Financial Report 2017

For the year ended December 31, 2017

Enriching lives,
in harmony with nature.

Kao

Management Discussion and Analysis

In the fiscal year ended December 31, 2017 (fiscal 2017), the Kao Group adopted International Financial Reporting Standards (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. 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.

Management Policies

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.

Management Metric Used as a Target

As its principal management metric, the Kao Group uses economic value added (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.

* EVA is a registered trademark of Stern Stewart & Co. EVA is defined as net operating profit after tax (NOPAT) less a charge for the cost of capital employed in the business.

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

Long-term Management Strategy

Long-term Targets

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

Make Kao 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 in net sales (¥1.0 trillion outside Japan)
  - 17% operating margin
  - 20% ROE
- Provides a high level of returns to stakeholders

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 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 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

Cash Dividends per Share

Note: Impact of share splits is reflected retroactively.

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."

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.

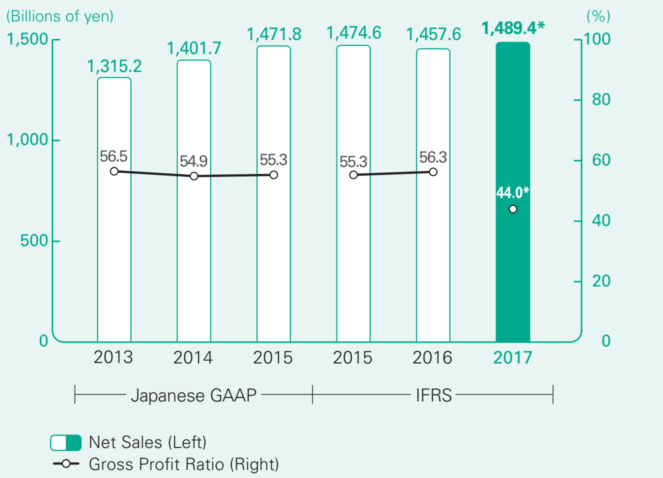
* The Kao Group defines *Yoki-Monozukuri* as a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction. In Japanese, *Yoki* literally means "good/excellent," and *Monozukuri* means "development/manufacturing of products."

(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.

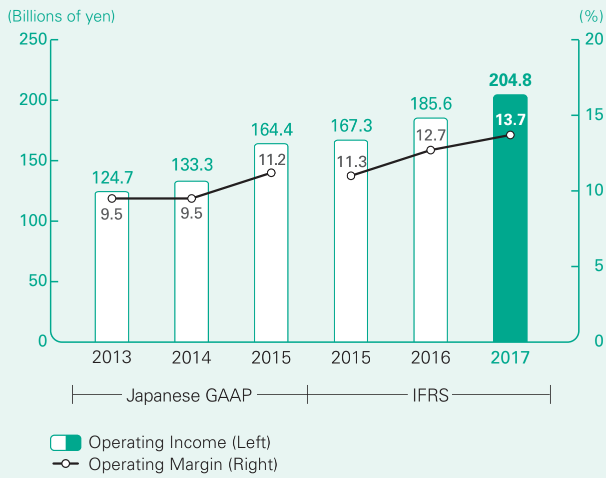
(3) During fiscal 2017, a portion of cosmetics production at Kao Corporation's Odawara Factory near Tokyo, Japan was found to be non-compliant with the Fire Service

Net Sales / Gross Profit Ratio



* In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan. As a result, certain items formerly treated as SG&A expenses are accounted for as reductions of net sales or cost of sales.

Operating Income / Operating Margin



Costs, Expenses and Income as Percentages of Net Sales

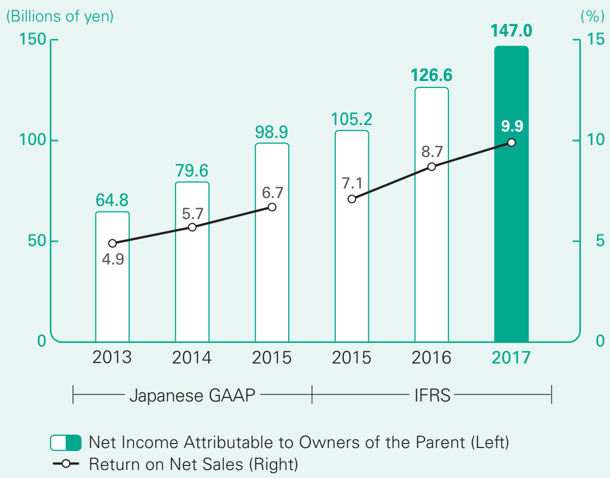
	IFRS			Japanese GAAP
Years ended December 31, 2017, 2016 and 2015	2017	2016	2015	2015
Cost of sales	56.0%	43.7%	44.7%	44.7%
Gross profit	44.0	56.3	55.3	55.3
Selling, general and administrative expenses	30.4	43.5	43.6	44.1
Operating income	13.7	12.7	11.3	11.2
Income before income taxes and minority interests	—	—	—	11.0
Income before income taxes	13.7	12.6	11.3	—
Net income	—	—	—	6.7
Net income attributable to owners of the parent	9.9	8.7	7.1	—

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.

Basic Approach to Selection of Accounting Standards

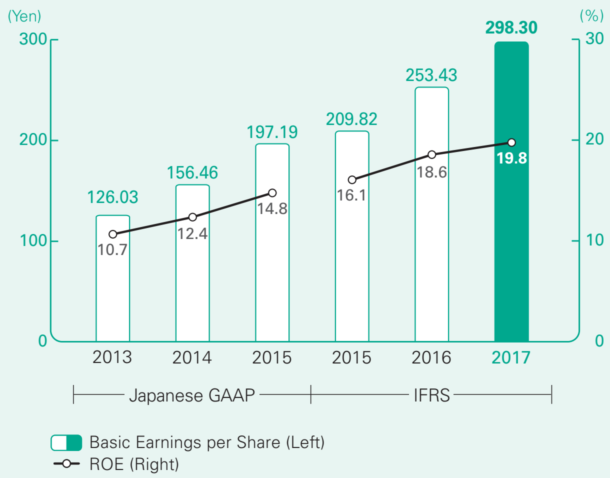
Having decided that unifying accounting standards within the Kao Group will contribute to improving the quality of its business management, the Kao Group has voluntarily adopted IFRS from the fiscal year ended December 31, 2016 (fiscal 2016). This will enable management based on standardized procedures 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

Net Income Attributable to Owners of the Parent* / Return on Net Sales



* Net income attributable to owners of the parent was reported as net income under Japanese GAAP for the years ended December 31, 2013 to 2015.

Basic Earnings per Share / ROE



the application of IFRS will facilitate the international comparability of its financial statements in capital markets.

Overview of Consolidated Results

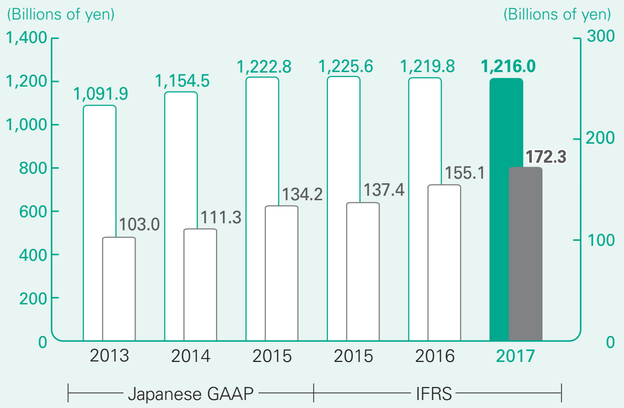
The Kao Group got off to a smooth start in fiscal 2017, the first fiscal year of the Kao Group Mid-term Plan K20 covering the four years from 2017 to 2020. Consolidated operating results met the forecast announced on October 30, 2017, and the Kao Group was able to increase operating income and net income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

Net Sales / Operating Income

Consumer Products Business



Note: In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan.

Net Sales (Left)
Operating Income (Right)

Analysis of Income Statement

Net sales increased 2.2% compared with the previous fiscal year to ¥1,489.4 billion. 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, an increase of ¥19.2 billion compared with the previous fiscal year, the operating margin was 13.7% and income before income taxes was ¥204.3 billion, an increase of ¥20.9 billion. Net income was ¥148.6 billion, an increase of ¥20.7 billion.

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

Information by Segment

Consumer Products Business

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

In Japan, sales decreased 2.1% to ¥886.2 billion. 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, 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. On a like-for-like basis, sales increased 3.5%. In Europe, sales decreased 1.5% to ¥63.8 billion. On a like-for-like basis, sales decreased 4.1%.

Operating income increased ¥17.2 billion compared with the previous fiscal year to ¥172.3 billion 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. On a like-for-like basis, sales increased 2.1%.

Sales of cosmetics decreased 4.8% to ¥242.7 billion. 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

Net Sales / EBITDA / Operating Income / Capital Expenditure

Notes: In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan. 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.

Net Sales (Left)
EBITDA (Right)
Operating Income (Right)
Capital Expenditure (Right)

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. 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 compared with the previous fiscal year to ¥57.6 billion.

Human Health Care Business

Sales increased 7.8% compared with the previous fiscal year to ¥294.3 billion. 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 compared with the previous fiscal year to ¥38.7 billion, 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. 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 compared with the previous fiscal year to ¥76.1 billion 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. 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 compared with the previous fiscal year to ¥30.3 billion, despite the impact of sharp fluctuations in raw material costs.

Financial Position

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

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

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

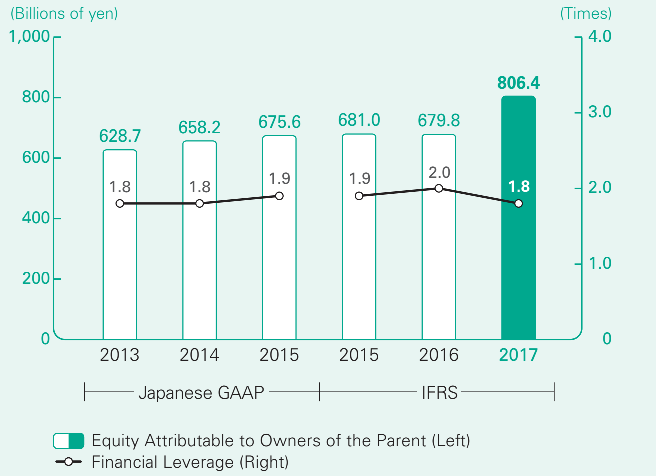
As a result of the above factors, the ratio of equity attributable to owners of the parent to total assets was 56.5% compared with 50.8% at December 31, 2016.

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

Cash Flows

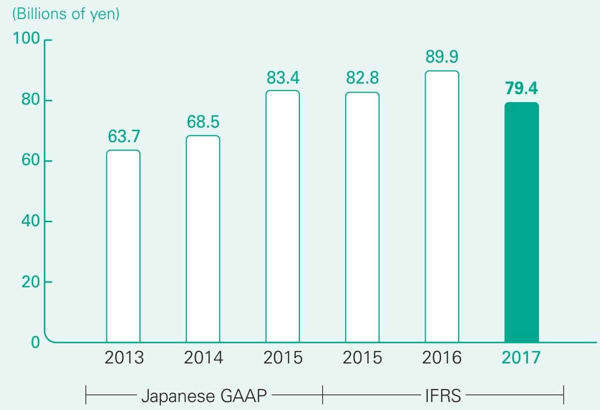
The balance of cash and cash equivalents at December 31, 2017 increased ¥40.0 billion compared with December 31, 2016 to ¥343.1 billion, including the effect of exchange rate changes.

Equity Attributable to Owners of the Parent[1] / Financial Leverage[2]



1. Equity attributable to owners of the parent is presented as net worth under Japanese GAAP as of December 31, 2013 to 2015. Net worth is equity, excluding minority interests and stock acquisition rights.
2. Financial Leverage = Total Assets ÷ Equity Attributable to Owners of the Parent

Capital Expenditures



Cash Flows from Operating Activities

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

Cash Flows from Investing Activities

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

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

Cash Flows from Financing Activities

Net cash flows from financing activities totaled negative ¥53.2 billion. This primarily consisted of ¥50.7 billion for dividends paid to owners of the parent and non-controlling interests. The Kao Group repaid borrowings of ¥10.0 billion in March 2017 and ¥20.0 billion 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.

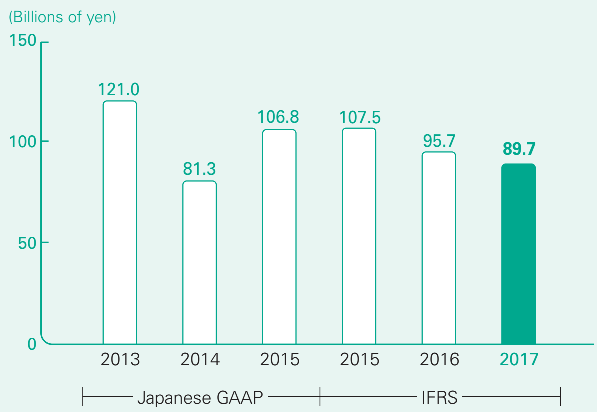
Basic Policies Regarding Distribution of Profits and Dividends for the Period

From the standpoint of EVA, the Kao Group makes effective use of its steadily generated operating cash flow for the following purposes toward further growth.

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

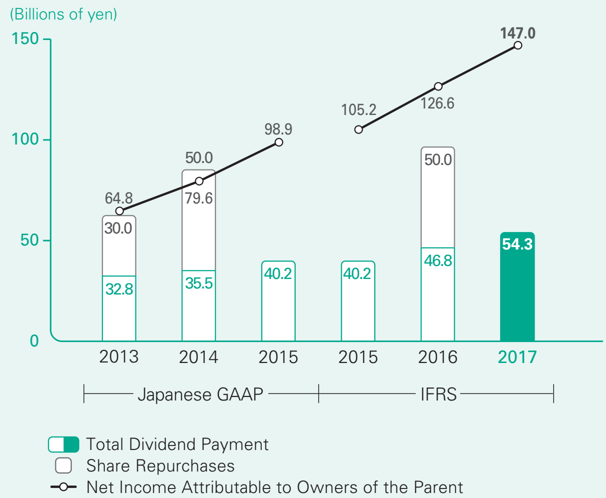
In accordance with this policy, the Company announced a year-end dividend for fiscal 2017 of ¥56.00 per share, an increase of ¥2.00 per share from the forecast announced on October 30, 2017 and an increase of ¥8.00 per share

Free Cash Flows*



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

Total Dividend Payment / Share Repurchases* / Net Income Attributable to Owners of the Parent



* Excludes repurchase of shares of less than one trading unit

compared with the previous fiscal year. Consequently, cash dividends for the fiscal year will increase ¥16.00 per share compared with the previous fiscal year, resulting in a total of ¥110.00 per share. The consolidated payout ratio was 36.9%.

For fiscal 2018, the Company plans to pay total cash dividends of ¥120.00 per share (38.9% payout ratio), an increase of ¥10.00 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.

EVA and Related Activities

EVA for fiscal 2017 was ¥90.4 billion, an increase of ¥17.0 billion compared with the previous fiscal year due to a substantial increase in net operating profit after tax (NOPAT), despite an increase in capital costs from the previous fiscal year.

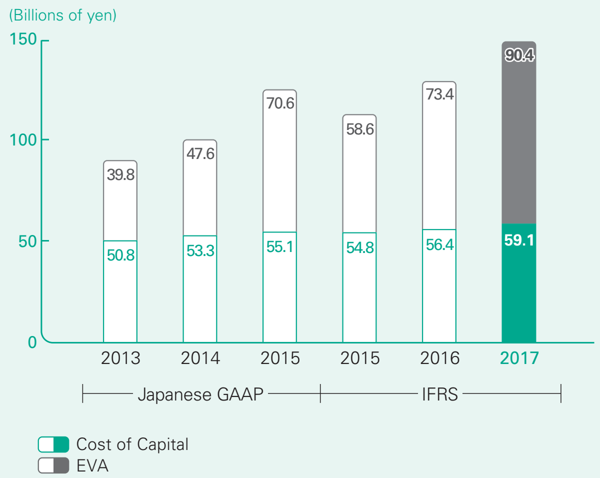
The Kao Group conducted the following EVA-related activities during the fiscal year.

Investing for Growth: During fiscal 2017, the Kao Group invested aggressively for future growth. Capital expenditures were ¥79.4 billion. In the Consumer Products Business, the Kao Group carried out activities including facility expansion, streamlining, maintenance and renewal in each of its businesses. The Kao Group reinforced its supply system in the Human Health Care Business by expanding production capacity at its factories for sanitary products inside and outside Japan, and completed the construction of a new production building in the Beauty Care Business to enhance production capacity in Taiwan. In the Chemical Business, the Kao Group expanded production capacity inside and outside Japan, in addition to conducting activities including streamlining, maintaining and renewing facilities. The closing for the acquisition of a hair salon business in the United States that was announced in December 2017 took place in January 2018. Research and development expenditures were ¥56.7 billion, which was the equivalent of 3.8% of net sales, remaining at a high level relative to net sales.

