Consolidated Financial Results for the Fiscal Year Ended December 31, 2017 [IFRS]

February 1, 2018

Company name: Kao Corporation — Tokyo Stock Exchange in Japan
Stock code: 4452 (URL: http://www.kao.com/global/en/investor-relations/library/results/)
Representative: Michitaka Sawada, President and CEO
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Scheduled starting date of the dividend payments: March 26, 2018
Supplementary documents of the financial results: Yes
Financial results information meeting: Yes (for institutional investors and analysts)

(Millions of yen, except per share amounts)
(Amounts less than one million yen are rounded)

1. Consolidated financial results for the fiscal year ended December 31, 2017 (from January 1, 2017 to December 31, 2017)

(1) Consolidated operating results

(Percentages indicate year-on-year changes)

	Fiscal year ended December 31, 2017	%	Fiscal year ended December 31, 2016	%
Net sales	1,489,421	2.2	1,457,610	(1.1)
Operating income	204,791	10.4	185,571	10.9
Income before income taxes	204,290	11.4	183,430	10.5
Net income	148,607	16.2	127,889	20.7
Net income attributable to owners of the parent	147,010	16.2	126,551	20.3
Comprehensive income	179,890	91.1	94,129	2.1

Note: In the fiscal year ended December 31, 2017, the Kao Group adopted IFRS 15, “Revenue from Contracts with Customers” and its amendments early in tandem with a revision of its sales system for the Consumer Products Business in Japan (Reference: Page 25, “Changes in Accounting Policies” in "Notes to Consolidated Financial Statements"). Net sales growth adjusted for the impact of these changes and excluding the effect of currency translation was 5.6%.

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Basic earnings per share (Yen)	298.30	253.43
Diluted earnings per share (Yen)	298.09	253.18
Ratio of net income to equity attributable to owners of the parent	19.8%	18.6%
Ratio of income before income taxes to total assets	14.8%	13.8%
Ratio of operating income to net sales	13.7%	12.7%
(Reference) Share of profit/loss in investments accounted for using the equity method	2,007	1,894

(2) Consolidated financial position

	December 31, 2017	December 31, 2016
Total assets	1,427,375	1,338,309
Total equity	819,364	691,463
Equity attributable to owners of the parent	806,381	679,842
Ratio of equity attributable to owners of the parent to total assets	56.5%	50.8%
Equity attributable to owners of the parent per share (Yen)	1,636.41	1,379.37

(3) Consolidated cash flows

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Net cash flows from operating activities	185,845	184,307
Net cash flows from investing activities	(96,146)	(88,639)
Net cash flows from financing activities	(53,244)	(95,043)
Cash and cash equivalents at the end of the year	343,076	303,026

2. Dividends

	Year ending December 31, 2018 (Forecast)	Year ended December 31, 2017	Year ended December 31, 2016
Annual cash dividends per share (Yen)			
1st quarter end	-	-	-
2nd quarter end	60.00	54.00	46.00
3rd quarter end	-	-	-
Fiscal year end	60.00	56.00	48.00
Total	120.00	110.00	94.00
Total dividend payment amount		54,293	46,787
Payout ratio (consolidated)	38.9%	36.9%	37.1%
Ratio of dividends to equity attributable to owners of the parent (consolidated)		7.3%	6.9%

3. Forecast of consolidated operating results for the fiscal year ending December 31, 2018 (from January 1, 2018 to December 31, 2018)

(Millions of yen, except per share amounts)
(Percentages indicate year-on-year changes)

	Year ending December 31, 2018	%
Net sales	1,540,000	3.4
Operating income	215,000	5.0
Income before income taxes	215,000	5.2
Net income attributable to owners of the parent	152,000	3.4
Basic earnings per share (Yen)	308.46	-

4. Others

(1) Changes in significant subsidiaries during the year (changes in specified subsidiaries resulting in change in scope of consolidation): None

(2) Changes in accounting policies and changes in accounting estimates

1) Changes in accounting principles required by IFRS: None

2) Changes in accounting principles due to reasons other than 1): Yes
For details, please refer to page 25, "Changes in Accounting Policies" in "Notes to Consolidated Financial Statements"

3) Changes in accounting estimates: None

(3) Number of issued shares outstanding at the end of the year (ordinary shares)

	December 31, 2017	December 31, 2016
Number of issued shares including treasury shares	495,000,000	504,000,000
Number of treasury shares	2,225,561	11,137,654

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Weighted average number of shares outstanding during the year	492,832,099	499,355,189

Explanation regarding the appropriate use of forecast of operating results and other special items

Forward-looking statements such as earnings forecasts and other projections contained in this release are based on information available at the time of disclosure and assumptions that management believes to be reasonable, and do not constitute guarantees of future performance. Actual results may differ materially from expectations due to various factors.

Please refer to page 1 to 14, "1. Summary of Operating Results and Financial Position" for the suppositions that form the assumptions for earnings forecasts and cautions concerning the use of earnings forecasts.

1. Summary of Operating Results and Financial Position

(1) Summary of Operating Results

Operating Results for the Fiscal Year Ended December 31, 2017

In the fiscal year ended December 31, 2017 (fiscal 2017), the Kao Group adopted IFRS 15, "Revenue from Contracts with Customers" and its amendments early in tandem with a revision of its sales system for the Consumer Products Business in Japan (Reference: Page 25, "Changes in Accounting Policies" in "Notes to Consolidated Financial Statements"). To facilitate comparison, growth adjusted for the impact of these changes and excluding the effect of currency translation is presented as "like-for-like" below.

(Billions of yen, except per share amounts)

	2017	2016	Growth
Net sales	1,489.4	1,457.6	2.2% Like-for-like: 5.6%
Operating income	204.8	185.6	10.4%
Operating margin (%)	13.7	12.7	-
Income before income taxes	204.3	183.4	11.4%
Net income	148.6	127.9	16.2%
Net income attributable to owners of the parent	147.0	126.6	16.2%
Basic earnings per share (Yen)	298.30	253.43	17.7%

1) Trends in Overall Results for the Fiscal Year Ended December 31, 2017

The Kao Group got off to a smooth start in fiscal 2017, the first fiscal year of the Kao Group Mid-term Plan "K20" covering the four years from 2017 to 2020. Consolidated operating results met the forecast announced on October 30, 2017, and the Kao Group was able to increase operating income and net income for the eighth consecutive fiscal year and achieve record-high operating income for the fifth consecutive fiscal year.

From January to December 2017, the markets for household and personal care products and cosmetics in Japan, which are key markets for the Kao Group, were in solid condition on a value basis according to retail sales and consumer purchasing survey data. In particular, the e-commerce channel grew substantially and inbound demand (demand from visitors to Japan) for cosmetics increased significantly, mainly in the department store channel. Average unit prices for household and personal care products increased by one point.

Under these circumstances, the Kao Group worked to launch and nurture products with high added value in response to changes in consumer needs based on its concept of "*Yoki-Monozukuri,"** which emphasizes research and development geared to consumers and customers. The Kao Group also conducted cost reduction activities and other measures.

* *The Kao Group defines* Yoki-Monozukuri *as a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction. In Japanese,* Yoki *literally means "good/excellent," and* Monozukuri *means "development/manufacturing of products."*

Net sales increased 2.2% compared with the previous fiscal year to 1,489.4 billion yen. On a like-for-like basis, net sales increased 5.6%. In the Consumer Products Business, sales increased in Japan due to factors including market growth, launches of new and improved products, and further enhancement of sales promotion activities. Outside Japan, sales in Asia and the Americas increased. In the Chemical Business, sales increased as the Kao Group worked to adjust selling prices in response to increased costs for natural fats and oils.

