

# Kao Corporation

## **Notice Regarding Introduction of New Performance Share Plan for Members of the Board of Directors, etc.**

February 2, 2017

Kao Corporation (the "Company"— *Ticker Code:4452*) announces that its Board of Directors resolved to introduce a performance share plan (the "Plan") at the meeting of the Board of Directors held on the date hereof and to submit a proposal regarding the Plan to the Annual General Meeting of Shareholders to be held on March 21, 2017 (the "AGM").

### 1. Purpose of Introducing the Plan, etc.

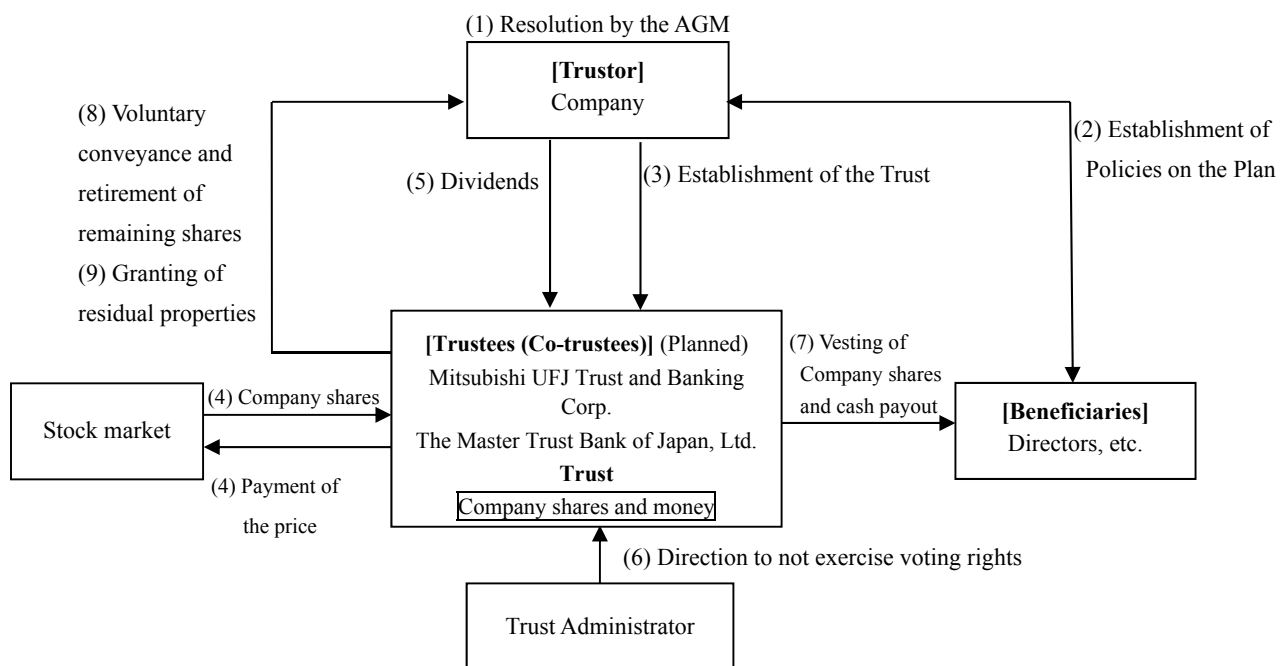
- (1) The Company is introducing the Plan for the members of the Board of Directors (excluding Outside Directors) and Executive Officers (hereinafter referred to as "Directors, etc.") as a highly transparent and objective Directors' compensation system that is closely linked to company performance. The purpose of this Plan is to improve the Company's mid- and long-term performance as well as increase the awareness of contributions to increasing corporate value.\*<sup>1</sup>\*<sup>2</sup>
- (2) Introduction of the Plan is subject to approval at the AGM.
- (3) The Company will introduce the Plan using a structure called a Board Incentive Plan Trust ("BIP Trust"). A BIP Trust is designed as an executive incentive plan based on the performance share plans and restricted stock plans in the U.S.A. wherein the Company's shares that are acquired through the BIP Trust and the amount of money equivalent to the converted value of such Company's shares (the "Company Shares, etc.") will be vested or paid ("vested, etc.") to Directors, etc. depending on executive positions and the level of achievement of performance targets in the mid-term plan, etc.

