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| Dates:   | Thursday, May 30, and Monday, June 3, 2019   |
| Agenda:  | (1) Kao Group Mid-term Plan 2020 / Initiatives for FY2019 / Market and Performance Overview / ESG Strategy, etc.<br>(2) Q&A Session and Dialogue |
| Speaker: | Michitaka Sawada, President and CEO  |

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### **(1) Kao Group Mid-term Plan 2020 / Initiatives for FY2019 / Market and Performance Overview / ESG Strategy, etc.**

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#### **Kao Group Mid-term Plan 2020 (K20)**

- There is a tendency to focus on financial KPIs, but the Kao Group considers it most important to cultivate a distinctive corporate image. We launched new ESG strategy “Kirei<sup>1</sup> Lifestyle Plan” on April 22, 2019. We will shift course from *Yoki-Monozukuri*<sup>2</sup> to *Yoki-Monozukuri* with an ESG perspective, and provide people, society and the Earth with environmentally friendly products and services.
- We are working according to K20 to achieve the financial KPI targets and returns to stakeholders.
  1. The Japanese word *Kirei* describes something that is clean, well-ordered and beautiful, all at the same time. For Kao, this concept of *Kirei* not only describes appearance, but also attitude to seek to create beauty for oneself, and also for other people and for the natural world around us.
    - > News Release  
[Kao launches new ESG Strategy “Kirei Lifestyle Plan” to support consumer lifestyle changes \(https://www.kao.com/global/en/news/2019/20190422-001/\)](https://www.kao.com/global/en/news/2019/20190422-001/)
    - > Kao Integrated Report 2019  
[\(https://www.kao.com/global/en/investor-relations/library/reports/\)](https://www.kao.com/global/en/investor-relations/library/reports/)
    - > Kao Sustainability Databook 2019  
[\(https://www.kao.com/global/en/sustainability/databook/\)](https://www.kao.com/global/en/sustainability/databook/)
  2. 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.”

#### **Initiatives for FY2019**

- Progress was smooth in FY2017, results fell short of the forecast in FY2018, and FY2019 will be the decisive year for accomplishing K20. Responding to the increase in the consumption tax rate in Japan this autumn is of the utmost importance. We are working to meet last-minute demand by making outlays in areas including production and distribution. If the consumption tax hike is postponed, the impact on business results will be extremely large.
  - In the Cosmetics Business, January-March sales of the eleven global strategy brands (G11) increased 18% and sales of the eight regional strategy brands (R8) increased 9% compared with the same period a year earlier. Performance in April and May was also strong. In autumn, we plan to strengthen our prestige skin care lineup. We are working to exceed the full-year forecast. We will recover where we lag behind the competition.
  - As we expected, baby diapers struggled in January-March as resellers’ purchase of products from Japan to sell in China declined, resellers lowered selling prices in China due to their inventory adjustments, and we did not respond to price pressure from cross-border online retailers, but the outcome was within the range of our assumptions. We have seen recovery from April. In Japan, our market share is rising due to measures for domestic consumers. We are not worried.  
We launched a super-premium product line on cross-border e-commerce platforms on June 1, 2019 at a per diaper price more than double that of current *Merries* made in Japan. We are working for a year-on-year increase in sales over the full year.
  - We conducted structural reforms in the Consumer Products Business in the Americas and Europe, and operating income in January-March increased compared with the same period a year earlier. For 2020, we are aiming for an operating margin of 10% in both the Americas and Europe, and planning to develop new products and brands with an ESG perspective, which is gaining attention in the Americas and Europe.
  - Shampoos and conditioners struggled in January-March, mainly due to the large proportion of mass market products, but in April we launched *and and*, a new brand for the more
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diverse and fragmented small mass market in Japan, and in the second half we will launch new and improved products and conduct effective marketing for the small mass market. We will focus on profits. Since we have still not been able to make a full rollout in Asia, global growth will take more time.

- In the Chemical Business, we expect sales to continue to decline due to the drop in prices of natural fats and oils, but we aim to set a new record high for operating income for the year by shifting to higher-value-added products.
- We are working on technology innovations, and launched *Attack ZERO* concentrated liquid laundry detergent, which contains our newly developed surfactant Bio IOS. We also plan to commercialize Fine Fiber technology by the end of the year. We will address the issue of plastic waste, including marine plastic waste, with Package RecyCreation.
- From our new business projects, we plan to launch new products during the year in the intersection of the fields of cleanliness, beauty and health. Although sales and profits will not be large in the current fiscal year, we will cultivate them to be our third mainstay area, making a significant social contribution.
- We announced our ESG strategy. We will work for *Yoki-Monozukuri* centered on ESG.

