

Date and time:

Tuesday, November 1, 2022, 17:00-18:10 (JST)

Respondents:

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1. The current raw material market price is declining and the yen is depreciating. How do you expect the impact of hikes in raw material prices to be in FY2023?

The current prices for crude oil and natural fats and oils are 95 US dollars per barrel and 900 US dollars per ton, respectively, and the current exchange rate is 145 yen. We expect the average prices for crude oil and natural fats and oils in FY2023 will be 90 US dollars per barrel and 900 to 1,100 US dollars per ton, respectively. Although it depends on the exchange rate, while the negative impact of hikes in raw material prices may remain in the first half, we expect there is a possibility that it will contribute to profits in the second half.

The price of palm oil is declining considerably. Will the price of palm kernel oil continue to be high?

Palm oil is mainly used for food, while palm kernel oil is mainly used for industrial purposes, and so their prices are not always linked. We have exchanged views with our partners in Indonesia and Malaysia, and based on this, we expect the price of palm kernel oil to be 900 to 1,100 US dollars per ton.

What do you expect the price of pulp to be?

Most of our pulp is imported from the United States and there is a delay of nearly six months including inventory until an impact on the profit or loss is reflected. Since the price of pulp is hiking due to logistics disruption in the United States, we expect the high price will continue in the first half of FY2023 and will decrease slightly in the second half.

2. You explained that your operating income for the third quarter of FY2022 decreased due to the issue of business sentiment in the United States and China as well as a failure to achieve plans for the sales expansion of some products. What is the breakdown by business segment? Also, was there a loss of inventory valuation in the Chemical Business?

The factors for the 6-billion-yen shortfall against the plan for the third quarter include a decrease in sales due to the impact of economic slowdown in China including the Cosmetics Business, a failure to achieve plans for the sales expansion of new products including fabric

softeners, and hikes in raw material prices. In addition to these, there was an impact of a little less than 2 billion yen due to the depreciation of yen. By business segment, the Cosmetics Business, Hygiene and Living Care Business, and Chemical Business are related to these factors. Of the impact of hikes in raw material prices, 70% affected the Hygiene and Living Care Business. The Chemical Business had a loss of inventory valuation of around 1 billion yen.

At the time of the announcement of the financial results for the first quarter, you explained that the depreciation of yen would have a net-positive impact on operating income. Does this remain unchanged? The situations have changed since then as the export of baby diapers has decreased and the raw material costs have risen.

As we explained before, the impact of the depreciation of yen on operating income is unchanged. In terms of the US dollar, the increase in raw material costs will outweigh the increase in profits of subsidiaries outside Japan, slightly affecting operating income negatively. As for the Chinese yuan, on the other hand, the depreciation of yen works positively with respect to operating income.

3. The like-for-like* sales growth rate in Asia in the third quarter remained on the same level in the Cosmetics Business and was +17% in the Health and Beauty Care Business. Will you explain the relevant factors and the outlook of the businesses in Asia?

The market is on a recovery track in the Health and Beauty Care Business. For instance, the UV care products market in Thailand was +36% in the second quarter and +53% in the third quarter. Sales of *Bioré* skin care brand including UV care products are growing mainly in Indonesia and Thailand, and we expect this growth to continue. In Asia, we are focusing on UV care products. In the Cosmetics Business, sales in China fell short of the same period a year earlier. However, because sales in Asian countries other than China slightly increased, net sales in the Cosmetics Business remained on the same level overall. The cosmetics market in China in the third quarter was -3% and the sales growth rate was also at the same level as the market. The market in Japan has started to recover, and an increase in sales in Japan offset the sales decrease in China. The market in China is expected to decline below the previous year in the fourth quarter as well, and we made a downward revision to sales. We expect to offset the decrease in sales in China by implementing proactive measures in the market in Japan, which is slowly recovering, by making preparation for inbound demand, as well as by taking cross-border e-commerce measures.

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

4. What are the reasons for the decrease in operating income in the third quarter being greater than in the first and second quarters? Apart from the impact of hikes in raw material prices, what are the factors that lowered the gross margin ratio?

The factors were as follows: in addition to slowdown in the market in China, deviation with sales expansion plans for products including fabric softeners, and hikes in raw material prices, there was a decline in sales of skin care products in the United States. Also, sales of high-value-added products did not grow in the hair care and oral care, which are businesses with issues.

To what extent did the sales of hair care and oral care products decrease? On the other hand, to what extent did the sales of *Bioré* grow?

Sales of oral care products and hair care products decreased by 5% and 10%, respectively, and sales of *Bioré* grew by 7%.

5. There was a 6-billion-yen shortfall against the operating income plan for the third quarter, and the market environment in the fourth quarter does not appear to change significantly. Will you explain the reasons in specific figures for not changing your forecast for FY2022?

To achieve the full-year operating income forecast of 145 billion yen, 68.1 billion yen is needed in the fourth quarter. This would be a 33.6 billion yen increase in operating income compared with the same period a year earlier, but there is an additional impact of -12 billion yen from hikes in raw material prices. Furthermore, since 7.1 billion yen in structural reform costs including the impairment loss on facilities for baby diapers recorded in FY2021 will no longer exist, we need to achieve an increase in operating income of 38.5 billion yen. We aim to achieve half of this figure through an increase in gross margins as a result of increased sales, and the remainder through 7 billion yen in price increases, 5 billion yen in Total Cost Reduction (TCR) activities, as well as fixed cost reduction, and other activities. To achieve an 18 billion-yen increase in gross margins, a sales increase of approximately 30 billion yen is required. In other words, this corresponds to a sales increase of approximately 10 billion yen per month or a +8% growth year on year. The current growth rate in Japan is +5% in the Household and Personal Care (H&PC) market and +10% in the cosmetics market. Under these market environments, we aim to achieve the forecast by leveraging Kao's comprehensive strength including new sales measures.