\*<sup>1</sup> Subject to the approval of the proposal regarding the Plan at the AGM, the Company will abolish stock options (share remuneration type stock options) as a form of executive compensation except for the ones already allotted and new stock options will no longer be issued from fiscal year 2017 onwards. As a result, the compensation for Directors, etc. will consist of "base salary," "bonus" and "performance share."

\*<sup>2</sup> The Company has established a Compensation Advisory Committee, which is chaired by an Independent Outside Director, and in which the majority of the members are Independent Outside Directors and Audit & Supervisory Board Members, to ensure the transparency and objectivity of the determination process regarding compensation for the members of the Board of Directors and Executive Officers. The introduction of the Plan has been reviewed at the Compensation Advisory Committee.

## 2. Details of the Plan etc.

### ( 1 ) Structure of the BIP Trust



- (1) The Company will gain approval of executive compensation at the AGM with respect to the introduction of the Plan.
- (2) The Company will establish the Policies on the Plan related to the executive compensation at the meeting of the Board of Directors with respect to the introduction of the Plan.
- (3) The Company will entrust money within the upper limit approved by the resolution at the AGM in (1) and establish a trust (“Trust”) wherein Directors, etc. who meet the beneficiary requirements are Beneficiaries.
- (4) The Trust will acquire the Company’s shares from the stock market using money entrusted in (3) in accordance with the directions of the Trust administrator. The number of shares to be acquired by the Trust shall be within the upper limit as approved by the resolution at the AGM specified in (1).
- (5) Dividends for the Company’s shares under the Trust will be paid in the same manner as for other Company’s shares.
- (6) Voting rights will not be exercised during the Trust term with regard to the Company’s shares under the Trust.
- (7) During the Trust term, pursuant to the Policies on the Plan, Beneficiaries will receive the Company’s shares equivalent to a certain ratio of points after the points have been granted. Meanwhile, the Company’s shares in a number equivalent to the remaining points will be converted into cash in the Trust in accordance with the Trust Agreement and Beneficiaries will receive the monetary equivalent. Also with respect to dividends that have been paid in relation

to the Company's shares under the Trust, Beneficiaries will receive money according to the number of points calculated by multiplying the cumulative total number of single fiscal-year points (provided in (2) (5) below) as at each dividend record date by the achievement linked coefficient (provided in (2) (5) below).

- (8) The residual shares at the expiry of the Trust term due to under-achievement of performance targets or for other reasons during the Covered Period (provided in (2) (1) below) will continue to be subject to vesting to Directors, etc., if the Trust continues to be used for the Plan or similar performance share plan. If the Trust is terminated by expiry of the Trust term, the Trust will voluntarily convey the residual shares to the Company as a measure of shareholder returns, and the Company will retire said residual shares by a resolution of the meeting of the Board of Directors.
- (9) Any residual dividends pertaining to the Company's shares under the Trust that arise at the expiry of the Trust term will be utilized as funds to acquire the Company's shares in the case of the continued use of the Trust, but in cases where the Trust is to be terminated, the portion exceeding the allowances for trust expenses will be donated to organizations that have no conflict of interest with the Company and Directors, etc.

\* In the case where the number of shares under the Trust might fall short of the number of shares corresponding to the number of points to be granted to each Director, etc. (provided in (2) (5) below) during the Trust term, or in the case where the money in the trust property might be insufficient for paying trust fees and trust expenses, the Company may entrust additional money to the Trust to the extent of the upper limit of trust money referred to in (2) (8) below.

## (2) Content of the Plan

### (1) Outline of the Plan

The Plan is a performance share plan covering a series of fiscal years subject to the mid-term plan (the "Covered Period"), by which Company Shares, etc. are vested, etc. depending on an executive's position and the level of achievement of performance targets in the mid-term plan, etc. (The initial Covered Period shall be four fiscal years from the fiscal year ending December 31, 2017 to the fiscal year ending December 31, 2020.) Executive compensation under the Plan consists of: the "achievement-linked portion," in which Company Shares, etc. are vested, etc. depending on the level of achievement of performance targets in the mid-term plan, and the "fixed portion," in which a certain number of Company Shares, etc. are vested, etc. each year. The "achievement-linked portion" aims to motivate to achieve the performance targets in the mid-term plan and to reinforce the linkage of payment of executive compensation with medium- or long-term performance. The "fixed portion" seeks to reinforce shared interests between shareholders and Directors, etc. through shareholding by the Directors, etc. The ratio of the achievement-linked portion to the fixed portion shall be 70% to 30%.

