Karolinska Development AB, AGM 2013

Item 16 Complete proposal "Guidelines for Remuneration to Executive Management"

Proposal from the board of directors of Karolinska Development AB (publ) for approval of *Guidelines for Remuneration to Executive Management*

It is proposed that the annual general meeting resolves to approve the proposal for Guidelines for Remuneration to Executive Management.

Guidelines for Remuneration to Executive Management

1 Applicability etc.

These Guidelines have been proposed by the board of directors of Karolinska Development and have been approved by the annual general meeting held on May 14, 2013. These Guidelines shall be in force during the period up until the annual general meeting in 2014.

The Guidelines apply to salary and other forms of remuneration to the CEO and other management personnel (executive management). They apply to all categories of remunerations and benefits, whether paid in cash or not, whether paid now or in the future, and whether certain or uncertain. Remuneration and issues of securities which are subject to Chapter 16 of the Swedish Companies Act (the LEO law) are not covered by these Guidelines.

2 Guidelines for remuneration

2.1 General

Karolinska Development shall maintain remuneration levels and terms required to recruit and keep an executive management with the competence and experience necessary to meet the company´s operational goals. The total remuneration to a management employee shall be competitive, reasonable and appropriate.

Fixed salaries shall be set based on each individual´s experience and field of responsibility. The fixed salary shall be revised annually with respect to each calendar year.

Variable remunerations shall (i) be formed to promote Karolinska Development´s long term value adding; (ii) be based upon criteria that are predetermined, clear, measurable and that can be influenced, (iii) if in the form of variable salary, have a fixed cap (unless such salary does not incur any costs to the company other than social security contributions); (iv) be excluded when calculating pension insurance premiums.

The company´s costs for pension for an employee shall be paid during the period when the employee is active in the company. Pension insurance premiums shall not be paid following the retirement of an employee. Premiums shall, in addition to what may follow from applicable laws, be paid in accordance with an adopted pension premium plan. Premiums may, by way of exception, be paid with a flat percentage.

Where the company terminates an employment, the termination period shall not exceed six months for the executive management. Severance pay may be paid only to the CEO.

In addition, management employees are entitled to such benefits that are applied for all employees of Karolinska Development, such as sick pay, health care etc. The number of paid holidays is thirty. Employees are not allowed to receive fees for serving as directors of the board of the portfolio companies of Karolinska Development. The company does not provide company cars.

2.2 Incentive program 2008-2010

The program is a combined warrant- and profit sharing program, comprising three parts decided by the annual general meetings 2008, 2009 and 2010. The program was initially intended to be a five year program, but it was terminated after three years. The termination has no effect on the programs already implemented.

The program consists of two parts; one conventional *warrant program* based on warrants issued by Karolinska Development and one *profit sharing plan* related to the value development of the portfolio companies.

Warrant program: During 2008-2010 the participants were entitled to subscribe for warrants once a year corresponding (in case of full exercise) to 0.5 per cent of the shares in Karolinska Development. Thus, the total dilution for the three years could have been a maximum of 1.5 per cent. Based on actual participation in the warrant programs, the actula maximum dilution amounts to 0.98 per cent. Warrants in the first program were issued in 2008 and entitles the holders to subscription for new shares in 2012. Warrants in the second program were issued in 2009 and entitles the holders to subscription for new shares in 2013. Warrants in the third program were issued in 2010 and entitles the holder to subscription for new shares in 2014. The warrants were issued at market value established by an independent valuation expert.

Profit sharing plan: Each warrant program 2008-2010 is linked to a profit sharing plan for 2008-2010 respectively. The profit sharing plan for 2008 relates to the investment portfolio of Karolinska Development as of December 31, 2007. The other profit sharing plans relate to investments carried out during the calendar year prior to the year of issuance of the plan.