### **Household and Personal Care Products and Cosmetics Markets in Japan**

- In January-March, the household and personal care products market grew 5 percentage points compared with the same period a year earlier according to consumer purchasing survey data (SCI<sup>3</sup>) and 3 percentage points according to retail point-of-sales data (SRI<sup>3</sup>).
- In January-March, the cosmetics market remained flat compared with the same period a year earlier according to consumer purchasing survey data (SLI<sup>3</sup>). The market shrank 2 percentage points according to retail point-of-sales data (SRI), which covers only about 30% of the cosmetics market, mainly drugstores and supermarkets, but does not include department store data. This was likely due to the substantial increase in inbound demand for sunscreen products in the previous year.
- In April, the cosmetics market shrank 7 percentage points according to retail point-of-sales data (SRI). Compared with the same month a year earlier, the sunscreen products market increased 116% in March 2018 and 47% in April 2018, and decreased 41% in March 2019 and 33% in April 2019.
- For skin care cosmetics, the market has been weak in 2019, rebounding from strong sales of anti-wrinkle products in 2018.
- We do not see worsening business confidence.

3. SRI, SCI, SLI: Point-of-sale and consumer monitor data by INTAGE Inc.

### **Forecast of Consolidated Operating Results for FY2019**

- In the first quarter, operating income decreased 1.2 billion yen due to the impact of baby diapers sold to consumers in China.
- In the second quarter, we intend to recover the decrease in first-quarter operating income. We have been proceeding as planned in April and May.
- In the third quarter, we expect a significant increase in operating income from capturing last-minute demand before the consumption tax rate hike. We aim for operating income of 225.0 billion yen for the full fiscal year.

### **Highlights**

- Selected as one of the "World's Most Ethical Companies" for the 13th consecutive year. Kao is the only Japanese company to be selected all 13 times. It is the embodiment of the corporate philosophy of Integrity we have put into practice. Selection has been set as a KPI for executive officers of Kao.
- Received first place overall ranking and first place in the diversity promotion category of *Nikkei Woman* magazine's "100 Best Companies Where Women Actively Take Part" for 2019. Our ratio of female employees in Japan was 51% in 2018. The ratio of female managers was 18% in Japan, 48% outside Japan, and 27% globally. In 2019, we appointed a woman to the position of Outside Director and another to the position of Audit & Supervisory Board Member. In the Cosmetics Business, the presidents of two beauty counseling specialist companies are women.

Kao established the Nagase Housework Science Laboratory 85 years ago in 1934, and women have been playing an active role. We began recruiting female university graduates in the 1970s, and expanded employment opportunities for female graduates in the 1980s.

Keeping pace with the enforcement of Japan's Equal Employment Opportunity Law, in 1990 we established functions for promoting women's participation and advancement in the workplace, and appointed our first female vice president. The following year, we introduced the "Merries Time System" (named after Kao's baby diapers brand) to promote childcare leave, shorter working hours and an improved corporate climate.

In 2000, we began initiatives to promote equal partnerships and respect for diversity. In 2006, we began an initiative to support childcare by male employees; now the male paternity leave rate is nearly 50% in Japan, and we encourage all eligible employees to take childcare leave. In 2008, we enhanced nursing care support, and in 2014, the President and CEO exchanged views with women and seniors globally at Roundtable Meetings with the aim of revitalizing human resources. In 2016, the D&I (Diversity and Inclusion) Department was established, and the female vice president continues to work to promote diversity. We want to continue these initiatives.

- Formulated Kao's ESG strategy "Kirei Lifestyle Plan"

Our social, natural and management environment is changing faster and more substantially than ever, and we believe that only technology innovation can respond to these changes and drive change. Kao is a technology innovation company.

However, there are two sides to technology innovation, and the negative side has meant sacrifices for people, society and the Earth, such as global warming due to CO<sub>2</sub> emissions from the use of fossil fuels and the problem of plastic waste. We have entered an age in which taking advantage of the positive side of technology innovation requires simultaneously understanding and responding to this negative side—in other words, initiatives for ESG. We aim to be a company that proposes technology innovations that shift from *Yoki-Monozukuri* to *Yoki-Monozukuri* with an ESG perspective. This is the core of Kao's corporate philosophy, and it comprises the following three points.