Increasing Profit: Costs for raw materials such as natural fats and oils increased during fiscal 2017. However, due to efforts to address this issue by working to adjust selling prices in the Chemical Business, as well as market growth, launches of new and improved products, stepped-up sales promotion activities and other factors in the Consumer Products Business in Japan, the Kao Group continued to achieve double-digit growth in operating income compared with the previous fiscal year.

Financial Improvement: For fiscal 2017, Kao Corporation paid annual dividends per share of ¥110.00, an increase of ¥2.00 per share from its initial forecast and a year-on-year increase of ¥16.00, or 17%. As a result, Kao Corporation has achieved 28 consecutive fiscal periods of dividend growth, the longest for a listed company in Japan.

EVA / Cost of Capital



Business Risks and Other Risks

Various risks arise in the course of a company's business. The Kao Group manages risks appropriately by identifying and evaluating risks to formulate and implement necessary countermeasures, among other activities. In addition, in the event a risk manifests itself, the Kao Group sets up an emergency response organization and strives to minimize damage and loss by responding promptly. However, in the event a major risk such as those described below manifests itself, it may exert a significant impact on the Kao Group's business results and financial condition. The major risks described below are not a comprehensive list of risks the Kao Group faces. Other risks exist and may have an impact on investment decisions. Any statements below concerning the future are judgments made by Kao Corporation as of the submission of its securities report to the Ministry of Finance.

(1) Consumer Products Business

1. Response to Changes in Consumer Needs

The Kao Group's Consumer Products Business is affected by business cycles and changes in consumers' values in the market of each country. The Consumer Products Business maintains and improves brand value by understanding changes in consumer needs and using the comprehensive strength of the Kao Group's product development and manufacturing in working to create high-value-added products and provide services through approaches in areas including the environment, health, the aging society and hygiene. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to provide products and services that respond to changes in consumer needs and brand value could decrease. This could have an impact on the Kao Group's business results and financial condition.

2. Response to Changes in Retailing

The Kao Group's Consumer Products Business is affected by changes in the structure of retailing, including progress in the creation of new corporate groups through retail industry mergers and integration in the market, and the emergence and expansion of new retail channels. The Consumer Products Business conducts sales activities and makes new offerings that respond to these structural changes. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to conduct sales activities or make new offerings that respond to these structural changes. This could have an impact on the Kao Group's business results and financial condition.

(2) Chemical Business

The Kao Group's Chemical Business is affected by factors including trends in customer demand and fluctuations in raw material prices. The Chemical Business promotes creation of high-value-added products that match customer needs, conducts research and development of products in consideration of the environment, and provides such products while working to reduce costs and deal with product prices. However, as a consequence of uncertainties in these business activities due to various factors, the Chemical Business may be unable to provide products that match customer needs or respond to matters such as fluctuations in raw material prices. This could have an impact on the Kao Group's business results and financial condition.

(3) Business Acquisitions, Business Alliances and Mergers

The Kao Group may implement business acquisitions, business alliances, mergers or other such measures. When implementing them, the Kao Group makes decisions after thoroughly assessing economic value and its partner companies. However, due to various unforeseeable uncertainties in its business activities, the Kao Group may be unable to produce the results it initially expected. This could have an impact on the Kao Group's business results and financial condition.

(4) Overseas Business Expansion

As one of its growth strategies, the Kao Group is conducting operations in markets in Asia, the Americas, Europe and elsewhere, with a particular emphasis on strengthening its operations in countries where higher economic growth rates and market expansion are forecast. However, the Kao Group may be unable to strengthen its operations as a consequence of uncertainties due to various factors in the course of business including the occurrence of a slowdown in economic growth or uncertain political or social conditions, intensifying competition, the inability to conduct sufficient cost management or the emergence of problems in relationships with retail outlets, sales agents or other trading partners. This could have an impact on the Kao Group's business results and financial condition.

(5) Procurement of Raw Materials

Market prices for natural fats and oils and petroleum-related materials used as raw materials for products of the Kao Group are affected by factors including geopolitical risks, the balance between supply and demand, abnormal weather and exchange rate fluctuations. The Kao Group has moved to reduce the effect of increases in raw material prices through measures including cost reductions and passing on increases in raw material costs into product prices. In addition, the Kao Group is conducting development of substitute raw materials for natural fats and oils through research into advanced effective utilization of non-edible raw materials. However, unexpected radical changes in market prices could have an impact on the Kao Group's business results and financial condition.

(6) Product Quality

The Kao Group designs and manufactures products from the viewpoint of consumers, in compliance with related laws and regulations and voluntary standards. In the development stage prior to market launch, the Kao Group conducts thorough safety testing and survey research to confirm the safety of products. After market launch, the Kao Group works to further improve quality by incorporating the opinions and desires of consumers through its consumer communication centers. However, the unanticipated occurrence of a serious quality problem or concerns about product safety or reliability resulting from new scientific knowledge would not only cause difficulties for the relevant brand, but would also have a major impact on the reputation of all of the Kao Group's products. This could have an impact on the Kao Group's business results and financial condition.

(7) Response to Natural Disasters, Accidents and Other Incidents

To deal with earthquakes and other natural disasters, the Kao Group has formulated disaster countermeasures for its production facilities and primary offices and a business continuity plan (BCP), and will continue to strengthen and reinforce them in the future. However, the occurrence and consequent damage of an earthquake on a scale exceeding assumptions that hinder the supply of products to the market due to problems in areas such as securing raw materials and maintaining production, among other impediments, could have a serious impact on the Kao Group's business results and financial condition. In addition, the emergence of major changes in demand trends due to a worsening economic environment associated with the earthquake could have a serious impact on the Kao Group's business results and financial condition. Furthermore, the occurrence of an explosion or fire at production facilities, information and control system malfunction, problems at a supplier of raw materials, dysfunction of social infrastructures such as electric power and water, environmental pollution from harmful substances, the spread of infectious disease, terrorism, political change, riots and other incidents could hinder the supply of products to the market. This could have a serious impact on the Kao Group's reputation, business results and financial condition.

(8) Currency Exchange Rate Fluctuations

Foreign currency-denominated transactions are affected by changes in currency exchange rates. The Kao Group hedges foreign exchange risk through various measures such as settlement of transactions through foreign currency accounts, foreign exchange contracts, and currency swaps to mitigate the effect on business results. The Kao Group does not engage in derivative transactions for the purpose of speculation. However, because items on the financial statements of overseas consolidated subsidiaries are translated into Japanese yen, substantial variance in the exchange rate from the expected rate at the time of conversion will have an impact on the Kao Group's business results and financial condition.

(9) Impact of Deferred Tax Assets and Impairment

The Kao Group records various tangible fixed assets and intangible assets and deferred tax assets including assets used in the course of business and goodwill incurred in corporate acquisitions. The Kao Group may not generate the expected cash flow due to divergence from planned future business results, a decline in market value or other factors. This could have an impact on the Kao Group's business results and financial condition.

(10) Securing Human Capital

The Kao Group strives to secure diverse, superior human capital to achieve its business goals globally. Human capital with advanced expertise in areas such as research and development, production, marketing and sales is indispensable in aiming for the *Yoki-Monozukuri* (see note on page 3) that consumers support. However, an inability to secure the necessary human capital due to changes in employment conditions or other factors could have an impact on the Kao Group's business results and financial condition.

(11) Compliance with Laws and Regulations

In the course of its business activities, the Kao Group must comply with a variety of laws and regulations concerning areas such as standards for product quality and safety, the environment and chemical substances, as well as accounting standards, tax law and regulations related to labor and transactions. The Kao Group has constructed a compliance system and strives to comply with all related laws and regulations. However, a serious legal violation by the Kao Group or by a consignee or other party could have an impact on the Kao Group's reputation, business results and financial condition. Moreover, a change in current laws and regulations, or new laws and regulations could restrict the Kao Group's business activities, require investment for compliance, or otherwise affect the Kao Group. This could have an impact on the Kao Group's business results and financial condition.

(12) Information Management

The Kao Group possesses confidential information related to matters including research and development, production, marketing and sales, as well as the personal information of numerous customers used for product development, sales promotion and other purposes. The Kao Group conducts thorough information management using guidelines for handling information and implements appropriate security measures for its information systems, including both hardware and software. However, a leak of confidential or personal information held by the Kao Group resulting from an attack on its server, unlawful access, a computer virus or other factor that exceeds expectations could have an impact on the Kao Group's reputation, business results and financial condition.

(13) Litigation

The Kao Group conducts diverse businesses globally, and various types of litigation may be brought against it. The result of such litigation could have an impact on the Kao Group's business results and financial condition.

Consolidated Statement of Financial Position

Kao Corporation and Consolidated Subsidiaries
As of December 31, 2017

(Millions of yen)

Assets	Notes	2017	2016
Current assets			
Cash and cash equivalents	8, 35	343,076	303,026
Trade and other receivables	9, 35	216,507	208,459
Inventories	10	183,921	165,200
Other financial assets	35	14,914	13,038
Income tax receivables		2,653	1,462
Other current assets	11	28,162	23,812
Subtotal		789,233	714,997
Non-current assets held for sale	12	147	344
Total current assets		789,380	715,341
Non-current assets			
Property, plant and equipment	13	395,800	370,835
Goodwill	14	138,735	137,783
Intangible assets	14	16,829	14,689
Investments accounted for using the equity method	15	7,682	4,701
Other financial assets	35	27,345	25,473
Deferred tax assets	16	40,918	50,939
Other non-current assets	11, 20	10,686	18,548
Total non-current assets		637,995	622,968
Total assets		1,427,375	1,338,309

Liabilities and equity	Notes	2017	2016
Liabilities			
Current liabilities			
Trade and other payables	19, 35	224,893	216,893
Bonds and borrowings	17, 35	25,262	30,289
Other financial liabilities	18, 35	7,739	8,164
Income tax payables		34,255	32,621
Provisions	21	4,822	11,370
Contract liabilities	26	17,296	—
Other current liabilities	22	107,404	131,112
Total current liabilities		421,671	430,449
Non-current liabilities			
Bonds and borrowings	17, 35	95,322	90,357
Other financial liabilities	18, 35	10,091	11,666
Retirement benefit liabilities	20	64,694	94,773
Provisions	21	10,617	13,809
Deferred tax liabilities	16	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	23	85,424	85,424
Capital surplus	23	107,980	107,648
Treasury shares	23	(9,593)	(57,124)
Other components of equity	23	(12,315)	(21,821)
Retained earnings	23	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

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2017

(Millions of yen)

	Notes	2017	2016
Net sales	6, 26	1,489,421	1,457,610
Cost of sales	10,13,14,20	(834,107)	(637,502)
Gross profit		655,314	820,108
Selling, general and administrative expenses	13,14,20,27	(452,666)	(633,368)
Other operating income	13,26,28	14,909	13,677
Other operating expenses	13,14,20,29	(12,766)	(14,846)
Operating income	6	204,791	185,571
Financial income	6,20,30	1,452	1,389
Financial expenses	6,20,30	(3,960)	(5,424)
Share of profit in investments accounted for using the equity method	6,15	2,007	1,894
Income before income taxes	6	204,290	183,430
Income taxes	16	(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)	31	298.30	253.43
Diluted (Yen)	31	298.09	253.18

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2017

(Millions of yen)

	Notes	2017	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	32, 35	1,166	(906)
Remeasurements of defined benefit plans	32	21,260	(16,111)
Share of other comprehensive income of investments accounted for using the equity method	32	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	32	8,541	(16,661)
Share of other comprehensive income of investments accounted for using the equity method	32	(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

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2017

(Millions of yen)

		Equity attributable to owners of the parent												
					Other components of equity									
	Notes	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	23	—	—	49,373	(165)	—	—	—	—	(165)	(48,914)	294	—	294
Purchase of treasury shares	23	—	—	(1,842)	—	—	—	—	—	—	—	(1,842)	—	(1,842)
Share-based payment transactions	34	—	332	—	—	—	—	—	—	—	—	332	—	332
Dividends	25	—	—	—	—	—	—	—	—	—	(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	23	—	—	1,099	(189)	—	—	—	—	(189)	(404)	506	—	506
Purchase of treasury shares	23	—	—	(50,021)	—	—	—	—	—	—	—	(50,021)	—	(50,021)
Share-based payment transactions	34	—	—	—	227	—	—	—	—	227	—	227	—	227
Dividends	25	—	—	—	—	—	—	—	—	—	(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

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2017

(Millions of yen)

	Notes	2017	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	8	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	8	343,076	303,026

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2017

1 Reporting Entity

Kao Corporation (hereinafter the "Company") is a corporation established pursuant to the Companies Act of Japan (hereinafter the "Companies Act") with its headquarters in Chuo-ku, Tokyo.

The consolidated financial statements of the Company and its subsidiaries (hereinafter the "Group") have a closing date of December 31 and comprise the financial statements of the Group and the interests in associates of the Company.

The Group manufactures consumer products including cosmetics, skin care products, hair care products, sanitary products, fabric care products, and chemical products including fatty alcohols and surfactants. The Group delivers its products to customers through its sales companies and distributors in Japan and other countries. Details of these principal business activities of the Group are presented in Note 6 "Segment Information."

2 Basis of Preparation

(1) Compliance with International Financial Reporting Standards (hereinafter "IFRS")

The Group's consolidated financial statements have been prepared in accordance with IFRS issued by the International Accounting Standards Board, as permitted by the provision of Article 93 of the Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance of Japan No. 28 of 1976), as they satisfy the requirements for an "IFRS Specified Company" in Article 1-2 of the same ordinance.

(2) Basis of Measurement

The Group's consolidated financial statements have been prepared on the historical cost basis, except for certain assets and liabilities including financial instruments measured at fair value as presented in Note 3 "Significant Accounting Policies."

(3) Functional Currency and Presentation Currency

The Group's consolidated financial statements are presented in Japanese yen, which is the Company's functional currency. All financial information presented in Japanese yen is rounded to the nearest million yen.

(4) Early Adoption of New or Revised Standards and Interpretations

The Group has early adopted IFRS 9 "Financial Instruments" (issued in November 2009, revised in July 2014) (hereinafter "IFRS 9"), and IFRS 15 "Revenue from Contracts with Customers" (issued in May 2014) and "Clarifications to IFRS 15" (issued in April 2016) (together, hereinafter "IFRS 15") in preparing its consolidated financial statements.

3 Significant Accounting Policies

(1) Basis of Consolidation

1) Subsidiaries

Subsidiaries refer to all business entities controlled by the Company. The Company controls an entity when it has exposure, or rights, to variable returns from involvement with an investee and has the ability to affect those returns through its power over the investee.

The financial statements of subsidiaries are included in the consolidated financial statements of the Group from the date the Company gains control until the date it loses control of the subsidiary.

All intergroup balances, transactions, income and expenses and unrealized gains and losses arising from intergroup transactions are eliminated in preparing the consolidated financial statements.

A change in the Company's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the Group.

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. Comprehensive income of subsidiaries is attributed to owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All subsidiaries have the same closing date as the Company.

2) Associates

An associate is defined as an entity over which the Company has significant influence on financial and operating policy decisions but does not have control over the entity. The Company is presumed to have significant influence over another entity when it directly or indirectly holds at least 20%, but no more than 50% of the voting rights of that entity. Entities over which the Company is able to exercise significant influence on financial and operating policy decisions are also included in associates, even if it holds less than 20% of the voting rights.

Investments in associates are initially recognized at cost, and are accounted for by the equity method from the date the Company gains significant influence until the date it loses that influence.

Goodwill recognized on acquisition of associates (less any accumulated impairment losses) is included in investments in associates.

The closing dates of some associates differ from that of the Company. Associates with different closing dates prepare additional financial closing as of the closing date of the Company.

(2) Business Combinations

Business combinations are accounted for using the acquisition method. The consideration of an acquisition is measured as the aggregate of the acquisition-date fair value of the assets transferred, liabilities assumed and equity securities issued by the Company to the former owners of the acquiree in exchange for control of the acquiree.

Identifiable assets and liabilities of the acquiree in business combinations are measured at their acquisition-date fair value, with the following exceptions:

- Deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognized and measured in accordance with IAS 12 "Income Taxes" and IAS 19 "Employee Benefits", respectively.
- Non-current assets and disposal groups that are classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are measured in accordance with that Standard.
- Liabilities or equity instruments related to share-based payment transactions of the acquiree or share-based payment transactions of the Company entered into to replace such transactions of the acquiree are measured in accordance with IFRS 2 "Share-based Payment."

Any excess of the consideration over the net fair value of identifiable assets acquired and liabilities assumed at the acquisition date is recognized as goodwill in the consolidated statement of financial position. Conversely, any deficit is immediately recognized as income in the consolidated statement of income.

Costs associated with business combinations, such as advisory fees, attorney fees and due diligence costs, are expensed as incurred.

The additional acquisition of non-controlling interests is accounted for as an equity transaction, and therefore no goodwill is recognized with respect to such a transaction.

