

Date and time:

Wednesday, October 30, 2019  
16:45-17:35

Respondents:

Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting & Finance  
Mitsuhiro Watanabe, Vice President, Investor Relations

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- 1) **Achieving your consolidated operating results forecast for the year ending December 31, 2019 requires an increase in net sales of 14.7% during 4Q compared with the same period a year earlier, which I think will be a high hurdle. How will you grow net sales?**

Due partly to a significant slowdown in sales of *Merries* baby diapers of Kao China in the 3Q 2018 and onward, the hurdle compared with the same period a year earlier will be lower. We will strive to achieve this high target through to the end by launching many new and improved products.

**Will you be spending on expenditures with a focus on achieving the operating income target?**

We have already started to improve the effectiveness of all kinds of expenditures, and we are focusing on achieving the operating income target.

- 2) **How were the conditions of *Merries* during the 3Q different from your expectations? How will you deal with the situation during the 4Q?**

Kao China is facing greater-than-anticipated price offensives from competitors in the baby diaper market. In addition, the negative impact of the depreciation of the yuan on operating income was approximately 3.0 billion yen for the first nine months of the fiscal year 2019 compared with the same period a year earlier. The baby diaper business is subject to currency exchange risk as *Merries* made in Japan are imported and sold.

Sales of *Tender Love*, *Merries* super-premium product line launched at Kao China, have yet to grow, partly due to their high price. We expect to increase their sales by stimulating trials in promotional events for e-commerce retailers during 4Q, such as Double Eleven (11.11), also known as Singles' Day.

**Weren't selling prices of *Merries* increased at Kao China as the impact of lower selling prices associated with the clearance of inventories by resellers eased?**

Local manufacturers have been increasing their shares in the baby diaper market and Kao China facing intense price competition from global competitors.

- 3) **To what extent did last-minute demand before the consumption tax rate increase in Japan affect net sales and operating income for the 3Q? What about the impact on each business segment? You mentioned that the last-minute demand was smaller than expected. What is its impact on inventory increases or on new and improved products?**

The increase in net sales due to the last-minute demand was approximately 10 billion yen, which was about half of what was originally planned. The impact on operating income was an increase of 2 to 3 billion yen. The impact on the Fabric and Home Care Business was the largest, and sales of cosmetics eight regional strategy brands (R8), shampoos and other products also grew.

We have been able to sufficiently control our inventories and we expect it will settle in about one month, so the impact on sales of new and improved products will be small.

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- 4) **Did the adverse weather conditions in Japan have greater negative effect and the last-minute demand before the consumption tax rate increase in Japan have less of an effect on the Skin Care and Hair Care Business?**

For hair care products, there was last minute demand for shampoos and conditioners for the mass market, but the market itself is continuing to shrink. Although we planned to significantly increase sales of skin care products, we failed to increase sales of seasonal products, including UV care products and wet wipes, due to the adverse weather conditions in Japan.

- 5) **The operating margin of the Cosmetics Business for 3Q exceeded 14%. Will you be able to maintain this level in 4Q?**

We intend to achieve an operating margin of 11-12% in the Cosmetics Business for the full fiscal year.

**I am looking forward to the launches of new products based on Fine Fiber technology.**

We plan to launch new products based on Fine Fiber technology in December 2019 and intend to expand the business by achieving substantial growth for such products next year.

(News Release 2019-11-01)

Kao launches Fine Fiber Technology to create a layered, ultra-thin skin care product for the cosmetic industry ([www.kao.com/global/en/news/business-finance/2019/20191101-001/](http://www.kao.com/global/en/news/business-finance/2019/20191101-001/))

- 6) **Achieving your consolidated operating results forecast for the year ending December 31, 2019 requires an increase in operating income of nearly 10 billion yen compared with the same period a year earlier during 4Q. What do you expect the impact of fluctuation in the raw materials prices and cost reductions, the recovery of Merries, and other factors to be like?**

We have been working to reduce costs by several billion yen. We are also aiming for an increase in operating income of several billion yen in the Human Health Care Business, but it faces greater risks than the other businesses.

**Do you mean the risk relating to baby diapers business in Kao China? What is its market share situation?**

At Kao China, a challenge is how much it can recover the growth of baby diapers. The extent to which this risk is covered by the growth of the Cosmetics Business will be important.

Each of several companies has a 12-13% share of the baby diaper market and the situation in which they are competing with each other remains unchanged.