- 1) Enhance our ability to innovate using technology
- 2) Respond to the negative aspects of technology innovation
- 3) Understand and thoroughly adhere to our underlying corporate philosophy

ESG initiatives can also lead to short-term profits for companies if they lead the way. We want you to understand that even though it may take time, Kao aims for profitable growth by achieving increases in sales and profit while investing a considerable portion of that profit in ESG. We want to have dialogue with our shareholders and investors not just about sales and profit, but also about our ESG initiatives.

Based on the key corporate message "Kirei—Making Life Beautiful," our ESG strategy proposes the Kirei Lifestyle from the perspective of consumers, and sets forth our commitments to people, society and the Earth, 19 leadership actions (priority themes) and medium-to-long-term targets. ESG will be an important point in the next mid-term plan. We intend to step up our KPIs for ESG.

As chairman of the Clean Ocean Material Alliance (CLOMA), which was established by the Ministry of Economy, Trade and Industry, I would like to review the recycling system and respond in a way that considers not only characteristics such as the degradability of plastic but also total environmental impact, including energy required for production.

Contributing to society is the foundation of ESG, which results in sustainable profitable growth that, in turn, leads to returns to stakeholders.

- Technology innovation

Bio IOS, the surfactant in *Attack ZERO*, is a sustainable base material made using the residue of pressed palm oil from the fruit of the oil palm. *Attack ZERO* requires very little rinsing and removes stubborn stains with its strong cleaning power, so the amount of fabric softener can also be reduced.

We want to cultivate *Attack ZERO* over the next 2-3 years by promoting it from a different angle that includes the ESG perspective, so that its merits can be understood.

We will consider the negative aspects of technology innovation and respond with innovations such as Bio IOS and new containers from Package RecyCreation.

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## (2) Summary of Q&A Session and Dialogue

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**My impression is that Kao has made a major change in course toward ESG management, but aside from executive officers whose compensation is partly linked**

**to sustainability indicators, how pervasive is this ESG approach among employees at the vice president level and below?**

Inside the company, management is actively disseminating information on ESG management in various settings including our intranet, and Kao Group members are becoming more aware of ESG. In the first half of our 2019 Integrated Report, we also explain what Kao aims for, and at the ESG Promotion Meeting the general managers of business and functional departments discuss the 19 leadership actions of our ESG strategy. We also want to tackle things we could not do before because of the high cost.

**How will you communicate your shift toward ESG management to consumers? Will you tell them that Kao is changing its products because society must change, and therefore they should use your products? Or will you promote the spread of products with an ESG perspective before consumers are aware of ESG?**

We want our message to be understandable to consumers. For example, *Men's Bioré ONE* is a cleanser that can be used to wash hair, face and body using a new surfactant that doesn't dry out hair but also does not leave skin feeling oily. Combining shampoo, facial cleanser and body wash all in one product allowed us to reduce the amount of plastic used. Rather than using previous methods of communication, we want to promote products from an ESG perspective by providing specific information that makes sense to consumers.

**What kind of organization and process do you have for making judgements about investments in cases where the return on investment in ESG will not come until after the term of office of the executive officers who are making the decision?**

To give an example, when creating a brand with an ESG perspective, it may take time to realize a return on investment. So, the ESG Committee, which is chaired by the President and CEO, will make strategic expenditures for the first one or two years, and then the relevant business department will take responsibility for making investment decisions using EVA. The strategic expenditures will allow us to make and realize a return on investments that we could not make before.

The problem of waste plastic is becoming a hot topic in society, so the timing is good for this kind of initiative. We are also conducting public relations activities.

**How will you account for those strategic expenditures?**

They will be accounted for as research and development expenses or other expenses, but we will internally manage ESG investments separately from conventional investments so that we understand the results.

By doing so, even if the cost of a product doubles due to the use of bioplastics, for example, we want to invest decisively and take the time to communicate information to consumers to gain their understanding.

**Is my understanding correct that you will work for ESG confident that your investments will lead to business growth?**

Business growth is premised on contributing to society. If we lose this perspective, the result will be nothing more than social contribution activities. If we do not get consumers to understand that we benefit society, they will not buy our products, and our business will not grow, so we will start with countries and regions that are highly attuned to ESG. For example, in the United Kingdom, the Ellen MacArthur Foundation has been working on marine plastic countermeasures for some time, so the level of awareness there is high. Sophisticated efforts are required, but we have greater expectations for business growth from ESG investment there than in Japan.