Business combinations under common control are business combinations in which all of the combining entities or combining businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. These business combinations are accounted for based on the carrying amounts.

(3) Foreign Currency Translation

1) Functional currency and presentation currency

The presentation currency used in the Group's consolidated financial statements is Japanese yen, which is the Company's functional currency. Subsidiaries and associates in the Group determine their own functional currencies and each entity's transactions are measured in its functional currency.

2) Foreign currency transactions

Foreign currency transactions are translated into the functional currency at the spot exchange rate at the date of the transaction, or an exchange rate that approximates the spot rate.

At the end of each reporting period, foreign currency monetary items are translated into the functional currency using the rates at the end of each reporting period.

Non-monetary items that are measured in terms of historical cost in foreign currencies are translated using the exchange rates at the date of acquisition. Non-monetary items that are measured at fair value in foreign currencies are translated into the functional currency using the exchange rates at the date when the fair value was measured. Exchange differences arising from such translations and settlements are recognized in profit or loss. However, exchange differences arising from equity instruments measured at fair value through other comprehensive income and cash flow hedges are recognized in other comprehensive income.

3) Financial statements of foreign operations

Assets and liabilities of foreign operations are translated at the rates at the end of each reporting period. Income and expenses are translated at the average exchange rates for the period, provided that there were no significant fluctuations in the exchange rates during the period. Exchange differences arising from translation of the financial statements of foreign operations are recognized in other comprehensive income. On the disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation is reclassified from equity to profit or loss when the gain or loss on disposal is recognized.

(4) Financial Instruments

The Group has early adopted IFRS 9.

1) Financial assets

(i) Initial recognition and measurement

The Group initially recognizes trade and other receivables at the date they are originated. Other financial assets are initially recognized at the transaction date when the Group becomes a party to the contractual provisions of the financial instrument.

At initial recognition, all financial assets are measured at fair value, but those that are not classified as financial assets measured at fair value through profit or loss are measured at fair value plus transaction costs directly attributable to the acquisition of the financial asset. Transaction costs of financial assets measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies the financial assets it holds as (a) financial assets measured at amortized cost; (b) debt instruments measured at fair value through other comprehensive income; (c) equity instruments measured at fair value through other comprehensive income; or (d) financial assets measured at fair value through profit or loss. This classification is determined at initial recognition, and measurement of financial assets after initial recognition is performed according to the classification of the financial asset as follows:

(a) Financial assets measured at amortized cost
Financial assets held by the Group are measured at amortized cost if both of the following conditions are met:

- The financial asset is held in a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

After initial recognition, the carrying amounts of financial assets measured at amortized cost are recognized using the effective interest method less impairment loss, if any. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(b) Debt instruments measured at fair value through other comprehensive income
Financial assets held by the Group are classified as debt instruments measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial asset; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

(c) Equity instruments measured at fair value through other comprehensive income
The Group has made an irrevocable election to present subsequent changes in the fair value of certain equity instruments in other comprehensive income, and classifies them in equity instruments measured at fair value through other comprehensive income.

These financial assets are measured at fair value after initial recognition, and changes in the fair value are included in other comprehensive income. If the Group disposes of an investment, or if the fair value of the investment declines significantly, the cumulative gain or loss recognized in other comprehensive income is reclassified from other components of equity to retained earnings.

Dividends from equity instruments measured at fair value through other comprehensive income are recognized as financial income in profit or loss.

(d) Financial assets measured at fair value through profit or loss
Financial assets that are not classified as financial assets measured at amortized cost, debt instruments measured at fair value through other comprehensive income, or equity instruments measured at fair value through other comprehensive income are classified as financial assets measured at fair value through profit or loss. The Group's financial assets that are measured at fair value through profit or loss include certain short-term investments and derivative assets. The Group has not irrevocably designated any financial assets as measured at fair value through profit or loss.

These financial assets are measured at fair value after initial recognition, and changes in their fair value are recognized in profit or loss. Gains and losses on financial assets measured at fair value through profit or loss are recognized in profit or loss.

(iii) Impairment of financial assets
With respect to impairment of financial assets measured at amortized cost, the Group recognizes a loss allowance for expected credit losses on such financial assets.

At each reporting date, the Group assesses whether the credit risks on the financial assets have increased significantly since initial recognition.

If credit risk on a financial instrument has not increased significantly since initial recognition, the loss allowance for that financial instrument is measured at an amount equal to the 12-month expected credit losses. If credit risk on a financial instrument has increased significantly since initial recognition, the loss allowance is measured in an amount equal to the lifetime expected credit losses.

However, the loss allowance on trade receivables and others is always measured in an amount equal to the lifetime expected credit losses.

The expected credit losses of financial assets are estimated in a way that reflects the following:

- An unbiased and probability-weighted amount determined by evaluating a range of possible outcomes
- The time value of money
- Reasonable and supportable information about past events, current conditions and forecasts of economic conditions that is available without undue cost or effort at the reporting date

The amounts of these measurements are recognized in profit or loss.

If an event that reduces an impairment loss occurs after the impairment loss has been recognized, the impairment loss will be reversed to the extent of the decrease and credited to profit or loss.

(iv) Derecognition of financial assets

The Group derecognizes financial assets only when the contractual rights to the cash flows from the financial assets expire, or when the Group transfers financial assets and substantially all the risks and rewards of ownership of the financial assets.

2) Financial liabilities

(i) Initial recognition and measurement

The Group initially recognizes bonds and borrowings at the date they are issued, and other financial liabilities at the transaction date.

Upon initial recognition, all financial liabilities are measured at fair value. However, financial liabilities measured at amortized cost are measured in the full amount after deducting directly attributable transaction costs from the fair value.

Transaction costs of financial liabilities measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies financial liabilities as either financial liabilities measured at fair value through profit or loss, or financial liabilities measured at amortized cost. This classification is determined at initial recognition. Measurement of financial liabilities after initial recognition is performed as follows, according to the classification of the financial liability.

The Group's financial liabilities measured at fair value through profit or loss are derivative liabilities. The Group has not irrevocably designated any financial liabilities as measured at fair value through profit or loss at initial recognition. Financial liabilities measured at fair value through profit or loss are measured at fair value after initial recognition, and any changes in their fair value are recognized in profit or loss for the period.

Financial liabilities measured at amortized cost are subsequently measured at amortized cost using the effective interest method. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(iii) Derecognition of financial liabilities

The Group derecognizes financial liabilities when they are extinguished (i.e., when the obligation specified in the contract is discharged or cancelled or expires).

3) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the consolidated statement of financial position only when the Group currently has a legally enforceable right to set off the recognized amount and intends either to settle on a net basis or realize the assets and settle the liabilities simultaneously.

4) Fair value of financial instruments

The Group recognizes the fair value of financial instruments using various valuation methodologies and inputs. The fair values recognized based on the observability of inputs into the valuation methodologies are grouped into the following three levels:

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities

Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Fair value measured with unobservable inputs for the asset or liability

5) Hedge accounting

The Group uses interest rate swaps and other derivatives to hedge interest rate risk. At the inception of a hedging relationship, the Group formally designates and documents the hedging relationship and the interest rate risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and the methods of assessing whether the hedging relationship meets the hedge effectiveness requirements. In addition, the Group assesses whether the hedging relationship meets the hedge effectiveness requirements, both at the inception and on an ongoing basis. Ongoing assessments are conducted either at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first.

In accordance with the Group's risk management policy, derivatives that meet the criteria for hedge accounting with respect to interest rate risk are designated as cash flow hedges and accounted for as follows.

Derivatives designated as hedging instruments in cash flow hedges are interest rate swaps to convert floating-rate financial liabilities to fixed-rate financial liabilities. The effective portion of changes in the fair values of derivatives designated as cash flow hedges is recognized in other components of equity until the associated hedged transactions are executed and profit or loss is recognized. Gains or losses on derivatives recognized in other components of equity are reclassified into profit or loss at the time when the associated hedged transactions are recognized in profit or loss. However, any ineffective portion of the change in fair value of the derivatives is recognized immediately in profit or loss.

Hedge accounting is discontinued prospectively only when the hedging relationship ceases to meet the qualifying criteria. This includes instances when the hedging instrument expires or is sold, terminated or exercised.

The Group does not use fair value hedges or net investment hedges in foreign operations.

(5) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments that are highly liquid and readily convertible to known amounts of cash subject to an insignificant risk of changes in value, and that mature or become due within three months from the date of acquisition.

Cash and cash equivalents include certificates of deposit, time deposits, commercial paper, public and corporate bonds in investment trusts, and money in trust.

(6) Inventories

Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition, and are determined principally by the weighted average method.

(7) Property, Plant and Equipment

Property, plant and equipment are measured using the cost model and carried at cost less any accumulated depreciation and any accumulated impairment losses.

The cost of an item of property, plant and equipment comprises any costs directly attributable to acquisition of the asset and the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Depreciation of assets other than land and construction in progress is calculated on a straight-line basis over the estimated useful lives of the assets.

The estimated useful lives of major asset items are as follows:

- Buildings and structures: 10 to 35 years
- Machinery and vehicles: 7 to 14 years
- Tools, furniture and fixtures: 3 to 10 years

The estimated useful lives, residual values and depreciation method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

(8) Goodwill and Intangible Assets

1) Goodwill

Goodwill arising from a business combination is not amortized, and is carried at cost, determined at the acquisition date, less any accumulated impairment losses.

In addition, goodwill is allocated to the cash generating unit or group of cash-generating units that is expected to benefit from the synergies of the business combination, and is tested for impairment at least once a year by each fiscal year end or if there are indications of impairment. Impairment loss on goodwill is recognized in profit or loss and is not reversed in subsequent periods.

Goodwill measurements at initial recognition are presented in Note 3 "Significant Accounting Policies (2) Business Combinations."

2) Intangible assets

Intangible assets are measured using the cost model and carried at cost less any accumulated amortization and any accumulated impairment losses.

The costs of separately acquired intangible assets comprise any costs directly attributable to acquisition of the assets.

The costs of intangible assets acquired in business combinations are measured at fair value at the acquisition date.

Expenditures related to internally generated intangible assets are recognized as expenses when incurred, with the exception of development expenses that meet the criteria for capitalization. Software development expense only meets the criteria for capitalization.

After initial recognition, with the exception of intangible assets with indefinite useful lives, intangible assets are amortized on a straight-line basis over their estimated useful lives.

The Group has no intangible assets with indefinite useful lives. The estimated useful lives of major intangible assets are as follows:

- Trademarks: 10 years
- Software: 5 years

The estimated useful lives, residual values and amortization method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

3) Research and development expenses

Research expenditures are expensed as incurred. Development expenditures are capitalized only if they can be measured reliably, future economic benefits are probable, and the Group intends to, and has sufficient resources to, complete development and to use or sell the asset. If research expenditures and development expenditures cannot be clearly distinguished, they are expensed as incurred as research expenditures.

(9) Leases

The Group classifies a lease that transfers substantially all the risks and rewards incidental to ownership of an asset as a finance lease and a lease other than a finance lease as an operating lease.

In finance lease transactions, leased assets and lease obligations are initially recognized at the lower of the fair value of leased property and the present value of the minimum lease payments, each determined at the inception of the lease.

Leased assets are depreciated on a straight-line basis over the shorter of their estimated useful lives and lease terms. Lease payments are apportioned between the finance charges and the reduction of the outstanding liability using the interest method.

Lease payments under operating leases are recognized as an expense on a straight-line basis over the lease term.

Determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement, in accordance with IFRIC Interpretation 4 "Determining Whether an Arrangement Contains a Lease."

(10) Impairment of Non-financial Assets

Non-financial assets, excluding inventories, deferred tax assets, non-current assets classified as held for sale and assets arising from employee benefits, are assessed at the end of each reporting period to determine whether there is any indication of impairment. If there is an indication of impairment, the recoverable amount of the asset is estimated. For goodwill, the recoverable amount is estimated at least once a year by each fiscal year end, irrespective of whether there is any indication of impairment.

The recoverable amount of an asset or a cash-generating unit is the higher of its value in use and fair value less cost of disposal. The discount rate used in calculating the asset's value in use is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset, for which the future cash flow estimates have not been adjusted.

If it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the cash-generating unit to which the asset belongs is measured. Goodwill acquired in business combinations is allocated to each of the cash-generating units or groups of cash-generating units of the Group that is expected to benefit from synergies of the business combinations after the acquisition date, and is tested for impairment.

Because corporate assets do not generate separate cash inflows, the recoverable amount of individual corporate assets cannot be measured unless management has decided to dispose of the asset. If there is an indication that a corporate asset may be impaired, the recoverable amount of the cash-generating unit or group of cash-generating units to which the asset belongs is measured and compared with the carrying amount.

Impairment losses are recognized in profit or loss whenever the recoverable amount is less than the carrying amount. Such impairment losses of the cash-generating unit or group of cash-generating units are recognized by first reducing the carrying amount of any goodwill allocated to the cash-generating unit or group of cash-generating units, and then allocating the rest of the losses to other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

The Group reviews assets other than goodwill at each fiscal year end to determine whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If there are any such indications, the Group estimates the recoverable amount of the asset.

Impairment losses on assets other than goodwill that were recognized in prior fiscal years are reversed only when there have been changes in the estimates used to determine the recoverable amount of the asset since the last impairment loss was recognized. In this case, the carrying amount of the asset is increased as a reversal of impairment loss to the recoverable amount.

Impairment losses are reversed up to the carrying amount, net of amortization or depreciation, that would have been determined had no impairment loss for the asset been recognized in prior fiscal years.

(11) Employee Benefits

1) Post-employment benefits

The Group sponsors a defined benefit plan and a defined contribution plan as post-employment benefit plans for employees.

(i) Defined benefit plan

For the defined benefit plan, the projected unit credit method is used to individually determine the present value of defined benefit obligations, related current service costs and past service costs of each plan.

The discount rate is determined by referring to market yields at the end of the fiscal year on high quality corporate bonds corresponding to the period until the expected date of future benefit payment.

The net amount of the present value of defined benefit obligations and the fair value of plan assets is accounted for as a liability or asset. However, if the defined benefit plan has surplus, the net defined benefit asset is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. Net interest on the net defined benefit liability (asset) is recognized in profit or loss as financial expenses (income).

Remeasurements of the net defined benefit liability (asset) are recognized in other comprehensive income and immediately reclassified to retained earnings in the period in which they occur.

Past service costs are recognized in profit or loss for the period in which they are incurred.

(ii) Defined contribution plan

Payments to defined contribution plan are recognized as expenses when employees have rendered services entitling them to the contributions.

2) Other employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis, and are recognized as an expense when the related services are rendered.

For bonuses, when there is a present legal or constructive obligation to make payments of bonuses, and a reliable estimate of the obligation can be made, the estimated amount to be paid is accounted for as a liability.

For the paid absence expenses, when there is a legal or constructive obligation with respect to accumulating paid absence systems and a reliable estimate of the obligation can be made, the estimated amount to be paid based on those systems is accounted for as a liability.

(12) Share-based Payments

1) Stock option plan

The Company has a stock option plan accounted for as an equity-settled share-based payment plan. Due to the introduction of a performance share plan from the fiscal year ended December 31, 2017, the stock option plan has been abolished except for the options already granted.

2) Performance share plan

In the fiscal year ended December 31, 2017, the Company introduced a performance share plan accounted for as an equity-settled share-based payment plan.

The performance share plan measures service received at the fair value of the Company's shares on the date of grant, recognizing it as an expense from the date of grant through the vesting period and recognizing the same amount as an increase in capital surplus. The fair value of the Company's shares on the date of grant is determined by adjusting the market price of the shares taking expected dividends into account.

(13) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amounts recognized as provisions are the best estimates of necessary expenditures to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties associated with the obligation. When the effect of the time value of money is material, the amount of provision is measured at the present value of the expenditures expected to be required to settle the obligation.

(14) Revenue

The Group has early adopted IFRS 15 effective from the fiscal year ended December 31, 2017.

The Group recognizes revenue 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 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.

(15) Income Taxes

Income taxes consist of current income taxes and deferred income taxes. Income taxes are recognized as income or expenses and included in profit or loss, except for taxes related to business combinations and taxes related to items that are recognized directly in equity or in other comprehensive income.

1) Current income taxes

Current income taxes are recognized in the amount of the expected taxes payable to or receivable from the taxation authorities. Calculation of the amount of tax is based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period in countries where the Group conducts business and earns taxable income.

2) Deferred income taxes

Deferred tax assets and liabilities are recognized for temporary differences between the carrying amounts of assets or liabilities at the end of the reporting period and its tax base, and for tax loss carryforwards and tax credits.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available against such deferred tax assets. Deferred tax liabilities are recognized, in principle, for all taxable temporary differences.

The carrying amount of deferred tax assets is reviewed each period and reduced to the extent that it is no longer probable that sufficient future taxable income will be available to realize benefits from all or part of the assets. Unrecognized deferred tax assets are reassessed each period and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax assets to be recovered.

