

May 2018 Small Meetings with the CEO

Dates: Monday, May 28, and Thursday, May 31, 2018

Agenda: 1) Market and Performance Overview / Outline of Growth Strategy for the Cosmetics Business / ESG Activities, etc.
2) Q&A Session and Dialogue

Speaker: Michitaka Sawada, President and CEO

1) Market and Performance Overview / Outline of Growth Strategy for the Cosmetics Business / ESG Activities, etc.

Conditions in the Household and Personal Care Products and Cosmetics Markets in Japan¹

- The impact of e-commerce (EC) and demand from visitors to Japan (inbound demand) is increasing, and market data needs to be viewed from diverse perspectives.
- POS data from retail outlets (SRI) in 2017 covers about 80% of channels in the household and personal care products market and about 30% of channels in the cosmetics market. For January to March 2018, EC comprised about 14% of sales in household and personal care products and about 21% in the cosmetics market. The year-on-year growth of EC sales was greater than for other channels.
- The household and personal care products market remained firm in January to April 2018. Purchasing data from consumer monitors (SCI) showed greater growth than SRI because of EC growth.
- The cosmetics market in January to March 2018 was comparatively firm as seen from purchasing data for cosmetics, skin care and hair care products from female monitors (SLI). In March, SRI showed greater growth than SLI. Inbound demand grew in categories such as UV care.

1. SRI, SCI, SLI: POS and consumer monitor data by INTAGE Inc.

Conditions in the Markets outside Japan where Kao Operates (January to March 2018)²

- China was firm. Skin care, UV care, and sanitary napkins grew. Baby diapers decreased from the same period a year earlier, but the market seemed to be growing due to EC, which is not covered in this data. In China, we need to gain insight into EC, which constitutes a large part of the market.
- In the January to February period, Taiwan was weak, but it saw growth in March. In Hong Kong, inbound demand picked up and is trending toward recovery. Singapore continued to be weak. Although Malaysia grew strongly, we will need to continue watching political and economic trends. In Thailand, social conditions had stabilized and recovery was firm. Indonesia did not grow as much as expected, possibly due to the impact of currency depreciation.
- In the skin care and hair care markets in the United States, Kao has *Jergens* and *Bioré* skin care and *John Frieda* hair care brands, respectively. In the skin care market, hand and body lotion and anti-perspirants/deodorants were firm and facial cleansers were sluggish. The mass market for hair care was on par with the same period a year earlier. The UK hair care market was also flat. The facial cleanser and hair care markets in Germany were firm.

2. Nielsen data

1Q FY2018 Results

- Although we expected results in the first quarter to be lower than in the same period a year earlier, sales and operating income both exceeded the budget and results of the previous first quarter, making better progress than expected.
- In the Cosmetics Business, *Curél* derma care brand and *RMK* and *SUQQU* of e'quipe Ltd., a subsidiary of Kanebo Cosmetics, performed well. In China, *Curél* and *freeplus* sensitive skin cosmetics saw strong growth. When combined, sensitive skin cosmetics and Asia exceeded 20% of sales in the Cosmetics Business, and the operating margin exceeded 25%, so the Cosmetics Business in Asia is generating profit.

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- In skin care products, *Bioré* performed well. Personal health products such as oral care, bath additives and *MegRhythm* steam thermo sheets, as well as home care products and the Chemical Business were firm.
- By region, sales in Asia were strong, but sales of the Consumer Products Business in the Americas and Europe were weak.
- The Cosmetics Business, which was in the red for the first three quarters of the previous fiscal year, improved operating income by 3.1 billion yen year-on-year in the first quarter due to the incorporation of *Curél*, strong performance in Asia and improved performance in Japan.
- The Cosmetics Business in Japan and hair care products in Europe are issues to address. In the Human Health Care Business, sales of personal health products grew strongly. However, a one-time factor related to baby diapers resulted in a decline in sales year-on-year. Operating income in the Fabric and Home Care Business decreased slightly due to loss on disposal of property, plant and equipment and the impact of higher raw material costs.
- We will launch numerous new and improved products in Japan starting in April 2018.

