Date and time:
Thursday, February 2, 2023, 17:00-18:40 (JST)

Respondents:
Yoshihiro Hasebe, President and CEO
Masakazu Negoro, Senior Managing Executive Officer
Mitsuhiro Watanabe, Vice President, Investor Relations

1) **Will you explain your strategic price increases? First, what were the factors for the 2-billion-yen shortfall against the FY2022 plan in the Consumer Products Business in Japan? In addition, you are expecting 20-billion-yen effects from strategic price increases in FY2023, but how will you achieve this target while increasing the sales volume at the same time?**

The coverage of core items subject to price increases in FY2022 was 18%. We aimed for a coverage of 30% in all items within the Consumer Products Business in Japan including non-core items, with price increases totaling to 15 billion yen. Our achievement was in the context of announcing strategic price increases in February 2022, increasing prices ahead of our peer companies in the cosmetics and household and personal care (H&PC) sectors, and gradually implementing price increases while gaining understanding from retailers and consumers. In FY2023, price increases are becoming more widespread and the environment is different from the previous year. As a comprehensive cosmetics and H&PC manufacturer with a broad product portfolio, Kao aims to implement price increases at a small rate for a wide range of products, though this depends on negotiations with retailers. Even in this situation in which prices for many products are rising in general, we believe we will be able to gain support from consumers with our brand power and product appeal and therefore increase sales volume. As a result, we understand that it will not be difficult for us to achieve the 20-billion-yen target on a global basis in FY2023.

Is there risk of falling selling prices in the Chemical Business due to the worsening of the economy?

Although sales slowed down due to a pullback in customer spending and other factors in the fourth quarter of FY2022, the Chemical Business appropriately passed on rising costs through dialogue with customers. We expect the Chemical Business, our growth driver with a sales ratio outside Japan of over 60%, will be able to achieve both global growth and stable earnings.

If a small price increase is made for a wide range of items in the H&PC business in Japan, the impact on households would be significant. How will you work to increase sales and market share while increasing prices?

As shown on page 16 of the presentation material, we achieved an increase in profit with laundry detergents through strategic price increases while investing in marketing. By combining a method of growing sales and thus increasing market share along with a method of increasing profitability without losing market share, we will shift businesses to the upper right in the Profit Increase zone. There are various ways of increasing prices based on our brand power and position in the market. We will implement these methods as the best practice. Achieving both price increases and market share increases is not just a profit structure reform, but also a structural reform at Kao, and this will serve as the test of whether or not we will be able to strengthen global expansion.

2) What is key for recovering operating income to the level before the COVID-19 pandemic?

We will explain this in relation to each of the three areas shown on page 32 of the presentation material. In the Growth Driver area, we will grow focusing on the Cosmetics Business which recorded an operating income of 40.0 billion yen in 2019. The ratio of sales outside Japan is particularly high in the Cosmetics Business as a result of focused investment in the G11 brands, which have significantly grown compared to pre-COVID-19 levels. As such, we will grow the Cosmetics Business at a global scale. In the Chemical Business, we will increase the sales volume in the oleo derivatives business which has the No. 1 share position and which is one of the main businesses of the Chemical Business, while growing the business with unique technologies at the same time. In the Skin Care business, the *Bioré* skin care brand mainly consisted of facial or body cleansers ten years ago, but now has a high weight of UV care products. The Skin Care business is doing well in Japan and other Asian countries, and we can even expect growth in Brazil as well. We will grow the Skin Care business as our core business through technological differentiation.
The Stable Earnings area consisted of businesses with over 20% in operating income previously. However, they were significantly affected by hikes in raw material prices and increases in distribution and energy costs. We expect that we can improve the profitability of the Stable Earnings area by adding other businesses that are not reliant on the market conditions as growth drivers on the core businesses.
In the Business Transformation area, the Hair Care business was previously highly profitable with an operating income of over 20%. However, this business is currently performing extremely poorly. We aim to shift the Hair Care business to the Growth Driver or Stable Earnings area by extracting issues through implementing ROIC in each business, and we aim to achieve this by the end of FY2023.

When will the operating margin return to the level before the COVID-19 pandemic? Also, regarding the Kao Group Mid-term Plan 2025 "K25", will you review it?

Our discussion on target figures and time frames under K25 is ongoing, and we will explain how we will achieve K25 separately.

