

Date and time:

Wednesday, May 10, 2023, 16:00-16:50 (JST)

Respondents:

Masakazu Negoro, Representative Director, Senior Managing Executive Officer

Toru Nishiguchi, Director, Senior Managing Executive Officer

Mitsuhiro Watanabe, Vice President, Investor Relations

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**1) You stated that sales within the household and personal care (H&PC) Business decreased in underperforming categories. I would like to know the background of structural difficulties in the business.**

The decrease in sales within the H&PC Business was mainly affected by the decrease in sales of *Merries* baby diapers in China. We also faced tough conditions for fabric softeners in the underperforming categories.

**You stated that you will announce structural reforms in the baby diaper business in China. How is the preparation of the announcement coming along?**

With regard to *Merries*, we are currently holding deliberations to announce structural reform measures. We will explain the details during the earnings conference in August.

**Tough conditions in the market remained for fabric softeners in the first quarter, mainly in high-end products. With other companies launching new products from April onwards, what are your prospects for future improvements?**

Kao attempted to increase the prices of fabric softeners when competitors did not increase prices. As a result, the volume and market share of our products decreased. We are preparing measures, including the launch of new products, for the second quarter onwards. We intend to improve profitability by launching new products while maintaining market share.

**Is there a risk of decreasing profit due to further worsening of market conditions if companies launch new products when the market is not growing?**

We will comprehensively propose new offerings for laundry, including not only fabric softeners but also laundry detergents.

**2) Sales of the Cosmetics Business in Japan for the first quarter were -2.3% year on year on a like-for-like basis due to the impact of structural reforms. Why did the structural reforms, which had continued to be implemented as before, have an impact on the first quarter of this year? I would like to know the details of the structural reforms.**

In the Cosmetics Business, we set out a policy of reducing brands, of which there were 30 as of 2018, to focus on G11 and R8 brands, and are working with a target of completing these reduction efforts by 2024. In the first quarter, profit decreased due to reduced sales as a result of reducing brands and costs were incurred for inventory disposal. We expect a decrease in profit of 4 to 5 billion yen this year and also a certain decrease in profit next year.

**Sales in China during the first quarter were -41% year on year on a like-for-like basis. I would like to know details regarding the rebranding of *freeplus*, a hypoallergenic brand containing Japanese and Chinese botanical extracts.**

Ever since its launch, *freeplus* has been well received in China. Due partly to changes in the market environment, we implemented a total rebranding for the first time for this brand in April 2023. More than 90% of sales of *freeplus* is accounted for by China, and so in addition to importing products from Japan, we are reinforcing product development in China by assigning research and development personnel, among other measures. Due partly to the absence of last year's lockdowns, sales grew significantly in April on a year-on-year basis.

- 3) Are there any factors other than structural reforms, such as down-trading at drug stores and fierce competition in the skin care market, for the decrease in sales in the Cosmetics Business in Japan? You explained that sales in the Cosmetics Business decreased in terms of both price and volume during the first quarter. However, something does not feel right in light of the resumption of economic activities in Japan.**

The decrease in sales in terms of price in the Cosmetics Business was affected by stock clearance at lower prices before the rebranding of *freeplus* in China. The sales decrease in Japan was slightly affected by regulations for travel retailers in South Korea, which is included in sales within Japan.

**Does competition with local brands also have an impact in China?**

In China, *freeplus* and *Curél*, a derma care brand, are masstige brands and competition is intensifying in the market. However, thanks to each brand's unique identity, sell-out from our focus area of e-commerce is growing more than the market growth. Although competition is intensifying, it is not the case that our brand power is on a declining trend.

- 4) I would like to ask Mr. Nishiguchi, who in the past witnessed the process from the rise of the business in Asia to the struggles faced by *Merries* in China. I would like to know the reason why Kao's Consumer Products Business is losing in the competition to this degree, and I would like to know about any changes after Mr. Nishiguchi assumed the**

**top position.**

I understand that the largest factor for the weakness over the last four to five years is our heavy reliance on inbound sales when conditions were favorable.