Deferred tax assets and liabilities are not recognized for the following temporary differences:

- Taxable temporary differences arising from initial recognition of goodwill
- Temporary differences arising from initial recognition of assets and liabilities from transactions that are not business combinations and affect neither accounting income nor taxable income
- Taxable temporary differences on investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future
- Deductible temporary differences on investments in subsidiaries and associates, when it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the assets are realized or the liabilities are settled, based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are offset if the Group has a legally enforceable right to set off current tax assets against current tax liabilities and income taxes are levied by the same taxation authority on the same taxable entity.

The Company and some of its subsidiaries have adopted the consolidated tax system.

(16) Earnings per Share

Basic earnings per share are calculated by dividing net income attributable to owners of the parent by the weighted average number of ordinary shares outstanding during the period, adjusted for treasury shares held. Diluted earnings per share are calculated by adjusting the effects of all dilutive potential ordinary shares.

(17) Non-current Assets Held for Sale

A non-current asset or disposal group whose carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use is classified as a non-current asset or disposal group held for sale if it is highly probable that the asset or disposal group will be sold within one year and is available for immediate sale in its present condition, and the Group's management is committed to a plan to sell. Non-current assets are not depreciated or amortized while they are classified as held for sale or are part of a disposal group classified as held for sale. Non-current assets or disposal groups classified as held for sale are measured at the lower of the carrying amount and fair value less costs to sell.

(18) Equity and Other Capital

1) Ordinary shares

Ordinary shares are recognized in share capital and capital surplus at their issue price. Share issuance costs are deducted from the issue price.

2) Treasury shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or retirement of the Company's treasury shares. Any difference between the carrying amount and consideration received on the sale of treasury shares is recognized directly in equity.

(19) Dividends

Dividend distributions to shareholders of the Company are recognized as liabilities in the period in which year-end dividends are resolved upon by the General Meeting of Shareholders and interim dividends are resolved upon by the Board of Directors.

(20) Changes in Significant Accounting Policies

(Revenue)

The Group has early adopted IFRS 15 from the fiscal year ended December 31, 2017. As a transitional measure upon the early adoption of IFRS 15, the 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 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 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 in the consolidated statement of income for the fiscal year ended December 31, 2017. These changes had no effect on operating income or net income.

In addition, with the application of IFRS 15, refund liabilities for rebates and other payments, which were previously included in trade and other payables under current liabilities, liabilities for returned products, which were previously included in provisions, and refund liabilities for rebates and other payments and advances received from customers, which were previously 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 by 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, in the consolidated statement of financial position.

4 Significant Accounting Estimates and Judgments

The Group's consolidated financial statements include estimates and assumptions made by management regarding income and expenses, measurement of the carrying amounts of assets and liabilities, and disclosure of contingencies and others at the end of the reporting period. These estimates and assumptions are based on management's best judgment at the end of the reporting period, and take into account historical experience and various other factors that can be considered as reasonable. However, due to their nature, actual results may differ from these estimates and assumptions.

The estimates and their underlying assumptions are reviewed by management on an ongoing basis. The effects of revisions to accounting estimates and assumptions are recognized in the period when the estimates are revised and in future periods.

Estimates and assumptions that significantly affect the amounts recognized in the Group's consolidated financial statements are as follows:

(1) Impairment of Property, Plant and Equipment, Goodwill and Intangible Assets

The Group conducts impairment tests for property, plant and equipment, goodwill and intangible assets when there is an indication that the recoverable amount of the asset or cash-generating unit is less than the carrying amount.

Triggering events for impairment testing include, for example, significant changes with adverse effects on past or projected business performance, significant changes in the use of acquired assets, or changes in overall business strategy.

Furthermore, goodwill is tested for impairment at least once a year by each fiscal year end, irrespective of indication of impairment, to verify that the recoverable amount of the cash-generating unit to which goodwill is allocated exceeds the carrying amount.

Impairment tests are performed by comparing the carrying amount and the recoverable amount of the asset or cash-generating unit. If the recoverable amount is less than the carrying amount, the carrying amount is reduced to the recoverable amount and the reduction is recognized as an impairment loss. The recoverable amount is the higher of the value in use and the fair value less cost of disposal of the asset or cash-generating unit.

In calculating the value in use, the Group makes certain assumptions about the remaining useful life and future cash flows of the asset, discount rate, growth rate and other factors. These assumptions are based on management's best estimates and judgments, but may be affected by changes in future business plans, economic conditions or other factors. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 14 "Goodwill and Intangible Assets" presents the method for measuring the recoverable amount and sensitivity associated with goodwill.

(2) Post-employment Benefits

The Group provides a variety of post-retirement benefit plans that include a defined benefit plan. The present value of defined benefit obligations and related service costs are determined based on actuarial assumptions.

Actuarial assumptions are based on management's best estimates and judgments, but may be affected by the revision of inputs including the discount rate and mortality rate due to changes in economic conditions. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 20 "Employee Benefits" presents actuarial assumptions and related sensitivity.

(3) Provisions

The Group has recognized a provision for loss related to cosmetics, a provision for asset retirement obligations and other provisions in the consolidated statement of financial position.

The amounts recognized are the best estimates of the expenditures required to settle the present obligations, taking into account historical experience and other factors at the end of the reporting period.

The provision for loss related to cosmetics may be affected by changes in compensation-related and other expenses.

The provision for asset retirement obligations and other provisions may be affected by factors such as changes in future business plans.

If the actual amounts paid differ from the estimates, such differences could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 21 "Provisions" presents the nature and amounts of these provisions.

(4) Income Taxes

The Group recognizes and measures income tax payables and income taxes based on reasonable estimates of the amounts to be paid to the taxation authorities in each country. Such estimates are made using the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Calculating income tax payables and income taxes requires estimates and judgments of various factors, including interpretations of tax regulations by the Group and the taxation authorities and the experience of past tax audits.

Therefore, if the final tax outcome is different from the amount initially recognized, the difference is recognized in the period when the tax outcome is finalized.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available. The realizability of deferred tax assets is assessed using the tax rates that are expected to apply to the period when the asset is realized, based on tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Recognition and measurement of deferred tax assets are based on management's best estimates and judgments, but may be affected by future changes in business plans or other conditions, or by the amendment or promulgation of related laws. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 16 "Income Taxes" presents income taxes and amounts.

(5) Fair Value

The Group uses various inputs, including unobservable inputs, and valuation methodologies to estimate the fair value of specific assets and liabilities. When measuring fair value, the Group maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs, and management's best estimates and judgments are required in that process.

The fair value of these assets and liabilities is based on management's best estimates and judgments, but could be affected by factors including changes in inputs due to changes in economic conditions. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 35 "Financial Instruments" presents fair value measurement methods and amounts for major financial assets and liabilities measured at fair value.

(6) Contingencies

Contingencies are disclosed when there are items that could have a material effect on future business after considering the probability of occurrence and the amount of financial impact, taking into account all available evidence at the end of the reporting period.

5 New Standards and Interpretations Not Yet Adopted

New or revised major Standards and Interpretations that were issued by the date of approval presented in Note 40 "Approval of the Consolidated Financial Statements," but were not yet early adopted by the Group as of December 31, 2017 are as follows:

IFRS	Title	Mandatory adoption (From the fiscal year beginning)	Adoption by the Group	Overview of new or revised Standards and Interpretations
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 31, 2019	Revised lease definition, accounting treatment and disclosure

The Group is currently evaluating the possible impacts on the consolidated financial statements resulting from the adoption of IFRS 16 "Leases" and the estimates are currently not available.

6 Segment Information

(1) Summary of Reportable Segments

The Group's reportable segments are the components of the Group for which discrete financial information is available and which are regularly reviewed by the Board of Directors in deciding how to allocate resources and in assessing their performance. Net sales and operating income are the key measures used by the Board of Directors to evaluate the performance of each segment.

The Group is an organization comprising four main business units – the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business (collectively, the "Consumer Products Business") and the Chemical Business. In each business unit, the Group plans comprehensive business strategies and carries out business activities on a global basis.

Accordingly, the Group has four reportable segments: the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business.

Information about major customers has been omitted as the revenue from each customer is less than 10% of the Group's net sales.

Reportable segments		Major products	
Consumer Products Business	Beauty Care Business	Cosmetics	Counseling cosmetics, self-selection cosmetics
		Skin care products	Soaps, facial cleansers, body cleansers
		Hair care products	Shampoos, conditioners, hair styling agents, hair coloring agents
	Human Health Care Business	Food and beverage products	Beverages
		Sanitary products	Sanitary napkins, baby diapers
		Personal health products	Bath additives, oral care products, men's products, thermo products
	Fabric and Home Care Business	Fabric care products	Laundry detergents, fabric treatments
		Home care products	Kitchen cleaning products, house cleaning products, paper cleaning products, commercial-use products
Chemical Business		Oleo chemicals	Fatty alcohols, fatty amines, fatty acids, glycerin, commercial-use edible fats and oils
		Performance chemicals	Surfactants, plastics additives, superplasticizers for concrete admixtures
		Specialty chemicals	Toner and toner binder for copiers and printers, ink and colorants for inkjet printers, fragrances and aroma chemicals

(2) Sales and Results of Reportable Segments

Fiscal year ended December 31, 2017 (Millions of yen)

	Reportable segments							
	Consumer Products Business							
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliation[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	57,596	38,661	76,057	172,314	30,299	202,613	2,178	204,791
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
Other items								
Depreciation and amortization[3]	17,855	16,031	8,883	42,769	11,479	54,248	260	54,508
Capital expenditures[4]	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. Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the details of depreciation and amortization.
4. Capital expenditures include investments in property, plant and equipment and intangible assets.

Fiscal year ended December 31, 2016 (Millions of yen)

	Reportable segments: Consumer Products Business: Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliation[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	51,086	25,948	78,099	155,133	29,683	184,816	755	185,571
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
Other items								
Depreciation and amortization[3]	18,399	12,930	7,876	39,205	11,650	50,855	261	51,116
Capital expenditures[4]	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. Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the details of depreciation and amortization.
4. Capital expenditures include investments in property, plant and equipment, intangible assets and other non-current assets.

(3) Geographical Information

Sales to customers and non-current assets (excluding financial assets, deferred tax assets and retirement benefit assets) by region consist of the following:

Sales to Customers (Millions of yen)

	2017	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 by country or region based on the location of customers.

Non-current Assets (excluding Financial Assets, Deferred Tax Assets and Retirement Benefit Assets) (Millions of yen)

	2017	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

7 Business Combinations

(1) Acquisition of Ink Business of Chimigraf Holding, S.L. in Europe

1) Outline of Business Combination

Name of the acquired business and the acquiree:	Business-related assets of Chimigraf Ibérica, S.L.U., the subsidiary of Chimigraf Holding, S.L.; and Chimigraf France, S.A.S. and Chimigraf Italy, S.R.L.,the subsidiaries of Chimigraf Holding, S.L. (collectively, "Chimigraf")
Business outline:	Development, manufacturing and sales of flexographic ink and inkjet ink
Acquisition date:	April 1, 2017
Acquisition method:	Cash consideration to acquire assets and equity interests
Percentage of voting rights acquired:	100%

2) Primary Reason for Business Combination

Chimigraf is engaged in development, manufacturing and sales of flexographic ink and inkjet ink for package printing. With a wide range of product lineups and diverse ink designing technologies, Chimigraf has developed its business centered in Europe, and is expanding its sales network globally. In particular, Chimigraf is focusing on developing inkjet ink effective for various types of printing.

By taking advantage of newly acquired technologies, manufacturing facilities and sales networks from Chimigraf in addition to the Group's technologies, the Group aims to provide global customers with innovative products and services that can contribute to the mitigation of environmental impact.

3) Acquisition Cost of Acquired Business and Acquiree and Its Components

Acquisition cost of acquired business and acquiree:	2,979 million yen
Components of acquisition cost:	
Cash	2,979 million yen

4) Fair Value of Assets Acquired and Liabilities Assumed at the Acquisition Date

Current assets	1,182 million yen
Non-current assets	1,692 million yen
Total assets	2,874 million yen
Current liabilities	387 million yen
Non-current liabilities	3 million yen
Total liabilities	390 million yen

5) Goodwill

Goodwill recognized:	495 million yen
Components of goodwill:	Goodwill recognized for this business combination reflects excess earning powers in future from using newly acquired technologies, manufacturing facilities and sales networks from Chimigraf in addition to the Group's technologies. There is an immaterial amount of goodwill that is deductible for tax purposes.

6) Net Sales and Income of Acquired Business

Information on income associated with this business combination after the acquisition date and information on income assuming that the business combination took place on the date of January 1, 2017 are not presented because the impacts on the consolidated statement of income are immaterial.

(2) Acquisition of Oribe Hair Care, LLC in the U.S.

1) Outline of Business Combination

On January 17, 2018, the Company completed the acquisition of Oribe Hair Care, LLC (location: New York State, U.S.A.) pursuant to an acquisition agreement concluded through the Company's U.S. subsidiary on December 19, 2017. Because initial accounting for this business combination is incomplete at this time, detailed information on accounting is not presented.

Name of the acquiree:	Oribe Hair Care, LLC
Business outline:	Development, manufacturing and sales of hair care products for hair salons
Acquisition date:	January 17, 2018
Acquisition method:	Cash consideration to acquire equity interests
Percentage of voting rights acquired:	100%

2) Primary Reason for Business Combination

The "Oribe," a super-premium price brand for hair salons, which is owned by Oribe Hair Care, LLC, has a substantial presence in the top-class hair salon industry and among major specialty retailers in the United States. By utilizing the brand and products obtained through this acquisition, the Group aims to expand its brand portfolio for hair salons and to expand its customer base.

3) Fair Value of Assets Acquired, Liabilities Assumed and Goodwill Recognized at the Acquisition Date

Because the fair value of the assets acquired and liabilities assumed at the acquisition date is being determined, it has not been finalized at this time.

8 Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

(Millions of yen)

	2017	2016
Cash and deposits	260,176	186,226
Short-term investments	82,900	116,800
Total	343,076	303,026

The balance of cash and cash equivalents presented in the consolidated statement of financial position is equal to the balance of cash and cash equivalents presented in the consolidated statement of cash flows.

9 Trade and Other Receivables

Trade and other receivables consist of the following:

(Millions of yen)

	2017	2016
Trade receivables	211,990	205,099
Other receivables	5,915	4,546
Allowance for doubtful receivables	(1,398)	(1,186)
Total	216,507	208,459

Trade receivables are recognized when the Group's products are delivered because the Group's right to consideration is unconditional except for the passage of time from that point. Moreover, the Group receives payment within a short period of time after satisfying its performance obligation under separately determined payment terms. Because the period from satisfaction of the performance obligation to receipt of consideration is usually within one year or less, as a practical expedient, the Group does not adjust the promised amount of consideration for the effects of a significant financing component for such receivables.

10 Inventories

Inventories consist of the following:

(Millions of yen)

	2017	2016
Merchandise and finished goods	136,795	122,479
Work in progress	12,723	12,253
Materials and supplies	34,403	30,468
Total	183,921	165,200

The amount of inventories recognized as expenses and included in cost of sales for the fiscal years ended December 31, 2017 and 2016 were 714,981 million yen and 636,969 million yen, respectively.

Write-downs of inventories recognized as expenses for the fiscal years ended December 31, 2017 and 2016 were 5,093 million yen and 4,534 million yen, respectively.

11 Other Assets

Other assets consist of the following:

(Millions of yen)

	2017	2016
Other current assets		
Insurance receivable	8,120	6,330
Prepaid expenses	9,566	9,410
Other	10,476	8,072
Total	28,162	23,812
Other non-current assets		
Insurance receivable	2,654	11,095
Long-term prepaid lease payments	4,508	5,337
Long-term prepaid expenses	1,624	881
Other	1,900	1,235
Total	10,686	18,548

12 Non-current Assets Held for Sale

Certain assets including the buildings and land for sales offices were classified as non-current assets held for sale in the fiscal year ended December 31, 2017 and 2016 pursuant to the decision in the fiscal year ended December 31, 2016 to sell these assets. These assets were partially sold in the fiscal year ended December 31, 2017.

The fair value of these assets was based on third-party appraisal values using sales comparison and other approaches and sales prices determined with reference to sales contracts, and was categorized within Level 3 of the fair value hierarchy.

13 Property, Plant and Equipment

(1) Changes in Property, Plant and Equipment

The following tables present changes in acquisition costs, accumulated depreciation and accumulated impairment losses, and carrying amounts of property, plant and equipment.