3) **I have high expectations for the implementation of ROIC in each business. I think that while EVA is a metric used to monitor the growth of only one's own company, ROIC is a metric used to determine whether one's own company is winning when compared to other companies. Will the implementation of ROIC change the eagerness or sense of tension of individuals, how meetings will be conducted or other matters when it is reflected in the remuneration of executive officers and employees?**

We believe it is important for all employees to seriously engage in product development, business, and sales with a shared awareness, rather than changing the mindset of each individual employee. As the first step to raising awareness for making the business surely succeed, we have introduced ROIC in each business. We will work to spread this awareness among all employees in a top-down manner.
As with the reduction of inventory, developing products, and other efforts conducted while being conscious of capital costs, we understand that spreading this awareness to each individual employee is an issue. We will also take advantage of ROIC to implement strategic price increases, and by doing this we aim to achieve the operating income forecast for FY2023 of 120 billion yen.

The current situation of Kao is a result of being excessively conscious of costs in product development. High-end shampoo products are generally selling well even among budget-minded consumers. As such, I expect you to beat the competition with a hunger to win by thinking from a different angle.

As you pointed out, there are ways of thinking appropriately according to each category, in addition to being conscious of costs.

4) **Last year, you declared that you would reduce the number of brands even in the H&PC business amid the shrinking of Japanese market due to a declining population. However, your product categories remain the same and I do not feel a sense of speed. What is your progress in this regard? You also mentioned the implementation of ROIC in each business, but what needs to be done to make the company better?**

Your points on the slow speed in response are fair. However, with respect to diaper business, for example, we have been preparing to announce the direction for reviewing our business strategy. When focusing on Japan alone, there is a decline in population, but the outlook is different when thinking on a global scale. We need to think about what we can do to improve profitability, including adult incontinence products. Diapers 30 years ago are largely different from those available today. It is important not to only look at the current form of products and the current competitive situation, but also to think with a view to the future. Although we will also consider regions other than Japan, China and Indonesia in which we mainly develop our business, we need to consider investment carefully as it is a process industry. In this way, we will drastically review the business strategy from various viewpoints.

There are too many business development categories in the H&PC business in Japan due to risk diversification. Does this result in the underperformance of the business in Japan compared to the market?

It is true that we have too many businesses. However, this expansion of our business portfolio is not for the purpose of risk diversification. As with cosmetics products, *Healthya* functional drinks and other products, we have expanded our business areas and grown while taking on challenges. Our revision of our portfolio is not sufficient so far, and going forward will make decisions to withdraw from unprofitable brands and businesses.

Aren't there limitations to growth for comprehensive H&PC companies in Japan?

With a sense of crisis that there will be no future for a pure H&PC manufacturer, we have been developing Another Kao and aim to establish our new portfolio while collaborating with existing businesses.

5) **To what extent were strategic price increases in FY2022 implemented with respect to the plan? Also, other than fabric treatments, what products were you unable to increase the prices for as planned?**

We were able to increase nearly 100% of prices in line with the plan. We had a shortfall of about 1 billion yen against the plan. Although we increased prices of fabric softener as well, we were forced to review them in response to aggressive discounts offered by competitors. This was the main factor.

What is the rational for your ability to aim for coverage of all items subject to price increases in FY2023?

In FY2022, coverage of core items subject to price increases among all items in the Consumer Products Business in Japan was 18%. In the fourth quarter, coverage was 36% including price increases for non-core items. Based on our estimation assuming a target coverage of 100% with the items subject to price increases expanded to include all categories, we believe that quite a high coverage can be achieved. In FY2022, we tried various approaches for price increases and measured their effects for each product. We check the results as part of our ROIC analysis and we conduct brand management as well. With regard to simple price increases, streamlining sales promotion expenses and other forms of price increases, we are taking time to engage in negotiations according to the characteristics of each retailer. Now, we have a general understanding about the tolerance of retailers and consumers regarding price increases at a small rate for a wide range of products.

What are the reasons for your ability to make a second try for increasing the prices of fabric softeners, which you canceled in FY2022? Is it because the competitive environment has changed or the approach has changed to implement price increases at a small rate for a wide range of products?

In price increases at a small rate for a wide range of products, our price bargaining power and price elasticity are different for each category, and so we can focus on the categories in which we should take a chance. The range of categories for strategic price increases in FY2022 was narrow and so there was no price elasticity, resulting in only 18% coverage.

Will you show me the breakdown of the 10-billion-yen increase in operating income in FY2023 between the Consumer Products Business and the Chemical Business?

The Chemical Business accounts for around 30%.