Each annual plan entitles to a cash payment corresponding to, in aggregate, five per cent of the part of the return from the investments to which the annual plan relates, that exceeds a "threshold" ("Surplus Return"). At settlement the threshold shall consist of the initial value of the investments to which the annual plan relates to the extent that such investments have been exited, adjusted with an annual threshold interest of 6 per cent for the years 2008-2012 and 8 per cent for year 2013 and onwards. On the "credit side" there will be proceeds received from exits, if any, relating to the exit.

To the extent the Surplus Return exceeds an annual return of 35 per cent, the part of the Surplus Return exceeding 35 per cent, to which the participants in the profit sharing plan are entitled, shall be reduced by half. To the extent that the Surplus Return exceeds 50 per cent, another reduction by half shall apply to the Surplus Return which exceeds 50 per cent. Surplus Return exceeding 60 per cent shall not increase the entitlement of participants in the profit sharing plan.

In addition to Surplus Return, the 2010 plan shall also entitle to an aggregate of 37.5 per cent of the so called ”KDAB Carried Interest” in accordance with the limited Partner Agreement signed with European Investment Fund (”EIF”) regarding KCIF Co-Investment Fund KB (”KCIF”)[1]. KDAB Carried Interest can briefly be described as 20 per cent of the return exceeding a threshold interest of 6 per cent calculated on – and after repayment of – EIF´s investments in KCIF. According to the agreement with EIF, Karolinska Development is entitled to that part of the KDAB Carried Interest only if it is included in the company's profit sharing program. Thus, the company does not, in respect of this part of the profit sharing program, actually abstain from any amount it otherwise would have been entitled to, with the exception of social security contributions incurred due to the payout.

Participation in each profit sharing program is conditional on participation in the warrant program for the same year.

2.3 Incentive program for 2012-2014 (PSP 2012)

The 2012 annual general meeting resolved to implement a Performance Share Program 2012 (PSP 2012) which includes in total a maximum of 630 800 shares of series B according to the principal guidelines below.

1. <u>Participants in PSP 2012, allotment and personal investment</u>

PSP 2012 comprises a total of maximum 10 employees divided into three categories. Category 1 consists of the CEO and can at maximum be allotted 180,000 shares of series B. Category 2 consists of the CSO and CFO can at

[1] The board of directors shall be authorized to allocate part thereof to any future incentive program instead of to the plan for 2010.

maximum be allotted 120,000 shares of series B per person. Category 3 consists of other participants and can at maximum be allotted 36,000 shares of series B per person.

To participate in PSP 2012, the participants must acquire shares of series B in the company at market price on NASDAQ OMX Stockholm ("Saving Shares"). Participant in Category 1 must acquire 30,000 Saving Shares in order to be able to receive maximum allotment. Participant in Category 2 must acquire 20,000 Saving Shares in order to be able to receive maximum allotment. Participant in Category 3 must acquire 6,000 Saving Shares in order to be able to receive maximum allotment.

Acquisition of Savings Shares took place on December 27, 2012, since acquisition by participants was not possible prior to that date. As an employee is considered an individual who has signed a contract on permanent employment no later than on the day for the annual general meeting 2012.

For each Saving Share that the participant acquires and holds, the participant will, free of charge, be allotted one (1) matching share right ("Matching Share Right") and five (5) performance share rights ("Performance Share Rights") (together referred to as "Share Rights"). Provided that the conditions set out below in item 2) and item 3) respectively, are fulfilled, the Share Rights entitle to allotment of warrants in the Company entitling the holder to subscribe for shares of series B in the company as described below. Allotment of warrants, on the basis of Share Rights, shall be made following the publication of the company's interim report for the first quarter of 2015, however not earlier than three years after the PSP 2012 agreement is entered into ("Vesting Period").

2. Matching Share Rights

For each Saving Share that the participant acquires and holds, the participant is, free of charge, allotted one (1) Matching Share Right, which entitles the participant to, free of charge, receive one (1) warrant entitling the holder to subscribe for shares in the company, based on the conditions set out below:

(i) that the participant remains employed within the Group during the Vesting Period; and

(ii) that the participant has not disposed of its Saving Shares held during the Vesting Period.