**If your ESG initiatives are too far ahead of consumers' awareness, consumers won't go along with them, will they? Have you set a time frame?**

Our ESG strategy "Kirei Lifestyle Plan" sets medium-to-long-term goals for 19 leadership actions that we aim to achieve by 2025 and 2030. We want to be a half-step ahead in taking

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on issues such as global warming and plastic waste at a time when concerns are high, and communicate information to gain consumer understanding. We want to propose the Kirei Lifestyle with concepts from the consumer's point of view that are unique to Kao so that consumers have a real sense of what we are doing and go along with us. Consequently, we intend to substantially change our methods of communication.

**What is the risk that your plan for generating profits by developing new products from an ESG perspective ahead of your competitors does not go well? What are your thoughts on ESG initiatives outside Japan?**

ESG initiatives are appreciated when they are conducted in a way that consumers can easily understand and accept in their daily lives. There is a risk of lowering the targets because we cannot achieve the KPI of the 19 leadership actions. In the past, we have failed to reach ambitious targets for CO<sub>2</sub> reduction. There are many things that cannot be achieved without technology innovation, but we will work to make them possible. Fundamental research, for which we have been allocating half of our research and development expenditures, will be important.

As for examples of ESG initiatives outside Japan, we would like to start our rollout of new plastic containers from Package RecyCreation in the Americas and Europe. Companies in Japan have developed technologies and cooperated to reduce the amount of plastic they use with refill products. We want to communicate these strengths developed in Japan to the Americas and Europe and combine them with our global strengths in the Americas and Europe to go forward in a borderless fashion.

**I understand your course of action—you strengthen your brands with an ESG perspective, consumers recognize their value, your business grows, and Kao increases its presence—but is Kao the only company that can demonstrate these strengths?**

**Even if you are the first to launch ESG products in the Americas and Europe, won't your global competitors conduct large-scale rollouts later on to gain presence? Can you create a framework for enabling Kao to gain a greater presence and profits?**

The key will be the extent to which we make technology innovations that other companies are unable to achieve. At a certain stage, we will open our patents so other companies can use them. Even if we launch ESG products on a small scale, I think it will send a strong message. We want to consider making contributions to society in fields such as medical care, not just household and personal care products and cosmetics. Through advances in technology, we will create the third pillar of our operations with an ESG perspective. If we take the lead, we can be of great service to society and contribute significantly to business growth. We want to show you some examples of how we can achieve business growth with technology innovation with an ESG perspective.

**I get the impression that your ESG initiatives will significantly change the way you procure raw materials and energy, but can Kao do that on its own? Do you source from multiple companies or collaborate with other industries?**

We cannot do it alone. It will require interchange that creates global synergies, such as coordination between Kao's technologies and its supplier's technologies and raw materials. It will also require technology innovations that absorb climatic and seasonal fluctuations in prices of natural oils and fats and other products.

**As an investor, I want to focus on both ESG and ROE. Kao is in good financial condition, so if you make early investments in ESG, can I expect you to also be able to maintain good ROE at the same time?**

Our ROE target for FY2030 is 20%, but our ESG initiatives will take us down a different path to reaching it. We will continue to increase sales and profits, and we intend for ROE to grow over a period of 5 to 10 years, even if it declines temporarily. When formulating the next mid-term plan, we want to establish an indicator that lets investors know that the company is growing sustainably.

**What are your thoughts on the risk of climate change?**

If consumer lifestyles change due to climate change, our offerings to them will also change. For example, if the volume of sanitary napkin and baby diaper waste is too large, it cannot be incinerated, or if the problem of illegal dumping gains attention, the number of consumers who wash and reuse cloth items rather than using disposable products will increase. If this happens, our business environment will change. It will be essential to anticipate changes in lifestyles and make offerings ahead of time.

**Your ESG strategy proposes the Kirei Lifestyle from the perspective of consumers. Do you have some existing products that do not fit in and will they be discontinued in the future? Will you be able to cut costs that way?**

There are some that will, and some for which costs will increase due to measures we were previously not able to carry out in consideration of sales and profit. The ESG Committee will make specific decisions about cases that are not sufficiently addressed by the 19 leadership actions.

For example, previously we created special promotional items to increase sales and disposed of the returns we received, but in the future we will reduce waste by producing them in limited quantities so that they sell out.

**Outside Japan, companies do not have an Audit & Supervisory Board system, so in discussions with asset owners, they may question whether corporate governance is sufficient in case you have an Audit & Supervisory Board. How do you explain this to non-Japanese investors?**

The effectiveness of corporate governance is important, and I think that each company should use the framework that suits it best. At Kao, although Audit & Supervisory Board Members have no voting rights, they freely express their opinion at Board of Directors meetings, and the Directors take those opinions seriously and conduct full discussions. We think that in a company with an Audit & Supervisory Board, the full-time members can grasp the situation inside the company to conduct effective audits in cooperation with the outside members. To enhance the effectiveness of corporate governance, we should change the system as circumstances change.