In cases where the Trust is continued in accordance with (4)(b) below, fiscal years corresponding to subsequent respective mid-term plans shall be the respective Covered Periods.

(2) Resolution of the AGM with respect to introduction of the Plan

The AGM shall resolve the upper limit of trust money to be contributed to the Trust, the maximum total number of the Company Shares, etc. to be vested, etc. to Directors, etc. and other requirements.

(3) Eligibility for the Plan (Requirements for Beneficiaries)

In principle, Directors, etc. will be vested, etc. Company Shares, etc. equivalent to the number of fixed points (provided in (5) below) from the Trust on completing the specified Beneficiary admission procedures, conditional upon satisfying the following Beneficiary requirements at a certain time each year during the Covered Period. Also, Directors, etc. will be vested, etc. Company Shares, etc. equivalent to the number of achievement-linked points (provided in (5) below) from the Trust on completing the specified Beneficiary admission procedures, conditional upon satisfying the following Beneficiary requirements after the end of the Covered Period.

The requirements for Beneficiaries are as follows:

- (i) a person holds office as a Director, etc. on the last day of any fiscal year during the Covered Period (including persons who are newly elected as Directors, etc. after the Plan starts);
- (ii) a person has neither resigned due to his/her own convenience nor resigned or been dismissed for such reasons as having committed a certain illicit act or a serious violation of work/internal regulations, etc. while in office; and
- (iii) other requirements found necessary to accomplish the purpose of the Plan.

(4) Trust Term

(a) Initial Trust term

The initial Trust term shall be approximately four years, from April 2017 (scheduled) until June 2021 (scheduled).

(b) Continuation of the Trust

The Trust may be continued by modifying the Trust Agreement and entrusting additional money at the expiry of the Trust term, in which case the Trust term shall be extended further with respect to the number of years corresponding to the then mid-term plan. The Company will make additional contributions within the upper limit of trust money for which approval by resolution of an Annual General Meeting of Shareholders has been obtained for each extended Trust term, and continue granting points to Directors, etc. during the extended Trust term; provided, however, that in cases where such additional contributions are to be made, when there are any Company's shares (excluding Company's shares equivalent to points granted to Directors, etc. that are yet to be vested, etc.) and money remaining in the trust property ("Residual Shares, etc.") as at the last day of the Trust term prior to the extension, the sum of the amount of Residual Shares, etc. and additional trust money to be contributed shall be within the upper limit of trust money for which approval by resolution of an Annual General Meeting of Shareholders has been obtained. Such extension of the Trust term may not be limited to once, and the Trust term may be extended again in the same manner.

(5) Company Shares, etc. to be Vested, etc. to Directors, etc.

Company Shares, etc. to Directors, etc. are vested, etc. after the end of the Covered Period with

respect to the achievement-linked portion and after the end of each fiscal year during the Covered Period with respect to the fixed portion, in accordance with (6) below.

Points prescribed in (i) and (ii) below will be granted to Directors, etc. as a precondition for the vesting, etc. of Company Shares, etc. One point shall be equivalent to one Company share, and fractions less than one point will be disregarded, however, in cases where share split, consolidation of shares, etc. has been made during the Trust term with respect to Company's shares, the number of Company's shares per point will be adjusted according to the share split ratio, consolidation of shares ratio, etc.

(i) Achievement-linked portion

To Directors etc. who hold office on the last day of any fiscal year during the Covered Period (including Directors, etc. who resigned due to expiry of term of office or for other reasons on the last day of any fiscal year during the Covered Period and Directors, etc. who died on the last day of any fiscal year during the Covered Period), single fiscal-year points calculated by the following formula based on points that have been determined in advance with respect to each executive position ("Executive Position Points") will be granted on the last day of the fiscal year. After the end of the Covered Period, the number of achievement-linked points is calculated by adding up the single fiscal-year points granted to Directors, etc., and then multiplying such cumulative total by the achievement linked coefficient depending on the level of the achievement of performance targets in the mid-term plan etc. (the same applies to the Directors, etc. who resigned due to expiry of term of office or for other reasons during the Covered Period).