As for profits, although costs for natural fats and oils and other raw materials increased, due to the effect of increased sales in the Consumer Products Business in Japan and Asia, among other factors, operating income was 204.8 billion yen, an increase of 19.2 billion yen compared with the previous fiscal year, the operating margin was 13.7% and income before income taxes was 204.3 billion yen, an increase of 20.9 billion yen. Net income was 148.6 billion yen, an increase of 20.7 billion yen.

Basic earnings per share were 298.30 yen, an increase of 44.87 yen, or 17.7%, from 253.43 yen in the previous fiscal year.

Economic value added (EVA*), which the Kao Group uses as a management indicator, increased 17.0 billion yen compared with the previous fiscal year to 90.4 billion yen, due to a substantial increase in net operating profit after tax (NOPAT).

** EVA is a registered trademark of Stern Stewart & Co.*

The main exchange rates used for translating the financial statement items (income and expenses) of foreign subsidiaries and associates were as shown below.

	First quarter Jan. – Mar.	Second quarter Apr. – Jun.	Third quarter Jul. – Sep.	Fourth quarter Oct. – Dec.
Yen/U.S. dollar	113.71 (115.31)	111.13 (108.05)	110.97 (102.38)	112.92 (109.41)
Yen/Euro	121.13 (127.15)	122.28 (122.05)	130.35 (114.24)	132.95 (117.88)
Yen/Chinese yuan	16.50 (17.63)	16.19 (16.55)	16.63 (15.36)	17.07 (16.01)

Note: Figures in parentheses represent the exchange rates for the same period of the previous fiscal year.

2) Trends by Segment during the Fiscal Year

Summary of Segment Information

Consolidated Results by Segment

(Billions of yen)

	Net sales				Operating income			Operating margin (%)	
Fiscal year ended December 31	2017	2016	Growth %	Like-for-like%	2017	2016	Change	2017	2016
Beauty Care Business	586.0	601.6	(2.6)	2.1	57.6	51.1	6.5	9.8	8.5
Human Health Care Business	294.3	273.1	7.8	13.0	38.7	25.9	12.7	13.1	9.5
Fabric and Home Care Business	335.7	345.2	(2.7)	1.5	76.1	78.1	(2.0)	22.7	22.6
Consumer Products Business	1,216.0	1,219.8	(0.3)	4.4	172.3	155.1	17.2	14.2	12.7
Chemical Business	310.3	273.8	13.3	10.8	30.3	29.7	0.6	9.8	10.8
Total	1,526.3	1,493.6	2.2	5.5	202.6	184.8	17.8	-	-
Elimination and Reconciliation	(36.9)	(36.0)	-	-	2.2	0.8	1.4	-	-
Consolidated	1,489.4	1,457.6	2.2	5.6	204.8	185.6	19.2	13.7	12.7

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Consolidated Net Sales Composition

(Billions of yen)

Fiscal year ended December 31			Japan	Asia	Americas	Europe	Consolidated
Beauty Care Business	Cosmetics	2017	197.9	22.4	2.8	19.5	242.7
		2016	215.3	18.6	2.6	18.4	255.0
		Growth %	(8.1)	20.6	7.0	6.2	(4.8)
		Like-for-like %	(0.6)	30.2	3.5	5.4	2.1
	Skin care/hair care products	2017	195.9	30.8	72.3	44.2	343.3
		2016	198.3	33.1	68.9	46.4	346.7
		Growth %	(1.2)	(6.7)	4.9	(4.6)	(1.0)
		Like-for-like %	3.1	7.9	3.0	(7.9)	2.1
	Beauty Care Business	2017	393.8	53.3	75.1	63.8	586.0
		2016	413.7	51.7	71.6	64.8	601.6
		Growth %	(4.8)	3.1	5.0	(1.5)	(2.6)
		Like-for-like %	1.2	15.9	3.1	(4.1)	2.1
	Human Health Care Business	2017	197.5	96.7	0.0	-	294.3
		2016	190.8	82.2	0.0	-	273.1
		Growth %	3.5	17.6	-	-	7.8
		Like-for-like %	7.4	25.8	-	-	13.0
	Fabric and Home Care Business	2017	294.8	38.8	2.1	-	335.7
		2016	301.1	42.3	1.7	-	345.2
		Growth %	(2.1)	(8.3)	21.2	-	(2.7)
		Like-for-like %	1.6	0.4	17.7	-	1.5
Consumer Products Business		2017	886.2	188.8	77.3	63.8	1,216.0
		2016	905.6	176.2	73.3	64.8	1,219.8
		Growth %	(2.1)	7.1	5.5	(1.5)	(0.3)
		Like-for-like %	2.6	16.8	3.5	(4.1)	4.4
Chemical Business		2017	123.9	69.6	52.6	64.2	310.3
		2016	118.9	58.8	43.5	52.6	273.8
		Growth %	4.2	18.2	21.0	22.1	13.3
		Like-for-like %	4.3	14.0	17.8	16.2	10.8
Elimination of intersegment		2017	(31.8)	(3.4)	(0.1)	(1.6)	(36.9)
		2016	(31.5)	(3.1)	(0.1)	(1.4)	(36.0)
Consolidated		2017	978.2	255.0	129.8	126.4	1,489.4
		2016	993.0	232.0	116.7	116.0	1,457.6
		Growth %	(1.5)	9.9	11.2	9.0	2.2
		Like-for-like %	2.9	16.2	8.8	5.0	5.6

Note: Figures for the Consumer Products Business present sales to external customers and figures for the Chemical Business include sales to the Consumer Products Business in addition to external customers. To facilitate comparison, sales for the previous fiscal year are restated using the same method. Sales by geographic region are classified based on the location of the sales recognized.

Net sales to foreign customers were 37.0% of net sales compared with 33.8% for the previous fiscal year.

Consumer Products Business

Sales decreased 0.3% compared with the previous fiscal year to 1,216.0 billion yen. On a like-for-like basis, sales increased 4.4%.

In Japan, sales decreased 2.1% to 886.2 billion yen. On a like-for-like basis, sales increased 2.6%. The Kao Group made efforts that included launching numerous high-value-added products and enhancing proposal-oriented sales activities, in addition to strengthening its response to the e-commerce channel.

In Asia, sales increased 7.1% to 188.8 billion yen, with strong growth centered on China, Indonesia and elsewhere. On a like-for-like basis, sales increased 16.8%.

In the Americas, sales increased 5.5% to 77.3 billion yen. On a like-for-like basis, sales increased 3.5%. In Europe, sales decreased 1.5% to 63.8 billion yen. On a like-for-like basis, sales decreased 4.1%.

Operating income increased 17.2 billion yen compared with the previous fiscal year to 172.3 billion yen due to the effect of increased sales in the Human Health Care Business.

Note: The Kao Group's Consumer Products Business consists of the Beauty Care Business, the Human Health Care Business, and the Fabric and Home Care Business.

Beauty Care Business

Sales decreased 2.6% compared with the previous fiscal year to 586.0 billion yen. On a like-for-like basis, sales increased 2.1%.