**The export of baby diapers to Kao China is recovering. Is this due to the premium product line but not the super-premium product line?**

The premium product line made in Japan is recovering. The super-premium product line has yet to be accepted by consumers as its price is double that of the premium line. We will promote the super-premium product line based on its better quality and price to encourage consumers to try it.

**Is my understanding correct that there will be not much of a reaction during 4Q to the last-minute demand in the Fabric and Home Care Business?**

We have prepared new and improved products. We intend to cover for the small reaction to the last-minute demand with these products.

- 7) **You said that there are concerns about the impact of the Hong Kong protests. Was the impact already present during 3Q? What impact do you expect for each category in 4Q?**

Due to the decreasing number of tourists, the impact was already present on sales and operating income in 3Q. The impact was significant for baby diapers. Also, we were not able to grow in the Skin Care and Hair Care and the Cosmetics Businesses during this period. We intend to cover for the negative impact in these businesses as much as possible by Kao Indonesia, which is performing well despite not having a high operating margin, and other regions.

**Have you been able to cover for the above-mentioned impact on the Cosmetics Business with the growth of Kao China?**

It has substantially grown in Kao China and we have been able to cover for the impact.

**Have you already started to strengthen travel retail channel in the Cosmetics Business?**

Although it is still small scale, we have already started roll-out some brands gradually in travel retail channel and they are growing significantly. Since e-commerce and travel retail are focus channels in our growth strategy, we have been strengthening them.

- 8) **What were the factors contributing to the operating income increase in approximately 7 billion yen compared with the same period a year earlier in the Fabric and Home Care Business for 3Q?**

The factors increasing operating income in the Fabric and Home Care Business for 3Q were last-minute demand ahead of the consumption tax rate increase in Japan mainly for fabric care products, the contribution of home care products, and the decline in raw material prices. The reduction in advertising expenses due to the response to last-minute demand being prioritized was also a contributing factor.

**Won't marketing expenses be a factor reducing operating income due to many new and improved products in 4Q?**

Although marketing expenses will be a factor reducing operating income, we expect sales to increase on the launches of new and improved products. In addition, due to the smaller-than-expected last-minute demand, we expect an early recovery of sales from the reaction.

**Do you expect raw material prices to be a factor increasing operating income in 4Q?**

Yes, we do.

- 9) **What was the sales growth for the major brands in the Cosmetics Business in 3Q?**

The momentum remained the same as in the first half of the fiscal year 2019. For the first nine months of the fiscal year, in the eleven global strategy brands (G11) sales of the *Curél* derma care brand and *freeplus*, which is hypoallergenic and contains Japanese and Chinese botanical extracts, grew by more than 30% compared with the same period a year earlier and the *SUQQU* counseling

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brand also grew by more than double digits. In R8 the *Primavista* makeup brand grew by double digits and *ALLIE* UV care products grew by more than 50%.

**What was sales associated with the inbound demand (inbound sales) in the Cosmetics Business?**

Inbound sales slowed down in the 3Q. Although inbound sales of cosmetics products grew 20% during the first half compared with the same period a year earlier, they grew 5-6% in 3Q. The depreciation of the yuan was also seen to have an impact.

**Did the growth in cosmetics sales of Kao China cover for the downturn in inbound sales in the Cosmetics Business?**

It grew more than 40% in 3Q compared with the same period a year earlier.

**This year, sales in the Cosmetics Business started to grow in Japan also, and the hurdle will be higher next year. How can you grow the Cosmetics Business with new products, including products based on Fine Fiber technology?**

We are aiming for the growth of our prestige cosmetics, including new products based on Fine Fiber technology.

**10) When the currency exchange risk and price competition are taken into account, won't baby diapers for Kao China need to be those made at Kao China with cost competitiveness, rather than those made in Japan? Do you have a plan to shift their production from Japan to Kao China?**

We plan to reinforce the production capacity of plant of Kao China in Hefei, Anhui. The plant currently produces tape-type baby diapers for the mass segment, but we are considering the production of additional products such as super-premium type and pants-type diapers at Kao China in the future.

**I am aware that you have a large production capacity in Japan. Is there the possibility that you will shift production to Kao China? To what extent will you be able to reduce costs by doing so?**

We have been considering our baby diapers from many aspects so that they will further grow through various efforts, including substantial technological innovation in the future.

We think that the production cost would be slightly lower if we produce them at Kao China, but it would not be that much different from the cost of producing them in Japan. The quality of products that Kao China produces is as high as those in Japan. We should consider which production site to use after taking the currency exchange risk into consideration.

**Note**

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