(Calculation formula of single fiscal-year points) Executive Position Points x 70%

(Calculation formula of number of achievement-linked points)

Cumulative total of single fiscal-year points during the Covered Period x Achievement linked coefficient <sup>\*3\*4</sup>

<sup>\*3</sup> The achievement linked coefficient varies between 0% and 200% depending on the level of achievement of performance targets in the mid-term plan, etc. The performance targets etc. indicators will be the Compound Average Growth Rate (CAGR) of like-for-like net sales (excluding the effect of currency translation, change of sales system, etc.) and consolidated operating margin, etc. with respect to the initial Covered Period.

<sup>\*4</sup> In cases where a Directors, etc. dies before the end of the Covered Period (including cases where the Director, etc. died before the end of the Period after resigning due to expiry of term of office or for other reasons), the number of achievement-linked points will be calculated by adding together the single fiscal-year points granted up to the death and assuming that the achievement linked coefficient is 100%.

(ii) Fixed portion

To Directors, etc. who hold office on the last day of any fiscal year during the Covered Period (including Directors, etc. who resigned due to expiry of term of office or for other reasons on said day and Directors, etc. who died on said day), fixed points calculated by the following formula based on the Executive Position Points will be granted on the last day of each fiscal year during the Covered Period.

(Calculation formula of number of fixed points) Executive Position Points x 30%

(6) Method and Timing of Vesting, etc. of Company Shares, etc. to Directors, etc.

(i) Achievement-linked portion

The timing at which Company Shares, etc. pertaining to the achievement-linked portion are vested, etc. will be after the end of the Covered Period. The specific method and timing of vesting, etc. are as follows:

Directors, etc. who meet the requirements for Beneficiaries shall, at around June immediately after the end of the Covered Period, receive the Company's shares corresponding to 50% of the number of achievement-linked points (the number of shares less than a share unit will be rounded up), and receive money equivalent to the Company's shares corresponding to the number of remaining achievement-linked points that are converted into cash under the Trust. However, in cases where such Directors, etc. do not have a securities brokerage account that handles Japanese shares, such Directors, etc. shall receive money equivalent to Company shares corresponding to the number of achievement-linked points that are converted into cash under the Trust.

(ii) Fixed portion

The timing at which Company Shares, etc. pertaining to the fixed portion are vested, etc. will be after the end of each fiscal year during the Covered Period. The specific method and timing of vesting, etc. are as follows:

Directors, etc. who meet the requirements for Beneficiaries shall, at around June immediately after the end of each fiscal year during the Covered Period, receive Company shares corresponding to 50% of the number of fixed points (the number of shares less than a share unit will be rounded up), and receive money equivalent to Company shares corresponding to the number of remaining fixed points that are converted into cash under the Trust. However, in cases where such Directors, etc. do not have a securities brokerage account that handles Japanese shares, such Directors, etc. shall receive money equivalent to Company's shares corresponding to the number of fixed points that are converted into cash under the Trust.

Of note, Directors, etc. shall continue to hold Company shares acquired as the fixed portion until the end of the Covered Period.

(7) Treatment of the Death of Directors, etc.

If a Director, etc. who meets the requirements for Beneficiaries were to die during the Trust term, the Company's shares that correspond to the cumulative total of the number of achievement-linked points calculated at the time of his/her death and the number of fixed points subject to the pending Beneficiary admission procedures will be converted into cash under the Trust and the heir of said Director, etc. shall receive such cash from the Trust.

(8) Upper Limit of Trust Money to be Contributed to the Trust and the Maximum Number of Company's Shares to be Vested by the Trust (including the Company's shares subject to conversion into cash)

The upper limit of the amount of trust money to be contributed to the Trust with respect to the four-fiscal-year Covered Period shall be 1.85 billion yen (this will be the sum of the amount of funds for the Trust to acquire Company's shares as well as the amount of trust fees and trust expenses during the Trust term). Such upper limit of trust money takes into consideration the level of the existing stock options (share remuneration type stock options).

The maximum total number of Company's shares (including the Company's shares subject to conversion into cash) to be vested to Directors, etc. according to (6) above from the Trust in the four-fiscal-year Covered Period shall be 340,000 shares. This is set by using share price at the present time and other such factors as reference, in consideration of the aforementioned upper limit of trust money.

(9) Method for the Trust to Acquire the Company's Shares

The Trust shall schedule the initial acquisition of the Company's shares from the stock market within the upper limit of the funds and within the maximum number of the Company's shares to be vested, as specified in (8) above.