Concerning Kao's marketing, I have just started to work on it. Previously, we emphasized the actions of consumers when they use products. Today, however, we conduct marketing by subdividing the actions of consumers into those done when collecting information, when touching the product for the first time, when purchasing the product, and so on. This new way of marketing has led to successful cases such as with *Bioré* UV care products and *Essential* hair care products, and we will work to increase these sub-categories. In addition, the organization itself has also started to turn toward the desired direction.

**5) The price adjustments for oleo chemicals were continuing from the fourth quarter of last year. Have these price adjustments stopped declining during the first quarter?**

As was the case in the fourth quarter of last year, there continues to be a bad situation in the first quarter.

**What are the areas of the Chemical Business in Europe, such as food and industrial products, in which inventory adjustments were made?**

Oleo chemicals account for a large volume, but the applications are wide ranging, including raw materials for household articles and industrial products. Demand fell due to inventory remaining in the tanks and warehouses of customers in the Americas and Europe, as well as slowdown in the economy.

**Profit is below the plan in the Chemical Business. What is your plan to recover profitability going forward? Why were you unable to gain an understanding of the inventory status of customers despite the high market share of Kao in this area?**

The greatest recovery measure is adjusting selling prices in response to raw material price increases. For information materials in particular, we enter into a formula agreement with customers to determine prices. From the second quarter to the second half of the year, we will enter an environment where we can increase prices. As for surfactants, we are negotiating price increases by dividing them into sub-components, including energy cost and labor cost, and we will continue to implement additional price increases going forward. In the Chemical Business, we plan a 11.5-billion-yen increase in profit year on year during the second half of the year, of which approximately 60% is accounted for by price increases. For the remaining 40%, we will aim to increase profit through business based on adding facilities for highly profitable products and through an expansion in high added value products.

Please note that Kao's market share is not decreasing under these circumstances. The results

of the chemical industry in general for the first quarter were tough.

**Is my understanding correct that you are not covering underperformed profit through the Consumer Products Business and that you are working within the Chemical Business to recover unachieved profit?**

You are correct.

**6) I would like to know the background for the additional 5-billion-yen effects from price increases for the year.**

We increased the effects to cover the increasing labor costs and energy costs. Another reason is that retailers have gained more understanding regarding price increases.

**How will you increase the prices of cosmetics going forward?**

We plan to increase prices when adding value at the launch of new products in the future.

**Your forecast for the annual impact of rising prices of raw materials remains unchanged. Is there room for an upward swing in the profit?**

Our forecast for the impact of rising prices of raw materials is -12.0 billion yen year on year, which will remain unchanged unless there is a significant change in the conditions. We expect that the raw material prices in general have peaked out during the first quarter.

**7) In light of the market conditions during the first half of the year, I believe raw material prices will decrease a little more, giving a positive impact on profit. Is there any such possibility? If not, is that because of unique characteristics in the way Kao conducts procurement?**

The prices of natural fats and oils and petrochemical raw materials are forecast to decrease. However, the prices of petrochemical packaging materials, paper, pulp and energy costs are still increasing compared the level in the second half of last year due to a delay in the timing of price increases. For example, a price increase in petrochemical packaging materials takes place with a significant delay. First, the prices of petrochemicals increase and then those of derivatives. Since the price of a packaging container is determined by adding the processing cost, the time to increase the packaging price will be even more delayed. For such a complex processed product, the price increase is determined after analyzing its component and therefore time is needed to do so. It is not that the case that Kao has a unique way of conducting procurement.

**Some companies negotiate prices every half a year. Does Kao do the same?**

The time of price negotiations varies depending on the raw material. For some, we determine the prices each quarter, and for some, we determine prices on a monthly basis. For paper and pulp, we determine prices for each quarter; we do not take as long as half a year for almost any items in paper and pulp.

**You stated that the operating income in the Consumer Products Business for the first quarter is as planned. Are net sales as planned as well? If there is a delay in achieving the plan, I would like to know additional measures to secure operating income.**

Net sales in the Consumer Products Business are almost as planned.

**Note**

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