Acquisition Cost (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2016	393,994	715,613	115,639	72,980	18,734	1,316,960
Additions	313	245	4,490	36	79,781	84,865
Acquisitions through business combinations	272	175	31	126	14	618
Sales and disposals	(5,355)	(29,108)	(7,642)	(97)	(13)	(42,215)
Reclassification	24,591	39,877	9,055	384	(73,907)	—
Reclassification to assets held for sale	(585)	(22)	(7)	(216)	—	(830)
Exchange differences on translation of foreign operations	(4,410)	(10,069)	(1,860)	(194)	(64)	(16,597)
Other	79	86	(94)	(1)	(57)	13
December 31, 2016	408,899	716,797	119,612	73,018	24,488	1,342,814
Additions	566	230	4,762	13	67,471	73,042
Acquisitions through business combinations	697	100	48	83	—	928
Sales and disposals	(5,468)	(27,952)	(13,424)	(443)	(3)	(47,290)
Reclassification	18,605	36,152	7,464	370	(62,591)	—
Exchange differences on translation of foreign operations	2,766	4,327	1,197	274	359	8,923
Other	60	281	(315)	(0)	172	198
December 31, 2017	426,125	729,935	119,344	73,315	29,896	1,378,615

Accumulated Depreciation and Accumulated Impairment Losses (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2016	281,243	596,281	91,118	10,321	—	978,963
Depreciation[1]	11,934	22,448	10,396	—	—	44,778
Impairment losses[2]	13	—	—	96	—	109
Impairment losses reversed[2]	(0)	—	(1)	—	—	(1)
Sales and disposals	(4,990)	(28,415)	(7,264)	(1)	—	(40,670)
Reclassification to assets held for sale	(497)	(22)	(7)	—	—	(526)
Exchange differences on translation of foreign operations	(2,220)	(7,024)	(1,392)	—	—	(10,636)
Other	(23)	(66)	51	—	—	(38)
December 31, 2016	285,460	583,202	92,901	10,416	—	971,979
Depreciation[1]	13,036	25,133	11,323	—	—	49,492
Impairment losses[2]	—	18	1	—	—	19
Impairment losses reversed[2]	(0)	—	(1)	—	—	(1)
Sales and disposals	(5,132)	(27,219)	(13,185)	(96)	—	(45,632)
Exchange differences on translation of foreign operations	1,888	4,091	929	—	—	6,908
Other	69	272	(291)	—	—	50
December 31, 2017	295,321	585,497	91,677	10,320	—	982,815

Notes: 1. Depreciation of property, plant and equipment is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
2. Impairment losses on property, plant and equipment are included in other operating expenses and impairment losses reversed are recognized in other operating income in the consolidated statement of income.

Carrying Amount (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2016	112,751	119,332	24,521	62,659	18,734	337,997
December 31, 2016	123,439	133,595	26,711	62,602	24,488	370,835
December 31, 2017	130,804	144,438	27,667	62,995	29,896	395,800

(2) Leased Assets

The carrying amount of leased assets from finance leases included in property, plant and equipment is as follows:

(Millions of yen)

	Buildings and structures	Other	Total
January 1, 2016	5,441	83	5,524
December 31, 2016	4,060	54	4,114
December 31, 2017	3,195	58	3,253

(3) Impairment Losses

The Group allocates property, plant and equipment into cash-generating units based on the smallest identifiable group of assets that generates cash inflows that are largely independent. For idle assets, the Group evaluates whether to recognize impairment losses for individual properties based on impairment tests performed.

Impairment losses recognized for the fiscal years ended December 31, 2017 and 2016 were 19 million yen and 109 million yen, respectively.

(4) Commitments

Note 38 "Commitments" presents information on commitments to acquire property, plant and equipment.

14 Goodwill and Intangible Assets

(1) Changes in Goodwill and Intangible Assets

The following tables present changes in acquisition costs, accumulated amortization and accumulated impairment losses, and carrying amounts of goodwill and intangible assets.

Acquisition Cost (Millions of yen)

		Intangible assets			
	Goodwill	Software	Trademarks	Other[1]	Total
January 1, 2016	138,251	24,824	133,523	5,561	163,908
Additions	—	85	—	4,948	5,033
Acquisitions through business combinations	1,915	4	—	316	320
Sales and disposals	—	(2,629)	(133,523)	(361)	(136,513)
Reclassification	—	5,122	—	(5,115)	7
Exchange differences on translation of foreign operations	(2,383)	(246)	—	(164)	(410)
Other	—	124	—	(22)	102
December 31, 2016	137,783	27,284	—	5,163	32,447
Additions	—	84	—	6,229	6,313
Acquisitions through business combinations	495	11	2	780	793
Sales and disposals	—	(5,502)	(2)	(870)	(6,374)
Reclassification	—	5,194	—	(5,188)	6
Exchange differences on translation of foreign operations	457	134	—	17	151
Other	—	(9)	—	(11)	(20)
December 31, 2017	138,735	27,196	—	6,120	33,316

Note: 1. Software in progress is included in other in intangible assets.

Accumulated Amortization and Accumulated Impairment Losses (Millions of yen)

	Goodwill	Intangible assets Software	Trademarks	Other	Total
January 1, 2016	—	13,045	132,196	2,962	148,203
Amortization[1]	—	4,650	1,327	361	6,338
Sales and disposals	—	(2,626)	(133,523)	(346)	(136,495)
Exchange differences on translation of foreign operations	—	(225)	—	(135)	(360)
Other	—	71	—	1	72
December 31, 2016	—	14,915	—	2,843	17,758
Amortization[1]	—	4,839	—	177	5,016
Sales and disposals	—	(5,486)	—	(857)	(6,343)
Exchange differences on translation of foreign operations	—	117	—	(51)	66
Other	—	(10)	—	—	(10)
December 31, 2017	—	14,375	—	2,112	16,487

Note: 1. Amortization of intangible assets is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

Carrying Amount (Millions of yen)

	Goodwill	Intangible assets Software	Trademarks	Other	Total
January 1, 2016	138,251	11,779	1,327	2,599	15,705
December 31, 2016	137,783	12,369	—	2,320	14,689
December 31, 2017	138,735	12,821	—	4,008	16,829

(2) Goodwill

The following table presents the carrying amount of goodwill recognized in the Group's consolidated statement of financial position. Goodwill arising from business combinations is allocated at the acquisition date to cash-generating units benefiting from the business combination, and the goodwill belongs to the Beauty Care Business and the Chemical Business. The goodwill primarily relates to the acquisition of the Kanebo Cosmetics Group.

(Millions of yen)

	2017	2016
Beauty Care Business	136,075	135,618
Kanebo Cosmetics Group	119,400	119,400
Molton Brown Group	11,883	11,327
Other	4,792	4,891
Chemical Business	2,660	2,165
Total	138,735	137,783

(3) Impairment Test for Goodwill

The Group tests goodwill for impairment at least once a year by each fiscal year end or if there are indications of impairment.

The recoverable amount on the impairment test is measured based on value in use. The majority of goodwill recognized at the Group relates to the Kanebo Cosmetics Group.

For the goodwill associated with the Kanebo Cosmetics Group, cash flow projections that are the basis for the value in use are estimated using three-year medium-term plans that reflect past year's performance. The key assumptions used in formulating these estimates include sales growth rates and discount rates and the sales growth rates are consistent with the growth rate projections of the markets in which the cash-generating units operate. Estimated cash flows in years beyond the three-year forecasts approved by management were calculated using an annual growth rate of 0% and were discounted to present value using a weighted average cost of capital (WACC) of 7.1% for the fiscal year ended December 31, 2017 and 7.4% for the fiscal year ended December 31, 2016. While the value in use exceeded carrying amount at December 31, 2017, increasing the discount rate by 2.9% would result in impairment. For the fiscal year ended December 31, 2016, management assumed the probability that material impairment would occur in this cash-generating unit was low even in cases where the key assumptions used for the impairment test changed within the reasonably possible ranges.

(4) Intangible Assets with Indefinite Useful Lives

The intangible assets above include no intangible assets with indefinite useful lives.

(5) Commitments

Note 38 "Commitments" presents information on commitments associated with the acquisition of intangible assets.

15 Investments Accounted for Using the Equity Method

Investments in associates are accounted for using the equity method in the Group's consolidated financial statements. The carrying amount of investments in associates that are not individually material is as follows:

(Millions of yen)

	2017	2016
Investments accounted for using the equity method	7,682	4,701

Changes in the Group's share of net income and other comprehensive income of associates that are not individually material are as follows:

(Millions of yen)

	2017	2016
The Group's share of net income	2,007	1,894
The Group's share of other comprehensive income	316	(82)
The Group's share of comprehensive income	2,323	1,812

16 Income Taxes

(1) Deferred Tax Assets and Liabilities

Details of major causes of occurrence and changes in deferred tax assets and liabilities consist of the following:

Fiscal year ended December 31, 2017 (Millions of yen)

	January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2017
Deferred tax assets					
Property, plant and equipment and intangible assets	18,316	384	—	35	18,735
Retirement benefit liabilities	27,847	(1,536)	(9,624)	50	16,737
Accrued expenses	11,927	(561)	—	65	11,431
Unused tax losses	1,240	866	—	(7)	2,099
Other	15,841	(2,439)	—	(84)	13,318
Total deferred tax assets	75,171	(3,286)	(9,624)	59	62,320
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,945	(766)	—	(76)	7,103
Financial assets	2,764	—	509	(3)	3,270
Undistributed foreign earnings	12,730	(1,995)	—	—	10,735
Other	1,321	(611)	—	19	729
Total deferred tax liabilities	24,760	(3,372)	509	(60)	21,837
Deferred tax assets, net	50,411	86	(10,133)	119	40,483

Fiscal year ended December 31, 2016 (Millions of yen)

	January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2016
Deferred tax assets					
Property, plant and equipment and intangible assets	19,570	(1,292)	—	38	18,316
Retirement benefit liabilities	22,708	(1,024)	6,298	(135)	27,847
Accrued expenses	13,040	(889)	—	(224)	11,927
Unused tax losses	1,385	(135)	—	(10)	1,240
Other	17,739	(1,696)	—	(202)	15,841
Total deferred tax assets	74,442	(5,036)	6,298	(533)	75,171
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,959	92	—	(106)	7,945
Retirement benefit assets	(1)	1	—	—	—
Financial assets	3,649	—	(663)	(222)	2,764
Undistributed foreign earnings	12,390	340	—	—	12,730
Other	1,309	45	—	(33)	1,321
Total deferred tax liabilities	25,306	478	(663)	(361)	24,760
Deferred tax assets, net	49,136	(5,514)	6,961	(172)	50,411

Deferred tax assets and liabilities recognized in the consolidated statement of financial position are as follows:

(Millions of yen)

	2017	2016
Deferred tax assets	40,918	50,939
Deferred tax liabilities	435	528
Deferred tax assets, net	40,483	50,411

Deductible temporary differences and unused tax losses for which no deferred tax asset is recognized are as follows:

(Millions of yen)

	2017	2016
Unused tax losses	17,656	35,274
Deductible temporary differences	19,967	21,091
Total	37,623	56,365

Unused tax losses for which no deferred tax asset is recognized will expire as follows:

(Millions of yen)

	2017	2016
Not later than 1 year	507	10,974
Later than 1 year and not later than 2 years	3,426	4,132
Later than 2 years and not later than 3 years	7,007	5,551
Later than 3 years and not later than 4 years	5,336	7,320
Later than 4 years	1,380	7,297
Total	17,656	35,274

The aggregate amounts of taxable temporary differences associated with investments in subsidiaries and associates for which deferred tax liabilities were not recognized at December 31, 2017 and 2016 were 15,835 million yen and 12,385 million yen, respectively. The Group did not recognize deferred tax liabilities for these temporary differences because it was able to control the timing of the reversal of these temporary differences, and it was probable that the temporary difference will not reverse in the foreseeable future.

(2) Income Taxes

Income taxes consist of the following:

(Millions of yen)

	2017	2016
Current taxes	55,769	50,027
Deferred taxes[1]	(86)	5,514
Total	55,683	55,541

Note: 1. Deferred taxes include 160 million yen and 2,698 million yen for the fiscal years ended December 31, 2017 and 2016, respectively, due to tax rate changes.

(3) Reconciliation of Effective Tax Rate

The details of difference between the effective statutory tax rate and the Group's average actual tax rate consist of the following:

(%)

	2017	2016
Effective statutory tax rate	30.86	33.06
Tax credit for experimental research costs and other	(2.68)	(3.00)
Different tax rates applied to subsidiaries	(0.92)	(2.06)
Reassessment of recoverability of unused tax losses and deferred tax assets	0.48	0.32
Change in tax rates	0.08	1.47
Other	(0.56)	0.49
Average actual tax rate	27.26	30.28

Note: The "Act for Partial Revision of the Income Tax Act, etc." (Act No. 15 of 2016) and the "Act for Partial Revision of the Local Tax Act, etc." (Act No. 13 of 2016) enacted in Japan in the fiscal year ended December 31, 2016 reduced the income tax rate for fiscal years beginning on or after April 1, 2016. Accordingly, the effective statutory tax rate has changed from 33.06% to 30.86%.

17 Bonds and Borrowings

Bonds and borrowings consist of the following:

(Millions of yen)

	2017	2016	Average interest rate[1] (%)	Maturity
Short-term borrowings	201	220	0.95	—
Current portion of long-term borrowings	67	30,069	1.02	—
Long-term borrowings	70,347	40,410	0.12	2019-2023
Current portion of bonds[2]	24,994	—	—	—
Bonds[2]	24,975	49,947	—	—
Total	120,584	120,646		
Current liabilities				
Bonds and borrowings	25,262	30,289		
Non-current liabilities				
Bonds and borrowings	95,322	90,357		
Total	120,584	120,646		

Notes: 1. The average interest rate is the weighted average interest rate on the balance of borrowings as of December 31, 2017.
2. Details of bonds issued are as follows:

(Millions of yen)

Issuer	Bond name	Issue date	2017	2016	Interest rate (%)	Collateral	Maturity date
The Company	3rd unsecured bonds	June 14, 2013	24,994	24,982	0.39	None	June 20, 2018
The Company	4th unsecured bonds	June 14, 2013	24,975	24,965	0.62	None	June 19, 2020
Total			49,969	49,947			

18 Leases

(1) Finance Lease Payables

As a lessee, the Group leases assets including buildings. Some lease contracts include renewal options. The Group has no lease contracts with covenants such as restrictions on additional borrowings or additional leases.

The total of future minimum lease payments and the present value under finance lease contracts consist of the following:

(Millions of yen)

	Minimum lease payments		Present value of minimum lease payments	
	2017	2016	2017	2016
Not later than 1 year	789	884	755	842
Later than 1 year and not later than 5 years	2,337	2,622	2,276	2,532
Later than 5 years	149	634	147	626
Total	3,275	4,140	3,178	4,000
Financial charges	(97)	(140)	—	—
Present value of minimum lease payments	3,178	4,000	3,178	4,000

(2) Non-cancellable Operating Leases

As a lessee, the Group leases assets including land.

The total of future minimum lease payments under non-cancellable operating lease contracts consists of the following:

(Millions of yen)

	2017	2016
Not later than 1 year	8,414	8,808
Later than 1 year and not later than 5 years	16,347	16,660
Later than 5 years	6,917	7,627
Total	31,678	33,095

The total of minimum lease payments under operating lease contracts recognized as expenses is as follows:

(Millions of yen)

	2017	2016
Total of minimum lease payments	10,080	9,858

19 Trade and Other Payables

Trade and other payables consist of the following:

(Millions of yen)

	2017	2016
Trade payables	143,944	130,348
Non-trade payables	80,949	86,545
Total	224,893	216,893

20 Employee Benefits

(1) Post-employment Benefits

The Company and most of its domestic subsidiaries have a cash balance plan as a defined benefit plan and a defined contribution plan as post-employment benefits (The cash balance plan is linked to market interest rates). The defined benefit obligations held in Japan account for a large proportion of the Group's defined benefit obligations.

Cash balance plan benefits are determined using points acquired during the enrollment period and a multiplier based on the enrollment period. The Group may also pay an early retirement bonus allowance to employees who retire earlier than the retirement age.

In accordance with laws and regulations, the defined benefit plan is operated as a pension fund that is legally separated from the Group. The pension fund is managed by a Board of Representatives composed of representatives elected by the participating companies and the representatives of participating employees. Pension fund management institutions manage the pension fund's assets in accordance with management policies specified by the Board of Representatives. The Board of Representatives and the pension fund management institutions are legally required to act in the best interests of plan participants in executing their responsibilities for managing the plan assets.

Certain foreign subsidiaries have defined benefit plans and/or defined contribution plans as post-employment benefits.

The defined benefit plan is exposed to actuarial risk and to the risk of fluctuation in the fair value of plan assets. Actuarial risk primarily involves interest rate risk. Interest rate risk involves the potential for an increase in defined benefit plan obligations if the discount rate used to determine their present value decreases, because this discount rate is based on market yields on instruments including high-quality corporate bonds. The risk of fluctuation in the fair value of plan assets involves underfunding if actual interest rates are lower than the interest rate criteria for managing the plan assets.