Sales of cosmetics decreased 4.8% to 242.7 billion yen. On a like-for-like basis, sales increased 2.1%. Outside Japan, the Kao Group was able to substantially expand sales, with strong performance in Asia, mainly in China. However, sales in Japan fell slightly short of the previous fiscal year on a like-for-like basis. In addition to a decline in inbound sales, which grew significantly in 2016, mid-price skin care brands faced an uphill battle. On the other hand, major reforms of the cosmetics business are progressing steadily, and *SOFINA iP* base essence, which also started a rollout in Asia, performed well. The global brand *KANEBO* started a rollout in Europe, in addition to Japan and Asia. Sales of *SUQQU*, a prestige brand available in the department store channel, and *est the lotion*, which was launched in fall 2017, grew strongly.

Sales of skin care and hair care products decreased 1.0% to 343.3 billion yen. On a like-for-like basis, sales increased 2.1%. In skin care products, sales of *Bioré* grew steadily, with good performance in Japan, Asia and the Americas, and a rollout in Europe. In addition, sales of *Curél* derma care products grew strongly in Japan and Asia, due in part to the launch of new products for the aging care market and progress in building a lineup in the cosmetics category. On the other hand, sales of hair care products decreased in Japan due to the impact of the shrinking mass market. In Europe, sales of the *John Frieda* hair care brand decreased, but sales of professional hair care products were nearly on par with the previous fiscal year.

In December 2017, the Kao Group announced the acquisition of Oribe Hair Care, LLC, which owns *Oribe*, a super-premium-price brand in the United States for hair salons.

Operating income increased 6.5 billion yen compared with the previous fiscal year to 57.6 billion yen.

Human Health Care Business

Sales increased 7.8% compared with the previous fiscal year to 294.3 billion yen. On a like-for-like basis, sales increased 13.0%.

Sales of food and beverage products faced an uphill battle as the Kao Group was unable to sufficiently convey the value of the functional drink *Healthya*, which has been approved as a Food for Specified Health Uses (FOSHU), due in part to launches in numerous different fields of FOSHU products and Foods with Functional Claims related to body fat.

Sales of sanitary products increased. Sales of *Merries* baby diapers grew substantially. In Japan, amid fierce competition, sales increased in the domestic market and cross-border e-commerce for the Chinese market also grew substantially. In China, sales grew substantially, due in part to good progress in reforms of the sales structure that have been underway since fiscal 2016 and to increased shipments for e-commerce. In Indonesia, sales of locally manufactured products targeting the middle-class consumer segment grew steadily. Sales of *Laurier* sanitary napkins increased. The brand was hard pressed by fierce competition in Japan, while on the other hand, sales in Asia grew steadily.

Sales of personal health products increased. Sales of oral care products increased with the launch of new products and steady sales of high-performance products. Sales of *MegRhythm Steam Eye Mask* grew steadily as the Kao Group cultivated new users in Japan, despite a decrease in inbound demand compared with the previous fiscal year.

Operating income increased 12.7 billion yen compared with the previous fiscal year to 38.7 billion yen, mainly due to the effect of increased sales in Japan and Asia.

Fabric and Home Care Business

Sales decreased 2.7% compared with the previous fiscal year to 335.7 billion yen. On a like-for-like basis, sales increased 1.5%.

In Japan, sales of fabric care products increased on a like-for-like basis. Sales of laundry detergents were nearly flat in a severe market environment, despite the launch of improved *Attack Neo Antibacterial EX W Power* amid rising consumer awareness of bacteria. Sales of fabric softeners were steady. Growth in sales of home care products was firm due to consumer acceptance of high-value-added products. Sales of *CuCute* dishwashing detergent grew with the market penetration of a spray foam-type product.

In Asia, although price competition in laundry detergents was severe in Thailand and Indonesia, sales were nearly on par with the previous fiscal year.

Operating income decreased 2.0 billion yen compared with the previous fiscal year to 76.1 billion yen due to factors including the effects of increased raw material costs.

Chemical Business

Sales increased 13.3% compared with the previous fiscal year to 310.3 billion yen. On a like-for-like basis, sales increased 10.8%.

Sales of oleo chemicals increased due to factors including efforts to adjust selling prices globally in line with increased raw material costs. Sales of performance chemicals increased, partly due to a market recovery trend in infrastructure-related fields in Japan, in addition to an increase in automobile production volume in Japan, China and elsewhere. Sales of specialty chemicals increased steadily with growth in demand for information material-related, hard disk-related and other products. To expedite the development of water-based pigment inkjet ink that contributes to the mitigation of environmental impact and to accelerate the global expansion of such business, the Kao Group acquired companies in the United States and Europe and made them consolidated subsidiaries as of July 2016 for the company in the United States and as of April 2017 for the company in Europe.

Operating income increased 0.6 billion yen compared with the previous fiscal year to 30.3 billion yen, despite the impact of sharp fluctuations in raw material costs.

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Forecast for the Fiscal Year Ending December 31, 2018 (Billions of yen, except per share amounts)

	2018	2017	Growth
Net sales	1,540.0	1,489.4	3.4%
		Like-for-like*:	3.2%
Operating income	215.0	204.8	5.0%
Operating margin (%)	14.0	13.7	-
Income before income taxes	215.0	204.3	5.2%
Net income attributable to owners of the parent	152.0	147.0	3.4%
Basic earnings per share (Yen)	308.46	298.30	3.4%

**In this table and hereinafter, like-for-like growth rates exclude the effect related of translation of local currencies into Japanese yen.*

1) Forecast of Overall Business Results for the Fiscal Year Ending December 31, 2018

In fiscal 2018, which is the second year of the Kao Group Mid-term Plan “K20,” the Kao Group must lay the foundation for achieving K20 while steadily addressing outstanding issues. The Kao Group will thoroughly instill “*Integrity*,” which is one of the Values of the Kao Way, its corporate philosophy, as it undergoes the reforms of “Transforming Ourselves to Drive Change” set forth in K20 in order to make full use of its assets on an even higher level.

In the Consumer Products Business, the Kao Group will respond with precision to various changes in the business environment as it aims for sustained profitable growth globally with consumer-driven high-value-added products. In the Chemical Business, the Kao Group will work to develop high-value-added products that are not affected by fluctuations in raw material costs and to enhance its eco-chemical products with reduced environmental impact.

As of January 1, 2018, the Kao Group has made major changes in the structure of the Consumer Products Business in Japan. By eliminating the former business unit system to develop a new operating structure, the Kao Group will further speed decision-making and accelerate global growth to achieve profitable growth that includes the revitalization of businesses with issues. Accordingly, from the fiscal year ending December 31, 2018, the former Beauty Care Business will be managed as two separate businesses: the Skin Care and Hair Care Business, which targets the mass market, and the Cosmetics Business. In addition, to improve its comprehensive strengths, expertise, and productivity in its sales structure, the Kao Group combined its sales companies and reorganized its divisional structure into a functional structure, including the establishment of new companies specializing in in-store beauty counseling for cosmetics.

The Kao Group forecasts that net sales will increase 3.4% year on year to 1,540.0 billion yen. On a like-for-like basis, the Kao Group forecasts that net sales will increase 3.2%. The Kao Group expects an increase in sales volume from working to stimulate the market with measures including numerous launches of new and improved products that address diverse preferences and values.

Overall, the Kao Group expects higher raw material costs compared with the previous fiscal year, with prices for natural fats and oils forecast to remain at a relatively stable level and market prices for petrochemicals forecast to rise. The Kao Group will continue to conduct total cost reduction (TCR) activities, reforms of its marketing and sales activities, and other measures to support sustainable growth.

Based on these assumptions, the Kao Group forecasts a 5.0% increase in operating income to 215.0 billion yen, an operating margin of 14.0%, a 5.2% increase in income before income taxes to 215.0 billion yen, and a 3.4% increase in net income attributable to owners of the parent to 152.0 billion yen.

