notice period from Company	Notice period from individual
Simon Fox	18 July 2006	12 months	12 months
Neil Bright	23 April 2002	12 months	12 months
Gerry Johnson	8 September 2005	12 months	12 months

Note:

- (i) The service contract under which Mr Johnson was appointed as Managing Director of Waterstone's Booksellers Limited was the new model service contract as mentioned below and, therefore, remained in place on his appointment to the Board.

The Chairman and Non-Executive Directors do not have service agreements but have been engaged under letters of appointment. All are terminable by the Company without liability for compensation. All Non-Executive appointments are for an initial period of three years and can be extended for a subsequent period of three years. The period of appointment for Lesley Knox is until 22 April 2010, to 30 September 2009 for Christopher Rogers, to 30 September 2010 for Philip Rowley, to 1 February 2012 for Robert Swannell and to 12 March 2012 for Andy Duncan.

Robert Swannell, Andy Duncan and Lesley Knox, who are standing for re-election at the forthcoming Annual General Meeting, have letters of appointment as Non-Executive Directors and Neil Bright, who is also standing for re-election at the forthcoming Annual General Meeting, has a service contract which provides for a notice period of 12 months.

Copies of the Executive Directors' service agreements and the letters of appointment for the Chairman and each of the Non-Executive Directors are available at the registered office of the Company and will be available at the Annual General Meeting.

During the period under review, the Board carried out a process for evaluating the individual Directors, the Board as a whole and each of the Board Committees. Details of this performance evaluation process can be found in the Corporate Governance Report on page 21.

Compensation for early termination

The arrangements for early termination of an Executive Director's service agreement are decided by the Remuneration Committee and will be made in accordance with the service agreement provisions of each of the Executive Directors. Each service agreement provides for a payment in lieu of notice on early termination to the Executive Director, which shall consist of base salary and the cash equivalent of all other benefits. In the case of Mr Bright this would also include accrued bonus to date, if any. The Remuneration Committee may exercise discretion over deferred bonus entitlement and/or awards made under the performance share plan in accordance with the rules of the appropriate schemes.

In addition, Mr Bright's service agreement contains provisions that in the case of termination in breach of contract by the Company or termination by the Executive Director following material breach of contract by the Company within one year of a change of control of the Company, Mr Bright is entitled to compensation calculated on the same basis as set out above save that, in addition, he shall be entitled to an amount equal to the annual bonus he would have received for the 12 months after termination calculated on the basis of the Group's latest forecasts prior to the date of termination; the immediate vesting of all outstanding deferred bonus awards, the enhancement of pension arrangements by increasing his pensionable salary by 12 months, the provision of all other benefits to which Mr Bright is entitled for a period of 12 months (or the financial equivalent thereof) and, subject to the discretion of the Remuneration Committee, the vesting of any unexercised share options and awards made under the performance share plan.

If payments for termination are dealt with in accordance with the above provisions the restrictive covenants contained in Mr Bright's service agreement in favour of the Company will continue to apply.

A new model service agreement was introduced in 2006 which does not include any change of control provisions and requires the Executive Director to mitigate his loss. This service agreement was used for the appointment of Messrs Fox and Johnson and will be used for any future appointments of Executive Directors.

Outside directorships

No Executive Director may accept a non-executive directorship without the prior approval of the Board to ensure that they do not give rise to conflicts of interest. During the period under review Neil Bright was appointed as a Non-Executive Director and chairman of the Audit Committee of Holidaybreak plc. Mr Bright receives Non-Executive Directors fees of £38,500 for this directorship which he retains. No other Executive Director held any non-executive appointments.

Chairman and Non-Executive Directors' remuneration

The Chairman and the Executive Directors determine the remuneration of the Non-Executive Directors for their services as members of the Board and its Committees in accordance with the Company's Articles of Association. The Remuneration Committee determines the remuneration of the Chairman. A review takes place in January every two to three years. The policy is to pay fees at a market competitive level in comparison with companies of broadly similar size in terms of market capitalisation. The Company takes into account each individual's responsibilities and time commitments when setting fee levels. The Chairman, Robert Swannell, receives a basic fee of £200,000 pa. The Non-Executive Directors receive a basic fee of £40,000 pa. Christopher Rogers receives an additional £5,000 pa for chairing the Audit Committee. Lesley Knox receives an additional £5,000 pa for acting as Senior Independent Director and for chairing the Remuneration Committee.

The Chairman and Non-Executive Directors do not participate in any of the incentive or benefit schemes of the Group other than the provision of staff discount cards.

Shareholder approval

A resolution to approve the Remuneration Report is being proposed at the Annual General Meeting.

For and on behalf of the Board

Lesley Knox

Chairman of the Remuneration Committee

29 June 2009