1) Defined benefit liabilities recognized in the consolidated statement of financial position

Net defined benefit liabilities and assets recognized in the consolidated statement of financial position, defined benefit obligations and plan assets are as follows:

(Millions of yen)

	2017	2016
Present value of defined benefit obligations	333,614	355,579
Fair value of plan assets	(270,144)	(261,857)
Net defined benefit liabilities	63,470	93,722
Amounts recognized in consolidated statement of financial position		
Retirement benefit liabilities	64,694	94,773
Retirement benefit assets[1]	(1,224)	(1,051)
Net defined benefit liabilities	63,470	93,722

Note: 1. Retirement benefit assets are included in other non-current assets in the consolidated statement of financial position.

2) Defined benefit obligations

Changes in the present value of defined benefit obligations are as follows:

(Millions of yen)

	2017	2016
The present value of the defined benefit obligations at beginning of year	355,579	331,494
Current service cost[1]	9,839	8,784
Interest expense[2]	2,672	3,619
Remeasurements		
Actuarial (gains) losses arising from changes in demographic assumptions	(31)	(2,374)
Actuarial (gains) losses arising from changes in financial assumptions	(20,245)	28,545
Actuarial (gains) losses arising from experience adjustments	2,242	(1,245)
Past service cost and (gains) losses arising from settlements[3]	(407)	(33)
Benefits paid[4]	(12,015)	(10,964)
Changes due to termination (curtailment and settlement) of defined benefit plans	(4,738)	—
Exchange differences on translation of foreign operations and other	718	(2,247)
The present value of the defined benefit obligations at end of year	333,614	355,579

Notes: 1. Current service cost is recognized in profit or loss and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
2. Interest expense or interest income associated with the net of the present value of the defined benefit obligations and the fair value of plan assets is recognized in profit or loss and included in financial expenses or financial income in the consolidated statement of income.
3. Past service cost and (gains) losses arising from settlements are recognized in profit or loss and included in general and administrative expenses in the consolidated statement of income.
4. The weighted average duration of the defined benefit obligations in Japan was mainly 16.6 years at December 31, 2017 and 17.3 years at December 31, 2016.

3) Plan assets

Changes in the fair value of plan assets are as follows:

(Millions of yen)

	2017	2016
The fair value of plan assets at beginning of year	261,857	256,828
Interest income	1,882	2,692
Remeasurements		
Return on plan assets (excluding amounts included in interest income)	12,850	2,517
Contributions to the plan by the employer[1]	8,941	10,768
Payments from the plan	(10,624)	(9,752)
Changes due to termination (curtailment and settlement) of defined benefit plans	(4,738)	—
Exchange differences on translation of foreign operations and other	(24)	(1,196)
The fair value of plan assets at end of year	270,144	261,857

Note: 1. Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefits and maintaining the balance of pension financing when the plan is underfunded. The Group plans to contribute 8,808 million yen to the defined benefit plan for the fiscal year ending December 31, 2018.

Plan assets consist of the following:

(Millions of yen)

	2017			2016		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Equity securities	9,207	50,055	59,262	7,723	51,195	58,918
Japan	—	25,010	25,010	—	24,704	24,704
Overseas	9,207	25,045	34,252	7,723	26,491	34,214
Debt securities	7,518	192,628	200,146	7,489	180,216	187,705
Japan	—	128,279	128,279	—	116,734	116,734
Overseas	7,518	64,349	71,867	7,489	63,482	70,971
Other	257	10,479	10,736	237	14,997	15,234
Total	16,982	253,162	270,144	15,449	246,408	261,857

Note: Plan assets invested in pooled funds of trust banks are classified without quoted market prices in active markets.

Pension assets in Japan account for a large proportion of the Group's plan assets. The objective in managing the plan assets is to raise total returns to the greatest extent possible in order to ensure stable benefits and lump-sum payments for plan participants in the future and beneficiaries with a long-term view under acceptable risks. Specifically, the Group considers factors including expected rate of return on investments in appropriate assets, risks of each asset, and asset combinations to set an asset mix policy for an appropriate basic portfolio in future years as the basis for maintaining asset allocation. The Group reviews the basic portfolio annually and realigns it as necessary if the asset allocation conditions have changed since the asset mix was set.

4) Significant actuarial assumptions and related sensitivity analysis

Significant actuarial assumptions are as follows:

	2017	2016
Discount rate	Mainly 0.8%	Mainly 0.8%

Note: The above table presents the discount rate used by the Company and major domestic subsidiaries.

Sensitivity analysis of the effect of changes in the present value of the defined benefit obligations of the Company and major domestic subsidiaries given changes in the discount rate used as a significant actuarial assumption is as follows:

(Millions of yen)

	2017	2016
The impact on defined benefit obligations		
0.5% increase in discount rate	(23,414)	(25,807)
0.5% decrease in discount rate	24,311	26,774

Note: This sensitivity analysis estimates the effect on the defined benefit obligations at the end of each reporting period from changes in the discount rate while all of the other assumptions remain constant.

5) Defined contribution plans

Expenses related to the defined contribution plan recognized in profit or loss were 3,873 million yen and 3,551 million yen for the fiscal years ended December 31, 2017 and 2016, respectively and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

(2) Other Employee Benefit Expenses

Other employee benefit expenses recognized in cost of sales, selling, general and administrative expenses, and other operating expenses in the consolidated statement of income for the fiscal years ended December 31, 2017 and 2016 were 268,034 million yen and 258,225 million yen, respectively.

21 Provisions

Components of and changes in provisions consist of the following:

(Millions of yen)

	Provision for loss related to cosmetics	Provision for asset retirement obligations	Other provisions	Total
January 1, 2017	13,710	4,242	3,262	21,214
Increase	—	89	108	197
Interest expense on discounted provision	21	67	—	88
Decrease (provision used)	(4,968)	(89)	(415)	(5,472)
Decrease (provision reversed)	—	—	(668)	(668)
Exchange differences on translation of foreign operations	—	30	50	80
December 31, 2017	8,763	4,339	2,337	15,439

The effect of the adoption of IFRS 15 on provisions is presented in Note 3 "Significant Accounting Policies (20) Changes in Significant Accounting Policies." As a result of this adoption, liabilities for returned products, which had previously been presented as provision for sales returns, are presented as contract liabilities.

(1) Provision for Loss Related to Cosmetics

The Group has recognized estimated compensation and other expenses related to cosmetics for brightening products of Kanebo Cosmetics containing the ingredient Rhododenol, for which a voluntary recall was announced on July 4, 2013. The Group expects its insurance policy to cover 4,663 million yen of the estimated expenses.

(2) Provision for Asset Retirement Obligations

The Group recognizes asset retirement obligations principally based on or pursuant to reasonably estimated future expenditures using historical experience and other factors when the Group has a legal or contractual obligation associated with the retirement of property, plant and equipment and leased assets held for use.

These expenditures are generally expected to take place after a year or more, but are affected by factors including future business plans.

(3) Other Provisions

Other provisions consist of estimated expenses for business transformation at European subsidiaries and other expenses.

22 Other Current Liabilities

Other current liabilities consist of the following:

(Millions of yen)

	2017	2016
Accrued expenses	81,515	104,425
Consumption tax payables	9,741	8,655
Obligation for unused paid absences	7,558	6,199
Other	8,590	11,833
Total	107,404	131,112

23 Equity and Other Equity Items

(1) Share Capital

The numbers of shares authorized and issued are as follows:

(Shares)

	2017	2016
Authorized	1,000,000,000	1,000,000,000
Issued[1]		
Beginning balance	504,000,000	504,000,000
Change during the year[2]	(9,000,000)	—
Ending balance	495,000,000	504,000,000

Notes: 1. All of the issued shares of the Company are ordinary shares that have no par value and no limitations on rights. Issued shares are fully paid.
2. The number of issued shares during the fiscal year ended December 31, 2017 decreased by 9,000,000 shares due to the retirement of treasury shares pursuant to the resolution of the Board of Directors.

(2) Capital Surplus

Capital surplus consists of capital reserve and other capital surplus.

The Companies Act stipulates that over half of the capital contributed from the issue of shares must be included in share capital and that the remainder must be included in capital reserve. Moreover, capital reserve may be included in share capital by resolution of the General Meeting of Shareholders.

(3) Treasury Shares

The changes in treasury shares are as follows:

(Shares)

	2017	2016
Beginning balance[1]	11,137,654	2,541,816
Increase[2]	263,176	8,862,432
Decrease[3]	(9,175,269)	(266,594)
Ending balance[4]	2,225,561	11,137,654

Notes: 1. 556,492 shares of treasury shares held by associates were included at December 31, 2017 and 2016.
2. The increase of 263,176 shares of treasury shares during the fiscal year ended December 31, 2017 resulted from the acquisition of 257,300 shares by the Board Incentive Plan Trust (hereinafter "BIP Trust") and the purchase of 5,876 fractional shares.
The increase of 8,862,432 shares of treasury shares during the fiscal year ended December 31, 2016 resulted from the acquisition of 8,858,700 shares by resolution of the Board of Directors and the purchase of 3,732 fractional shares.
3. The decrease of 9,175,269 shares of treasury shares during the fiscal year ended December 31, 2017 resulted from the retirement of 9,000,000 shares by resolution of the Board of Directors, a decrease of 175,000 shares due to the exercise of stock options and the sale of 269 fractional shares.
The decrease of 266,594 shares of treasury shares during the fiscal year ended December 31, 2016 resulted from a decrease of 266,000 shares due to the exercise of stock options, and the sale of 594 fractional shares.
4. 556,492 shares of treasury shares held by associates were included at December 31, 2017 and 2016. In addition, 257,300 shares held by the BIP Trust were included at December 31, 2017.

(4) Other Components of Equity

1) Subscription rights to shares

The Company employs a stock option system and issues subscription rights to shares in accordance with the Companies Act; however, due to the introduction of a performance share plan from the fiscal year ended December 31, 2017, the stock option plan has been abolished except for the options already granted.

Note 34 "Share-based Payments" presents information including terms and conditions and amounts.

2) Exchange differences on translation of foreign operations

Foreign currency translation differences arise from the translation of financial statements of foreign operations prepared in foreign currencies.

3) Net gain (loss) on derivatives designated as cash flow hedges

The Group hedges its exposure to the risk of variability in future cash flows. Net gain (loss) on derivatives designated as cash flow hedges is the portion of the change in the fair value of the hedging instrument that meets the hedge effectiveness requirements under hedge accounting.

4) Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income

This is the accumulated amount of changes in the fair value of financial assets measured at fair value through other comprehensive income. The Group reclassifies net gain (loss) on revaluation of financial assets from other components of equity to retained earnings when it disposes of an investment or when fair value declines significantly.

5) Remeasurements of defined benefit plans

Remeasurements of defined benefit plans includes the effect of any variances between actuarial assumptions at the beginning of the year and actual results, the effects of changes in actuarial assumptions, actual return on plan assets and interest income on plan assets (excluding amounts included in net interest on the net defined benefit liability (asset)), and any change in the effect of the asset ceiling (excluding amounts included in net interest on the net defined benefit liability (asset)). Remeasurements of defined benefit plans are recognized in other comprehensive income and immediately reclassified from other components of equity to retained earnings in the period when they occur.

(5) Retained Earnings

Retained earnings consist of legal reserve and other retained earnings.

The Companies Act requires that an amount equal to one-tenth of dividends must be appropriated as capital reserve or as legal reserve until the total of the aggregate amount of capital reserve and legal reserve equals a quarter of share capital. Legal reserve may be appropriated to reduce a deficit, and also may be reversed by resolution of the General Meeting of Shareholders.

24 Basic Strategy for Capital Policy

The Group's capital policy follows a basic strategy of securing a sound financial structure to make investments for sustainable growth and tolerate the related risks, and to make stable, continuous returns to shareholders. To realize this policy, the Group uses Economic Value Added (hereinafter "EVA®[1]"), a management indicator that takes capital cost into account, as its main indicator and works to enhance its corporate value by improving EVA.

The Group manages all equity and interest-bearing liabilities as capital cost and intends to optimize capital cost from the viewpoint of safety and capital efficiency. For equity, the Group aims for a streamlined and sound structure from a medium- to long-term perspective with efficiency in mind and, while maintaining interest-bearing liabilities at a moderate level, aims to obtain high credit ratings which will allow it to procure capital for large-scale investments. The Group is not subject to significant capital regulations except for general requirements under the Companies Act and others.

Although the Group emphasizes shareholder returns, it realizes that investments for growth will meet the expectations of its stakeholders, and therefore prioritizes such investments. In addition to providing stable dividends, the Group aims to continuously increase dividends to reflect improvements in business results. The Group also uses surplus funds to flexibly conduct share repurchases.

In addition to making returns to shareholders, the Group retains the capital necessary to conduct investments for growth in a timely fashion and to ensure the appropriate resources to deal with situations that exceed assumptions while improving EVA.

For the fiscal year ended December 31, 2017, EVA 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 (hereinafter "NOPAT").

Note: 1. EVA is a monetary metric defined as NOPAT less capital cost. EVA is a registered trademark of Stern Stewart & Co.

25 Dividends

Dividends paid are as follows:

Fiscal year ended December 31, 2017

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
111th Annual General Meeting of Shareholders held on March 21, 2017	23,657	48	December 31, 2016	March 22, 2017
Board of Directors meeting held on July 27, 2017	26,608	54	June 30, 2017	September 1, 2017

Note: 1. Dividends on treasury shares held by associates accounted for using the equity method are deducted by an amount corresponding to the Group's equity in these associates. In addition, total dividends pursuant to the resolution of the Board of Directors held on July 27, 2017 are deducted by the amount of dividends held by the BIP Trust.

The dividend resolved at the 111th Annual General Meeting of Shareholders held on March 21, 2017 was 23,684 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 27, 2017 was 26,652 million yen before the deduction.

Fiscal year ended December 31, 2016

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
110th Annual General Meeting of Shareholders held on March 25, 2016	21,061	42	December 31, 2015	March 28, 2016
Board of Directors meeting held on July 28, 2016	23,077	46	June 30, 2016	September 1, 2016

Note: 1. Dividends on treasury shares held by associates accounted for using the equity method are deducted by an amount corresponding to the Group's equity in these associates.
The dividend resolved at the 110th Annual General Meeting of Shareholders held on March 25, 2016 was 21,085 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 28, 2016 was 23,103 million yen before the deduction.

Dividends with an effective date after the fiscal year end are as follows:

Fiscal year ended December 31, 2017

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
112th Annual General Meeting of Shareholders held on March 23, 2018	27,641	56	December 31, 2017	March 26, 2018

Fiscal year ended December 31, 2016

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
111th Annual General Meeting of Shareholders held on March 21, 2017	23,684	48	December 31, 2016	March 22, 2017

26 Revenue

(1) Disaggregation of Revenue

The Group is an organization comprising four main business units – the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business. Revenues of these four businesses are presented as net sales. The Board of Directors of the Company reviews them regularly to determine allocation of resources and to assess their performance. Revenue of logistics services to third parties is included in other operating income because it is not a part of the abovementioned four main businesses.

The Group disaggregates revenue from contracts with customers by separating the Consumer Products Business into cosmetics and non-cosmetics based on contracts with customers, with the Chemical Business as a separate division. Revenue by geographic region is disaggregated based on the location of revenue recognized. The relationship between disaggregated revenue and net sales by segment is as follows:

Fiscal year ended December 31, 2017 (Millions of yen)

	Japan	Asia	Americas	Europe	Total
Cosmetics	197,905	22,416	2,825	19,547	242,693
Skin care/hair care products	195,929	30,845	72,317	44,211	343,302
Beauty Care Business	393,834	53,261	75,142	63,758	585,995
Human Health Care Business	197,507	96,738	47	—	294,292
Fabric and Home Care Business	294,838	38,786	2,085	—	335,709
Consumer Products Business	886,179	188,785	77,274	63,758	1,215,996
Chemical Business	123,886	69,572	52,625	64,202	310,285
Elimination of intersegment	(31,833)	(3,352)	(99)	(1,576)	(36,860)
Consolidated	978,232	255,005	129,800	126,384	1,489,421
Revenue of logistics services to third parties included in other operating income	8,619	—	—	—	8,619
Total revenue from contracts with customers	986,851	255,005	129,800	126,384	1,498,040

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.

1) Consumer Products Business

The Consumer Products Business sells consumer products including cosmetics, skin care products, hair care products, sanitary products and fabric care products. Its customers are mainly retailers in Japan and retailers and wholesalers outside Japan. Revenue from such sales is recognized when control of a product is transferred to a customer, i.e., at the point in time a product is delivered and handed over at the place designated by a customer because legal title to the product, physical possession and the significant risks and rewards of ownership of the product are transferred to the customer and the customer has the right to decide the method of sale and selling price of the product.

In the Consumer Products Business, products may be sold with a rebate conditional upon achievement of certain targets such as the quantity or amount of sales (hereinafter "Achievement Rebate") or other payments. In such cases, the transaction price is determined in an amount deducting the estimated amount of the Achievement Rebate or other payments from the consideration promised in the contract with the customer. Estimates of Achievement Rebate or other payment amounts use the most likely outcome method based on historical experience and other factors, and revenue is recognized only to the extent that it is highly probable that a significant reversal will not occur.

