

Highlights for the 1st Half of FY2008

October 27, 2008

Kao Corporation

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<http://www.kao.co.jp/en/ir/analystmtg/index.html>

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Note: The yen amounts in these presentation materials are rounded down. Increase/decrease in yen amounts and percentage change are for reference only because quarterly accounting standards, as defined and published by the Accounting Standards Board of Japan, have been applied for the first time from the current fiscal year.

Agenda

■ ■ **Summary of the 1st Half of FY2008**

■ ■ **Topics by Business Segment**

■ ■ **FY2008 Forecast**

Summary of the 1st Half of FY2008

Key Points in the 1st Half of FY2008

Business environment

1. Both the household and personal care products and cosmetics markets in Japan were flat, although consumer sentiment has been cooling.
2. Consumer purchase prices of 15 major household and personal care products in Japan remained unchanged.
3. Market prices of raw materials decreased from their April-June 2008 peak, but were still higher than the same period a year earlier.

Highlights of business results

- | | | |
|----|--|-------------------------------------|
| 1. | Net sales: | 657.9 billion yen (+0.5%) |
| | - Currency translation impact: | -14.0 billion yen (-2.2%) |
| | - Like-for-like sales growth: | +17.5 billion yen (+2.7%) |
| 2. | Changes in net sales by business segment (compared with same period a year earlier): | |
| | - Increase: Consumer Products – Asia and Oceania, Chemical | |
| | - Decrease: Consumer Products – North America and Europe | |
| 3. | Contribution of new products in Consumer Products* in Japan: | 9% |
| 4. | Impact of higher raw material prices on COGS**: | -21.0 billion yen |
| 5. | Impact of price adjustments on profit: | +15.0 billion yen |
| 6. | Total Cost Reduction (TCR) activities: | +4.0 billion yen |
| 7. | Operating income: | 54.7 billion yen (-0.8 billion yen) |

* Excludes prestige cosmetics.

** Includes currency translation impact.

Financial Overview of the 1st Half of FY2008

- *We achieved net sales and profits generally in line with our forecast*, driven by high-value-added products, improved efficiency of marketing expenditures and reinforced integration of business operations in Asia, including Japan, despite higher raw material prices than our forecast and an economic slowdown.*


		<u>% of sales</u>	<u>Year-on-year</u>
Net sales:	¥657.9 billion		+0.5%
EBITA**:	¥73.7 billion	11.2%	-3.3%
Operating income:	¥54.7 billion	8.3%	-1.5%
Ordinary income:	¥54.9 billion	8.4%	-0.1%
Net income:	¥32.3 billion	4.9%	+10.5%
EBITDA:	¥98.0 billion	14.9%	-2.9%
Net income per share:	¥60.42		+12.4%
Retirement of treasury stock: 9.3 million shares			

* Forecast for the 1st half of FY2008 announced on April 23, 2008: Net sales = ¥660 billion, operating income = ¥54 billion, ordinary income = ¥53 billion, net income = ¥31 billion.

** Operating income before amortization of goodwill and intellectual property rights related to M&A



Overview by Business Segment of the 1st Half of FY2008

		Billion yen	Increase (Decrease)*			Billion yen	Increase (Decrease)*	
Beauty Care	Net sales	300.1	(3.7%)		Prestige Cosmetics	Net sales	146.8	(4.7%)
	Operating income	9.4	(0.5)			Operating income	(8.6)	(1.8)
Human Health Care	Net sales	97.6	+3.1%		Beauty Care excluding Prestige Cosmetics	Net sales	153.2	(2.7%)
	Operating income	7.0	+0.4			Operating income	18.1	+1.2
Fabric and Home Care	Net sales	138.9	+0.9%					
	Operating income	26.2	(3.6)					
Chemical	Net sales	140.9	+11.4%					
	Operating income	11.9	+3.0					
Consolidated	Net sales	657.9	+0.5%					
	Operating income	54.7	(0.8)					

* Increase (decrease) in percent for net sales and billion yen for operating income

Mid-term Growth Strategies

Profitable growth driven by high-value-added products

- Accelerate growth in the Beauty Care and Human Health Care* businesses.**
- Further strengthen and develop Fabric and Home Care, a core business.**
- Further enhance the Chemical business globally and locally with distinctive products that meet customer needs.**

*The scope of “Human Health Care” does not include pharmaceuticals.

Beauty Care Business

Proposals for total beauty

1H/FY2008 Topics

- Prestige cosmetics sales decreased from the same period a year earlier. Sales in Japan decreased due to the impact of the sluggish mid-priced cosmetics market, despite the introduction of new products.
- Premium skin care sales continued to increase as new products of the *Bioré* facial care and *Bioré U* body cleanser brands contributed as growth drivers.
- Premium hair care sales were flat, but almost in line with Kao's plan. Kao strengthened its number-one position* in the shampoo/conditioner market in Japan.
- In Asia, existing pan-Asian brands performed well. For example, Kao strengthened the *Bioré* brand by enhancing and improving the facial care lineup. Sales in North America and Europe were affected by cooling consumer sentiment and severe competition.