Strongly performing brands

- Sales of *Intensive Moisture Face Cream* were particularly strong in *Curél*. Sales of *Bioré Home Esthetics Massage Cleansing Gel*, which removes dirt and smooths skin, and *Bioré Refreshing Facial Sheets*, which can be used over make-up, were strong. Other products that performed strongly included *Rerise* hair color for gray hair, a unique hair color that is gentle on hair, based on naturally derived black hair melanin and *Pyuora Foaming Toothpaste* for prevention of bad breath.

New Strategies for the Cosmetics Business

- A growth strategy briefing on the Cosmetics Business is scheduled for June 2018.
- The main topics include initiatives for the mid-priced range market in Japan, inbound demand, travel retail (duty free shops), digital marketing and EC, and the development of brands with distinctive concepts and identities. We also need products that will be newsworthy.
- The sales of the Kao Group have been centered on the mid-priced range in the cosmetics market in Japan. The operating margin has declined as the market has become more polarized into high-priced and low-priced ranges while the mid-priced range has shrunk. We need to improve profitability.
- We have reviewed the portfolio of five business entities laterally: Molton Brown, Kanebo Cosmetics, e'quipe Ltd., Sofina and Curél. Among the total 49 brands we have across Kanebo Cosmetics, Kao and Molton Brown, we will focus on 11 global strategy brands (G11) and 8 regional strategy brands marketed mainly in Japan (R8) and concentrate investment in these brands. For other brands, we will examine the situation before making decisions.
- We also revised our sales channel-based strategy by making a clear distinction between counseling cosmetics and self-selection cosmetics. This may take a while.
- We plan to introduce *SENSAI*, one of the G11 brands sold mainly in Europe, to Japan and China, in 2019 and 2020, respectively. We will add higher value-added items to the *est* and *KANEBO* brands.

Striving to Achieve the Announced Forecast for FY2018

- The publicly announced forecast set high goals, exceeding our internal budget. It will not be easy to achieve these goals, but we will work hard to exceed them, even if by just a little.
- Key points for achieving the forecast:
 - (1) Maintain or improve market share for fabric care products (laundry detergents, fabric softeners, bleaches) to secure an operating margin of 20% or more
 - (2) Stable growth of sanitary products, centered on baby diapers
 - (3) Continue strongly performing businesses and launch and nurture new and improved products

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- (4) Improve businesses with issues: Cosmetics Business in Japan, hair care products, functional drink *Healthy*, the Consumer Products Business in the Americas and Europe
- (5) Stabilize and grow profits in the Chemical Business
- Destabilizing factors
 - (1) Intensifying competition in fabric care products
 - (2) Possible changes in regulations and business conditions related to competition and retailers for baby diapers in China
 - (3) Insufficient communication of the value of new and improved products, or insufficient impact of such communication
 - (4) Delay in the reform of the Cosmetics Business in Japan, accelerated weakening of hair care, deteriorating brand power in the Consumer Products Business in the Americas and Europe
 - (5) Higher raw material costs and fluctuations in exchange rates, especially Asian currency depreciation

Our Progress toward ESG Activities

- In the past, we have engaged in social contribution activities using the profits gained through our business operations. In the future, we will position ESG activities as a long-term investment and devote our efforts to activities that encourage customers to try our products.
- We deferred some activities because investment amounts were too large. In the case of bottle-like pouches (BLPs), a new type of refill container, a large amount of investment was required. Without a substantial increase in sales, we cannot recover this investment in the short term. However, we renewed all production equipment for BLP for body cleansers and shampoos and conditioners. This initiative is currently unprofitable, but we are aiming for long-term returns with developments such as Smart Holders for BLPs.
- By emphasizing long-term investment in ESG activities, we are hoping for return on business operations. We will oversee such investment with strong corporate governance.
- We are setting up a global organization in order to implement “Kirei* Action: Making life beautiful” worldwide as Kao-style ESG activities.
- We will engage in heartfelt and rigorous manufacturing practices, and Kirei Action will provide follow-up right to the end (final disposal) to ensure that the products we provide do not end up illegally dumped or as plastic marine debris and the like. We are committing to many kinds of activities.