The Kao Group will increase economic value added (EVA) by making full use of its assets to manage invested capital more efficiently, together with an increase in net operating profit after tax (NOPAT).

2) Forecast by Segment for the Fiscal Year Ending December 31, 2018

The following sales figures and growth rates for each business segment are based on the new operating structure implemented in fiscal 2018.

In the Consumer Products Business, the markets for household and personal care products and cosmetics, including inbound demand, are projected to grow slightly on a value basis in Japan. In markets outside Japan, growth is expected to continue in Asia, mainly in China and Indonesia, and moderate growth is projected in the Americas and Europe. Among sales channels, e-commerce is expected to continue to grow globally.

In the Cosmetics Business, the Kao Group will use its reorganization of the operating structure and sales organization to accelerate the major reforms of cosmetics that are currently under way. It will promote structural reforms in Japan while further strengthening its operations in Asia centered on China, where performance is strong. While working to create high-value-added products that leverage its original technologies, the Kao Group will clearly define its core brands and refine each brand to build a strategic brand portfolio. The Kao Group will also reclassify the *Curél* derma care brand, which had formerly been classified as a skin care and hair care product, into this business in fiscal 2018 for management in a new portfolio to further expand the derma care market.

As a result, the Kao Group forecasts that sales in this business will increase 2.3% year on year on a like-for-like basis to 273.8 billion yen.

In the Skin Care and Hair Care Business, the Kao Group will work to revitalize the market by assessing changes in consumer attitudes toward beauty and lifestyle habits as it adds greater value to products and proposes its own originality and appeal. The Kao Group will promote initiatives including launches and cultivation of distinctive new products tailored to changes in consumer needs and reform of marketing activities and sales methods to meet changes in consumer purchasing behavior. In fiscal 2018, the Kao Group will also reclassify *Success* men's products, which had formerly been classified in the Human Health Care Business, into this business for management in a new portfolio to enhance its total hair care proposals.

As a result, the Kao Group forecasts that sales in this business will increase 7.1% year on year on a like-for-like basis to 356.2 billion yen.

The Human Health Care Business will promote product development focused on health care for both body and spirit. In food and beverage products, the Kao Group will reform the business structure to enhance the unique appeal of *Healthya* functional drinks as a FOSHU business differentiated by its high level of functional health value. The Kao Group aims to create sanitary products that are gentle on skin and that offer greater comfort and a sense of confidence. In China, the Kao Group will further strengthen its strategic initiatives in the growing e-commerce channel. In Indonesia, the Kao Group will expand its rollout of baby diapers produced locally targeting the middle-class consumer segment. The Kao Group will work to further raise the brand value of its personal health products by continuing to make original new proposals with products that can become healthy daily lifestyle habits.

As a result, the Kao Group forecasts that sales in this business will increase 3.5% year on year on a like-for-like basis to 291.0 billion yen.

In the Fabric and Home Care Business, the Kao Group will strengthen its brands and offer proposals for enriched daily lives based on insights into changing consumer lifestyles, developing higher-value-added products that offer cleanliness, comfort and enjoyment in various everyday situations. In collaboration with retailers, the Kao Group will further promote its “eco together” environmental statement through measures including instructional activities aimed at reducing environmental impact throughout the entire product lifecycle with refill products for laundry detergents, fabric softeners, household cleaners and other products. The Kao Group will work to develop and nurture products that incorporate its technologies to meet local consumer needs in Asia and will expand its rollout of laundry detergent targeting the middle-class consumer segment in Indonesia.

As a result, the Kao Group forecasts that sales in this business will increase 3.1% year on year on a like-for-like basis to 346.0 billion yen.

In the Chemical Business, the Kao Group will promote global supply of distinctive high-value-added chemical products that meet the diverse needs of a wide range of industries. In oleo chemicals, the Kao Group will stably supply high-quality products to meet increasing demand for fatty alcohols, fatty amines and higher-value-added derivatives made from natural fats and oils, mainly in Asia. In performance chemicals, growth is forecast outside Japan and increased demand for infrastructure is forecast in Japan. In specialty chemicals, the Kao Group will work to expand sales of products related to information materials and strive to offer products that anticipate customer trends.

In addition, the Kao Group will work to expand sales by enhancing development of new products and materials using its unique technologies that contribute to reducing environmental impact in response to rising concern about the global environment, while cultivating the markets of emerging nations, where growth is expected.

As a result, including adjustments in selling prices in response to fluctuations in raw material prices, the Kao Group forecasts that sales in this business will increase 0.2% year on year to 311.0 billion yen. On a like-for-like basis, sales will decrease 0.3%.

3) Underlying Assumptions of the Forecast for the Fiscal Year Ending December 31, 2018

The above forecast was made assuming translation rates of one U.S. dollar to 110 yen, one euro to 135 yen and one Chinese yuan to 17.0 yen.

Please note that although there is potential for volatility in prices of natural fats and oils and petrochemicals, assumptions for prices are based on information currently available to the Kao Group.

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(2) Summary of Financial Position

Summary of Assets, Liabilities, Equity and Cash Flows

1) Summary of Assets, Liabilities, Equity and Cash Flows for the Fiscal Year Ended December 31, 2017

Consolidated Financial Position

(Billions of yen, except per share amounts)

	December 31, 2017	December 31, 2016	Incr./(Dcr.)
Total assets	1,427.4	1,338.3	89.1
Total liabilities	608.0	646.8	(38.8)
Total equity	819.4	691.5	127.9
Ratio of equity attributable to owners of the parent to total assets	56.5%	50.8%	-
Equity attributable to owners of the parent per share (Yen)	1,636.41	1,379.37	257.04
Bonds and borrowings	120.6	120.6	(0.1)

Consolidated Cash Flows

(Billions of yen)

	2017	2016	Incr./(Dcr.)
Net cash flows from operating activities	185.8	184.3	1.5
Net cash flows from investing activities	(96.1)	(88.6)	(7.5)
Free cash flow*	89.7	95.7	(6.0)
Net cash flows from financing activities	(53.2)	(95.0)	41.8

**Free cash flow is the sum of net cash flows from operating activities and net cash flows from investing activities.*

Total assets increased 89.1 billion yen from December 31, 2016 to 1,427.4 billion yen. The principal increases in assets were a 40.0 billion yen increase in cash and cash equivalents, an 8.0 billion yen increase in trade and other receivables, an 18.7 billion yen increase in inventories and a 25.0 billion yen increase in property, plant and equipment. The principal decrease in assets was a 10.0 billion yen decrease in deferred tax assets.

Total liabilities decreased 38.8 billion yen from December 31, 2016 to 608.0 billion yen. The principal increase in liabilities was an 8.0 billion yen increase in trade and other payables. The principal decrease in liabilities was a 30.1 billion yen decrease in retirement benefit liabilities.

Total equity increased 127.9 billion yen from December 31, 2016 to 819.4 billion yen. The principal increases in equity were net income totaling 148.6 billion yen and other comprehensive income totaling 31.3 billion yen. The principal decrease in equity was dividends totaling 50.6 billion yen.

As a result of the above factors, the ratio of equity attributable to owners of the parent to total assets was 56.5% compared with 50.8% at December 31, 2016.

In addition, Kao Corporation retired 9.0 million treasury shares on March 1, 2017.

Net cash flows from operating activities totaled 185.8 billion yen. The principal increases in net cash were income before income taxes of 204.3 billion yen, depreciation and amortization of 54.5 billion yen, increase in trade and other payables of 14.6 billion yen and other, which includes accrued expenses, of 14.5 billion yen. The principal decreases in net cash were increase in inventories of 15.3 billion yen, decrease in retirement benefit liabilities of 30.9 billion yen and income taxes paid of 55.3 billion yen.

