

# Kao's Growth Strategy and Synergy with Kanebo Cosmetics

July 26, 2006

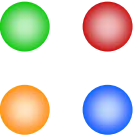
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These presentation materials were used in a conference call held on July 26, 2006.



These presentation materials contain forward-looking statements that are based on management's estimates, assumptions and projections as of July 26, 2006. Some factors, which include, but are not limited to, the risks and uncertainty associated with the worldwide economy, competitive activity and fluctuation in currency exchange and interest rates, could cause actual results to differ materially from expectations.

# ◆ Targets for Increasing Corporate Value by FY2010



## Kao's Growth Strategy

1. Accelerate growth in the business areas of **Beauty Care** and Health Care
2. Further strengthen and develop Fabric and Home Care, a core business
3. Further enhance the Chemical Products business globally and locally with distinctive products that meet customer needs



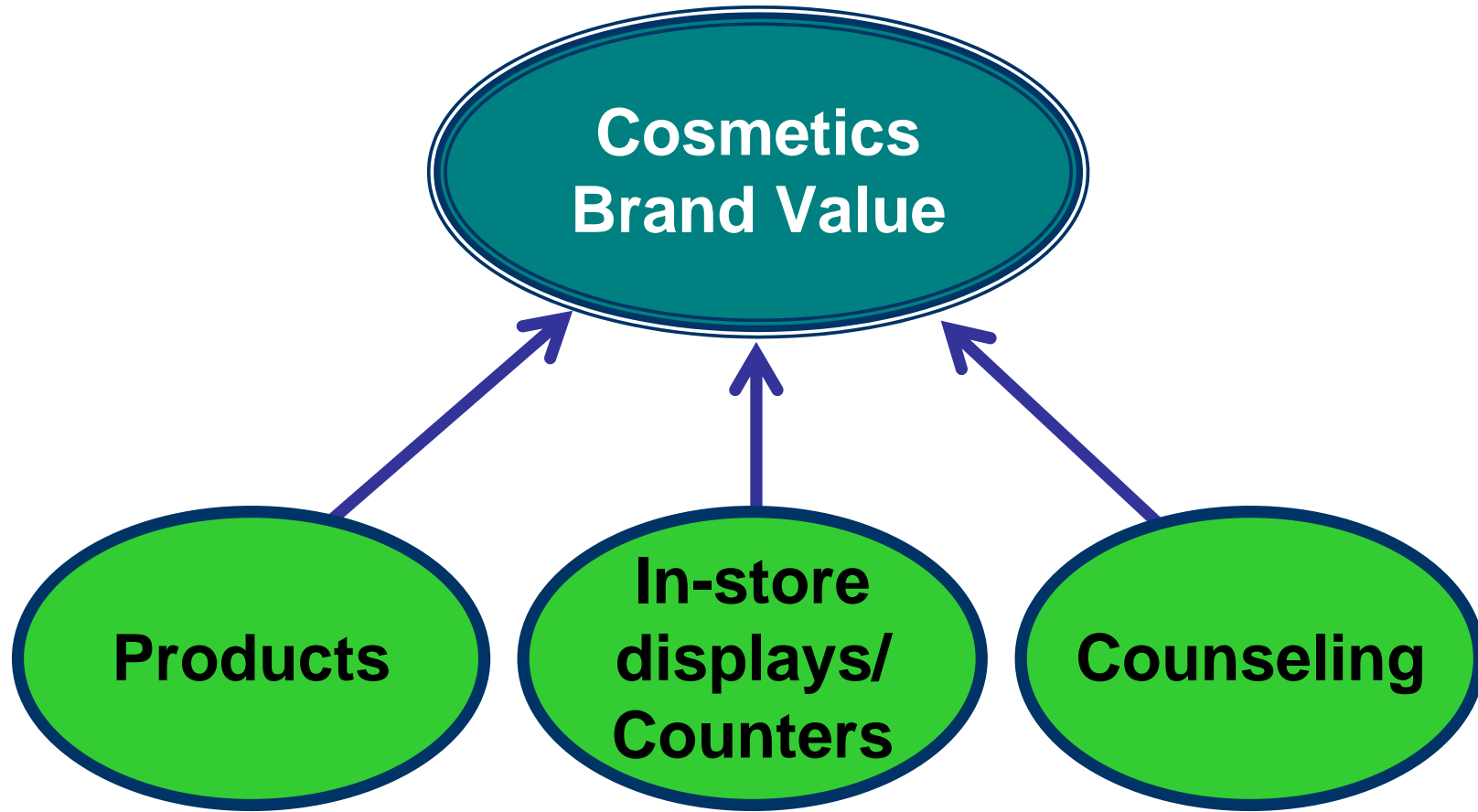
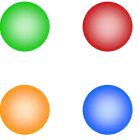
## Accelerate Consolidated Growth

- **Net Sales:**  
¥1.4-¥1.5 trillion  
in FY2010
- **Free Cash Flow:**  
Increase by ¥20 billion or  
more
- **Net Income per Share:**  
From ¥130 in FY2005 to  
¥170-¥190 in FY2010

## Uses of increased free cash flow:

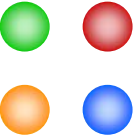
- ◆ Invest for growth
- ◆ Repay interest-bearing debt
- ◆ Maintain payout ratio around 40%
- ◆ Use surplus funds to repurchase stock

# ◆ Characteristics of the Cosmetics Business



**Use the features of each brand to raise value**

# ◆ Business Outline of Kanebo Cosmetics



## Corporate Value

- Valuation: ¥410 billion
- Expected tax effect: ¥100 billion

## Business Overview (FY2006 estimate\*)

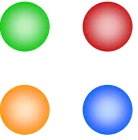
- Net sales: ¥200 billion (approx.)  
Real growth of 1-2% year-on-year
- Operating margin before amortization: 10% (approx.)