2H/FY2008 Topics

- In prestige cosmetics, Kao will nurture new brands and strengthen existing focal brands of Kanebo Cosmetics and Kao Sofina.
- In premium skin care and premium hair care, Kao will expand its product lineup by launching new products.
- In beauty care in North America and Europe, Kao will reinforce existing brands such as *John Frieda* and *KMS* premium hair care.

New products



SOFINA beauté skin care (left),
BLANCHIR SUPERIOR
whitening skin care (right)



Essential Damage Care hair
care series (left), *Bioré U*
body cleanser (right)



*Bioré Deep Moisturizing
Cotton Lotion* (left), *Bioré
Deep Free* facial foams sold
in China (right)



Blauné hair color foam (left),
SOFINA Primavista base
makeup (right)

* Source: SRI POS data

Beauty Care Business: Prestige Cosmetics

1H/FY2008 Topics

- The prestige cosmetics market in Japan was flat compared with the same period a year earlier. The mid-priced cosmetics market ranging between ¥2,000 and ¥5,000 was sluggish, while low- and high-priced cosmetics market grew.
- Kanebo Cosmetics sales: slightly below ¥110.0 billion (-2%*), operating margin**: 6%+
In Japan, Kanebo Cosmetics nurtured and strengthened new brands, while reinforcing focal brands in both the counseling and self-selection categories with brand formation by distribution channel and targeted age group. Sales outside Japan showed healthy growth driven by China.
- Kao Sofina started its second stage of brand revitalization following *SOFINA beauté* with the launch of *SOFINA Primavista* base makeup in September.

2H/FY2008 Topics

- In Japan, Kanebo Cosmetics will nurture brands by proactively enhancing its product line and selectively investing in its three focal counseling brands, *COFFRET D'OR*, *DEW SUPERIOR* and *BLANCHIR SUPERIOR*, and exclusive specialty store brands such as *TWANY* and *Lissage*.
In China, it will prioritize increasing sales per shop over increasing the number of outlets.
In North America and Europe, it will expand sales by strengthening the prestige brand *SENSAI*.
- Kao Sofina will launch totally renewed *AUBE couture* makeup in December to follow the revitalization of skin care and base makeup.
- Cost synergy: In addition to continuing joint media buying from the previous fiscal year, prestige cosmetics will streamline distribution for greater savings synergy according to plan.

* Growth rate for reference: Comparison with sales in Japan for Apr.-Sept. 2007 and outside Japan for Jan.-June 2007

** Operating margin before deduction of royalties

New products



BLANCHIR SUPERIOR whitening skin care (left),
COFFRET D'OR makeup (right)



EVITA (left) and *Impress IC* whitening skin care (right)



SOFINA beauté skin care (left),
SOFINA Primavista base makeup (right)



DEW SUPERIOR base makeup (left),
AUBE couture makeup (right)

Human Health Care Business

Develop and launch daily health care products.

1H/FY2008 Topics

- In food & beverages, strengthened initiatives against metabolic syndrome showed signs of easing the sales decline of *Healthya* functional drinks, while sales of the *Econa Healthy Cooking Oil* series maintained the level of the same period a year earlier.
- Kao carried out price adjustments in tandem with an improvement of *Merries* baby diapers. Sales continued to expand as consumers recognized the brand's value due to a major improvement in breathability.
- *Laurier Super Guard* sanitary napkins performed well in Japan, while *Laurier* brand sanitary napkins drove sales growth in China.
- Sales of personal health products increased with the contribution of *Success* men's products, primarily in the hair care category.
- Kao acquired Healthcare Committee Inc. in order to strengthen health-solution services.

2H/FY2008 Topics

- Expand sales of *Econa* healthy cooking oils and *Healthya* functional drinks by continuing to add loyal users through the activities linked to the mandatory special health examinations and specified health guidance.
- Further enhance the *Laurier* sanitary napkin brand with the introduction of new and improved *Laurier F* products that alleviate skin stress and offer peace of mind.
- Launch improved *Megurism* blood circulation enhancement products.

New products



Healthya Water Acerola Flavor sports drink



Merries baby diapers



Laurier brand sanitary napkins: *Super Slim Guard* in China (left) and *Laurier Super Guard* (right)



Laurier F sanitary napkins



Megurism blood circulation enhancement products



Fabric and Home Care Business

Proposals to offer pleasure and comfort for household chores

1H/FY2008 Topics

- Fabric care sales in Japan were flat compared with the same period a year earlier amid fierce competition and a shrinking gift market. *Attack* laundry detergent performed well even after a price adjustment that reduced product volume per package concurrently with an improvement of its cleaning power.
- In China, Kao increased *Attack* sales by further strengthening its sales system and expanding its business area. *Attack Easy* laundry detergent performed well in Indonesia following its success in Thailand.

2H/FY2008 Topics

- In laundry detergents in Japan, Kao followed its improvement of *Attack* by improving *New Beads* and adjusting its product volume in September.
- In Asia and Oceania, Kao will continue to work to increase sales by further enhancing the *Attack* brand product lineup with variants for hand laundering, with softener and suitable for multi-color clothes.
- In home care, Kao will revitalize home cleaners by launching new products under the *Magiclean* brand to further enhance its mega brand status.