Net cash flows from investing activities totaled negative 96.1 billion yen. This primarily consisted of purchase of property, plant and equipment of 83.7 billion yen and purchase of intangible assets of 6.3 billion yen.

Free cash flow, the sum of net cash flows from operating activities and net cash flows from investing activities, was 89.7 billion yen.

Net cash flows from financing activities totaled negative 53.2 billion yen. This primarily consisted of 50.7 billion yen for dividends paid to owners of the parent and non-controlling interests. The Kao Group repaid borrowings of 10.0 billion yen in March 2017 and 20.0 billion yen in September 2017 and borrowed the same amounts, respectively, in order to maintain an appropriate capital cost ratio and strengthen its financial base for growth investments.

The balance of cash and cash equivalents at December 31, 2017 increased 40.0 billion yen compared with December 31, 2016 to 343.1 billion yen, including the effect of exchange rate changes.

2) Forecast of Assets, Liabilities, Equity and Cash Flows for the Fiscal Year Ending December 31, 2018

Net cash flows from operating activities are forecast to be approximately 200.0 billion yen, due in part to an increase in income before income taxes.

Net cash flows from investing activities are planned to be approximately negative 140.0 billion yen, which will include proactive investments for further growth encompassing enhancement and rationalization of production capacity, greater distribution efficiency and other purposes, and payment for the acquisition of the business related to hair salons announced in December 2017.

In net cash flows from financing activities, the Kao Group expects to pay cash dividends and to make other expenditures.

As a result of the above, the balance of cash and cash equivalents as of December 31, 2018 is forecast to be approximately 340.0 billion yen, nearly the same level as in the previous fiscal year.

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(3) Basic Policies Regarding Distribution of Profits and Dividends for the Fiscal Years Ended December 31, 2017 and Ending December 31, 2018

The Kao Group uses economic value added (EVA) as its principal management metric and clearly sets the priority of the uses of its steadily generated cash flow from that viewpoint. Shareholder returns are one such use, and they are implemented after considering future demand for funds and the situation in financial markets.

Priority for use of cash flow:

1. Investment for future growth (capital expenditures, M&A, etc.)
2. Steady and continuous dividends (40% payout ratio target)
3. Share repurchases and early repayment of interest-bearing debt including borrowings

In accordance with these policies, the Company plans to pay a year-end dividend for fiscal 2017 of 56.00 yen per share, an increase of 2.00 yen per share from the forecast announced on October 30, 2017 and an increase of 8.00 yen per share compared with the previous fiscal year. Consequently, cash dividends for the fiscal year will increase 16.00 yen per share compared with the previous fiscal year, resulting in a total of 110.00 yen per share. The consolidated payout ratio will be 36.9%.

For fiscal 2018, the Company plans to pay total cash dividends of 120.00 yen per share (38.9% payout ratio), an increase of 10.00 yen per share compared with the previous fiscal year. This plan is in accordance with the Company's basic policies regarding distribution of profits, and free cash flow and other factors have also been taken into consideration. As a result, the Company is aiming for its 29th consecutive fiscal year of increases in dividends.

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2. Management Policies

1) Management Policies of the Kao Group

The Kao Group's mission is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective. Under this mission, the Kao Group considers its response to the environment, society and governance (ESG) – three elements that contribute to the formation of a sustainable society – to be an investment in the future and will achieve "profitable growth" by placing greater emphasis on this area.

This commitment is embraced by all members of the Kao Group as we further promote efforts to fully utilize our assets and work together with passion to share joy with consumers and customers in our core domains of cleanliness, beauty, health and chemicals.

The Kao Group aims to be a global company that is closest to the consumers and customers in each market, earning the respect and trust of its shareholders and all other stakeholders.

The Kao Group views corporate governance as the cornerstone of management for supporting management's intentions and ambitions from both "proactive" and "protective" aspects and for continuously increasing its corporate value. For this purpose, the Kao Group works for ongoing "*Innovation*"* and further enhances its internal controls for the execution of management that is swift, efficient and sound, as well as impartial and transparent, with the aim of being a company with a global presence.

**Innovation is one of the values of the Kao Way, the corporate philosophy of the Kao Group.*

The Kao Way is the corporate philosophy of the Kao Group. To implement the above policies, all members of the Kao Group will share the Kao Way and put it into practice every day as the foundation of our approaches and actions.

2) Management Metric Used as a Target

As its principal management metric, the Kao Group uses EVA, which measures true profit by factoring in the cost of invested capital. This essentially takes the perspective of shareholders and other asset owners to deploy capital efficiently and generate profits. The Kao Group believes that continuously increasing EVA will lead to increases in corporate value and thus corresponds with long-term benefits, not only for shareholders, but for all stakeholders. The target of the Kao Group's business activities is to increase EVA while expanding its business scale. The Kao Group uses this metric to assess its businesses, to make evaluations on investment in facilities, acquisitions and other items, and to develop performance targets for each fiscal year and for its compensation system.

3) Medium-to-long-term Management Strategies of the Kao Group

(1) Long-term Management Strategy

As its vision by 2030 based on the above management policies, the Kao Group aims to make Kao a company with a global presence by combining sustained “profitable growth,” and “contributions to the sustainability of the world” with proposals to resolve social issues and social contribution activities conducted through its business operations. To achieve this vision, the Kao Group will promote the further reinforcement of the existing businesses that are its strength and the creation of new markets from a global perspective utilizing the R&D capabilities that will create value for the future, in addition to implementing basic measures to further raise the level of safety and reliability.

It is becoming difficult to predict the various changes that will occur throughout the world in all aspects, such as speed, size and direction. To deal with this situation, the Kao Group aims to achieve the above vision by fully embracing the slogan of “Transforming Ourselves to Drive Change.”

The Kao Group’s vision by 2030 is as follows.

Make the Kao Group a company with a global presence that

■ Has a distinctive corporate image

Become a company that is always by the consumer’s side

■ Is a high-profit global consumer goods company that exceeds:

- 2.5 trillion yen in net sales (1.0 trillion yen outside Japan)
- 17% operating margin
- 20% ROE

■ Provides a high level of returns to stakeholders

(2) Mid-term Business Plan

The Kao Group regards its mid-term business plan for the period to 2020 as an important milestone toward achieving its vision by 2030. To enhance corporate value, it established the Kao Group Mid-term Plan 2020 “K20” targeting the four years from fiscal 2017 to fiscal 2020 and announced it publicly on December 12, 2016.

The Kao Group will thoroughly instill the “*Integrity*” set forth in the Kao Way, the Kao Group’s corporate philosophy, by sharing and practicing it among all employees while further enhancing non-financial (ESG) activities. In addition, by taking the full use of its assets to the next dimension, the Kao Group will realize profitable growth at a high level of quality and create new assets to achieve the following goals.

The Kao Group has established “*Kirei** – Making Life Beautiful” as the key message for its ESG activities. The Kao Group aims to create unique experiences and touch the hearts of consumers through products filled with its passion.

