

Date and time:

Wednesday, May11, 2022, 17:00-18:00 (JST)

Respondents:

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

Hideo Makino, Vice President, Financial Controllers

Mitsuhiro Watanabe, Vice President, Investor Relations

1. You said that the forecast of the negative impact of hikes in raw material prices has increased by 20 to 30 billion yen from the forecast at the beginning of FY2022 (-11 billion yen). How are you going to absorb it?

In addition to simply increasing prices, we will deal with it by substantive price increases through negotiations with retailers regarding discounts and other matters, reducing sales promotion materials, and shrinkflation products. We expect to be able to absorb about half of the negative impact with price increases and plan to absorb the remaining portion by cost reductions, which are currently being accumulated by each division.

2. Can you describe the negative impact of hikes in raw material prices of 30 to 40 billion yen on operating income by each raw material?

The price of pulp will increase around 40% to 50%, crude oil prices by more than 60%, and natural fats and oils by 70% to 80%. By business, almost all household and personal care business (H&PC business), mainly fabric care products, will be affected. We have assumed the crude oil price to be 110 US dollars per barrel and the price of natural fats and oils to be around 2,300 US dollars per ton, as the raw material prices. We anticipate the impact on our profits from prices of crude oil, natural fats and oils, and pulp and others to be at a ratio of 2 to 2 to 1.

You said that operating income for the first quarter was at the Company's plan. When do you expect operating income to turn around and to increase year-on-year because the impact of hikes in raw material prices will be seen in the second quarter or later?

We had a significant impact of hikes in raw material prices in the second half of FY2021, and expect that the market conditions will continue up to the first half of FY 2022. As such, our plan for operating income in the first quarter was below the previous year's level. Hikes in raw material prices had hardly any impact in the first half of FY2021. We plan to launch many new and improved products in the second quarter and onward, and plan to increase operating income by implementing various measures. However, due to the impact of lockdowns in China as a new risk, we expect a slightly difficult situation in the second quarter and that the recovery will take place in the second half.

3. Sales of Consumer Products Business in Japan in the first quarter seem weaker than the market. What are the factors behind this?

In the Cosmetics Business, Kao's sales remained at +2.7% even though the makeup market grew slightly more.

Regarding cosmetics, we did relatively well among the major manufacturers. For H&PC business, on the other hand, we plan to make a major recovery by launching new and improved products, starting with *Humming* fabric softener in March, an improved *Attack Zero* laundry detergent in May, and so on.

I understand that you plan to increase marketing expenses for the full fiscal year, but I presume you reduced expenses in the first quarter. This may have had an impact on sales.

We invest decisively in marketing expenses on the timing of large sales increases in a well-balanced manner. On a full-fiscal-year basis, we will steadily invest in marketing expenses.

Since a significant impact of hikes in raw material prices will be seen in the second quarter and onward, you seem to fall short of the announced operating income forecast. Is it a situation in which the only thing we can do is to watch the progress?

We will start to see the effects of price increases in H&PC business in Japan in the second quarter. In addition, we are hoping for sales to make a recovery when the market is stimulated after the spread of COVID-19 pandemic subsides.

4. Sales of the Health & Beauty Care Business in Japan have been decreasing for more than a year and its market share is also falling. Can you explain the reforms you will make to address the structural problems?

The situation in skin care products is that the COVID-19 pandemic and inclement weather have impacted UV care and other seasonal products, which are Kao's strength. Significant sales growth can be expected once the market returns to normal, and as we also have various new products and measures ready, we expect to be able to recover sales in the second quarter. On the other hand, hair care is a category in which major manufacturers are struggling. The market has been fragmented and manufacturers are competing to outsell one another. We are considering game-changing measures and we will actively use digital marketing and other measures.

Will you comment on the impact of the palm oil embargo in Indonesia?

Although there has been the palm oil embargo in Indonesia, the Kao Group processes palm oil into chemical products in Indonesia and exports them, therefore this is not a problem. In addition, there are no problems with our production in Malaysia either.

5. You said that you intend to absorb part of the impact of hikes in raw material prices by increasing sales volume. How will you do that?

Measures, including launches of new and improved products, are scheduled in Japan in the second quarter and onward. We will increase sales volume outside Japan as well, and sales are growing steadily in Indonesia and recovering in Thailand.

Why are the sales of Kao negative despite the strong recovery of the hair care market in the United States?

The impact of the logistics disruption is the main factor. It is not a brand or product issue, so we will recover sales in the second quarter and onward.

- 6. The cost of sales ratio for the first quarter of FY2021 was 59.2%, while that for the first quarter of FY2022 was 63.3%, so it increased about 4.4 percentage points. The impact of the 8 billion yen of hikes in raw material prices corresponds to 2.2 to 2.3 percentage points of sales. Will you explain the other factors that caused the cost of sales ratio to increase?**

Cost of sales was affected by increases in freight and logistics expenses. In the Chemical Business, the increases in raw material costs alone are adjusted to selling prices, and therefore the ratio needs to increase to that extent.

