Denka

June 4, 2015

To our shareholders,

Shinsuke Yoshitaka
President & CEO
DENKI KAGAKU KOGYO KABUSHIKI KAISHA

Supplementary explanation regarding Proposal No. 2
for the 156th Ordinary General Meeting of Shareholders

DENKI KAGAKU KOGYO KABUSHIKI KAISHA ("Denka") has learned that Institutional Shareholder Services, Inc. (hereafter, "ISS"), a U.S. proxy advisory firm, is recommending that Denka shareholders vote against Proposal No. 2: "Partial Amendment to the Articles of Incorporation," which will be proposed for shareholder approval at the 156th Ordinary General Meeting of Shareholders.

Proposal No. 2 covers a change in our corporate name, streamlining and an adjustment to the purpose of corporate activities, and a change in the number of directors. The aspect therein which has prompted ISS to recommend a vote against Proposal No. 2 stems from a concern that the addition of "investment in businesses for the purpose of corporate management" will allow management to bypass the process of confirming the will of shareholders to pursue businesses that do not contribute to improved corporate value.

Denka's rationale with regard to the proposal is as follows.

1. The Purpose of the Amendment to the Articles of Incorporation

We formulated Denka100, a management plan designed to maximize shareholder value, and we seek growth matched to market changes by concentrating management resources into areas that continue to generate demand for solutions, specifically the environment, energy, infrastructure and healthcare. Our growth strategies under this plan focus on efforts to create the most optimal production system and scrutinize every cost element while focusing management resources on new growth drivers and developing next-generation products.

Denka100 Numerical Targets (Fiscal 2017)
Consolidated operating income: At least ¥60 billion
(twice the level achieved in fiscal 2006)
Operating income ratio: At least 10%
Ratio of overseas sales to net sales: At least 50%

We feel it is necessary to pursue investment in new businesses in areas that supplement these growth areas as we transition into the implementation phase in line with stated strategies. In such scenarios, M&As and other strategic investments in areas that differ from those listed in our Articles of Incorporation could become necessary. If the Articles of Incorporation do not set forth the appropriate purposes of the business we might lose out on opportunities that require an expedited response. This in turn could cost us chances to boost corporate value and by extension erode shareholder value and for this reason the proposed amendment is intended to prevent just such disadvantageous situations. Our objective is to steadily capitalize on business chances while meeting the requirements of our compliance.

2. Denka's Governance Structure

(1) ISS takes the position that giving the Board of Directors carte blanche to decide investment into nonspecific businesses is not in the best interest of shareholders. Denka has recently made progress on changes to internal structures designed to improve the soundness and transparency of management practices and reinforce governance by combining the best of both "a good offense" and "a strong defense." This includes replacing the old board structure of nine directors, two of whom are outside directors, with a new board structure of eight directors, three of whom will be outside directors, and we plan to boost the ratio of outside directors on the Board of Directors above one-third, in line with the corporate governance code.

(2) As mentioned in (1) above we are asking shareholders to approve the appointment of three outside directors to the Board of Directors and two outside candidates for the Audit & Supervisory Board. We will be sending a notification to Tokyo Stock Exchange, Inc., that all these outside directors and outside Audit and Supervisory Board Members fulfill the TSE requirements for independent officers.

3. Shareholder Return Policy and Budget for Investment to Fuel Growth

Back in November 2014, we established a shareholder returns policy which stipulates that the returns achieved through the aforementioned management plan will be distributed to shareholders, and we clearly stated our position on strategic investments, including M&As, designed to promote further growth.

(1) Shareholder Returns Policy: Total payout ratio target of 50%
Note: Total payout ratio = (Dividends paid + Treasury stock purchased)/ Consolidated net income

(2) Method of Shareholder Returns:
- Dividends: Maintain steady cash dividend, with minimum payout ratio of 30%
  Treasury Stock Buybacks: Implement buybacks flexibly in response to the share price and market environment.

(3) Budget for Strategic Investments to Fuel Growth
After returns to shareholders, we will appropriate funds, on a scale of ¥50 billion, from retained earnings and cash flow, over four years from fiscal 2014 through fiscal 2017.

(4) Term
Four years ending with fiscal 2017, the target year of the Denka100 management plan.

The information above is provided not only as a supplementary explanation of our proposal but also to clarify our stand against ISS's recommendation to oppose the proposal.

We see this proposal as absolutely essential to our efforts to steadily increase shareholder value over the medium to long term, and we ask shareholders to vote yes at the upcoming general meeting of shareholders.

We hope you understand Denka's position on the issue, and we ask that you vote in favor of Proposal No. 2: "Partial Amendment to the Articles of Incorporation."

Please direct any enquiries to:
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