**Kirei is a Japanese word that represents the concept of cleanliness, beauty, health, purity, and fairness.*

K20 Goals – Three Commitments

■ Commitment to fostering a distinctive corporate image

■ Commitment to profitable growth

- Continue to set new record highs for profits
- Aim for like-for-like* net sales CAGR of +5%, operating margin of 15%
- Three 100 billion yen brands (*Merries* baby diapers, *Attack* laundry detergents, *Bioré* skin care products)

**Excluding the effect of currency translation, change of sales system, etc.*

■ Commitment to returns to stakeholders

- Shareholders: Continuous cash dividend increases (40% payout ratio target)
- Employees: Continuous improvement in compensation, benefits and health support
- Customers: Maximization of win-win relationships
- Society: Advanced measures to address social issues

The Kao Group must securely build this foundation under K20 to achieve its vision by 2030. This entails promoting the evolution of its post-deflation growth model of using proactive investments to generate earning power, thus achieving profitable growth. Doing so will require drastically revising current procedures, approaches and concepts to maximize and make full use of Kao Group assets. While remaining committed to thoroughly instilling "*Integrity*," the Kao Group will put into practice the K20 slogan of "Transforming Ourselves to Drive Change."

4) Issues for Management

With intensifying market competition, changing market structure and volatility in raw material market conditions and exchange rates, the operating environment remains uncertain. Changes in the attitudes of consumers regarding the environment, health and other matters and associated changes in their purchasing attitudes, as well as the aging society, hygiene and other social issues, are growing in significance. Moreover, amid the global expansion of business and the progress of structural changes in various fields, companies must deal with changes in the risks entailed in their businesses. Under these conditions, the Kao Group will promote both profitable growth and contributions to the sustainability of society through *Yoki-Monozukuri* that is a half-step ahead of these changes. To that end, it will address and deal appropriately with the following issues.

(1) To deal with changes in the risks entailed in its businesses, the Kao Group will define the serious company-wide risks among its main risks as corporate risks and work to prevent damage to the corporate value of the Group as a whole by further enhancing its management system.

(2) Regarding brightening products containing the ingredient Rhododenol sold by Kanebo Cosmetics, for

which a voluntary recall was announced on July 4, 2013, Kanebo Cosmetics has been responding earnestly with support for the recovery and compensation of people who have experienced vitiligo-like symptoms. In addition, the entire Kao Group is making efforts with a view of the tasks before it as working to prevent recurrence while striving to ensure greater safety and reliability.

(3) During fiscal 2017, a portion of cosmetics production at Kao Corporation’s Odawara Factory near Tokyo, Japan was found to be non-compliant with the Fire Service Act. In addition to suspending that portion of production and improving the production system to comply with the Fire Service Act, Kao Corporation inspected the status of compliance with said Act at each of its locations and confirmed that they are operating lawfully. Kao Corporation will strengthen its management system to prevent a recurrence and promote thorough compliance with laws and regulations.

5) Basic Approach to Selection of Accounting Standards

Having decided that unifying accounting standards within the Kao Group will contribute to improving the quality of its business management, the Kao Group has voluntarily adopted International Financial Reporting Standards (IFRS) from the fiscal 2016. This will enable management based on standardized procedures and information for each Group company and business, and the Kao Group intends to reinforce its management foundation in order to increase its corporate value as a global company. The Kao Group also believes that the application of IFRS will facilitate the international comparability of its financial statements in capital markets.

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Consolidated Statement of Financial Position

(Millions of yen)

	December 31, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	343,076	303,026
Trade and other receivables	216,507	208,459
Inventories	183,921	165,200
Other financial assets	14,914	13,038
Income tax receivables	2,653	1,462
Other current assets	28,162	23,812
Subtotal	789,233	714,997
Non-current assets held for sale	147	344
Total current assets	789,380	715,341
Non-current assets		
Property, plant and equipment	395,800	370,835
Goodwill	138,735	137,783
Intangible assets	16,829	14,689
Investments accounted for using the equity method	7,682	4,701
Other financial assets	27,345	25,473
Deferred tax assets	40,918	50,939
Other non-current assets	10,686	18,548
Total non-current assets	637,995	622,968
Total assets	1,427,375	1,338,309

(Millions of yen)

	December 31, 2017	December 31, 2016
Liabilities and equity		
Liabilities		
Current liabilities		
Trade and other payables	224,893	216,893
Bonds and borrowings	25,262	30,289
Other financial liabilities	7,739	8,164
Income tax payables	34,255	32,621
Provisions	4,822	11,370
Contract liabilities	17,296	-
Other current liabilities	107,404	131,112
Total current liabilities	421,671	430,449
Non-current liabilities		
Bonds and borrowings	95,322	90,357
Other financial liabilities	10,091	11,666
Retirement benefit liabilities	64,694	94,773
Provisions	10,617	13,809
Deferred tax liabilities	435	528
Other non-current liabilities	5,181	5,264
Total non-current liabilities	186,340	216,397
Total liabilities	608,011	646,846
Equity		
Share capital	85,424	85,424
Capital surplus	107,980	107,648
Treasury shares	(9,593)	(57,124)
Other components of equity	(12,315)	(21,821)
Retained earnings	634,885	565,715
Equity attributable to owners of the parent	806,381	679,842
Non-controlling interests	12,983	11,621
Total equity	819,364	691,463
Total liabilities and equity	1,427,375	1,338,309

Consolidated Statement of Income

(Millions of yen)

	Notes	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Net sales	1	1,489,421	1,457,610
Cost of sales		(834,107)	(637,502)
Gross profit		655,314	820,108
Selling, general and administrative expenses	2	(452,666)	(633,368)
Other operating income		14,909	13,677
Other operating expenses		(12,766)	(14,846)
Operating income	1	204,791	185,571
Financial income		1,452	1,389
Financial expenses		(3,960)	(5,424)
Share of profit in investments accounted for using the equity method		2,007	1,894
Income before income taxes		204,290	183,430
Income taxes		(55,683)	(55,541)
Net income		148,607	127,889
Attributable to:			
Owners of the parent		147,010	126,551
Non-controlling interests		1,597	1,338
Net income		148,607	127,889
Earnings per share			
Basic (Yen)	3	298.30	253.43
Diluted (Yen)	3	298.09	253.18

Consolidated Statement of Comprehensive Income

(Millions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Net income	148,607	127,889
Other comprehensive income		
Items that will not be reclassified to profit or loss:		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	1,166	(906)
Remeasurements of defined benefit plans	21,260	(16,111)
Share of other comprehensive income of investments accounted for using the equity method	317	(72)
Total of items that will not be reclassified to profit or loss	22,743	(17,089)
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of foreign operations	8,541	(16,661)
Share of other comprehensive income of investments accounted for using the equity method	(1)	(10)
Total of items that may be reclassified subsequently to profit or loss	8,540	(16,671)
Other comprehensive income, net of taxes	31,283	(33,760)
Comprehensive income	179,890	94,129
Attributable to:		
Owners of the parent	178,020	93,284
Non-controlling interests	1,870	845
Comprehensive income	179,890	94,129

Consolidated Statement of Changes in Equity

(Millions of yen)