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

(2) Summary of Q&A Session and Discussion

1. **In Kao Group Mid-term Plan “K20”, you set high targets for FY2017 and were able to achieve them, but aren’t the targets for FY2018 low? First-quarter performance seemed weak—are you progressing toward K20 as planned? If you don’t grow more, won’t you be unable to achieve the K20 targets?**

We don't expect sales and profits to grow in a linear fashion every year toward the K20 goals. We are working not only in our core business domains of cleanliness, beauty and health, but also preparing proposals for businesses at the intersection of these domains and for new products. We are planning for significant growth in FY2019 and FY2020. These plans do not include M&A.

2. **Your strategy in the Cosmetics Business is to strengthen the prestige category, but what do you think about the risk that market trends will change to favor affordable cosmetics?**

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Essentially, how to respond to changes in social and consumer needs is an ongoing issue. Because every individual has a different lifestyle, family, and health conditions, ultimately we are aiming for cosmetics that fit individual needs – each person's own individual brand. While we continue to strengthen the prestige category, we also want to gain insight into each individual's skin and hair characteristics and to predict conditions 5 to 10 years in advance, which will enable us to make reasonably priced offerings.

Until then, we would like to make Kao style offerings during this transition period. For example, with *Merit Pyuan*, we introduced moisture-activated fragrance technology, which was already used for other products, and combined this with hair care. The user's sweat creates a fragrance. This offering was tailored to people's lifestyles.

3. Does the new strategy for the Cosmetics Business diverge from the policy at the time of the CEO's appointment?

Our direction has not changed. We need to create unique brands, and we have been undertaking major reforms of the Cosmetics Business. Under the new management team of the Cosmetics Business, we will keep advancing these reforms using different methods, such as cultivating high-priced range brands with presence in the skin care market, consolidating mid-priced range brands, and responding to inbound demand.

4. When do you see the performance of the Cosmetics Business clearly improving?

In the Cosmetics Business, we are aiming for net sales of 300 billion yen and an operating margin of 10% by FY2020. As operating income was 5.1 billion yen in FY2017, we need an increase of about 25 billion yen over 3 years.

In the first quarter of FY2018, *Curél* was reclassified to the Cosmetics Business, and the strong performance of cosmetics in Asia and e'quipe made the business profitable. In addition, since the effect of introducing high value-added products to *est* and *KANEBO* will be significant from next fiscal year, we expect profits to increase in the latter half of the three-year period leading up to FY2020.

Double-digit growth for sales of prestige and mass brands in G11 and R8 can be expected. We will undertake brand reform in the mid-priced range, which will include increasing the quality of counseling and transforming to self-selection. These directions will be visible from FY2020 or later.

We expect steady improvements in operating income by focusing on brands, but we also anticipate a temporary decline in sales due to the effect of transforming from counseling brands to self-selection.

5. How many brands within the cosmetics business aren't showing profit?

The profit margin is low for mid-priced range brands due to the expenses related to counseling and television commercial advertising.

6. What proportion of sales currently comes from the 19 brands of G11 and R8, and what are you aiming for in future?

In FY2017, the G11 brands accounted for about 40% of sales. We are aiming for approximately 70% by around FY2025.

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7. How will you decide which brands other than G11 and R8 brands will be phased out in the future?

Firstly, we will determine whether they are profitable or not. We will simulate marketing expenses based on management on profitability for each brand, and also take production efficiency into consideration.

If you make this determination based on the management of profitability for each brand, don't you risk phasing out brands that might become popular later if you change the way they are sold?

We would only decide to phase out them after changing our approach and trying again. Taking on the efforts of communicating value more sharply via EC might also be necessary.

How will you judge the results of these efforts?

We will judge by the number of repeat purchases, as well as sales information and opinions given at stores.

8. In the Cosmetics Business, if you take on the efforts of reviving brands other than G11 and R8 brands, will you achieve your sales and operating margin targets of 300 billion yen and 10% by FY2020? Does this mean higher marketing expenses in order to increase sales of G11 and R8 brands and the need to take on the efforts of other brands, after which you will increase cost efficiency again?

We have decided to invest strategically in G11 and R8 brands, and are also planning new products leading up to FY2020. The extent to which we are able to revive brands other than G11 and R8 brands and achieve results by FY2020 will vary depending on the approach we take.

Asia, *e'quipe*, and cosmetics for sensitive skin have all grown, with the operating margin exceeding 20%. Continuing growth in these areas will be the most important step toward achieving sales of 300 billion yen and an operating margin of 10% by FY2020. Even though profits and expenses vary depending on the efforts, we want to be able to achieve the goals.

