

Date:

Tuesday, June 11, 2024

Agenda:

- (1) Answers to Preliminary Questions
- (2) Q&A Session and Dialogue

Speaker:

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(1) Answers to Preliminary Questions

Change in the organizational structure

- The company moved from a traditional matrix structure to a task-oriented scrum-type structure. I feel that this has allowed a culture to take root in which tasks are prioritized over the organization. As a result, new hair care products can now be launched within a year from the start of the project, compared to a previous average of two to three years from planning to launch.

Digital-related initiatives

- The goal of these initiatives is to revitalize management. By increasing the use of digital technology, we will be able to make management decisions faster and more clearly.
- As a concrete measure, we have integrated all data including competitor information obtained from the market and have achieved results by implementing and simulating strategies for price increases and measures for each brand and retail chain.
- Because of our focus on loyalty, we have created indicators and a database to measure loyalty and how it varies. Although these are not yet available for all brands, they help to enhance brand equity.

Progress of structural reforms

- The profit improvement effect in FY2024 is expected to be more than 18 billion yen.
- We will focus on improving the marginal profit rate and strengthening our global expansion using the power of digital technology, particularly in the Consumer Products Business.

(2) Q&A Session and Dialogue

1. **I would like to know why you were able to increase both prices and volumes in Fabric and Home Care products. For consumer products such as fabric softeners, I believe that price and cost-effectiveness are prioritized over evidence (that the product is effective). What kind of indicators did you focus on to bring increased loyalty?**

To measure loyalty, we analyze a combination of customer purchasing behaviors, online word-of-mouth, and other various kinds of information. We launch consumer goods based on evidence. For example, *Wide Hailer* laundry bleach has the highest cleaning power when combined with powdered detergent rather than liquid detergent. From now on, we will actively disseminate this kind of information along with evidence.

2. **You stated that one of the reasons for the improvement in profit margin at the most recent business results is the implementation of a profit-oriented management method that spans from design to sales through the use of digital transformation (DX). I would like to know the details about this.**

The new business management system using DX has been in place for about three years and is a major pillar of our business management method. With this system, we can see how much loyalty Kao products have. For example, it shows that even if products have the same market share, products with high loyalty have a high repeat rate and are more effective even with small marketing expenses. Through these efforts, each and every employee in the business and sales departments has become more profit conscious. In addition, the system has been enhanced with the ability to use various tools on smartphones starting in 2024. I expect to see even more effects from this in the future.

3. **Will employees in the sales department be able to see profits in real time, even in the Consumer Products Business outside Japan? Will the local evaluation system also change from a focus on sales to a focus on profit?**

This profit visualization system was independently completed by "citizen developers*" who work in sales in Japan. A similar system will be implemented outside Japan to show profits in real time. We currently have 1,500 citizen developers but would like to increase that to 3,000 in the future.

* Employees who are not IT engineers, but who identify familiar business issues and work to improve business processes on their own using IT tools.

Why is there a difference in profitability between the Americas and Europe within the Health and Beauty Care Business?

Differences in brand equity and the power of the company's approach to retailers are the reasons behind this. There are stronger and weaker regions for each product within the Americas and Europe, and so we will strengthen development in regions where we can best leverage the characteristics of our products.

4. **I would like to know about the next candidate businesses in the *Global Sharp Top* strategy for growth in 2025 to 2026. I would also like to know the progress of "Another Kao," the creation of new businesses.**

We have offset the impact of approximately 60 billion yen in hikes in raw material prices since 2021 through strategic price increases starting in 2022. We will set prices in line with value and aim to add even more value in the future. The businesses that we expect to grow are the Skin Care Business and the Hair Care Business in the Health and Beauty Care Business, the core brands in the Cosmetics

Business, and the Chemical Business. In the Hair Care Business, we have launched our first high-premium products under the *melt* brand in the spring of 2024, and we expect growth through further introduction of other new brands in the future. In the Chemical Business, profit margins are expected to improve due to growth in high-value-added products including semiconductor-related chemicals and agricultural adjuvant.