	Equity attributable to owners of the parent												
				Other components of equity									
	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
January 1, 2017	85,424	107,648	(57,124)	911	(29,761)	4	7,025	-	(21,821)	565,715	679,842	11,621	691,463
Net income	-	-	-	-	-	-	-	-	-	147,010	147,010	1,597	148,607
Other comprehensive income	-	-	-	-	8,221	(0)	1,472	21,317	31,010	-	31,010	273	31,283
Comprehensive income	-	-	-	-	8,221	(0)	1,472	21,317	31,010	147,010	178,020	1,870	179,890
Disposal of treasury shares	-	-	49,373	(165)	-	-	-	-	(165)	(48,914)	294	-	294
Purchase of treasury shares	-	-	(1,842)	-	-	-	-	-	-	-	(1,842)	-	(1,842)
Share-based payment transactions	-	332	-	-	-	-	-	-	-	-	332	-	332
Dividends	-	-	-	-	-	-	-	-	-	(50,265)	(50,265)	(369)	(50,634)
Changes in the ownership interest in a subsidiary	-	(0)	-	-	-	-	-	-	-	-	(0)	-	(0)
Transfer from other components of equity to retained earnings	-	-	-	(15)	-	-	(7)	(21,317)	(21,339)	21,339	-	-	-
Other increase (decrease)	-	-	-	-	-	-	-	-	-	-	-	(139)	(139)
Total transactions with the owners	-	332	47,531	(180)	-	-	(7)	(21,317)	(21,504)	(77,840)	(51,481)	(508)	(51,989)
December 31, 2017	85,424	107,980	(9,593)	731	(21,540)	4	8,490	-	(12,315)	634,885	806,381	12,983	819,364
January 1, 2016	85,424	108,659	(8,202)	902	(13,513)	(3)	8,430	-	(4,184)	499,299	680,996	10,991	691,987
Net income	-	-	-	-	-	-	-	-	-	126,551	126,551	1,338	127,889
Other comprehensive income	-	-	-	-	(16,248)	7	(970)	(16,056)	(33,267)	-	(33,267)	(493)	(33,760)
Comprehensive income	-	-	-	-	(16,248)	7	(970)	(16,056)	(33,267)	126,551	93,284	845	94,129
Disposal of treasury shares	-	-	1,099	(189)	-	-	-	-	(189)	(404)	506	-	506
Purchase of treasury shares	-	-	(50,021)	-	-	-	-	-	-	-	(50,021)	-	(50,021)
Share-based payment transactions	-	-	-	227	-	-	-	-	227	-	227	-	227
Dividends	-	-	-	-	-	-	-	-	-	(44,139)	(44,139)	(955)	(45,094)
Changes in the ownership interest in subsidiaries	-	(1,011)	-	-	-	-	-	-	-	-	(1,011)	1,007	(4)
Transfer from other components of equity to retained earnings	-	-	-	(29)	-	-	(435)	16,056	15,592	(15,592)	-	-	-
Other increase (decrease)	-	-	-	-	-	-	-	-	-	-	-	(267)	(267)
Total transactions with the owners	-	(1,011)	(48,922)	9	-	-	(435)	16,056	15,630	(60,135)	(94,438)	(215)	(94,653)
December 31, 2016	85,424	107,648	(57,124)	911	(29,761)	4	7,025	-	(21,821)	565,715	679,842	11,621	691,463

Consolidated Statement of Cash Flows

(Millions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Cash flows from operating activities		
Income before income taxes	204,290	183,430
Depreciation and amortization	54,508	51,116
Interest and dividend income	(1,295)	(1,247)
Interest expense	1,339	1,484
Share of profit in investments accounted for using the equity method	(2,007)	(1,894)
(Gains) losses on sale and disposal of property, plant and equipment, and intangible assets	3,111	3,466
(Increase) decrease in trade and other receivables	(3,464)	(4,049)
(Increase) decrease in inventories	(15,349)	(17,450)
Increase (decrease) in trade and other payables	14,637	4,388
Increase (decrease) in retirement benefit liabilities	(30,886)	19,967
Other	14,476	(7,175)
Subtotal	239,360	232,036
Interest received	1,069	1,003
Dividends received	2,047	1,479
Interest paid	(1,329)	(1,503)
Income taxes paid	(55,302)	(48,708)
Net cash flows from operating activities	185,845	184,307
Cash flows from investing activities		
Payments into time deposits	(26,673)	(11,570)
Proceeds from withdrawal of time deposits	25,349	3,703
Purchase of property, plant and equipment	(83,663)	(74,637)
Purchase of intangible assets	(6,273)	(5,060)
Acquisition of subsidiaries and businesses	(2,906)	(3,659)
Other	(1,980)	2,584
Net cash flows from investing activities	(96,146)	(88,639)
Cash flows from financing activities		
Increase (decrease) in short-term borrowings	(59)	(44)
Proceeds from long-term borrowings	30,000	200
Repayments of long-term borrowings	(30,090)	(317)
Purchase of treasury shares	(1,842)	(50,021)
Dividends paid to owners of the parent	(50,299)	(44,188)
Dividends paid to non-controlling interests	(369)	(955)
Other	(585)	282
Net cash flows from financing activities	(53,244)	(95,043)
Net increase (decrease) in cash and cash equivalents	36,455	625
Cash and cash equivalents at the beginning of the year	303,026	309,922
Effect of exchange rate changes on cash and cash equivalents	3,595	(7,521)
Cash and cash equivalents at the end of the year	343,076	303,026

Notes to Consolidated Financial Statements

Changes in Accounting Policies
Early Adoption of IFRS 15 "Revenue from Contracts with Customers" and its amendments

In the fiscal year ended December 31, 2017, the Kao Group early adopted IFRS 15 "Revenue from Contracts with Customers" (issued in May 2014) and "Clarifications to IFRS 15" (issued in April 2016) (together, hereinafter "IFRS 15"). As a transitional measure upon the early adoption of IFRS 15, the Kao Group applies this Standard retrospectively with the cumulative effect of initially applying this Standard recognized at the date of initial application.

In accordance with the adoption of IFRS 15, revenue is recognized based on the following five-step model.

Step 1: Identify the contract with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognize revenue when the entity satisfies a performance obligation

The Kao Group sells consumer products including cosmetics, skin care products, hair care products, sanitary products and fabric care products, as well as chemical products including fatty alcohols and surfactants. For sales of such products, because the customer obtains control over the products upon delivery, the performance obligation is judged to have been satisfied and revenue is therefore recognized upon delivery of the products. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates, returned products and other items.

Based on the above five-step model, as a result of identification of performance obligations under contracts with customers, the portion of sales promotion and other expenses that is consideration paid by the Kao Group to customers, which had previously been accounted for as selling, general and administrative expenses, is accounted for as reductions of net sales from the fiscal year ended December 31, 2017. In addition, freight/warehouse expenses, employee benefits and other expenses necessary for satisfying performance obligations that had previously been accounted for as selling, general and administrative expenses are accounted for as cost of sales from the fiscal year ended December 31, 2017.

As a result, compared with the application of the former accounting standard, net sales decreased by 45,742 million yen, selling, general and administrative expenses decreased by 174,999 million yen, and cost of sales increased by 129,257 million yen on the consolidated statement of income for the fiscal year ended December 31, 2017. These changes had no effect on operating income and net income.

In addition, with the application of IFRS 15, under current liabilities, refund liabilities for rebates, which had previously been included in "Trade and other payables," liabilities for returned products, which had previously been included in "Provisions," and refund liabilities for rebates and other payments and advances received from customers, which had previously been included in "Other current liabilities" are presented as "Contract liabilities."

As a result, compared with the application of the former accounting standard, as of the end of the fiscal year ended December 31, 2017, “Trade and other payables” under current liabilities decreased 2,279 million yen and as of the beginning and end of the fiscal year ended December 31, 2017, “Provisions” under current liabilities decreased by 3,965 million yen and 3,049 million yen, respectively, and “Other current liabilities” decreased by 12,582 million yen and 11,968 million yen, respectively, on the consolidated statement of financial position.