3. Performance Share Rights

For each Saving Share that the participant acquires and holds, the participant is, free of charge, allotted five (5) Performance Share Rights that entitles the holder to five (5) warrants. In order for Performance Share Rights to entitle to allotment of warrants, the conditions for the Matching Share Rights must be fulfilled. In addition, certain performance conditions must be fulfilled in order for Performance Share Rights to entitle to allotment of warrants. The Board of Directors intends to present whether the performance conditions have been fulfilled in the annual report of 2015.

The performance conditions for the Performance Share Rights are dependent on the company's share price development. For allotment of warrants, the average price paid for a share of series B in the company on NASDAQ OMX Stockholm during a period of ten (10) trading days beginning 2 May 2015 ("End Price") must exceed the average price paid for a share of series B on NASDAQ OMX Stockholm after the annual general meeting 2012 ("Start Price"). The board of directors has determined that the Start Price shall be 15.70 SEK. For maximum allotment of warrants the share must be traded at a level that corresponds to an average yearly share price growth of 30 percent from the Start Price. If the End Price is between the Start Price adjusted upwards by 6 percent yearly and the share price that triggers maximum allotment, the participants will receive a linear allotment of warrants.

Shared terms and conditions for Share Rights

In addition to what has been stated above, the following terms and conditions apply for both the Share Matching Rights and the Performance Share Rights: The Share Rights are allotted free of charge. The participants are not entitled to transfer, pledge, or dispose of the Share Rights or exercise any shareholder's rights regarding the Share Rights during the Vesting Period. Allotment, free of charge, of warrants in the company on the basis of held Share Rights will take place after the publication of the company's interim report for the first quarter 2015, however not earlier than three years after the PSP 2012 agreement is entered into. Each warrant entitles the holder to acquire one (1) share of series B in the company for a subscription price corresponding to the quota value of the share and requires that the option is exercised as soon as possible after receipt of warrant. The company will, through a cash payment, compensate the participants in PSP 2012 for any dividends distributed in respect of the shares that the respective warrants entitle to. The maximum value that a participant can receive at allotment of warrants in the program is limited to an amount per share that corresponds to ten (10) times the Starting Price.

2.4 Incentive program for 2013-2015 (PSP 2013)

The board of directors proposes that the 2013 annual general meeting resolves to implement a Performance Share Program 2013 (PSP 2013).

The program is based on the same priciples as the PSP 2012 program (see section 2.3 above), with two exceptions. The number of participants has been increased from 10 to 17. The cap has been increased from 10 to 20 times the Starting Price.

2.5 Calculated total cost

For a description of the calculated total cost for Karolinska Development due to the incentive programs, please see **Appendix 1**.

2.6 Directors of the board

Directors of the board that are not also employees of the company may not participate in incentive programs for executive management or other employees. Incentive programs for the directors may not include warrants.

3 Exceptions

The board of directors may on a case by case basis decide on exceptions from Clause 2.1-2.3, if there are special reasons. Circumstances that were known to the board of directors at the time when the Guidelines where implemented shall normally not constitute valid reason for an exception. The board must motivate any exception at the subsequent annual general meeting.

4 Information

For information to be provided according to the Swedish Companies Act, please see **Appendix 2**.

Information regarding the company´s costs due to its obligations towards participants in the incentive programs

Appendix 1A: The programs 2008-2010

Payment under each program is to be made annually, starting at the earliest six years after the end of each individual program and during a total period of ten years.

Payment for any given year requires that the return from exits, milestone payments or royalty payments from investments during the time when the plan was active exceeds a threshold which is determined by the total amount of investments made during the relevant year, increased by an annual interest.

A calculation of the amount of expected payments under the program must be based on assumptions regarding all future investments by Karolinska Development in each portfolio company, the size of such investments and the valuation applied in each investment, assumptions about new portfolio companies and investments in these as well as the cash flow generated from exits of portfolio companies or liquidation of portfolio companies.