**What capabilities does Kao's next president require? What are the criteria for selection?**

The qualities and abilities required are being discussed by the Committee for the Examination of Nominees for Directors, which consists of Outside Directors and Outside Audit & Supervisory Board Members.

It met three times last year and twice so far this year. I attend meetings when requested and give my opinion.

The most appropriate person to become the next president is, in short, someone who can realize ESG management that will be able to support Kao in 2025 and in 2030. At the very least, we require someone who understands and can embody our corporate philosophy, which is centered on ESG, to lead all the members of the Kao Group, and who understands technology innovation, since it is linked with ESG, to motivate others. In addition, we need someone who can both maximize the use of our assets and minimize problems as much as possible when they arise. Someone with good luck.

I am telling the committee what I personally think, but I don't know who will be the next president, or when the appointment will be. It will be discussed by the Board of Directors. At the General Meeting of Shareholders, the independent Outside Directors who chair the Committee for the Examination of Nominees for Directors and the Compensation Advisory Committee explains what is being discussed at each of the committees.

**What was the purpose of putting you in charge of human capital development? What direction will you take, and what would you like to change?**

I would like to change the way we have done things so far by thinking about our frameworks and operations from the perspective of our employees, rather than the perspective of the

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Human Capital Development Division. I will take a year to review recruiting, evaluation, compensation and other matters.

For example, are we employing diverse human capital by screening through employment interviews? How should we view recommendations from schools? Are we hiring the people who want to work at Kao? I would like to reduce inefficiencies, improve efficiency and hire more diverse human capital.

Even in a results-oriented approach, isn't the burden too great due to an overly elaborate system? I want to simplify procedures and emphasize feedback from evaluations.

I want to invest in energizing our human capital, which is the lifeblood of the company.

### **Why aren't you worried about baby diapers in China?**

For baby diapers, we are carrying out a plan for the *Merries* brand that looks 10 years ahead. We are not considering the mass market, which consists of the mid and low-price segments. *Merries* currently hold the top share in China at 13-15%, according to data from The Nielsen Company, and when we make improvements to offer a better product, consumers can notice the quality. From the absorbents to the surface and outer materials, we are developing technologies aiming for the world's best diapers that are gentle on the skin and highly breathable, and in June we launched a super-premium product line for China.

In 2018, the number of births in China was 15.23 million. In Japan, it was 920,000, so China remains a large market. Prices have dropped substantially due to the impact of products resold from Japan. Therefore, from now on we intend to promote products based on their added value.

Looking at it over the medium-to-long term, we are not worried.

The Human Health Care Business is aiming for year-on-year increases in sales and operating income for the full year.

### **Can your baby diapers take market share away from local manufacturers in China? You focus on the high-price segment and you don't deal with the low-price segment, do you?**

In the future, we want our products for the mass market that are currently being produced at the Hefei Plant in China to be higher-value-added products, regardless of whether we make them in China, in Japan or in another country. With an ESG perspective, we will expand globally by aiming for the premium niche for sanitary napkins as well as for baby diapers.

### **Will you enter new markets for sanitary napkin in the future?**

We will increase sales of sanitary napkins in countries in Asia where our market share is low. Our market share is high in Japan and exceeds 30% in Indonesia and Thailand. However, in the areas of China where we operate (Shanghai, Beijing and the Pearl River Delta) our share is 13-14% (about 4% for all of China, including e-commerce) and our share in Vietnam is still low, so we aim to grow by introducing high-value-added products. We are not thinking about entering the Americas or Europe anytime soon.

### **In China, there appears to be polarization between products that consumers will buy even if the price is high and products where they will settle for a lower-priced option. Aren't baby diapers considered to be the latter type of product?**

In China, even low-priced baby diapers have improved in quality, and now few products cause rashes when they are worn, but Kao has used its high level of technology to develop products where consumers can clearly notice differences in areas such as feel and fit. We want to communicate more information on topics such as the problem of stress on the baby's belly caused by the tightness of pants-type diapers. We will emphasize that our diapers do not slide down even though they are not tight. We will make offerings for mothers who want good quality items for their babies.