Are marketing expenses managed as a whole for the Cosmetics Business?

Marketing expenses are managed by brand, using small PDCA cycles. Lumping all expenses together would prevent us from seeing which brands are sound.

How are you making the Cosmetics Business more cost-efficient?

We cut costs by managing brands individually, as well as implementing cost reductions common to all brands in areas such as advertising forms and marketing methods.

9. Your leading competitors in the Cosmetics Business have 2 or 3 major brands with significant sales. Isn't the number of G11 and R8 brands too numerous to properly allocate investment, compared with competitors? Shouldn't you first develop 2 or 3 major brands over the next 3–5 years?

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We want several counseling brands, each aiming for net sales of 50 billion yen. Our competitors took time to build up their brands, and inbound demand gave them a boost. Not every G11 brand will be able to achieve 50 billion yen in sales. Focusing on and investing in three brands does not necessarily mean they will do well. Each G11 brand has its own distinctive potential. Building a brand takes time.

Will you make significant investments in individual G11 and R8 brands?

We will launch new products. We will make the *est* brand unlike the past, for example, by using new skin diagnosis techniques, making it the pinnacle of brands that capture holistic beauty from the perspective of the body as a whole.

The G11 brands are global strategy brands. We will develop them into brands with special features. R8 brands are those focused on Japan. They cannot remain in our portfolio unless we can sharpen up their concepts and identities. Some brands will need major investment, while other brands can be sharpened up without much investment.

If you develop the G11 brands globally, won't the marketing expenses also be large for each brand?

Within G11, *SENSAI*, *KANEBO*, and *est* are all high-priced skin care brands. *KATE*, *freeplus*, and *Curél* are mass, self-selection brands, and *SOFINA iP* will also become self-selection. We will not be making major marketing investments in every brand.

10. Have you devised any mechanisms to ensure the success of your Cosmetics Business strategy?

We will increase cost efficiency and production efficiency while growing Asia and the *Curél*, *freeplus* and *e'quipe* brands, which are performing strongly. We will improve profits by addressing inefficient marketing and transforming counseling brands into self-selection to improve per-store sales efficiency. While drastically revising and investing in our brand portfolio, we will also undertake detailed expense management to improve the operating margin to close to 10%.

11. Your struggle in hair care has been prolonged; do you think that you can restore performance by changing your marketing and sales methods—for example, as you did with *Merit Pyuan*? Or do you intend to use the recently acquired *Oribe* luxury hair care brand for mass-market hair care and cosmetics branding as well? How will you make the most of *Oribe*?

In the market, hair care brands, especially in-bath mass brands such as shampoos and conditioners are becoming weaker globally. Many small-mass-market products are sold via EC to satisfy consumers' desire to choose their own individual brand, proposing concepts such as silicone-free, natural and botanical to date. As there are still some approaches to function that have not yet been proposed, we will make distinctive Kao style proposals. We need to strengthen existing mass brands to ensure they maintain their market share.

We acquired U.S.-based Oribe Hair Care, LLC to secure a professional hair care business aimed at luxury salons. Together with *Goldwell*, which is strong in Europe, we will develop business aimed at luxury salons in the United States and Europe. In combination with the HD³ Dye Technology announced last year, we hope to raise sales of our professional hair

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care products from the 40 to 50 billion yen range to 100 billion yen. We are not considering expanding use of the *Oribe* brand to mass-market hair care.

We launched *John Frieda* hair care products for men and they have performed well. We will expand the image of *John Frieda* to meet needs in each country, while rebuilding it as a salon-quality brand.

Shampoos and conditioners are becoming harder to distinguish from each other as their performance improves. We will enhance the features of out-of-bath products such as hair color and styling, where we can utilize our technologies to achieve differentiation.

12. I think sometimes hair care products are selected for their great design rather than their contents. What are your thoughts on investing in design?

Design is extremely important because sales vary depending on usability and design even when the contents are the same. We pay particular attention to searching for the best designs for beauty care products. I think we need more opportunities to exchange opinions on designs, to ensure that we are not hampered by preconceptions.

13. What is the situation for the food and beverage products, which is a focal issue?

In food and beverage products, we will first work toward recovery of our *Healthya* functional drinks, which is a focal issue, and intend to propose new products that utilize our research results and technologies.

14. Regarding business outside Japan, where do you see issues and how will you respond?

Outside Japan, the Consumer Products Business in the Americas and Europe is tough at the moment, especially hair care products.

For baby diapers in Asia, we are concentrating on made-in-Japan products for the premium market and locally-made products for the mass market in China, and on locally-made pants-type diapers for the mass market in Indonesia. Ultimately, we want to manufacture sanitary products locally for in-market consumption, so we will introduce advanced technologies aimed at making premium products locally.

15. In the consumer goods industry, many Japanese companies are lagging behind competitors outside Japan due to price competition and systemic changes. What kinds of risks do you anticipate and how are you responding?

We do not intend to take on everything. Some situations are simply unwinnable. In our areas of expertise, we will offer proposals from new perspectives that are useful to society and consumers, thus expanding the market. The Kao Group's presence outside Japan is still small, but we will increase it through this global niche strategy.

Can Kao become the fifth or even third-ranked company in the global consumer goods industry using that strategy?

Look at China. Although we may describe it as a "niche," our sales are on a scale of tens of billions of yen or more. By building up such sales, we will grow. We'd like to be ranked fifth

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in some way, not only in sales, but also in operating income and operating margin, for example. We have the potential.

16. When entering a new market, is it important that the market is growing or is the market's size more important?

One way is to offer technologies and products that society can utilize and that are useful for consumers in growing markets, but not only in emerging countries—there will be opportunities even if the market is mature. Our *Healthya* green tea is accepted as a food for specified health uses, our offerings for enjoyment at family bath time with the bubbles from our bath additive products is expanding the market, and our *Magiclean* sheets with microfibers that remove dust and dirt, leaving surfaces sparkling clean just by adding water have expanded the market. Even existing markets can be expanded with offerings from new perspectives. We intend to keep moving forward in both growing and mature markets.

17. Despite your policy of taking risks and meeting efforts wherever opportunities exist, are you not going to move into new markets or emerging countries and regions such as Thailand or India with baby diapers?

As a manufacturer of consumer goods, we want to make product proposals that can contribute to each and every consumer. Baby diapers are one such product. We are not considering entering global markets with our baby diapers alone. We make substantial expenditures in R&D to develop products with high added value. We consider the places, timing, and ways in which our products can be best used.

We have many ideas, including entering India, the Middle East, Europe, and the United States, but we first consider what we can do for babies and their families.

Do you believe that personal care products are seeing better growth than baby diapers in Asian markets, and will yield more profit if you concentrate on them?

No. The situation is different depending on the country or region.

What are your thoughts on future expansion in Asia? In which categories would you enter those markets?

We are considering a variety of options. We will enter India. We cannot disclose details such as which categories we will enter.

Does that mean you are focusing on preparing for such expansion?

For example, our share of sanitary napkins in China is only about 5%. There are many things we still have not done in Asia. We want to achieve a skin care image with baby diapers and sanitary napkins that are also gentle to the skin, and we would like to move into the area of health support.

18. Markets for sanitary napkins in Asia seem to be growing. How will you expand sales of sanitary napkins there? What do you think needs to be done in order to expand sales substantially in China as you did for *Merries* baby diapers?

The high-value-added *Laurier Super Slim Guard*, offering excellent absorbency despite its thinness and a surface material that is gentle to the skin, sells well in Asia's sanitary napkin

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markets. We assume that, just like beauty care, sanitary napkins will shift toward the small-mass-market domain. In the future, sanitary napkin proposals for the small-mass-market will be important. We are preparing for this situation differently, depending on the country and region.

In China, the market for sanitary napkins is growing and proportion of sales accounted for by EC is still lower than for baby diapers, so it will continue to grow. Our share of the sanitary napkin market for Mainland China is still 5%, so we could very well double this.

Is production capacity a problem?

It is not a problem.

19. What is your future strategy for baby diapers in China?

It is important to maintain the image of *Merries* as the number-one brand in the premium market. Because falling prices due to the activities of resellers in China are an issue, we are also working to further increase direct business retailers and to narrow the selling price differences between Japan and China. We are also working on improvements to provide better products.

In China, pants-type diapers accounted for 15% of the market in 2015, and grew faster than expected to 24% of the market in 2017, so we will work to respond quickly to the shift from tape-type to pants-type diapers. Local manufacturers have improved the quality of their tape-type diapers and expanded their overall market share, but we expect they will take some time to respond with pants-type diapers.

20. For your global niche strategy, I understand the adult incontinence products market in Asia is large, but what is your future strategy?

Our competitors have a large share of the adult incontinence products market, and even in Japan, Kao's market share is only about 10%. However, it is gradually increasing due to acceptance of our pants-type diapers for light incontinence that can be used exactly like underwear. We also would like to expand market share of pants-type diapers by cooperating with retailers entering into markets in Asia from Japan.

Where do you sell adult incontinence products in Asia?

We sell in China, Taiwan and Malaysia. Sales are not large yet.

21. In Japan, I believe there are changes in purchasing behavior such as a move toward regular purchasing, larger sizes, refills, and bulk purchasing, but hasn't this caused a downward trend in unit prices? How do you perceive changes in consumer purchasing behavior?

According to SRI, sales of items with high unit prices have been increasing over the past few years, but when multiplied by quantity for total sales value, the market has shrunk slightly. Shampoos and conditioners sold via EC have higher unit prices. We will renew our mass brands, and also make Kao-style offerings for the small mass market. In beauty care, large sizes were selling well for a while, but they are not selling now, perhaps due to consumer desire to use different types of products. Large sizes of laundry detergent products are selling via EC. Large sizes are a key point of the market.

22. In Japan, a consumption tax increase is scheduled for October 2019, and the number of visitors to Tokyo is expected to increase in 2020 due to the Tokyo Olympic Games. What is your outlook on domestic demand and inbound demand in Japan in the short term and medium-to-long term?

Regarding the consumption tax increase, it is most important to gain regular shelf space in stores and increase market share. The advantage lies in quickly grasping and responding to the in-store inventory situation. To that end, we are reinforcing our production capacity and making preparations for distribution.

Regarding inbound demand, if we can convey the excellence of our products to visitors to Japan, they will purchase, and use our products, and understanding their advantages, will repeatedly purchase them via cross-border EC after returning home. We need to devise more ways to convey the value of our products.

Since the target products for inbound demand change in short cycles, there will be many opportunities.

23. Kao's competitive advantage is its ability to acquire a large share of the market with mechanisms enabling it to quickly grasp store sales and market share, and to leverage that market share to become more cost-efficient. As EC expands, won't it become more difficult to gather information, making it necessary to implement other mechanisms, which in turn will incur costs as well as EC handling fees? How will you respond to the expansion of EC?

There was a time when it was difficult to gather information due to the expansion of EC, but that is not a problem now. Rather, our concern is that instead of mass market media advertising, word-of-mouth communication spread through smartphones via social media causes sudden sales rushes, after which the desired product goes out of stock, and if we increase production, the timing may no longer be ripe and the product no longer sells. It is important to gain a sense of whether or not something will sell well.

We pre-launched *Rerise* hair color for gray hair via EC, and later launched it at brick-and-mortar stores once we had gauged consumer response. Especially in beauty care, we are starting measures such as increasing our accuracy in sales forecasting and production planning.

24. How will the advantage of the direct sales system, which keeps you close to retail stores, change with the expansion of EC? How will you respond?

We can collaborate with retailers, including both brick-and-mortar stores and EC. Even for retailers centered on brick-and-mortar stores, if we adopt the marketing method of pre-launching products via EC to generate word-of-mouth on social media, and follow up with mass-media advertising before selling at physical stores, both EC and physical store-focused retailers can enjoy advantages. *Rerise* is being rolled out this way.

25. Can you secure profitability in EC given that manufacturers have been requested "cooperation fees" from EC companies?

We would hope that we can mutually discuss the essential objectives and negotiate to build win-win relationships. To that end, it is important to have a strong brand.

26. How will you respond to the issue of increasing distribution volume with the expansion of EC?

We have worked toward shared delivery with wholesalers and retailers, but we have been shifting toward securing our own supply chain to ensure unimpeded distribution. An uptrend in distribution costs due to increasing deliveries to distribution centers of retailers and deliveries in small lots has made increasing efficiency important.