Another Kao is intended to strengthen three categories: circular economy, digital and health care. We are promoting high-value-added products, including setting prices in line with their value, highly durable asphalt modifiers in the Chemical Business and marketing strategies using DX. We expect that these efforts will lead to significant growth in the near future and further strengthen our existing businesses.

What is the future positioning of the Sanitary Business?

The Sanitary Business had been stagnant for several years, but achieved profitability in the first quarter of FY2024. We plan to make the business even more stable and profitable, aiming to achieve profitability in FY2024. The Sanitary Business includes baby diapers, adult incontinence products, and sanitary napkins, each of which we want to use as important touchpoints with consumers. For example, sanitary napkins are positioned differently from other companies' brands, in the sense that they are products for women and can be leveraged for other brands such as *Curél* and *Bioré*.

5. **I would like to know the background behind the achievement in profitability for the Sanitary Business, as well as the outlook for the future. Will the business continue to be profitable in the future?**

We were able to increase prices while maintaining market share, partly due to an improved business environment and structural reforms. Brand switching is less likely in this category, so sudden changes in market share are unlikely. Therefore, in order to maintain and grow market share, it is important to increase loyalty. Kao has developed a tool to measure the level of loyalty and to monitor it on a daily basis. As a result, unless there are large-scale investments, we expect to continue operating in the black in the future. Since sanitary napkins, diapers, and adult incontinence products are used by women, children, and the elderly, respectively, they are very important in terms of touchpoints with customers, and we aim to achieve stable profitability in the future.

Have you been able to increase the prices of both sanitary napkins and baby diapers?

We are able to increase prices on both sanitary napkins and baby diapers. We plan to increase the market share of sanitary napkins in Japan while increasing their prices. We will also focus efforts on adult incontinence products in the future.

6. **I have the impression that you continued to invest in baby diapers in China for several years, even though it was not profitable. How will the introduction of ROIC change things in the future?**

At that time, profits exceeded 20 billion yen, and it was not expected that the business would be as sluggish as it is today. Now, ROIC has been introduced and we have been able to visualize the balance between investments and profit effects for each business. As a result, we closed our baby diaper plant in China in 2023 as part of structural reforms, and reorganized our plants in Japan. The effects of these initiatives are now steadily emerging.

I understand the qualitative details of Kao's strengths and initiatives, but I would like to know if there are any quantitative indicators, KPIs, or other details that should be looked at during periods of declining profits.

The first is improvement in ROIC and marginal profit rate by business, and the second is profit margin and market share, not the volume of sales. We will set an indicator related to whether either of these is improving, while we review the business model and marketing strategy. We have implemented structural reforms to strengthen our portfolio against the various external factors that have emerged over the past few years. Currently, we have strengthened the competitive advantage of our core brands and are embarking on global expansion with a sense of speed. We will establish a corporate culture and structure that is steady in the face of external changes.

- 7. You are currently investing aggressively in marketing. Do you expect to see the full results of this investment during the period of the Kao Group Mid-term Plan 2027 (K27)? Or will it be a longer-term investment to achieve a larger profit margin in, for example, five years from now?**

Marketing expenses are used in different ways depending on the category. In principle, we try to invest aggressively when we judge that we can increase loyalty with our core brands.

- 8. The ROIC target for K27 is 11%. I feel this is not enough based on Kao's past performance. Is there any room for the target value to go up? Also, many companies take two to three years to establish ROIC within the company. What is Kao's current situation?**

The ROIC target of 11% for FY2027 is a figure that excludes positive external factors such as lower raw material prices.

I feel that ROIC is very well established within the company. All departments use ROIC as an indicator, which has clarified departmental responsibilities and strengthened collaboration. We are now in a phase of achieving further results.