1. Segment Information

(1) Summary of reportable segments

Major products by reportable segment are as follows:

<table>
<tr><th colspan="2">Reportable Segments</th><th colspan="2">Major Products</th></tr>
<tr><td rowspan="8">Consumer Products Business</td><td rowspan="3">Beauty Care Business</td><td>Cosmetics</td><td>Counseling cosmetics, Self-selection cosmetics</td></tr>
<tr><td>Skin care products</td><td>Soaps, Facial cleansers, Body cleansers</td></tr>
<tr><td>Hair care products</td><td>Shampoos, Conditioners, Hair styling agents, Hair coloring agents</td></tr>
<tr><td rowspan="3">Human Health Care Business</td><td>Food and beverage products</td><td>Beverages</td></tr>
<tr><td>Sanitary products</td><td>Sanitary napkins, Baby diapers</td></tr>
<tr><td>Personal health products</td><td>Bath additives, Oral care products, Men's products, Thermo products</td></tr>
<tr><td rowspan="2">Fabric and Home Care Business</td><td>Fabric care products</td><td>Laundry detergents, Fabric treatments</td></tr>
<tr><td>Home care products</td><td>Kitchen cleaning products, House cleaning products, Paper cleaning products, Commercial-use products</td></tr>
<tr><td colspan="2" rowspan="3">Chemical Business</td><td>Oleo chemicals</td><td>Fatty alcohols, Fatty amines, Fatty acids, Glycerin, Commercial-use edible fats and oils</td></tr>
<tr><td>Performance chemicals</td><td>Surfactants, Plastics additives, Superplasticizers for concrete admixtures</td></tr>
<tr><td>Specialty chemicals</td><td>Toner and toner binder for copiers and printers, Ink and colorants for inkjet printers, Fragrances and aroma chemicals</td></tr>
</table>

(2) Sales and results of reportable segments

(Millions of yen)

Fiscal year ended December 31, 2017	Reportable Segments: Consumer Products Business: Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliations[1]	Consolidated
Net sales								
Sales to customers	585,995	294,292	335,709	1,215,996	273,425	1,489,421	-	1,489,421
Intersegment sales and transfers[2]	-	-	-	-	36,860	36,860	(36,860)	-
Total net sales	585,995	294,292	335,709	1,215,996	310,285	1,526,281	(36,860)	1,489,421
Operating income (loss)	57,596	38,661	76,057	172,314	30,299	202,613	2,178	204,791
% of net sales	9.8	13.1	22.7	14.2	9.8	-	-	13.7
Financial income								1,452
Financial expenses								(3,960)
Share of profit in investments accounted for using the equity method								2,007
Income before income taxes								204,290
Depreciation and amortization	17,855	16,031	8,883	42,769	11,479	54,248	260	54,508
Capital Expenditure[3]	27,422	23,892	12,675	63,989	15,245	79,234	121	79,355

Notes:
1. The operating income reconciliation of 2,178 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Capital expenditures include investments in property, plant and equipment and intangible assets.

(Millions of yen)

Fiscal year ended December 31, 2016	Reportable Segments: Consumer Products Business: Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliations[1]	Consolidated
Net sales								
Sales to customers	601,620	273,067	345,163	1,219,850	237,760	1,457,610	-	1,457,610
Intersegment sales and transfers[2]	-	-	-	-	36,025	36,025	(36,025)	-
Total net sales	601,620	273,067	345,163	1,219,850	273,785	1,493,635	(36,025)	1,457,610
Operating income (loss)	51,086	25,948	78,099	155,133	29,683	184,816	755	185,571
% of net sales	8.5	9.5	22.6	12.7	10.8	-	-	12.7
Financial income								1,389
Financial expenses								(5,424)
Share of profit in investments accounted for using the equity method								1,894
Income before income taxes								183,430
Depreciation and amortization	18,399	12,930	7,876	39,205	11,650	50,855	261	51,116
Capital Expenditure[3]	20,135	41,752	16,050	77,937	11,877	89,814	86	89,900

Notes:
1. The operating income reconciliation of 755 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Capital expenditures include investments in property, plant and equipment, intangible assets and other non-current assets.

(3) Geographical Information

The breakdown of sales to customers and non-current assets (excluding financial assets, deferred tax assets and retirement benefit assets) by geographic area is as follows:

(Millions of yen)

Sales to customers	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Japan	938,074	964,904
Asia	288,087	251,284
(China)	134,751	103,346
Americas	134,219	120,782
(United States)	102,763	93,148
Europe	129,041	120,640
Total	1,489,421	1,457,610

Note: Sales are classified based on the location of customers.

Non-current assets (excluding financial assets, deferred tax assets and retirement benefit assets)	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Japan	431,673	415,993
Asia	85,290	81,927
Americas	22,610	22,854
Europe	28,935	24,731
Total	568,508	545,505

2. Selling, General and Administrative Expenses

The breakdown of selling, general and administrative expenses is as follows:

(Millions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Freight/warehouse	55	58,168
Advertising	89,935	97,437
Sales promotion	58,940	83,161
Employee benefits	147,007	191,122
Depreciation	8,870	11,236
Amortization	4,784	6,173
Research and development	56,703	54,567
Other	86,372	131,504
Total	452,666	633,368

The note “Changes in Accounting Policies” in “Notes to Consolidated Financial Statements” presents the impact on selling, general and administrative expenses resulting from the adoption of IFRS 15. As a transitional measure upon the adoption of IFRS 15, the Kao Group applies this Standard retrospectively with the cumulative effect of initially applying this Standard recognized at the date of initial application and thus has not adjusted the amounts for the comparative period. Expenses of 17,703 million yen, 1,344 million yen, 24,653 million yen and 2,042 million yen previously included in “Freight/warehouse,” “Advertising,” “Sales promotion” and “Other,” respectively, are accounted for as reductions of net sales. Expenses of 44,887 million yen, 3,106 million yen, 52,725 million yen, 2,874 million yen, 96 million yen and 25,569 million yen previously included in “Freight/warehouse,” “Sales promotion,” “Employee benefits,” “Depreciation,” “Amortization” and “Other,” respectively, are accounted for as cost of sales. As a result, compared with the application of the former accounting standard, selling, general and administrative expenses decreased by 174,999 million yen.

Furthermore, as an additional item other than the adoption of IFRS 15 impacting selling, general and administrative expenses, the Kao Group revised its sales system for the Consumer Products Business in Japan in the fiscal year ended December 31, 2017. Expenses of 1,735 million yen and 21,672 million yen previously included in “Sales promotion” and “Other,” respectively, are accounted for as reductions of net sales. As a result, selling, general and administrative expenses decreased by 23,407 million yen.

3. Earnings per Share

(1) The basis for calculating basic earnings per share

(Millions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Net income attributable to owners of the parent	147,010	126,551
Amounts not attributable to ordinary shareholders of the parent	-	-
Net income used to calculate basic earnings per share	147,010	126,551
		(Thousands of shares)
Weighted average number of ordinary shares	492,832	499,355
		(Yen)
Basic earnings per share	298.30	253.43

(2) The basis for calculating diluted earnings per share

(Millions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2016
Net income used to calculate basic earnings per share	147,010	126,551
Adjustments to net income	-	-
Net income used to calculate diluted earnings per share	147,010	126,551
		(Thousands of shares)
Weighted average number of ordinary shares	492,832	499,355
Increase in ordinary shares		
Subscription rights to shares	337	483
Weighted average number of ordinary shares after dilution	493,170	499,838
		(Yen)
Diluted earnings per share	298.09	253.18
Summary of potential ordinary shares not included in the calculation of diluted earnings per share because they have no dilutive effect	-	-

4. Significant Subsequent Events

None applicable.

Notes regarding Assumption of Going Concern

None applicable.