6) **While the like-for-like* sales growth rate in FY2022 was +3.7%, the FY2023 forecast for this rate is +2.3%. Isn't that a conservative estimate? Is this due to factors such as a decrease in sales volume as a result of strategic price increases and the impact of structural reform? Or alternatively, is the growth rate temporarily smaller in anticipation of higher growth in FY2024 and onward?**

The sales forecast assumes to some extent that there will be a decrease in sales volume and market share as a result of strategic price increases. We will minimize the decrease in sales volume as much as possible, while implementing price increases corresponding to hikes in raw material prices. We consider FY2023 to be the year to achieve both price increases and sales expansion and therefore an increase in profits. The extent to which we can gain a high-profit structure when hikes in raw material prices have subsided is important. We will use FY2023 as a springboard to focus on sales increase or profit increase in FY2024 and onward depending on the year because we consider it is difficult to simply increase both of them.

* Like-for-like growth rate excludes the effect of translation of local currencies into Japanese yen.

Isn't the sales forecast for FY2023 an easily achievable figure?

It is definitely not an easy figure. Sales increased in FY2022, driven by the increased sales of the Chemical Business including selling price adjustments. In FY2023, however, we will soundly increase profitability while increasing market share. The figure in the sales forecast incorporates all of the following elements: the goals to strive for, the things we want to do and the things we should do.

Does the sales forecast for FY2023 assume a considerable decrease in sales volume?

We will minimize the decrease in sales volume as much as possible. As shown in page 16 of the presentation material, a decrease in sales volume is unavoidable to some extent. However, we will exert control to increase profits. It is quite difficult to achieve both selling price increases and sales volume increases at the same time like with laundry detergents and skin care products.

7) **Looking at the changes in ROE and earnings per share, earning power is decreasing after the peak in FY2017 to FY2018. On the other hand, dividends are growing, with share buyback in the last five years amounting to 200 billion yen. During the same period, the share price fell significantly and the total return to shareholders in these five years was substantially negative. I greatly doubt that these returns to shareholders are an appropriate use of cash. I suggest that it is necessary to invest for growth instead of increasing returns to shareholders.**

It is just as you pointed out. We had been repurchasing our own stock until FY2020 while considering the uses of cash flow. Dividends per share no longer significantly increase like they did in the situation from FY2014 to FY2020, and we slightly lowered the dividend payment for FY2023. Although there were some potential investment projects for growth, we were unable to fully invest in them. We will increase returns to shareholders by proactively investing in growth drivers to create a new business portfolio.

8) **I think the implementation of ROIC is good, but how will you manage the two metrics: EVA that aims to improve the absolute value and ROIC that aims to improve the percentage? The implementation of ROIC will make you conscious of WACC, but how will you manage WACC when this differs for each business? Will you also consider the option of withdrawing from unprofitable businesses?**

We will continue EVA management. To increase EVA, we will implement ROIC in each business and aim to improve the capital efficiency of each business. The implementation of ROIC is intended to spread the idea of improving efficiency, and so we are not considering at this time, for instance, to set ROIC targets for each business and aim to achieve them. Naturally, we are considering to withdraw from businesses with poor capital efficiency based on comparisons with other companies or analysis.

Has the idea of setting EVA as an axis and using ROIC and WACC for determining business unprofitability spread across business divisions?

We will spread this idea from now on.

Due to poor judgment on the external environment, the accuracy of the operating results forecast is low and there is a continued shortfall against the targets. In addition, will there be improvements to the method of building up operating results involving placing a high weight on the fourth quarter but ultimately resulting in a shortfall compared to the announced forecast? This time, I believe you have considered various matters including a reduction in executive compensation. Since this is extremely important for having dialogue with and earning the trust of the capital market, I would like to hear from management regarding their view on the guidance on operating results.

I, as the president and CEO of Kao, took the shortfall compared to the announced forecast seriously and proposed to voluntarily partially return my compensation in an attempt to clarify my management responsibility. By spreading ROIC, we will transform business divisions, sales, product development, distribution and other areas. Our pattern for realizing a profit features an increase in profitability toward the latter half of the year. We anticipate an extremely severe situation for the first half of FY2023 as well, and so the key will be how well we can achieve results without decreasing profits. If we can gain the ability to create profit this year, the way that profits will be realized in FY2024 and onward will change. For FY2023, we have strict views on all of the following factors: the impact of hikes in raw material prices, strategic price increases, sales and profit. However, the business environment will naturally change and we have prepared many countermeasures accordingly. Our top priority for FY2023 is to achieve the announced forecast by leveraging all these measures.