Information on Item 4 of the agenda of the Annual General Meeting of LPKF Laser & Electronics AG on May 31, 2018

Description of the new remuneration system for the members of the Management Board

Laser & Electronics

Contents

1 Background

The system for the remuneration for members of the Management Board of LPKF Laser & Electronics AG was last approved by the Annual General Meeting on June 5, 2014. On March 20, 2018, the Supervisory Board resolved to modify the remuneration system, which has been unchanged since 2013, with immediate effect. It is for this reason that the modified remuneration system is being submitted for approval under Item 4 of the agenda at this year's Annual General Meeting.

2 Objective

With this change to the remuneration system the Supervisory Board hopes to align the interests of the Management Board and the shareholders' interests even more closely. This is to be achieved by linking the remuneration of the Management Board more closely with the increase in the enterprise value. In addition, the new system will be aligned strongly to the return on capital, cash flow, and the long-term value increase. It combines the objectives for profitability, liquidity, and sustainable growth and is capital market-oriented. The new remuneration system focuses more strongly on performance-related components and meets the recommendations of the German Corporate Governance Code. When reviewing and adjusting the remuneration system, the Supervisory Board was advised by an external, independent remuneration expert.

As before, the criteria for the appropriateness of Management Board remuneration will be as follows: the tasks of the respective Management Board members, their specific personal performance, the business situation, success, future prospects, and sustainable development of the Company, the appropriateness of remuneration taking into account the competitive environment, and the remuneration structure applying in the Company.

The remuneration structure for each member of the Management Board will continue to comprise fixed basic remuneration, two short-term incentive (STI) and one long-term incentive (LTI) variable remuneration component, along with fringe benefits (benefits in kind). As provided for in the German Stock Corporation Act and German Corporate Governance Code, a high proportion of remuneration will be based on variable remuneration components, whose assessment basis is predominantly multi-year in scope.

3 Key Remuneration Components and Changes

3.1 Non-performance based components

Fixed remuneration consists of non-performance based remuneration, which is paid out pro rata in monthly installments as a salary and fringe benefits. The fringe benefits include a company car for business and private use, as well as allowances for health and nursing care insurance.

3.2 Performance based Components

The new system provides for short and long-term variable remuneration components. As short-term incentives (STI), the remuneration components ROCE (STI 1) and cash flow (STI 2) replace the previous remuneration components EBIT and long-term EBIT (formerly EBIT per employee). As a long-term variable remuneration component, the LTI option program has been restructured. Besides sustainable value creation, this means the performance of LPKF shares will be taken into account even more strongly. The long-term remuneration components LTI 1 quality and LTI 3 long-term EBIT no longer apply. The variable remuneration components of the new system are based on more differentiated key performance indicators which take account of a rapid realignment of the Company and reward sustainable value creation in particular. The remuneration components LTI, STI 1 and STI 2 are based on demanding objectives, the achievement of which determines the size of the individual remuneration component. The individual variable remuneration components are capped. In addition, they are only paid if defined thresholds are reached (floor).

3.2.1 Short-term Incentives

STI 1 is calculated on the basis of the return on capital employed (ROCE) indicator published in the annual report. A payment from STI 1 is made in cash after the consolidated financial statements for the financial year in question are approved. The size of STI 1 is staggered depending on the target achievement, with a payout being made only if at least a ROCE indicator at the level of the cost of capital is achieved. The target value is a ROCE of 18%, with a cap of 30%. Linear interpolation is not used between the target levels.

STI 2 is measured using the ratio of cash flow to total capital. With this indicator, payment is also made in cash in the year after the consolidated financial statements are approved. The size of STI 2 is staggered, with a target value of 13%, a floor of 8% and a cap of 21%. Linear interpolation is not used between the individual staggered values.

The target values of STI 1 were set independently in the current planning and are based on the Company's goals. In the case of a changed company situation, a change of the target values is possible.

In the case of negative ROCE or cash flow, the loss is retrospectively considered in the following year, with STI 1 and STI 2 determined again, taking account of the negative ROCE or cash flow of the following year. Any resulting overpayments are to be reimbursed by members of the Management Board. In addition, account is not taken of extraordinary developments or the sale of key assets when calculating STI 1 and STI 2.