In addition, in the event that the Group makes payments to customers such as funding for sales promotions, if the consideration paid to customers is payment for separate goods or services from the customer and fair value cannot be reasonably estimated, revenue is measured by deducting the consideration from the transaction price.

Among the products in the Consumer Products Business, cosmetics are composed of counseling cosmetics and self-selection cosmetics. The Group may provide support to customers when they sell counseling cosmetics through counseling to final consumers.

In addition, when selling cosmetics, a certain level of product returns from customers associated with the termination of products is expected to occur. Because the Group has an obligation to refund the consideration for a product if a customer returns it, the Group recognizes a liability for sales returns as a deduction from revenue for projected refunds to customers. To estimate liabilities related to such sales returns, the Group uses the most likely outcome method based on historical experience and other factors, and revenue is recognized only to the extent that it is highly probable that a significant reversal will not occur. When customers return products, the Group has the right to collect the products from the customers, but because returned goods are primarily the result of a product termination, the products returned have no asset value and therefore such assets are not recognized.

2) Chemical Business

The Chemical Business sells chemical products such as fatty alcohols and surfactants. Its customers are mainly the users and distributors of the products. Revenue from such sales is recognized when control of a product is transferred to a customer, i.e., at the point in time a product is delivered and handed over at the place designated by a customer because legal title to the product, physical possession and the significant risks and rewards of ownership of the product are transferred to the customer and the customer has the right to decide the method of sale and selling price of the product. Revenue from sales of products in the Chemical Business is measured at transaction prices for contracts with customers.

(2) Liabilities from Contracts with Customers

Liabilities from contracts with customers are as follows:

(Millions of yen)

	January 1, 2017	December 31, 2017
Contract liabilities		
Advances	2,501	392
Refund liabilities	14,046	16,904
Total	16,547	17,296

Among liabilities from contracts with customers, estimates of Achievement Rebates or other payment amounts expected to be paid to customers related to sales by the end of the reporting period and liabilities for returned products are recognized as refund liabilities. As of the beginning and end of the fiscal year ended December 31, 2017, 3,965 million yen and 3,049 million yen, respectively, of liabilities for returned products previously included in provisions as provision for sales returns were included in the refund liabilities.

The balance of advances as of January 1, 2017 was fully recognized as revenue during the fiscal year ended December 31, 2017. The amount of revenue recognized during the fiscal year ended December 31, 2017 from performance obligations satisfied in previous periods was not material.

(3) Transaction Price Allocated to the Remaining Performance Obligations

The Group uses the practical expedient of omitting the disclosure of information on the remaining performance obligations because it has no significant transactions with individual expected contractual terms exceeding one year. In addition, there are no significant amounts in consideration from contracts with customers that are not included in transaction prices.

(4) Assets Recognized from the Costs of Obtaining or Fulfilling Contracts with Customers

The amount of assets recognized from the costs of obtaining or fulfilling contracts with customers during the fiscal year ended December 31, 2017 was not material. In addition, if the amortization period of the assets that the Group otherwise would have recognized is one year or less, the Group uses the practical expedient of recognizing the incremental costs of obtaining the contract as an expense when incurred.

27 Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of the following:

(Millions of yen)

	2017	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

Note 3 “Significant Accounting Policies (20) Changes in Accounting Policies” 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 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, were 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, were 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 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, were accounted for as reductions of net sales. As a result, selling, general and administrative expenses decreased by 23,407 million yen.

28 Other Operating Income

Other operating income consists of the following:

(Millions of yen)

	2017	2016
Revenue of logistics services to third parties	8,619	8,300
Royalty income	1,112	1,022
Other	5,178	4,355
Total	14,909	13,677

29 Other Operating Expenses

Other operating expenses consist of the following:

(Millions of yen)

	2017	2016
Expenses of logistics services to third parties	7,688	7,454
Losses on sale and disposal of property, plant and equipment	3,729	3,817
Expenses for business transformation at European subsidiaries	—	1,776
Other[1]	1,349	1,799
Total	12,766	14,846

Note: 1. Note 13 "Property, Plant and Equipment" presents impairment losses included in other.

30 Financial Income and Financial Expenses

Financial income consists of the following:

(Millions of yen)

	2017	2016
Interest income		
Financial assets measured at amortized cost	1,059	1,012
Retirement benefit assets	38	26
Dividend income		
Financial assets measured at fair value through other comprehensive income		
Financial assets derecognized during the year	0	9
Financial assets held at year end	224	205
Financial assets measured at fair value through profit or loss	12	21
Other	119	116
Total	1,452	1,389

Financial expenses consist of the following:

(Millions of yen)

	2017	2016
Foreign exchange loss[1]	1,765	2,859
Interest expenses[2]		
Financial liabilities measured at amortized cost	1,339	1,484
Retirement benefit liabilities	828	953
Other	28	128
Total	3,960	5,424

Notes: 1. Valuation gains or losses on currency derivatives that are not designated as hedges are included in foreign exchange loss.
2. Valuation gains or losses on interest rate derivatives that are not designated as hedges are included in interest expenses.

31 Earnings per Share

(1) The Basis for Calculating Basic Earnings per Share

(Millions of yen, unless otherwise noted)

	2017	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
Weighted average number of ordinary shares (Thousands of shares)	492,832	499,355
Basic earnings per share (Yen)	298.30	253.43

(2) The Basis for Calculating Diluted Earnings per Share

(Millions of yen, unless otherwise noted)

	2017	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
Weighted average number of ordinary shares (Thousands of shares)	492,832	499,355
Increase in ordinary shares		
Subscription rights to shares (Thousands of shares)	337	483
Weighted average number of ordinary shares after dilution (Thousands of shares)	493,170	499,838
Diluted earnings per share (Yen)	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	—	—

32 Other Comprehensive Income

Amount arising during the fiscal year and tax effects for each component of other comprehensive income are as follows:

Fiscal year ended December 31, 2017 (Millions of yen)

	Gains (losses) arising for the year	Tax effect	After tax effect
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	1,675	(509)	1,166
Remeasurements of defined benefit plans	30,884	(9,624)	21,260
Share of other comprehensive income of investments accounted for using the equity method	457	(140)	317
Total of items that will not be reclassified to profit or loss	33,016	(10,273)	22,743
Items that may be reclassified subsequently to profit or loss			
Exchange differences on translation of foreign operations	8,541	—	8,541
Share of other comprehensive income of investments accounted for using the equity method	(1)	0	(1)
Total of items that may be reclassified subsequently to profit or loss	8,540	0	8,540
Total	41,556	(10,273)	31,283

Fiscal year ended December 31, 2016 (Millions of yen)

	Gains (losses) arising for the year	Tax effect	After tax effect
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	(1,569)	663	(906)
Remeasurements of defined benefit plans	(22,409)	6,298	(16,111)
Share of other comprehensive income of investments accounted for using the equity method	(128)	56	(72)
Total of items that will not be reclassified to profit or loss	(24,106)	7,017	(17,089)
Items that may be reclassified subsequently to profit or loss			
Exchange differences on translation of foreign operations	(16,661)	—	(16,661)
Share of other comprehensive income of investments accounted for using the equity method	(7)	(3)	(10)
Total of items that may be reclassified subsequently to profit or loss	(16,668)	(3)	(16,671)
Total	(40,774)	7,014	(33,760)

33 Cash Flow Information

The major changes in liabilities arising from financing activities are changes from financing cash flows and there are no significant non-cash changes.

34 Share-based Payments

(1) Stock Options

1) Outline of stock options

The Company issued the following two types of stock options to directors, executive officers and employees of the Group. Due to the introduction of a performance share plan from the fiscal year ended December 31, 2017, the stock option plan has been abolished except for the options already granted.

(i) Stock options for share-based payment

Stock options for share-based payment were granted as compensation for directors and executive officers who do not concurrently serve as directors. These stock options were intended to motivate and inspire recipients to enhance the Company's results and value of shares and to further enhance corporate value by aligning the interests of recipients with those of shareholders by further increasing the linkage among the compensation of recipients, the Company's results and value of shares.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled
- Exercise period: Five years from July 1 of two years after the date the stock options were granted

(ii) Conventional stock options

Conventional stock options were granted to the employees of the Company and the directors and employees of its subsidiaries and associates as incentives. These stock options were intended to further enhance corporate value by aligning the interests of recipients with those of shareholders.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled
- Exercise period: Five years from September 1 of two years after the date the stock options were granted

2) Number of stock options and weighted average exercise price

	2017		2016	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
	(Shares)	(Yen)	(Shares)	(Yen)
Beginning balance of outstanding	549,000	1,331	846,000	1,654
Granted	—	—	40,000	1
Exercised	(175,000)	1,672	(266,000)	1,886
Expired at maturity	(61,000)	2,190	(71,000)	2,355
Ending balance of outstanding	313,000	973	549,000	1,331
Ending balance of exercisable	273,000	1,115	469,000	1,558

Notes: 1. The weighted average share price on the date of exercise for the fiscal years ended December 31, 2017 and 2016 was 6,254 yen and 5,821 yen, respectively.
2. The exercise price and the weighted average remaining contractual life for stock options outstanding at the end of the period are as follows:

2017			2016		
Range of exercise price	Number of shares	Weighted average remaining contractual life	Range of exercise price	Number of shares	Weighted average remaining contractual life
(Yen)	(Shares)	(Years)	(Yen)	(Shares)	(Years)
1	178,000	3.3	1	222,000	4.0
2,254	135,000	0.7	2,190 - 2,254	327,000	1.4
Total	313,000	2.2	Total	549,000	2.4

(2) Performance Share Plan

1) Outline of performance share plan

In the fiscal year ended on December 31, 2017, the Company introduced a performance share plan (hereinafter the "Plan") for the members of the Board of Directors (excluding Outside Directors) and Executive Officers (collectively, "Directors, etc.") as a highly transparent and objective compensation system that is closely linked to company performance. The purpose of the Plan is to improve the Company's mid- and long-term performance as well as increase the awareness of contributions to increasing corporate value.

The Company has introduced the Plan using a structure called a 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. wherein the Company's shares that are acquired through the BIP Trust and the amount equivalent to the converted value of such shares will be vested or paid to Directors, etc. depending on their executive positions and level of achievement of performance targets in the mid-term plan and other factors. The shares held by the BIP Trust are accounted for as treasury shares.

The Plan grants specified points (1 point = 1 share) to Directors, etc. each year depending on their executive positions and other factors on the condition that the requirements of a designated beneficiary, such as holding the office of Director, etc. on the last day of each fiscal year during the eligibility period, have been satisfied. The Company's shares and cash in the amount of the converted value of such Company's shares equivalent to the number of such points may be granted and paid following completion of settlement procedures by the designated beneficiary, after the end of the eligibility period in the case of performance-linked points, and for a specified period each year during the eligibility period in the case of fixed points.

The Plan is accounted for as an equity-settled share-based payment transaction.

2) Number of points granted during the period and weighted average fair value of points

The fair value of the points on the date of grant is determined by adjusting the market price of the Company's shares taking expected dividends into account.

The number of points granted during the period and the weighted average fair value of the points are as follows:

	2017	
	Achievement-linked points	Fixed points
Number of points granted during the period	34,125	14,625
Weighted average fair value (Yen)	6,821	6,767

(3) Share-based Payment Expenses

Share-based payment expenses recognized in the consolidated statement of income for the fiscal years ended December 31, 2017 and 2016 were 332 million yen and 227 million yen, respectively.

35 Financial Instruments

(1) Classification of Financial Instruments

The amounts of each classification of financial assets are as follows:

(Millions of yen)

Financial assets	2017	2016
Financial assets measured at amortized cost		
Cash and cash equivalents (Note 8)	313,176	268,126
Trade and other receivables (Note 9)	216,507	208,459
Other	24,639	22,404
Financial assets measured at fair value through profit or loss		
Cash and cash equivalents (Note 8)	29,900	34,900
Derivatives	602	791
Other	2,926	2,888
Financial assets measured at fair value through other comprehensive income		
Equity securities	14,092	12,428
Total	601,842	549,996
Current assets		
Cash and cash equivalents	343,076	303,026
Trade and other receivables	216,507	208,459
Other financial assets	14,914	13,038
Subtotal	574,497	524,523
Non-current assets		
Other financial assets	27,345	25,473
Total	601,842	549,996

Equity securities held by the Group are mainly issued by the entities that maintain business relationships with the Group and held for the long-term without speculative purposes. The Group has designated such equity securities as financial assets measured at fair value through other comprehensive income. Names of major equity securities and their fair values are as follows:

As of December 31, 2017

(Millions of yen)

Company name	Fair value
Seven & i Holdings Co., Ltd.	3,011
Seven Bank, Ltd.	1,930
Livedo Corporation	981
Tokio Marine Holdings, Inc.	978
The Nisshin OilliO Group, Ltd.[1]	962
Saiwai Trading Co., Ltd.	956
Aeon Co., Ltd.	799
Izumi Co., Ltd.	700
Japan Alcohol Trading Co., Ltd.	552
Keytrading Co., Ltd.	373

Note: 1. The Settsu Oil Mill, Inc.'s shares were exchanged to the Nisshin OilliO Group, Ltd.'s shares through a share exchange on May 1, 2017.

As of December 31, 2016 (Millions of yen)

Company name	Fair value
Seven & i Holdings Co., Ltd.	2,863
Seven Bank, Ltd.	1,675
Tokio Marine Holdings, Inc.	913
Saiwai Trading Co., Ltd.	863
Livedo Corporation	835
Aeon Co., Ltd.	687
Settsu Oil Mill, Inc.	533
Izumi Co., Ltd.	502
Japan Alcohol Trading Co., Ltd.	462
Keytrading Co., Ltd.	359

The Group derecognizes some financial assets measured at fair value through other comprehensive income by sale for reasons including asset efficiency and changes in business relationships. The total amounts of the fair value of such financial assets at the time of sale and the cumulative gains or losses on sales are as follows:

(Millions of yen)

	2017	2016
Fair value	24	1,036
Cumulative gains (losses)	10	658

The Group transfers to retained earnings the cumulative gains or losses arising from changes in the fair value of financial assets measured at fair value through other comprehensive income recognized as other components of equity when it disposes of an investment or when fair value declines significantly. Cumulative gains or losses of other comprehensive income, net of taxes, that were transferred to retained earnings for the fiscal years ended December 31, 2017 and 2016, were 7 million yen and 435 million yen, respectively.

The amounts of each classification of financial liabilities are as follows:

(Millions of yen)

Financial liabilities	2017	2016
Financial liabilities measured at amortized cost		
Trade and other payables (Note 19)	224,893	216,893
Bonds and borrowings (Note 17)	120,584	120,646
Other	16,804	19,057
Financial liabilities measured at fair value through profit or loss		
Derivatives	1,026	773
Total	363,307	357,369
Current liabilities		
Trade and other payables	224,893	216,893
Bonds and borrowings	25,262	30,289
Other financial liabilities	7,739	8,164
Subtotal	257,894	255,346
Non-current liabilities		
Bonds and borrowings	95,322	90,357
Other financial liabilities	10,091	11,666
Subtotal	105,413	102,023
Total	363,307	357,369

There are no significant assets pledged for the above financial liabilities. The Group held deposits received, which is interest-bearing liability in other financial liabilities, at December 31, 2017 and 2016 totaling 12,599 million yen and 13,275 million yen, respectively. The average interest rate on deposits received as of December 31, 2017 was 0.12%.

(2) Risk Management on Financial Instruments

The Group manages financial instrument risk based on the following policies to avoid and mitigate market risk, credit risk and liquidity risk.

1) Market risk management

The Group is exposed to the risk of market variability such as fluctuations in exchange rates, interest rates and share prices. The Group appropriately manages market risk to mitigate risk. In addition, the Group uses derivatives mainly consisting of foreign exchange forward contracts, currency swaps and interest rate swaps with the objective of appropriately managing market risk. The Group executes and manages derivatives in accordance with the internal policies that define the objectives, position limit, scope, organizational structure and others. The Group limits the use of derivatives to actual risk mitigation needs, and does not use derivatives for trading or speculative purposes. Therefore, as a rule, changes in the fair value of derivative instruments that the Group holds effectively offset changes in the fair value or cash flows.

(i) Exchange rate risk

The Group also operates outside Japan, and therefore is exposed to the risks of exchange rate fluctuations associated with transactions conducted in foreign currencies and with net investments in foreign operations. The Group minimizes the effect of exchange rate fluctuations on operating results by settling transactions denominated in foreign currency through foreign currency accounts, and by hedging the risk of exchange rate fluctuations using derivative instruments such as foreign exchange forward and currency swaps.

Details of foreign exchange forward contracts and currency swaps between the Japanese yen, which is the Group's functional currency, and its main foreign currencies including the U.S. dollar, the euro and the Chinese yuan are as follows:

The Group did not apply hedge accounting for these derivative transactions, but determined that these transactions effectively offset the impact of fluctuations in exchange rates.