*\*Figures represent the 11 months from February through December 2006, which are included in Kao's consolidated results.*



**The acquisition of Kanebo Cosmetics will accelerate the Beauty Care business, a growth driver for Kao**

# ◆ Cosmetics Market in Japan



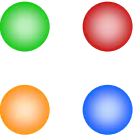
## Market Size and Trends (FY2005)














- Annual Growth Rate: 1.4% (SLI retail basis)
- Market Size: ¥1.5 trillion  
(Preliminary Report on Chemical Industry,  
Ministry of Economy, Trade and Industry)
- Product Trend: Growth of products priced ¥5,000+
- Channel Trend: Increase in sales at mass retailers,  
centered on drugstores



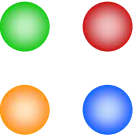
**Growth expected from new, higher-value-added offerings that make the most of brand features**




# ◆ Channel/Brand Structure of the Cosmetics Business in Japan



		Department Stores	Drugstores/ GMS	Specialty Stores
Counseling	High prestige	   		  
	Prestige		 	 
Self-selection	Mass market			

# ◆ Overseas Cosmetics Business Development



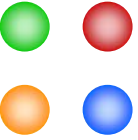
	Asia	North America/Europe
<b>Kao Sofina</b> 	Sold in department stores in Hong Kong, Taiwan, Shanghai	
<b>Kanebo</b> 	Sold in 11 countries/areas in Asia	Centered on prestige brand <i>Sensai</i>
<b>Molton Brown</b> 		Sold in the U.K. and over 70 countries/areas worldwide



**About 10% of cosmetics business net sales**



# ◆ Measures to Increase Brand Value in the Cosmetics Business



Income growth and intensive investment for further growth

Increase brand value

Sales expansion

## Enhance product strength

- Maximize mutual use of product development capabilities of Kao and Kanebo Cosmetics

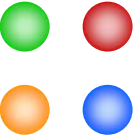
## Enhance product lineup suitable for each channel and in-store displays and counseling

- Deploy Kao Group's total capabilities to strengthen presence in each channel

## Strengthen/expand overseas business

- Brand strategy with focus on priority regions:  
Expand business in China → Aim for net sales over ¥20 billion in FY2010
- Collaboration with Molton Brown

# ◆ Sales Targets of the Cosmetics Business



**Expand sales by generating synergy**

**“Over ¥10 billion” Brands: 8 → Double**

**FY2001 to FY2005**

**Sales growth rate**

**1-2%/year**

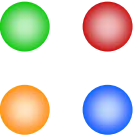


**FY2006 to FY2010**

**Accelerated  
sales growth**

**4-6%/year**

# ◆ Cost Synergy in the Cosmetics Business



## Generating synergy in the supply chain

- Increase efficiency by promoting work process integration and allocation of roles, while placing importance on relationships with stakeholders

- Shared use of Infrastructure  
- Active use of retained seeds  
- Shared research and survey data

- Joint procurement of raw and packaging materials  
- Mutual use of production facilities

- Optimized media buying

- Joint delivery  
- Optimized distribution bases

Cumulative cost synergy (to FY2010)  
¥10-¥15 billion

Income Growth

R&D

Production/  
Procurement

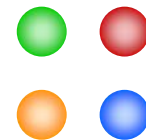
Marketing

Logistics

Sales

Service

# ◆ Cosmetics Business Sales and Income Targets



**Expand sales by generating synergy**

Annual Sales  
Growth Rate

**FY2006 to FY2010  
4-6%/year**

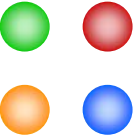
**Achieve income growth rate exceeding sales growth rate**

Annual Operating  
Income Growth Rate

**FY2006 to FY2010  
8-10%/year**

Note: Operating income excluding amortization expenses from the acquisition of Kanebo Cosmetics

# ◆ Increased Free Cash Flow from Acquisition of Kanebo Cosmetics



## Main Increases/Decreases in Net Cash (FY2006 estimate)

Change (¥ billion)

➤ Operating income before taxes: (Kanebo Cosmetics operating income - Amortization)	<b>-5.0</b>
➤ Amortization of trademarks and other intellectual property rights: (with tax effect)	<b>17.0</b>
➤ Tax effect of amortization of intellectual property : (decrease in income taxes paid) (Effective tax rate: 40.54%)	<b>6.9</b>
➤ Amortization of goodwill (without tax effect) :	<b>10.0</b>
➤ Changes in working capital, capital expenditures, etc.	⋮

**Increase in free cash flow: Over ¥20 billion**

**Investment for further growth**