- 9. I would like to know the reason why the rollout of *melt* started so well. The high-premium market is becoming increasingly competitive in itself. What are the future strategies and prospects for the Hair Care Business?**

As part of our strategy to make the Hair Care Business into a Growth Driver business for the future, we have created six categories for the directions related to the Hair Care Business and plan to launch six

new products within each category in turn. Therefore, the new products to be launched in the future will not overlap in any category. Our goal is to achieve the No. 1 market share in all the six categories. Global expansion will proceed in a similar fashion.

The current market share for the Hair Care Business in Japan is in the first half of the 10% range and the operating margin is below 15%. In the future we would like to achieve a Japanese market share and operating margin of more than 20%. Including sales of products for hair salons, we believe that global sales of hair-care-related products have the potential to grow to around 180 billion yen.

10. I would like to know about the current positioning of the Life Care Business. Is there a possibility that it could be added as a Growth Driver business in the future through M&A or other measures?

We are currently reviewing our strategy following the transfer of the *Healthya* health drinks business. However, we believe this is a very important business to meet the more pressing needs that consumers have. I would like to give further explanation at some point about the future positioning of the Life Care Business in our business portfolio.

Despite the strong performance of the *ORIBE* brand for high-end hair salons, the business in the Americas does not appear to be growing. I would like to know why and what the prospects are for the future.

The business in the Americas was overly focused on economies of scale. It dealt with a wide range of retail chains for small volumes, resulting in lower profit margins. *ORIBE* has performed well by leveraging this insight gained through reflection and focusing on digital rollout, chiefly in flagship salons. We will also focus on digital rollout for the *Bondi Sands* premium skin care brand. Going forward, we can also expect contributions to profit from increased production of tertiary amines in the Chemical Business, so we expect increased profits in both the Consumer Products and Chemical Businesses.

11. The operating margin for the Health and Beauty Care Business in the first quarter appears to be lower than expected. What are the reasons for this? Also, is cannibalization occurring between *melt* and other Kao products?

The main reasons for the low operating margin in the first quarter are as follows:

- The impact of the hikes in raw material prices related to cleaning agents
- A decrease in the operating margin of *GOLDWELL* products for hair salons, due to ongoing structural reforms

The approximate operating margin targets for each business are 20% for the Fabric and Home Care Business, 15% for the Health and Beauty Care Business, and 15% for the Cosmetics Business.

There is no cannibalization between *melt* and other existing products such as *Essential* and *ines*. They

are different in terms of both the targeted price range and consumer segment. We plan to expand the number of stores that handle *melt* starting in July 2024.

To what extent do you think price increases will be possible in the future?

Circumstances vary by product category, but we believe it will continue to be possible to implement price increases in line with the timing of new or improved product launches. However, the more important point is how long the increased price can be sustained. It makes no sense if the price drops soon after the product is launched. Retention rates are linked with loyalty, and so we are keeping a close eye on these two points.

12. I would like to know about changes in your pricing strategy. Why did you decide to move from a policy of passing on the impact of raw material price hikes to prices that are in line with value?

Low prices in Japan have a negative impact on global expansion, so it is necessary for customers in Japan to recognize the value in relation to the price. For example, with *Merries* baby diapers, there was an increase in transactions whereby people purchased diapers at a lower price in Japan and sold them at a higher price in markets outside Japan, which resulted in a decline in brand value and thereby a loss of competitiveness. To prevent this from happening again, we will increase the value of products and raise the selling price. This will improve profit margins in line with the achievement of K27.

Is it possible to continue to gain understanding from the drugstore and wholesale industries regarding price increases? I would also like to know if there is anything Kao can do to encourage changes in the price structure, or if there are any challenges regarding the price structure.

We want to strengthen our relationship with drugstores. Currently, the government is allowing moderate inflation in conjunction with wage increases, so we can say that the current landscape makes it easier to increase prices. The drugstore industry is also stepping up its global expansion, and we believe our goals are the same.

Will the concept of price setting in line with value penetrate within the market in Japan in the future, given the presence of simultaneous promotional campaigns, especially on e-commerce sites?