- 7. If half of the impact of hikes in raw material prices, 30 to 40 billion yen, is to be absorbed by price increases, the figure corresponds to 15 to 20 billion yen. I remember you explained at the beginning of FY2022 that price increases in baby diapers and fabric care products would absorb 7 to 8 billion yen of the impact. While Kao has an advantage in terms of negotiation power due to its large market shares for these categories, can the shortfall be compensated by price increases in other categories?**

We also have products in other categories with high market shares and have started to consider raising their prices. Instead of simply raising prices, we will negotiate with retailers on the streamlining of sales promotion expenses and sales promotion materials used in stores.

You said that you would increase cost reductions and reduced costs by 2 billion yen during the first quarter. I remember that the initial cost reduction plan for the FY2022 was 6 billion yen. Can you tell us how you will further increase cost reductions to reach that amount?

Total Cost Reduction (TCR) means reducing costs by using a little ingenuity. In addition to TCR activities, we will control various expenses, including travel and transportation expenses and other factors.

How about the price-increase situation outside Japan?

We have already increased prices outside Japan, which had an effect of around 1 to 2 billion yen in the first quarter. We expect a price-increase effect of nearly 5 billion yen for the fiscal year. The effects of price increases in Japan are expected to appear in the second quarter.

- 8. When compared to the growth in the cosmetics market, how have Kao's sales performed? Can you explain its reasons focusing on Japan and China?**

The sales growth rate of the Cosmetics Business in Japan was +2.7%, slightly outpacing the market in Japan. In Asia, amid a visible slowdown in the market of China, our sales were strong with a growth rate of +17%, which was partly due to successful sales on International Women's Day and other factors. Our strong brands, *freeplus*, which is hypoallergenic and contains Japanese and Chinese botanical extracts, and *Curél*, derma care brand, achieved significant outcomes. As shown in "G11 and R8 Brands growth and share of sales" on page 17 of the presentation material, sales of G11 account for over 70% of the Cosmetics Business and grew +14% year-on-year. The overall sales of the Cosmetics Business also grew strongly at a rate of about +7%.

As indicated on page 14 of the presentation material, will sales of the Cosmetics Business in the second quarter be affected by lockdowns in China and other factors? Is this impact on sales not a consumer demand issue but rather caused by the disruption to logistics?

That's correct. We anticipate there will be a considerable negative impact on the 6.18 campaign event in China scheduled for during this period. Our sales in the second quarter will be weaker than we initially expected, but we are hoping that after a period of subdued demand, a rebound in consumption will be seen in the third quarter or later and will regain momentum in the second half of the year. Demand for the brands is strong.

9. Are you suggesting that the effect of the price increases on increased sales was seen outside Japan? Which price increases of products are you specifically referring to?

As far as price increases are concerned, there was a positive effect of around 1 to 2 billion yen. In Asia, we increased the prices of *Attack* laundry detergent, *Laurier* sanitary napkins, *Bioré* skin care, and other brands. In the Americas and Europe, the effects of price increases were also seen for *Jergens* skin care brand and *John Frieda* hair care brand. We have not increased the prices of baby diapers in China.

Did the sales volume in the Hygiene and Living Care Business not increase in Japan because of the start of price-increase negotiations?

Sales of fabric care products and *Laurier* were not so bad. Although sales of baby diapers were below year-on-year, this was not due to the impact of price increases from April. Sales of baby diapers in Japan include sales at stores and sales from cross-border e-commerce for China. Sales at stores in Japan were affected by the impact of the shrinking market, while sales from cross-border e-commerce were affected by the impact of efforts toward normalizing sales.

10. Will you explain the sensitivity to changes in raw material prices and foreign exchange rates on operating income?

Kao's sensitivity to raw material prices involves an extremely complex process, so we cannot disclose it clearly. As for Kao's sensitivity to foreign exchange rates, it is difficult to

give you an across-the-board explanation due to the many currencies involved. But as a guide, if the yen is the only currency to weaken by 1%, we expect sales to increase by approximately 5 billion yen and operating income to increase by several hundred million yen.

11. I understand that price increases of H&PC business in Japan from April have already been reflected in selling prices at stores. Is my understanding correct? Do price increases have an adverse effect on retailers or on consumers' purchasing trends? If so, what sort of countermeasures do you have in mind?

Price increases have already been reflected in selling prices at stores. Although the results of this will appear in the financial results for the second quarter or later as prices were increased in April, in the event of a significant decline in sales, we will analyze the reasons and act according to the circumstances. We believe that it will be necessary to ascertain whether the sales decline is due to price increases or not.

Note

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