New products



Attack laundry detergent (left), *Wide Haiter EX* Power bleach (right)



Attack Easy laundry detergent in Indonesia



Resesh fabric and air fresheners



New Beads laundry detergent (left), *Glass Magiclean* cleaner (right)



Chemical Business

Further enhance the Chemical business globally and locally with distinctive products that meet customer needs.

1H/FY2008 Topics

- Sales volume increased driven by fatty alcohols in Asia, where the economy is expanding. Kao carried out price adjustments for chemical products globally in response to a hike in raw material prices.
- In Japan, Kao further promoted high-value-added products and carried out sales expansion initiatives for polishing agents for hard disks and other specialty chemicals.
- In North America and Europe, Kao concentrated on high-value-added products such as toner binder for copiers and printers.

2H/FY2008 Topics

- Kao will continue to focus on high-value-added specialty chemicals including color toner and toner binder for copiers and printers.
- In performance chemicals, Kao will promote product development of environment-conscious polylactide resin and other products in response to increasing environmental needs from customers.
- Kao has expanded manufacturing facilities for tertiary amines in the Philippines to respond to rising demand.



Fatty alcohols



Polishing agents for hard disks



Color toner for copiers and printers



Tertiary amines



Use of Increased Free Cash Flow*

Use annual free cash flow of approximately ¥100 billion effectively from an EVA standpoint toward further growth.

1. Capital expenditures and M&A for future growth

2. Steady and continuous cash dividends, aiming for a consolidated payout ratio at the 40% level

*FY2008
forecast*



- *Cash dividends per share: ¥56*
- *19th consecutive year of increase in cash dividends (planned)*
- *Payout ratio: 43.5%*

3. Share repurchases and repayment of interest-bearing debt including borrowings

1H/FY2008



- *Repayment of long-term debt: ¥22.0 billion*

*Free cash flow = Net cash provided by operating activities + Net cash used in investing activities

FY2008 Forecast

Major Assumptions for FY2008 Forecast

1. Business environment:

- In Japan, the household and personal care products and cosmetics markets will remain flat.
- Consumer purchase prices of 15 major household and personal care products* in Japan will remain flat.

2. Net sales:	1,330.0 billion yen	(+0.9%)
- Currency translation impact:	-26.0 billion yen	(-1.9%)
- Like-for-like sales growth:	+37.5 billion yen	(+2.8%)
3. Impact of higher raw material prices on COGS**:	-36.0 billion yen	
4. Impact of price adjustments on profit:	+22.0 billion yen	(approx.)
5. Total Cost Reduction (TCR) activities:	+8.0 billion yen	

* Excludes prestige cosmetics.

** Includes currency translation impact.



FY2008 Forecast

Aim to achieve profitable growth with high-value-added products amid greater uncertainty in the global economic outlook and raw material price trends.

		<u>% of sales</u>	<u>Year-on-year</u>
Net sales:	¥1,330.0 billion		+0.9%
EBITA*:	¥155.0 billion	11.7%	-1.6%
Operating income:	¥117.0 billion	8.8%	+0.6%
Ordinary income:	¥115.0 billion	8.6%	+0.7%
Net income:	¥69.0 billion	5.2%	+3.7%
EBITDA:	¥205.0 billion	15.4%	-2.2%
ROE:	11.8%		+10 bps
Net income per share:	¥128.73		+5.1%
Cash dividends per share:	¥56		+¥2
Payout ratio:	43.5%		

* Operating income before amortization of goodwill and intellectual rights related to M&A



Appendices

Business Segments and Main Product Categories

Consumer Products
Business

Beauty Care

1H/FY2008 sales: ¥300.1 billion

[-3.7% year-on-year / Share of net sales: 45.7%]

Beauty salon products
Prestige cosmetics
Premium skin care
Premium hair care



Consumer
driven

Human Health Care

1H/FY2008 sales: ¥97.6 billion

[+3.1% year-on-year / Share of net sales: 14.8%]

Functional food and beverages
Oral care
Blood circulation enhancement products
(incl. bath additives and thermal pads)
Sanitary products



Consumer Products
Business

Consumer Products
Business

Fabric and Home Care

1H/FY2008 sales: ¥138.9 billion

[+0.9% year-on-year / Share of net sales: 21.1%]

Laundry detergents and fabric treatments
Products for kitchen, bath, toilet and
living room care



Chemical

1H/ FY2008 sales: ¥140.9 billion

[+11.4% year-on-year / Share of net sales: 18.4%]

Oleo chemicals
Performance chemicals
Specialty chemicals



Chemical Business

* Sales include intersegment sales. Share of net sales is calculated based on sales to customers.



Kao's Cosmetics Mega Brands

Cosmetics Mega Brands
(annual sales
more than 10 billion yen)
in FY2007



REVUE



BLANCHIR



TWANY



FINE-FIT



KATE



SALA



EVITA



MOLTON BROWN
LONDON



LISSAGE



R M K



SENSAI



