Continuous Profitable Growth for Greater Corporate Value

Kao Corporation

Annual Report 2000

For the year ended March 31, 2000

Profile

Kao Corporation has served the needs of consumers for more than a century. Kao is one of the leading companies in Japan for personal care products, cosmetics, laundry and cleaning products, hygiene products, and bath additives.

The Company has also earned a reputation as a quality manufacturer of chemical products. Committed to a global approach to business, Kao has operations in 26 countries in Asia, North America, Europe and other parts of the world.

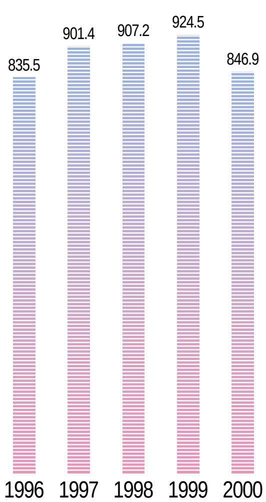
Contents

Financial Highlights

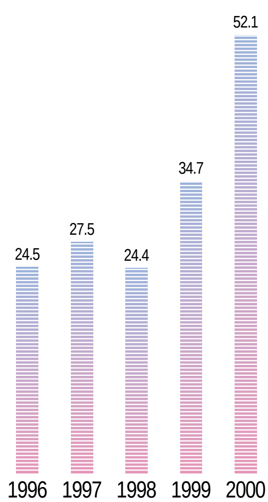
Kao Corporation and Consolidated Subsidiaries					Years ended March 31, 2000, 1999 and 1998
	Billions of yen			Millions of U.S. dollars	Change
	2000	1999	1998	**2000**	**2000**/1999
For the year:					
Net sales	**¥846.9**	¥924.5	¥907.2	**$7,978.5**	(8.4)%
Consumer Products	**632.4**	656.1	—	**5,957.8**	(3.6)
Cosmetics *Sofina*	**70.8**	74.4	—	**667.8**	(4.8)
Subtotal	**703.3**	730.6	696.8	**6,625.6**	(3.7)
Chemical Products	**143.6**	193.9	210.4	**1,352.9**	(26.0)
Net income	**52.1**	34.7	24.4	**491.3**	50.2
At year-end:					
Total assets	**¥750.0**	¥751.7	¥778.7	**$7,065.6**	(0.2)%
Total shareholders' equity	**474.9**	451.7	424.4	**4,474.6**	5.1
	Yen			U.S. dollars	Change
Per share:					
Net income	**¥ 83.45**	¥ 55.98	¥ 40.10	**$0.79**	49.1%
Cash dividends	**20.00**	16.00	15.00	**0.19**	25.0
Total shareholders' equity	**765.59**	727.01	684.90	**7.21**	5.3

Notes: 1. The U.S. dollar amounts are translated, for convenience only, at the rate of ¥106.15=US$1, the approximate exchange rate at March 31, 2000.
2. Net income per share is computed based on the weighted average number of shares outstanding during the respective years.
3. