

Date and time:

Tuesday, February 4, 2020, 17:00 – 18:30 (JST)

Respondents:

Michitaka Sawada, Representative Director, President and CEO

Tomoharu Matsuda, Director, Managing Executive Officer

Yoshihiro Murakami, Managing Executive Officer, Responsible for Consumer Products – Cosmetics Business, Representative Director, President, Kanebo Cosmetics Inc.

Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting & Finance

- 1. What were the factors behind the 4.0 billion yen decrease in operating income in the Fabric and Home Care Business in the fourth quarter compared with the same period a year earlier? Store prices appear to have dropped considerably toward the year end, but did you need to adopt price adjustments to secure sales? What is the outlook for 2020, taking into account your planned improvements to *Attack ZERO*?**

The decrease in operating income in the Fabric and Home Care Business in the fourth quarter was due to (1) a lack of dynamic growth in the market compared with a year earlier, (2) our investment in promotions to encourage people to try *Attack ZERO*, for which sales growth has been slower than planned, in order to expand market share as we headed into 2020, and (3) our investment to expand market share for fabric softeners, where we had been making little progress due to intensifying competition, to lay the groundwork for growth from new products in 2020.

You reduced selling, general and administrative expenses 3.0 billion yen overall in the fourth quarter. What were the categories where you reduced expenditures while investing to capture market share in the Fabric and Home Care Business?

We reduced various indirect costs as well as costs directly related to our businesses.

- 2. In 2019, the strong growth in profit from the Cosmetics Business offset the weak performance of baby diapers. Will the expansion of the Cosmetics Business in 2020 create a profit structure that can more than offset the performance of baby diapers? How will you achieve a recovery in baby diapers?**

In 2020, as we work to ensure that sales of baby diapers is about same as previous year's level, we will endeavor to recover as much as possible ahead of 2021, when we plan to launch new products. We aim to increase sales in Indonesia, where *Merries* baby diapers have been performing well. We intend to offset the expected decline in sales in Japan through a recovery in Kao China's local business and cross-border e-commerce. Kao China is stepping up activities in the e-commerce channel, and cross-border e-commerce has been on a recovery track. We will also focus on communicating our value so consumers fully understand the quality of our products.

Why are Kao's pants-type baby diapers having a hard time in the Chinese market? Is it because of competition with local or global manufacturers?

It is due not so much to competition or other factors but to falling short of our plan. While our sales of tape-type diapers are down, pants-type diapers are growing by double digits. To cover for our tape-type diapers, we want to strengthen pants-type diapers, which account for a growing proportion of the Chinese market. We intend to communicate the

merits of *Merries* as a product designed to remain in place without constricting the waist, with growing children in mind, in addition to its breathability and absorbency that other companies are also promoting. Strengthening pants-type diapers will be crucial in the Chinese market, where they account for a growing share.

- 3. In light of the weak state of baby diaper sales in the Chinese market what are the circumstances in terms of the market, competition and retail inventory? Consumers in the Chinese market place more importance on word-of-mouth than on anything businesses tell them, so don't you need to fundamentally change your way of marketing? Rather than trying to curb reselling by resellers, isn't there also a way of stimulating sales with resales that may improve brand equity?**

In 2019, births in Japan declined to an estimated 864,000. Therefore, Kao China's baby diaper business, with its large target market, will become even more important to us in the future. In the past, there was a great deal of reselling in the Chinese market of baby diapers purchased in Japan, so we took measures to secure orders at stores in Japan. However, due in part to the decrease in reselling, which was caused by a variety of factors, we have now stopped taking those measures.

In the Chinese market, although a decline in brand equity led to a decrease in sales volume of *Merries*, the brand continues to vie for top share in the market. Even with the impact of the decreasing birth rate in China, the rate of conversion to disposable diapers has been increasing, so market volume is not expected to decrease. However, we need to think about an acceptable price range for regional cities where the conversion rate is rising. We intend to respond fully to changes in the market.

- 4. Kao's competitors outside Japan achieve high sales growth rates by acquiring startup companies. Is Kao considering buying a startup for further growth?**

We basically think of B-to-B companies as M&A targets, so we are not considering M&A to increase sales. However, to expand our business domains from an ESG perspective, we will need to cooperate with companies in fields that are new to us. That cooperation will require consideration of M&A targets other than B-to-B companies. For example, we would like to expand our business domains into the fields of therapeutics and hygiene.

- 5. Your plan for 2020 takes into account the impact of the spread of the new strain of coronavirus on inbound demand. What impact do you expect on Kao China's business?**

In 2019, inbound demand accounted for approximately 10% of Cosmetics Business sales globally. Kao China's Cosmetics Business sales are roughly the same size, accounting for around 30% of Kao China's Consumer Products Business sales, with a high operating margin. If there is an economic slump in the Chinese market and demand for cosmetics weakens, it will have an impact, but we have not incorporated this in our plan. The impact on businesses other than cosmetics, such as baby diapers, is expected to be minor. We are considering expanding hygiene-related products as a possibility in the Chinese market.

- 6. How do you view trends in consumption in Japan following the increase in the consumption tax rate in 2019?**

We are worried about a weak recovery from the drop in sales following the last-minute demand that preceded the consumption tax rate increase. If consumption behavior weakens due to a natural disaster or other factor, cosmetics will likely be affected. We intend to pay close attention to the latest market trends.

7. How were conditions for the Cosmetics Business in Japan in the fourth quarter? Why do you plan on 3.8% growth in the Cosmetics Business in Japan in 2020, even though you expect a slowdown in inbound demand?

In the Cosmetics Business, the G11 brands selected for the new global portfolio announced in 2018 performed well, with year-on-year growth of 18% in 2019. In Japan, Kao is not only enhancing these brands, which include hypoallergenic *freeplus* containing Japanese and Chinese botanical extracts, and derma care brand *Curél*, both of which perform extremely well for Kao China's Cosmetics Business, but other brands as well. We also expect growth from stepping up our activities in the travel retail channel and cultivating the prestige skin care products we launched in 2019.

Can we also expect an effect from new products in Japan?

We are nurturing our skin care brands in the high-price range including new product lines for *est* and *SENSAI* launched in fall 2019 as well as products that apply Fine Fiber Technology. We are also preparing for new initiatives.

How much did Kao China's Cosmetics Business grow in 2019? What is the outlook for the G11 brands in 2020?

In 2019, Kao China's Cosmetics Business sales increased about 1.5 times year-on-year. We are aiming for double-digit growth for the G11 brands in 2020.

8. Your plan is for sales of baby diapers in 2020 to be on par with the previous year. Do you mean that you are aiming for sales growth by investing in marketing expenses, but expect profit to be on par with the previous year?

In the Human Health Care Business, we expect sales of baby diapers to be on par with the previous year, and growth in sanitary napkins and personal health products. We will work for a recovery in profit on baby diapers.

9. Looking at statistics on exports of baby diapers from Sakata Port, they appear to be on a recovery track, but what about your retail inventory in the Chinese market?

We cannot precisely determine retail inventory, but we do not see an increase for cross-border e-commerce. We aim to improve our cross-border e-commerce by shifting the management system from Japan to Kao China.

10. ROIC has improved along with the significant change in Kao's business structure due to the growth of the Cosmetics Business and other factors. What do you think Kao's future business portfolio should be?

We believe that expanding our business domains from an ESG perspective will be key to Kao's future growth. We commercialized Fine Fiber Technology in cosmetics products in

2019, and we intend to expand its applications from cosmetics to the field of therapeutics. We are also looking to eventually expand RNA monitoring into the business domain of health. Moreover, we aim to become a company with a global presence by deploying our collective strengths in new business domains, such as a recycling business associated with product disposal. We aim for profitable growth as a result of all these initiatives. We intend to proceed within a broad framework that will include collaboration with other companies.

11. I think dealing with the business domain of health will require Kao to take major actions such as M&A and business alliances. What is your decision or vision?

Tackling a new business domain will require the ability to create a broad framework. In 2020, we will work to create a base for going even further in maximizing use of our assets.

Note

The content presented in these materials is the opinion of the Company. The content is a summary of questions and answers at an analyst meeting. The Company makes no guarantee or promise regarding the accuracy or completeness of this information, which is subject to change without notice.

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