For illustration purposes, a theoretical scenario is that Karolinska Development invests a total of SEK 2 billion in companies, where at least one investment is made during the five years when the plans are active, and later divests these holdings at an average of SEK 150 million per company. The assumed revenues for such exits are the same for all holdings and represent a total surplus of SEK 6.5 billion. Based on this example, the profit sharing program would generate a payment of SEK 9.1 million per year for the management team as a group. In a case where the total surplus equals SEK 4 billion, the program would generate a payment of SEK 6 million for the management team as a group. The originally planned five year incentive programs have been aborted after three years and anticipated payouts should be proportionally reduced.

With the same assumptions as above and co-investments by KCIF of SEK 20 million during ten years, the payment above would increase by 20-30 per cent through payments made by KCIF as set out in Section 2.2 of the profit sharing program. With the exception of social security contributions, Karolinska Development will not incur any additional costs as a consequence of such payments.

Appendix 1B: PSP 2012

If all *Share Rights* within PSP 2012 are exercised the total number of shares will increase. These new shares will correspond to around 1.0 per cent of the total number of shares and 0.8 per cent of the total number of votes. All S*hare Rights* plus all outstanding warrants correspond to around 1.9 per cent of the total number of shares and 1.5 per cent of the total number of votes, in case of full exercise. It is estimated that the group may incur costs due to S*hare Rights* in the form of social contribution costs of up to a total of SEK 3.4 million by way of repurchase of shares, corresponding to a dilution of 0.3 per cent, and in the form of administrative costs during the life span of the *Share Rights*.

Appendix 1B: PSP 2013

If all proposed Share Rights within PSP 2013 are exercised, the number of shares will increase. These new shares will constitute, at full exercise, approximately 1 percent of the outstanding shares and approximately 0.8 percent of the votes. At full exercise of the now proposed Share Rights and outstanding warrants the number of new shares will constitute approximately 2.3 percent of outstanding shares and approximately 1.8 percent of the votes calculated after full exercise of outstanding warrants and proposed Share Rights. In addition 150,800 shares of series B are required to cover social security fees, which corresponds to approximately 0.3 percent of the outstanding shares and approximately 0.2 percent of the votes.

The Board's proposal does give rise to a dilution effects in accordance with IAS 33 and does, therefore, result in an effect on reported earnings per share. At maximum allotment and average yearly growth in share price by 30 percent from an assumed share price of SEK 22, the dilution effect will be approximately 0.97 percent.

The Share Rights can cause costs for the Group in the form of social security fees at exercise. Social security fees shall be expensed, allocated to the periods during which services were performed. Expenses shall be calculated by applying the same valuation model as utilized when the Share Rights were issued. The provision that arises shall be revalued in conjunction with each financial report.

Social security fees fall due to payment when the Share Rights are exercised. The social security fees are expected to amount to approximately 31 percent of the value of the Share Rights.

The Board has proposed that the effect on cash flow that may arise as a result of social security fees when Share Rights are exercised shall be hedged by acquisition and transfer of own shares on NASDAQ OMX Stockholm.

The Share Rights will in addition give rise to accounting costs in accordance with IFRS 2. These costs shall be determined on the allotment date and shall be allocated over the vesting period. In accordance with IFRS 2, the theoretical value of the Share Rights shall form the basis of the calculation of these costs. The theoretical value shall not be re-valued in subsequent reporting periods, although adjustments shall be made for any Share Rights that have not been earned in conjunction with every financial report. In this manner, the accumulated costs at the end of the vesting period will correspond to the number of Share Rights for which conditions have been fulfilled.

Appendix 2

Information according to the Swedish Companies Act

Information regarding decided remunerations to executive management not yet due for payment

There are no decided remunerations to executive management not yet due for payment, except for the profit sharing programs for 2008-2010 as described in the Guidelines.

Information regarding deviations from previously decided Guidelines

There are no deviations from the guidelines for remunerations to executive management resolved by the general meeting.