Do you have a plan to make an additional strategic price increase during the fourth quarter?

In the fourth quarter, we will execute the 7-billion-yen strategic price increase that was already included in the plan. We plan to make a further price increase next year.

6. **Operating income for the third quarter was a 6-billion-yen shortfall against the plan, meaning that the original plan for the quarter was a 9 billion yen decrease in operating income. Was your plan for the fourth quarter and the second half an increase in operating income of 27.5 billion yen and 18.4 billion yen, respectively?**

That is correct.

The result for the fourth quarter of FY2021 was a decrease in operating income of 21.0 billion yen including 7.1 billion yen in structural reform costs. Other than this, does the decrease in operating income of 14.0 billion yen include an increasing factor reflecting environmental improvements compared to the severe conditions during the same period last year?

In FY2021, raw material prices hiked from the third quarter to the fourth quarter. In addition, the market slowed down in Japan due to the declaration of a state of emergency and the market conditions were extremely severe. We expect that the market environment will improve in the fourth quarter of FY2022.

7. **I believe a recovery of sales and operating income in the Health and Beauty Care Business, which has high profitability, is important. Will you explain the outlook for this business in the fourth quarter and FY2023?**

Japan is about to enter the cold season and bath additives and *MegRhythm* thermo products are currently selling well. Strong sales of these products can be expected during the fourth quarter. Sales growth of UV care products can be expected in Asia. Although sales in China are slowing down, sales in other Asian countries are strong and grew approximately +15% in the third quarter. Results from structural reform of hair care business in Japan are likely to gradually appear starting in FY2023 and the profitability of the Health and Beauty Care Business is also likely to improve.

Please summarize the issues in hair care and oral care products. Have the stock keeping units (SKU) been reduced as a result of structural reforms? Are these products losing in the market?

In Japan's hair care market, sales in premium price segments beyond 1,000 yen and 1,500 yen are strong. Also, the trends in the market change extremely quickly with new concepts. On the other hand, the price ranges of Kao's brands such as *Essential* and *Merit* are targeted at the mass market, and these brands are losing in the market in terms of a sense of speed as well. Based on our new structural reform policy for hair care business as we explained during the announcement of the financial results for the second quarter, we will make the best use of Kao's global brand power. There are many brands in the oral care market and

high functional products in the high price range are growing, but we have yet to take sufficient measures. We hope we will be able to regain market share through brand renewal and other initiatives.

How long will the decrease continue in sales of hair care and oral care products?

We will set out structural reform policies and implement them starting next year. We expect that sales will start to recover next year.

8. Will you give us the breakdown between Japan and outside Japan regarding the decrease in operating income of 9.2 billion yen in the Hygiene and Living Care Business for the third quarter?

Operating income decreased approximately 8.0 billion yen in Japan.

It is assumed that price increases in many items such as foods from October will lead to a more negative consumer sentiment. Will the Hygiene and Living Care Business be able to recover profitability during the fourth quarter?

We will increase sales and market share by taking measures including a recovery of fabric softeners. There will also be an advantage from the decrease in natural fats and oil prices.

How much did price increases contribute to operating income in the Hygiene and Living Care Business?

Although we do not disclose specific amounts, the Hygiene and Living Care Business accounts for a high percentage of the 15-billion-yen effect of annual strategic price increases.

9. The Cosmetics Business in Japan and Europe for the third quarter looks weak. Did it fall short of the plan?

Sales in Japan were +3%. However, at stores on a sell-out basis, sales were +6%, which was the same level as the market. Although sales were weaker than the two-digit growth that we expected in the plan, they were still doing well. *KATE* makeup and foundation and UV care products from *KANEBO* prestige skin care and makeup brands are growing and Japan has momentum. We expect the market will grow over +6% in the fourth quarter. We expect sales will grow beyond the market through various measures. In total, we expect two-digits sales growth with inbound demand and cross-border e-commerce. In Europe, *SENSAI* continues to sell well. The U.K. accounts for 80% of sales of *MOLTON BROWN*, but this brand struggled in the third quarter due to the impact of the demise of Her Majesty Queen Elizabeth II and economic disorder. However, the Christmas campaign is doing well and sales for this brand

are expected to recover in the fourth quarter. We hope we will be able to offset the decline in China with sales increase in Japan and Europe.

A profit was gained despite a shortfall in sales in the first half as a result of structural reforms. However, how was the situation in the third quarter? Will you be able to achieve the operating income plan for FY2022?

In the third quarter, we were able to increase operating income as expected despite the continued decline in sales in China. The fourth quarter accounts for a large percentage of sales. We expect sales growth in the fourth quarter, and therefore we hope we will be able to achieve the annual operating income planned at the beginning of the year.

Did operating income in the Cosmetics Business for the third quarter perform better than the plan?

Although sales fell short of the plan, operating income was as planned.

10. The sales volume of laundry detergents increased and the sales volume of baby diapers did not decrease much even after the strategic price increases. Is this outcome due to Kao's strength?

The decisive factor in increasing prices is promoting high-value-added products and brand power. We launched 17 new and improved products, more than twice as many as last year, and we promoted high-value-added products by making the best use of our high brand power in laundry detergents. In addition, as a result of initiating negotiations on price increases with retailers at an early stage, we were able to deeply discuss and finalize our sales measures.

Will the same result be obtained even if you increase the price of fabric softeners or home care products?

The same result cannot be obtained from products with low brand power. The key is whether we can capture market needs and offer attractive products with high added value.

Note

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