### **Compared with the previous time you personally oversaw a recovery in the baby diapers business, how difficult will it be to put the baby diaper business back on its feet again this time?**

It will be more difficult this time. Previously, there were also issues to be solved in terms of quality, and our brand concept was out of sync, so we were able to stage a recovery by marshaling our technologies and thoroughly investigating how to make the product gentle on the skin. Now, the quality of baby diapers in the market has improved in both Japan and China. We intend to review what people ideally want from baby diapers in both countries and achieve it with our high-level technologies.

**Did you launch the new product in China because needs for baby diapers in China are significantly different from those in Japan?**

We thought that offering products tailored to the needs of Chinese consumers, rather than those made in Japan for Japanese consumers, would make them more likely to notice the quality. Of course, there are some aspects in common with products made for Japanese consumers, but just like with beauty care products, it is becoming necessary to meet finely diversified needs.

**Pants-type diapers seem to be making rapid inroads in China's baby diaper market. Kao has a large share in the tape-type diapers segment, so will you be able to respond?**

Pants-type *Merries* are also high quality, and we will expand sales.

**In China's baby diaper market, Japanese, European, American and local manufacturers are all working on high-value-added products and competition is fierce, so even if products are resold from Japan, isn't the supply from manufacturers becoming excessive? If each company continues an aggressive approach, won't the market become a red ocean?**

The level of technology is key. Improving baby diapers on the technological level is a good thing for the babies, so we want to compete well in technology development as a lead-in to India and other regions where the market is expanding, in addition to China. Long term, there is also the possibility of a rollout to Africa and the Middle East, or even to the Americas and Europe, with an ESG perspective.

Kao will become more competitive while contributing to society by making offerings with an ESG perspective that include cutting back on materials to reduce waste and making waste easier to incinerate through disposal methods that employ devices to reduce moisture after diapers are used. We want to work on waste disposal in cooperation with other companies both inside and outside our industry.

**Won't your current development system be unable to sufficiently handle addressing market needs, developing technologies, responding to regulations and proposing localized mechanisms for waste disposal?**

We will work jointly with the government. For example, China prohibits the import of waste plastic, and its environmental regulations are becoming stricter. Water shortages have also become a social problem in China, so we sell laundry detergents there that save water, and has been encouraging water conservation by conducting the Nationwide Cleanliness and Water-saving Initiatives every year jointly with the Center for Environmental Education and Communications, part of China's Ministry of Environmental Protection. Since last year, we have also been operating a booth at the China International Import Expo. In order to carry out the initiatives we propose using our technologies that are localized in China—and to meet regulations—we need to collaborate with the government. We will also consider cooperation with other companies to promote these initiatives more forcefully.

**Are you planning to enter the adult incontinence products market in China?**

We are making preparations for China's adult incontinence products market because it is expected to be larger than the baby diaper market in the future. There are more elderly people in China than in Japan, but adult incontinence products are not as visible in stores or online as they are in Japan. We are investigating market conditions such as what people use at home

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and in hospitals in urban and rural areas, and whether there is a general concept of such products for "active seniors," an area where Kao is strong.

**With the progress of Online Merges with Offline (OMO), when China and other countries in Asia have compiled digital data on consumer behavior, how will you respond in each country in order to understand the consumers there? What course are you plotting as an organization, what has already changed, and what investments have you made?**

We analyze consumer data from various angles. However, particularly in China, there are many aspects that are complicated from a Japanese perspective and that we still do not understand well, such as lifestyle differences between urban and rural areas and among the various classes.

**There are cases of Japanese companies partnering with major retailers in China, both online and offline, to try to share information. What are your thoughts on that?**

For cosmetics, that kind of cooperation is possible because who is buying and what is selling are known to a certain extent, but household and personal care products are inexpensive and the conditions of use are diverse. For example, for laundry detergents, water hardness differs by region, which complicates matters by making it necessary to have sales data and water hardness data for each region. It is difficult to analyze the consumer data we have acquired because of questions such as what sector of the market it is from and whether it is representative of the whole market. We would like to obtain data in cooperation with other companies, the government and other sources to analyze premium niche targets, the same as we have done for baby diapers.

**I think cooperating with competitors would be effective for ESG initiatives and surveys of consumer data in the Chinese market, but how likely is that to actually happen?**

It is possible. With ESG perspective, we can share the various technologies that are our strong suit in R&D and cooperate in hand-washing classes and recycling initiatives, and I hope we can expand them globally.

**According to market data, shipments of Kanebo Cosmetics increased substantially in April. What was the reason for that?**

Growth in sales of Kao Group cosmetics has been below market growth, but the gap is getting smaller. Our eight regional strategy brands (R8) are improving. Their reputation is growing and spreading among users due to marketing that combines TV commercials, hands-on events, digital marketing and other methods. We have been seeing improvement in switching mid-price cosmetics to self-selection and shifting to digital marketing.