27. Given the shift to digital marketing and expansion of EC, has your approach to product development changed in order to improve Return on Invested Capital for marketing investments?

Rather than changing our approach to product development, we are changing the way we convey our value. Mass marketing enables us to emit messages widely with impact, while digital marketing such as use of videos on social media conveys detailed information to limited targets.

Do you plan to develop products exclusively for EC?

For example, on some EC websites, the version of *Bioré u foaming hand soap* we sell comes in a limited design bottle, but the product content itself is no different from the brick-and-mortar store version.

28. I believe it is easy to match external big data with your own consumer data. How are you making use of this?

Starting with marketing using POS data, we analyze data in keeping with the times, but in product development it is important to understand not only the data but everything else too. It takes more than big data to understand how cleanliness, beauty, health and the body is linked to a person's true feelings.

29. What do you think about influencer marketing via social media to convey information?

We want influencers to actually use our products and give their honest opinions via social media. We don't do stealth marketing to make influencers say only positive things. Integrity is important.

What do you think of cosmetics ranking websites? Do you actively use these for marketing?

We don't actively use them, but we do refer to them. Of course, we are pleased if users give our products a number-one ranking in their evaluations. Widespread communication of positive experiences of product use is effective in increasing the number of people who know how to use our products well and have a feel for how good they are.

30. It is believed that quantum computers will enable more efficient product development that is highly compatible with Kao's Chemical Business. What impact will quantum computers have on Kao's strengths in research and development? Can you give examples that show how it can maintain your superiority in this area?

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We are not worried. We have already used quantum chemical calculations to create chemical substances with less experimentation. But quantum computers cannot create brands.

For example, when we develop sanitary napkins, we run simulations in which we change the dynamics of menstrual flow. Engineers and others from our discontinued information technology business support this product development.

31. Although the development of new products seems to be progressing recently, isn't the number of new products rather small in the Fabric and Home Care Business?

We want to propose not only improved products but also new products and innovations that will change society. Once a year, we select a few research projects to help spark innovation. For example, *Rerise* and *Pyuora foaming toothpaste*, among others. We also conduct ongoing research and development for our Fabric and Home Care Business on a daily basis, constantly checking our progress. We are close to proposing some innovations.

32. Why aren't there any female directors on the Board? How many years will it take for a woman from within the company ranks to be promoted to director?

There are two female executive officers. With regard to female directors, we are approaching specialized candidates outside the company with a sense for management. Currently, Kao has seven directors, but we would like to bring this number to around 10, and appoint some female directors with a management sense. We will also make efforts to appoint some non-Japanese executive officers.

33. You said you had set the publicly announced FY2018 forecast higher than the internal budget. You are having difficulties in cosmetics and hair care. It may be because the diversity of the organization has not kept pace with the changing times. I would like you to make changes that will bring a sense of the new era under your leadership as President and CEO. For example, appointing executive officers from abroad.

I think you are right. When formulating K20, based on awareness of problems caused by our own shortcomings in changing despite the dramatically changing times, we created the slogan "Transforming Ourselves to Drive Change."

As a company that has been continuously growing for over 130 years, it will take some time to change, especially human resources and legal affairs and other corporate divisions that support management and play a central role in our corporate culture, philosophy and climate, but if we do not change by 2020, we cannot hope for future growth.

In order to make full use of human resources from outside the company, we are working on laying the groundwork for driving change. In the near future, our organization for ESG activities will also undergo a major transformation to a global organization.

34. Kao revised the management of the Consumer Products Business in 2018. What changes have occurred in the past five months, such as improvements in communication to reflect the opinions of the younger generation?

In some areas there has been immediate change, and in other areas it will take time to make necessary changes to the corporate culture and climate. Companies with a strong

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corporate culture and climate grow continuously without experiencing serious problems, but these factors can also prove an obstacle to effecting major changes. I'd like to aim for change that starts with a willingness to transform ourselves. I'd also like to think about how we recruit personnel and how we can provide opportunities to take on the challenge of new roles to change the organization.

35. You are currently engaged in a variety of initiatives, such as shifting to digital marketing, investing in new production systems to respond to the small mass market, and made structural reforms by reducing the management hierarchy to speed up decision-making, etc. With these organizational changes, what stage are you at in your progress toward 2030? What effects have you seen, and what will you do leading up to 2030?

These efforts are around 70% to 80% complete. Transforming ourselves to drive change is important. We are taking steps such as changing the way we deliberate within members of management, eliminating excessive conference materials and changing to a discussion-centered approach starting from explanations to improve efficiency. However, it will take time to achieve an understanding of self-transformation among all of our members, review and change previous methods, approaches and ways of thinking, and translate that understanding into action. We will continue to encourage change as we uncover more cases that call for change.

36. The shortage of labor in Japan has expanded from the previous shortage of blue collar workers to a shortage of white collar workers, and now to competition among companies and across business industries for limited high-end, talented human resources. We are seeing companies that facing challenges due to the distortion of their population pyramids and because they have under-invested in human resources. What kinds of issues are there in talent management, and how do you think this has to change?

It depends on the level, but I don't think it's necessarily good to simply hire human resources from outside the company. Through reform of management of the Consumer Products Business from units into divisions, we reduced hierarchy by doing away with heads of business units and considerably increase the number of young division managers. I'd like to create active opportunities for them to demonstrate their abilities, and I want to give younger managers a greater role in our organization, including as executive officers.

If we can transform ourselves, we can also stimulate and re-energize our organization by hiring outstanding human resources from outside the company. I want to prepare for FY2030 by the end of FY2020.

37. What is the approximate scale of costs or investments in ESG activities? How do you decide these activities, and how are the results evaluated? Do KPIs reflect evaluations from external organizations?

We are preparing an organization for ESG activities. We are currently discussing timing, duration, investment amount and types of activities. Since we will not get return on our investment in new BLPs in the next few years, we wouldn't have invested in this initiative under our previous way of thinking, but if we also consider rollouts outside Japan of Smart Holders for BLPs, which eliminate the need for a main bottle, there will be a return. The periods for investment and return on investment depend on each individual case, but we

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will actively consider many projects. We want to use biodegradable plastics, plant-derived plastics, and oil from algae—even if only to a small extent.

If we make capital expenditures of 90 billion yen, that is about 6% of sales, but even 1% of sales represent a major investment. We must become a company that can cover this amount in other ways. Since this is impossible if we only consider short-term profits, we need to ensure that shareholders and investors can understand our long-term direction. Kao has made selection as one of the World's Most Ethical Companies[®] one of its director compensation KPIs.

38. With regard to ESG, the new BLP refill containers will lead to opportunities to enhance brand value, but I believe that you have strengthened your activities in response to risks—for example, your commitment to improving quality following the issue related to vitiligo-like symptoms—so shouldn't you place priority on conveying such information in your Integrated Report and by other means?

How has this commitment to quality been discussed and fostered by the Board of Directors and in the company following the above mentioned issue?

Rather than ESG, perhaps our Integrated Report should contain more information on how we foster our commitment to safety, security and quality. The Board of Directors also discusses quality problems extensively.

If a quality issue arises, it is quite possible that the Kao Group will not remain viable. Last year, although it was not a quality issue, there was a case in which a portion of the cosmetics production at our Odawara Plant, near Tokyo, was non-compliant with the Fire Service Act. The Board of Directors discussed this fully, and in response to this risk, it decided to publicly announce thorough measures to prevent any recurrence.

To what extent has your stance on ESG penetrated the company?

Not enough yet. We are considering how much we should invest in ESG, which projects to carry out and how, and what kind of results we are aiming for. We seek to enhance our corporate value and become a company with global presence.

39. Kao is working proactively to use RSPO-certified palm oil for sustainable procurement of raw materials, but how will you cover the increased cost burden of this initiative? How far have you progressed in developing technology to create an alternative for palm kernel oil from algae to improve cost competitiveness?

Regarding procurement of raw materials, in addition to actively using RSPO-certified palm oil and gaining an understanding of the human rights situation in the supply chain utilizing Sedex, we are working to improve traceability back to plantations and mills, but this is costly.

We cannot immediately recover this investment, and we would not consider asking consumers to bear this cost, so we absorb it in other ways. We believe that declaring and implementing ethical activities such as this will lead to an increase in long-term corporate value.

Research on algae is progressing, but it still takes time in terms of cost. Replacing raw materials will be difficult on a large scale, but we want to see results quickly, however small.

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Note

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