Promotional campaigns in themselves are conducted all over the world, and we believe that these campaigns have little impact on product value. However, caution must be exercised in some parts of Asia, where excessive promotions can reduce the value of the product.

13. Japan has a lower minimum wage than the U.S. Even if you wanted to increase selling prices in Japan, wouldn't it be difficult to do so in the future without an overall increase in wages?

Consumer goods account for a small share of household consumption spending. Therefore, the impact of price increases is not as great as for foodstuffs. Also, it is less likely for brand switching to occur in consumer goods based on price. The challenge is that the prices of consumer goods in Japan are currently low by global standards. We must set prices according to their value.

I would like to know what your future profit targets are for the Cosmetics Business and how you plan to achieve them.

While it is important to increase prices, we believe it is also important to cultivate high-loyalty brands. Of the G11 and R8 brands, we are aggressively investing in brands that we intend to grow globally (*Curél*, a derma care brand, the *KANEBO* prestige skin care and makeup brand, and others), and we are gaining results that are commensurate with our investment. By continuing this investment, we are hoping that some of our core brands will grow enough to support the entire portfolio. The *KATE* makeup brand has also gained extremely strong recognition in Asia at the moment. Going forward, we will change the profit structure for each brand to achieve our profit targets.

14. I understand that you will not be using a mass-market oriented strategy for *Curél*. How do you plan to increase loyalty?

Curél is positioned as one of the top three core brands in the Cosmetics Business. In addition to our efforts in Japan, we are also developing a unique approach in markets outside Japan. We will present evidence to consumers through the improvement of their own skin and thereby increase loyalty to products that bring them tangible results. We will also disclose the specific scale and areas of global expansion in the future.

15. I understand that *Curél* is a brand that you want to grow based on evidence, so your strategy is different from other cosmetics brands that focus on sensibilities and concepts. How do you plan to grow your cosmetics brands other than *Curél*?

To expand cosmetics globally, we need both skin care and makeup products. Kao has launched brands that span multiple categories, with the *Bioré* skin care brand being a typical example in this regard. *Bioré* is a brand born out of the desire to solve customer needs in their entirety, without being tied to specific categories. One of Kao's strengths is that we have many touchpoints with customers by making our brands go beyond single categories. The same approach applies to *Curél*. This brand brings all categories together with a focus on sensitive skin.

There are only a few directly operated *MOLTON BROWN* stores in Japan. How do you plan to carry out communication?

As with *Bioré UV*, we are implementing a marketing strategy to sell products through limited channels.

The strategy of starting small with *Bioré UV* has produced results. Instead of starting with multiple stores carrying the product, we make an intentional choice to start small and implement a marketing strategy that builds loyalty.

16. I feel that brand consolidation has ended in the Cosmetics Business for now. What is your outlook for the future?

In the Cosmetics Business, we design our portfolio based on three vectors: 1) products that leverage Kao's strengths, 2) technologies and products that are superior to those of other companies and 3) products that meet customers' needs. Globally, we are also classifying the brands that match each area, and the way they do so. For example, *KATE* is a brand that is expanding rapidly in Asia, but we are not planning to expand to AEMEA (the Americas, Europe, the Middle East and Africa). This is because *KATE* is a brand of makeup that is tailored to the bone structure and shape of Asian faces. We believe that it is not only the area that is important, but also the way in which we respond to the needs of customers. G11 is a group of brands that we intend to develop globally, and we are finalizing concrete strategies for further growth of the Cosmetics Business. We will give more details about this another time.

17. Regarding your approach to shareholder returns, what level can I expect for this in the context of ongoing growth in your business performance going forward? I would also like to know your thoughts on share repurchases.

Our basic approach to shareholder returns has not changed. Once profit levels return to normal, we plan to pay out a stable dividend payout ratio of 40–50%. In addition, the following priorities are considered for the use of cash flow:

- (1) Investment for future development (capital expenditures, human capital, M&A, etc.)
- (2) Steady and continuous cash dividends
- (3) Share repurchases

Note

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