(10) Exercising Voting Rights Related to the Company's Shares under the Trust

Voting rights related to the Company's shares under the Trust (the Company's shares before being vested, etc. to Directors, etc.) shall not be exercised during the Trust term to ensure the neutrality of the Company's management.

(11) Treatment of Dividends of the Company's Shares under the Trust

Considering that Company Shares, etc. pertaining to the achievement-linked portion will be vested, etc. only after the end of the Covered Period, and in order to motivate the achievement of the mid-term plan, dividends paid to the Trust with respect to the Company's shares under the Trust will, not only be allocated to trust fees and trust expenses, but also be reserved in the amount equivalent to the per-share dividend amount per point according to the number of points calculated by multiplying the cumulative total of single fiscal-year points of Directors, etc. as at each dividend record date during the Covered Period by the achievement linked coefficient, so that Directors, etc. will receive such reserve amounts together with vesting Company Shares, etc. according to (6) above.

(12) Treatment at the Expiry of the Trust Term

The residual shares at the end of the Trust term due to under-attainment of performance targets, etc. during the Covered Period will continue to be subject to vesting to Directors, etc., if the Trust continues to be used for the Plan or similar performance share plan. If the Trust is terminated by expiry of the Trust term, the Trust will voluntarily convey the residual shares to the Company as a measure of shareholder returns, and the Company will retire said shares by resolution of the Board of Directors.

Any residual dividends pertaining to the Company's shares under the Trust that arise at the expiry of the Trust term will be utilized as funds to acquire the Company's shares in the case of the continued use of the Trust, but in cases where the Trust is to be terminated, the portion exceeding the allowances for trust expenses will be donated to organizations that have no conflict of interest with the Company and Directors, etc.

(Reference)

[Content of Trust Agreement]

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|-----------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (1) Type of Trust:                | Monetary trust other than a specified solely-administered monetary trust (Third party benefit trust)                                                                                                                    |
| (2) Purpose of Trust:             | To improve the Company's mid- and long-term performance as well as increase the awareness of contributions to increasing corporate value                                                                                |
| (3) Trustor:                      | The Company                                                                                                                                                                                                             |
| (4) Trustee:                      | Mitsubishi UFJ Trust and Banking Corporation (scheduled)<br>(Co-trustee: The Master Trust Bank of Japan, Ltd.)                                                                                                          |
| (5) Beneficiaries:                | Person(s) who meets beneficiary requirements among Directors, etc.                                                                                                                                                      |
| (6) Trust administrator:          | A third person who has no conflict of interest with the Company<br>(Certified public accountant)                                                                                                                        |
| (7) Date of Trust Agreement:      | April 27, 2017 (scheduled)                                                                                                                                                                                              |
| (8) Trust term:                   | April 27, 2017 (scheduled) to the end of June 2021 (scheduled)                                                                                                                                                          |
| (9) Start of the Plan:            | May 1, 2017 (scheduled)                                                                                                                                                                                                 |
| (10) Exercise of voting rights:   | No voting rights will be exercised.                                                                                                                                                                                     |
| (11) Type of acquired shares:     | Ordinary shares of the Company                                                                                                                                                                                          |
| (12) Amount of trust money:       | 1.81 billion yen (scheduled) (including trust fees and trust expenses)                                                                                                                                                  |
| (13) Time to acquire shares:      | From May 1, 2017 (scheduled) to May 31, 2017 (scheduled)<br>(excluding the period from five business days before the end of each fiscal period (including the quarterly fiscal period) to the end of the fiscal period) |
| (14) Method of share acquisition: | To be acquired from the stock market                                                                                                                                                                                    |
| (15) Rights holder:               | The Company                                                                                                                                                                                                             |
| (16) Residual properties:         | The Company, as the rights holder, may receive residual properties within the extent of allowances for trust expenses, which are calculated by deducting funds to acquire the Company's shares from the Trust money.    |

[Affairs related to Trust and Shares]

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|--------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (1) Affairs related to trust:  | Mitsubishi UFJ Trust and Banking Corporation will be the Trustee of the Trust and will engage in affairs related to the Trust.                                                       |
| (2) Affairs related to shares: | Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. will engage in affairs related to vesting of the Company's shares to Beneficiaries based on the administrative service agreement. |