3.2.2 Long-term Incentives

As LTI options, the rolling long-term bonus plan was refined and aligned to a value-oriented performance target. The details are set out in the plan terms and conditions, which form part of the contractual agreements with the members of the Management Board. Key factors determining the level of the LTI are the performance in the value contribution of the LPKF Group as an absolute value and the change in the share price. The value contribution is calculated as follows: (ROCE - WACC) * capital employed. The LTI is thus directly coupled to the target focus on profitable growth and a long-term increase in the enterprise value. The ROCE value applied is the same as the target value from STI 1, with capital employed based on corporate planning.

For a contractually defined annual allocation value, fictitious shares (“virtual shares”) are granted. The number of virtual shares granted results from the individual allocation value divided by the average closing price of the LPKF Laser & Electronics AG share in the first quarter after January 1 of the year of allocation. The planning period is three years. After the performance period comes to an end, the beneficiaries are entitled to a calculated payout amount, which, in turn, is determined by the final number of virtual shares. The final number of virtual shares is calculated by multiplying the virtual shares originally allocated by a performance factor, which is dependent on the average value contribution of the LPKF Group during the relevant performance period. In turn, the payment amount is derived by multiplying the final virtual shares with the average price of the shares of LPKF Laser & Electronics AG in the first quarter after the end of the relevant performance period. The amount paid out is limited to four times the allocation value. In addition, the final number of virtual shares is capped at 200% of the allocated virtual shares. Advanced payments are not planned. No minimum bonus was agreed.

4 Comparison of the Old and New Management Board Remuneration System

Short-term incentive (STI)	OLD		NEW	
Plan Type	Additive bonus plan with two components		Additive bonus plan with two components*	
Key performance indicators	EBIT	Long-term EBIT	ROCE	Cash flow/total capital
Payout curve	Targets dependent on scenario planning: • Normal scenario = 100% achievement • Defensive scenario = 0% achievement • 120% aggressive scenario = 125% goal achievement (cap) • Threshold at 5% EBIT margin • Linearly interpolated		• Target value of 18% • Threshold of 8% • Cap of 30% • Not interpolated	• Target value of 13% • Threshold of 8% • Cap of 21% • Not interpolated
Performance period	1 year		1 year	
Payment	In cash		In cash	
Adjustment	Adjustment in the case of extraordinary developments or sale of key assets		Adjustment in the case of extraordinary developments or sale of key assets, whereby a positive adjustment is not envisaged.	
Clawback	No negative EBIT in the following year, otherwise negative EBIT included		No negative EBIT/cash flow in the following year, otherwise negative EBIT/cash flow included	

* Target values in accordance with the Company's long-term objectives

Long-term incentive (STI)	OLD	NEW
Plan Type	Rolling virtual performance share plan, corresponding to a euro amount at the time of award	Rolling virtual performance share plan, corresponding to a euro amount at the time of award
Key performance indicators	• Average EBIT margin over 4, 5 or 6 years to determine the number of virtual shares • Average share price change over a 4, 5 or 6-year term • Average price over 30 days prior to the end of the period for determining the payment amount	• Average value contribution over 3 years for determining the number of value rights: (ROCE-WACC) * capital employed • 3-month average price after the end of the period for determining the payment amount
Payout curve	• EBIT margin < 10% → performance factor = 0 • EBIT margin = 10% → performance factor = 0.25 • EBIT margin = 15% → performance factor = 1 • EBIT margin ≥ 20% → performance factor = 1.5 • Cap: absolute payment cap of 300% of the allocation value	• Target value contribution results in a performance factor of 1 • Target value contribution is determined by the planned capital employed and target ROCE • Per EUR 1 million value contribution above or below target value: increase or decrease in performance factor of 10% • Cap: 200% of the allocated value rights and absolute payment cap of 400% of the allocation value
Performance period	4 years, extendable to either 5 or 6 years (option)	3 years
Payment	In cash (once after the end of the 4, 5 or 6-year option period) Personal investment in the form of LPKF shares necessary	In cash (once after the end of the 3-year performance period)

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