(Millions of yen)

	2017			2016		
Derivatives transactions	Contract amount	Contract amount over 1 year	Carrying amount (fair value)[1]	Contract amount	Contract amount over 1 year	Carrying amount (fair value)[1]
Foreign exchange forward contracts:						
Selling						
U.S. dollar	13,800	7,280	135	16,308	7,280	60
Euro	70	—	1	74	—	3
Chinese yuan	—	—	—	1,065	—	(1)
Buying						
Euro	120	—	(2)	151	—	(6)
Chinese yuan	725	—	(98)	701	701	(52)
Currency swaps:						
Receiving Japanese yen, paying U.S. dollar	8,004	2,339	(53)	—	—	—
Receiving Japanese yen, paying Chinese yuan	1,987	—	(325)	2,279	2,279	(158)

Note: 1. Note 35 "Financial Instruments (3) Fair Value of Financial Instruments" presents the method of measuring the fair value of the above derivatives.

The above assets or liabilities related to derivative transactions are included in other financial assets or other financial liabilities in the consolidated statement of financial position.

Net exposure to exchange rate risk consists of the following. Amounts hedged against exchange rate fluctuation risk with derivatives are excluded.

As of December 31, 2017 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	8,713	161	8,458

As of December 31, 2016 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	2,210	707	5,342

The following table illustrates the impact on income before income taxes in the consolidated statement of income from foreign currency-denominated financial instruments held by the Group at the end of each fiscal year if the Japanese yen appreciated by 10% against the U.S. dollar, the euro and the Chinese yuan.

The effects of translating financial instruments denominated in the Group's functional currency, and the assets, liabilities, income and expenses of foreign operations are not included in the analysis. The analysis also assumes that currencies other than those used in the calculation remain constant.

(Millions of yen)

	2017	2016
U.S. dollar	(871)	(221)
Euro	(16)	(71)
Chinese yuan	(846)	(534)

(ii) Interest rate fluctuation risk
The Group obtains finances through long-term borrowings and bonds for maintaining an appropriate cost of capital and strengthening its financial base for investment for growth. The Group considers interest rate market movements and the balance between floating and fixed interest rates in making decisions about long-term funding. The Group's short-term borrowings generally have floating interest rates. The Group hedges interest rate risk as necessary using derivative instruments such as interest rate swaps, and therefore estimates its exposure to interest rate fluctuation risk is limited.

(iii) Share price fluctuation risk
The Group held marketable equity securities, primarily those of companies with which the Group has business relationships, totaling 10,165 million yen and 8,956 million yen at December 31, 2017 and 2016, respectively. These equity securities are exposed to share price fluctuation risk. However, the Group annually evaluates the rationale and reviews ongoing advisability and position size of these holdings. Fluctuations in their prices do not affect net profit or loss because all of these equity securities are designated as financial assets measured at fair value through other comprehensive income.

2) Credit risk management
The Group is exposed to credit risk such as a counterparty's default on its contractual obligations resulting in financial losses to the Group.

(i) Trade and other receivables
Notes and accounts receivable are trade receivables that expose the Group to customer credit risk. The Group manages that risk with an internal process for investigating and approving customer credit on initial transactions, and by obtaining deposits, collateral or other guaranties as necessary. The Group also manages due dates and outstanding balances by customer, and periodically reconfirms the creditworthiness of major customers. Non-trade receivables expose the Group to business partner credit risk, but these receivables are almost entirely settled in the short-term.

(ii) Short-term investments
Short-term investments are recognized in cash and cash equivalents and other financial assets. They are highly safe and liquid financial instruments that include commercial paper issued by entities with high bond ratings, bond investment trusts, and money held in trust.

(iii) Loan receivables
Loan receivables expose the Group to borrower credit risk. The Group manages this risk with an internal process for investigating and approving borrower credit on initial lending transactions, and by obtaining deposits, collateral or other guaranties as necessary. The Group also periodically reconfirms the creditworthiness of borrowers.

(iv) Derivatives
The Group executes and manages derivatives in accordance with the internal policies that define the objectives, position limit, scope and organizational structure. The Group limits the use of derivatives to actual risk mitigation needs, and does not use derivatives for trading or speculative purposes, and reduces credit risk by limiting transactions to highly creditworthy financial institutions.

The carrying amount after impairment of financial assets in the consolidated statement of financial position represents the Group's maximum exposure to the credit risk of financial assets. The Group is not exposed to excessive credit risk associated with a particular customer that requires exceptional management.

The Group recognizes an allowance for doubtful receivables for trade receivables and other financial assets measured at amortized cost by estimating future credit losses in consideration of recoverability and significant increases in credit risk. The Group determines if credit risk has increased significantly by evaluating changes in default risk with reference to factors including downgrading of internal credit ratings, the decline of counterparty results, and delinquency information.

Trade receivables are particularly important financial assets for the Group. The Group collectively measures expected credit losses of the financial assets for the entire period to recognize the allowance for doubtful receivables. In the following situations that would adversely affect future cash flows, however, the Group measures expected credit losses individually by treating each receivable as a credit-impaired financial asset:

- Where the customer has serious financial difficulties
- Where the customer defaults or becomes delinquent in accounts receivable payments despite repeated demands for payment
- Where it is more likely that the customer will go into bankruptcy or face a situation that forces it to reconstruct its business

The Group directly writes down the carrying amount if it does not reasonably expect to recover all or part of the trade receivables, following an internal process of investigation and approval.

The Group held security deposits for credit enhancement totaling 6,463 million yen and 6,413 million yen at December 31, 2017 and 2016, respectively.

The carrying amount of trade receivables and changes in the related allowance for doubtful receivables are as follows:

Fiscal year ended December 31, 2017

(Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2017	204,736	363	205,099
Change during the year (Recognition and derecognition)	3,914	45	3,959
Transfer to credit-impaired financial assets	(99)	99	—
Other changes	2,890	42	2,932
December 31, 2017	211,441	549	211,990

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2017	781	382	1,163
Increase during the year	237	84	321
Decrease during the year (charge-offs)	(69)	(34)	(103)
Decrease during the year (other)	(77)	(10)	(87)
Transfer to credit-impaired financial assets	—	—	—
Other changes	43	37	80
December 31, 2017	915	459	1,374

Fiscal year ended December 31, 2016

(Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2016	206,494	472	206,966
Change during the year (Recognition and derecognition)	2,472	(36)	2,436
Transfer to credit-impaired financial assets	28	(28)	—
Other changes	(4,258)	(45)	(4,303)
December 31, 2016	204,736	363	205,099

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2016	803	465	1,268
Increase during the year	217	18	235
Decrease during the year (charge-offs)	(85)	(28)	(113)
Decrease during the year (other)	(72)	(36)	(108)
Transfer to credit-impaired financial assets	(6)	6	—
Other changes	(76)	(43)	(119)
December 31, 2016	781	382	1,163

The following tables present an analysis of the carrying amount of trade receivables and the allowance for doubtful receivables by days past due.

As of December 31, 2017 (Millions of yen unless otherwise noted)

	Not due	Days past due: Less than 30 days	Over 30 days	Over 60 days	Over 90 days	Total
Trade receivables	200,841	7,033	1,441	680	1,995	211,990
Allowance for doubtful receivables	195	135	55	44	945	1,374
Expected credit loss (%)	0.1	1.9	3.8	6.5	47.4	0.6

As of December 31, 2016 (Millions of yen unless otherwise noted)

	Not due	Days past due: Less than 30 days	Over 30 days	Over 60 days	Over 90 days	Total
Trade receivables	197,543	4,315	1,248	553	1,440	205,099
Allowance for doubtful receivables	256	82	30	60	735	1,163
Expected credit loss (%)	0.1	1.9	2.4	10.9	51.0	0.6

3) Liquidity risk management

Liquidity risk is the risk that the Group may not be able to fulfill its obligation to pay financial liabilities that come due.

The Group uses methods such as scheduled medium- and long-term financing plans to understand its liquidity and consistently ensure the availability of sufficient funding.

The Group has also implemented the Global Cash Management System to reduce liquidity risk through the focused and efficient management of the Group's capital in Japan and overseas.

Financial liabilities including derivative instruments by maturity date consist of the following:

As of December 31, 2017 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other payables	224,893	224,893	224,892	1	—	—	—	—
Bonds and borrowings	120,584	120,614	25,268	40,046	25,038	30,235	21	6
Lease obligations	3,178	3,275	789	690	666	495	486	149
Long-term deposits payable	6,463	6,463	—	—	—	—	—	6,463
Derivative financial liabilities								
Currency related	1,022	1,022	635	—	296	—	91	—
Interest rate related	4	4	3	—	—	—	1	—
Total	356,144	356,271	251,587	40,737	26,000	30,730	599	6,618

As of December 31, 2016 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other payables	216,893	216,893	216,869	24	—	—	—	—
Bonds and borrowings	120,646	120,699	30,289	25,066	40,045	25,038	235	26
Lease obligations	4,000	4,140	884	779	684	667	492	634
Long-term deposits payable	6,413	6,413	—	—	—	—	—	6,413
Derivative financial liabilities								
Currency related	758	758	337	159	—	—	262	—
Interest rate related	15	15	7	8	—	—	—	—
Total	348,725	348,918	248,386	26,036	40,729	25,705	989	7,073

(3) Fair Value of Financial Instruments

1) Fair value hierarchy levels

For financial instruments measured at fair value, the fair values developed based on the observability of inputs into the valuation techniques used in measurement are categorized within the following three levels:

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities
Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3: Fair value measured with inputs not based on observable market data for the asset or liability

2) Financial instruments measured at fair value

The measurement methods for the main financial instruments measured at fair value are as follows:

(i) Short-term investments (excluding short-term investments measured at amortized cost)
Short-term investments are included in cash and cash equivalents, and are designated as financial assets measured at fair value through profit or loss. Short-term investments primarily consist of bond investment trusts and money held in trust, and are measured with a financial model using observable inputs such as interest rates.

(ii) Derivative assets and derivative liabilities
Derivative assets and derivative liabilities are included in other financial assets and other financial liabilities, and are designated as financial assets and financial liabilities measured at fair value through profit or loss. Consisting of instruments including foreign exchange forward contracts, currency swaps and interest rate swaps, derivative assets and derivative liabilities are primarily measured with a financial model using observable inputs such as exchange rates and interest rates.

(iii) Equity securities
Equity securities are included in other financial assets, and are designated as financial assets measured at fair value through other comprehensive income. Equity securities that are categorized within Level 1 are publicly listed and traded in active markets, and are measured using market prices on exchanges. Equity securities that are categorized within Level 3 are unlisted, and are primarily measured using a net asset valuation model, which measures corporate value based on the net asset of the issuing company with adjustments based on fair value.

The fair value hierarchy of financial instruments measured at fair value is shown below.

The Group recognizes transfers of financial instruments between levels of the fair value hierarchy at the end of each fiscal year. No financial instruments were transferred between levels of the fair value hierarchy for the fiscal years ended December 31, 2017 or 2016.

As of December 31, 2017 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	29,900	—	29,900
Derivative assets	—	602	—	602
Other	—	2,926	—	2,926
Financial assets measured at fair value through other comprehensive income				
Equity securities	10,165	—	3,927	14,092
Total	10,165	33,428	3,927	47,520
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	1,026	—	1,026
Total	—	1,026	—	1,026

As of December 31, 2016 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	34,900	—	34,900
Derivative assets	—	791	—	791
Other	—	2,888	—	2,888
Financial assets measured at fair value through other comprehensive income				
Equity securities	8,956	—	3,472	12,428
Total	8,956	38,579	3,472	51,007
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	773	—	773
Total	—	773	—	773

Changes in financial instruments categorized within Level 3 are as follows:

(Millions of yen)

	2017	2016
Beginning balance	3,472	3,212
Gains (losses)[1]	454	231
Purchases	—	30
Other changes	1	(1)
Ending balance	3,927	3,472

Note: 1. All gains and losses are associated with financial assets measured at fair value through other comprehensive income at the end of each reporting period. These gains and losses are recognized in net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income in the consolidated statement of comprehensive income.

Financial instruments categorized within Level 3 are primarily unlisted equity securities. Each responsible department of the Group refers to the Group accounting policies in measuring the fair value of unlisted equity securities each quarter using recently available data, and reports any changes in fair value and the reasons to the department manager, and to senior management as necessary.

3) Financial instruments measured at amortized cost

The following tables present the measurement techniques for measuring the fair value of major financial instruments measured at amortized cost. Financial instruments for which carrying amounts are a reasonable approximation of fair value or financial instruments that are not material are not included in the tables.

(i) Cash and cash equivalents (excluding short-term investments measured at fair value), trade and other receivables, and trade and other payables

Carrying amounts approximate fair value because these are settled in the short-term.

(ii) Bonds and borrowings

The fair value of bonds is based on market prices. The fair value of borrowings is the present value of remaining principal and interest discounted using a deemed interest rate on equivalent new borrowings.

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost are as follows:

As of December 31, 2017 (Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,969	—	50,345	—	50,345
Borrowings	70,615	—	70,946	—	70,946

As of December 31, 2016 (Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,947	—	50,548	—	50,548
Borrowings	70,699	—	71,084	—	71,084

36 Principal Subsidiaries

Principal subsidiaries consist of the following. Voting rights at December 31, 2017 did not significantly change from a year earlier.

Company name	Country	Principal businesses	Voting rights (%)
Kao Group Customer Marketing Co., Ltd.	Japan	Control of sales companies and other subsidiaries in Japan	100.0
Kao Customer Marketing Co., Ltd.	Japan	Beauty Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics Inc.	Japan	Beauty Care	100.0
Kanebo Cosmetics Sales Inc.	Japan	Beauty Care	100.0
Kao Transport & Logistics Co., Ltd.	Japan	Logistics and related services in Japan	100.0
Kao (China) Holding Co., Ltd.	China	Control of subsidiaries in China Beauty Care	100.0
Kao Corporation Shanghai	China	Beauty Care Human Health Care Fabric and Home Care	100.0
Kao (Hefei) Co., Ltd.	China	Human Health Care	100.0
Kao Commercial (Shanghai) Co., Ltd.	China	Beauty Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics (China) Co., Ltd.	China	Beauty Care	100.0
Kao (Shanghai) Chemical Industries Co., Ltd.	China	Chemical	100.0
Kao (Taiwan) Corporation	Taiwan	Beauty Care Human Health Care Fabric and Home Care Chemical	92.2
Pilipinas Kao, Inc.	Philippines	Chemical	100.0
Kao Industrial (Thailand) Co., Ltd.	Thailand	Beauty Care Human Health Care Fabric and Home Care Chemical	100.0
Kao Commercial (Thailand) Co., Ltd.	Thailand	Beauty Care Human Health Care Fabric and Home Care	100.0
Fatty Chemical (Malaysia) Sdn. Bhd.	Malaysia	Chemical	70.0
PT Kao Indonesia	Indonesia	Beauty Care Human Health Care Fabric and Home Care	72.2
Kao USA Inc.	U.S.A.	Beauty Care	100.0
Kao America Inc.	U.S.A.	Corporate service to subsidiaries in the U.S. Holding company for Chemical Business in the U.S.	100.0
Kao Specialties Americas LLC	U.S.A.	Chemical	100.0
Kao Germany GmbH	Germany	Beauty Care	100.0
Kao Manufacturing Germany GmbH	Germany	Beauty Care	100.0
Kao Chemicals GmbH	Germany	Chemical	100.0
Molton Brown Limited	U.K.	Beauty Care	100.0
Kao Chemicals Europe, S.L.	Spain	Control of subsidiaries in Chemical Business in Europe, etc.	100.0
Kao Corporation S.A.	Spain	Chemical	100.0

37 Related Parties

(1) Transactions with Related Parties

Disclosure is omitted because there is no material related party transaction.

(2) Primary Executive Management Compensation

Primary executive management compensation consists of the following. The Group's primary executive management includes members of the Board of Directors and executive officers of the Company for each fiscal year.

(Millions of yen)

	2017	2016
Short-term benefits	1,315	1,131
Post-retirement benefits	30	39
Share-based payments	332	227
Total	1,677	1,397

38 Commitments

Commitments to acquire property, plant and equipment and intangible assets after the end of each reporting period are as follows:

(Millions of yen)

	2017	2016
Acquisition of property, plant and equipment	37,906	27,100
Acquisition of intangible assets	1,237	1,306
Total	39,143	28,406

39 Significant Subsequent Events

There were no significant subsequent events to present.

40 Approval of the Consolidated Financial Statements

The Consolidated Financial Statements were approved by Michitaka Sawada, President and Chief Executive Officer, and by Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting and Finance, on March 20, 2018.

Independent Auditor's Report

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Kao Corporation:

We have audited the accompanying consolidated statement of financial position of Kao Corporation and its subsidiaries as of December 31, 2017, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, and notes to consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kao Corporation and its subsidiaries as of December 31, 2017, and the consolidated results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu LLC

March 20, 2018

Member of
Deloitte Touche Tohmatsu Limited

Enriching lives, in harmony with nature.

Kao Corporation

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