**If the Cosmetics Business performs strongly and accounts for a larger proportion of total sales, will company-wide marketing expenses increase? Also, will communicating information on your ESG initiatives increase marketing expenses?**

We have optimized and reduced marketing expenses. Previously, advertising costs were equivalent to about 6-7% of net sales. Considering the scale of net sales in FY2018, that same rate would have meant advertising expenses of about 100 billion yen, but we streamlined them down to 5.3%, or 80.3 billion yen.

In the Cosmetics Business, we reviewed our marketing methods and we have been shifting from mass marketing to digital marketing. The issue going forward is how to conduct effective marketing without increasing costs. Consumers no longer accept information from corporate advertising and the like. An effective method of communication would be, for example, to hold a hands-on event, after which attendees post information about it on social media or elsewhere on the Internet, which spreads the word about the product's merit and in turn attracts more attendees to the event who enhance the product's reputation by spreading the word further.

As for ESG, we need to gain consumers' understanding of its relevance through advertising that promotes products from a different perspective. We have to consider those kinds of expenditures, but we would like to keep them within a certain scope so that advertising expenses do not increase.

**To achieve your company-wide operating margin target of 15% in FY2020, I think you will need to improve the operating margin of the Cosmetics Business to offset baby diapers. Will you be able to continue improving it through progress in structural reforms, or will you have to consider the risk of a decline in the profit margin of brands other than the G11 and R8 brands?**

The Cosmetics Business is making good progress. It had an operating margin of 9.9% in FY2018 and is aiming for 11-12% this year. By also working in areas such as building up travel retail, which is still small in scale, we intend to make up for the delay in recovery and achieve a 15% operating margin soon.

After that, growth will need to come from brand image. We want to create a whole new world of cosmetics that includes Fine Fiber technology applications and personalization.

The Cosmetics Business can offset baby diapers for a while, but we must achieve a recovery for baby diapers and come up with another mainstay product. We are considering whether it will be a new product in the intersection of the fields of cleanliness, beauty and health or a skin care product, or whether we can make a comeback with a reorganization in the Americas and Europe or a shampoo or conditioner product.

Sales of sanitary napkins are growing, but that alone will not be enough.

**Among Japanese companies in the cosmetics market in China, one company seems to have a substantial lead. Can you envision a scenario in which Kao's share would grow sharply, as it did with baby diapers?**

We are still at an early stage with our prestige brands, but our *Curél* and *freepius* brands have been growing substantially in the mass market.

**Has the experience of achieving a 15% share immediately upon launching the baby diaper business in China helped the Cosmetics Business?**

Our focus on the e-commerce channel, where growth is expected, has been a factor in the growth of baby diapers in China. Responding quickly to new changes is important for business growth. The Cosmetics Business has also been conducting various initiatives.

**You also need to expand the scale of the Consumer Products Business in the Americas and Europe. Will you do that by expanding sales of *Bioré*?**

We will, but we are also considering other approaches with an ESG perspective, for example.

**Is it efficient to compete with Procter & Gamble, L'Oreal and Unilever in markets in the Americas and Europe, where Kao does not have a high level of recognition? Instead, couldn't you try a "Kao Inside" strategy where you partner with competitors in the B-to-B Chemical Business and supply materials to them? Looking at the next 30 years, how will your global strategy change?**

We have three global strategies. 1) Roll out the Consumer Products Business in the Philippines, Mexico and other countries where the Chemical Business operates. 2) Roll out the Consumer Products Business in regions where ESG initiatives are in effect. We have been considering India and the Middle East, but with an ESG perspective, the countries and regions where we plan to roll out business will be different from before: If we tackle the plastic waste problem, then it will be Europe; if we deal with hygienic conditions, then it will be Africa. 3) Use the Chemical Business to deploy Kao's materials in competitors' consumer products. For example, Kao is not able to sell its laundry detergents around the world, so we will supply our Bio IOS surfactant to competitors.

With an ESG perspective, we will be able to supply our competitors with distinctive products in a win-win relationship, so our global strategy will also change. Consequently, we must step up our efforts to a whole new level in fundamental research that leads to technology innovations.

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**In Europe, companies specialize in B-to-B innovation or B-to-C efficiency. In Japan, there are companies that have both B-to-B and B-to-C businesses to maintain superior product development capabilities, but as a result, their profitability is lower than their global competitors. That is how they are viewed by the stock market as well. I think it would be good if the stock market recognized that it can expect unprecedented new growth under your new ESG strategy. How do you feel about that?**

I agree that it would be a good thing.

**You have said that the Consumer Products Business aims to achieve a 10% operating margin in both the Americas and Europe by FY2020. Is this the target for the growth in brand value that will result from increasing Kao's presence with your ESG initiatives? Or do you expect a further increase in the margin beyond 10% as a result of the ESG initiatives?**

I think we will achieve further increases in the margin with our ESG initiatives, but they will also require initial costs. We would like to make our first product offering as early as possible next year and follow it with the second as soon as possible thereafter.

**Of the last two times the consumption tax rate was raised in Japan, there seems to have been more last-minute demand the second time, according to the Family Household Income and Expenditure Survey. Do you expect an even greater increase in last-minute demand ahead of the third consumption tax rate hike in October 2019? Will products other than laundry detergents be subject to such demand? Will there be any problems in areas such as procuring raw materials to meet it?**

We are basically finished with our preparations for last-minute demand, and there are no problems with raw material procurement.

For this tax rate increase, a reduced tax rate system will be implemented, and the rate for food will not change, so last-minute demand for household and personal care products and cosmetics may be larger. On the other hand, this time the change in the tax rate is two percentage points, from 8% to 10%, so I think it is also possible that last-minute demand may not increase as much as the previous time, when the tax rate increase was three percentage points. In addition, the last time the tax rate increased, the volume of laundry detergents for sale in cases was too large, which led to returns. This time, we expect the number of cases for sale to be lower. Aside from laundry detergents, there will also be last-minute demand for sanitary napkins and baby diapers, but overall we expect last-minute demand to be roughly the same as last time.

**Do you have any concerns that the move toward higher-value-added products may collapse if business confidence worsens after the consumption tax hike in Japan? How will you respond if that occurs?**

In Japan, the business environment is severe as increases in food prices have an impact on personal consumption, and household and personal care products and cosmetics may also be affected by the consumption tax rate increase. On the other hand, mobile phone charges are decreasing and the sharing economy is expanding, so we expect an increase in trial purchases that lead to selective consumption among Millennials and Generation Zers who are in their 20s and 30s. We intend to stimulate consumption by offering attractive products and opportunities to try them. It will be important to respond to the diversification of consumer needs.

**Are you aiming for operating income of around 70 billion yen in the third quarter?**

Yes, around that.

The larger the market share, the greater the impact of the consumption tax rate increase will be. If the rate hike is postponed, at the very least we must increase sales and income by considering ways to optimize sales and income from approximately 2,000 items, including moving new product launches forward and dealing with seasonal products.

**It looks like you've taken up a lot of shelf space in supermarkets, convenience stores and other retail outlets for the launch of *Attack ZERO*. Is the large-scale rollout because it is such an important new product?**

*Attack ZERO* is an important new product, so we also focused on in-store promotion. We are working to ensure we can meet the demands of retailers. After the sell-in of the one-hand pump dispenser bottle, we can expect demand for refills. Users will clearly notice the difference if they keep using *Attack ZERO*, so we want to increase the number of new users and take time to cultivate them.

**Kao Integrated Report 2019 has a special feature on digital transformation as an advanced technology strategy. I think that this kind of up-front investment in information systems, which takes time to recoup, is extremely important for K20 and beyond. What are your thoughts on such investments? I also think that having people on the team with expertise and good judgment is necessary so that investment in information systems is not a failure. What are your thoughts on human capital development strategy in this regard?**

Last year, we launched the Strategic Innovative Technology Team (SIT) headed by Senior Managing Executive Officer Yoshihiro Hasebe, who is responsible for Research and Development. We selected team members with expertise and good judgement and made up-front investments to promote our digital transformation. We will conduct a drastic overhaul using AI for core mechanisms and expand the peripheral systems.

**Can you get real-time information on your global supply chain, including what is being made and where, as well as where it is being shipped to, by linking all of Kao's functions, including production, sales and distribution?**

We can already get basic information.

**What is the impact of M&A between two raw material manufacturers and the integration of their businesses?**

The objective of such an M&A and business integration would be to utilize the companies' respective technologies to increase added value. Therefore, we could expect the benefit of receiving proposals from an integrated supplier that leverage different synergies than before. For overlapping businesses, there are cases where even raw materials with the same performance characteristics have different properties due to different production methods or other factors. Therefore, integration would likely require us to take measures including adjustments to production facilities.

Consequently, the impact would be negative in the short term and positive in the long term.

Note

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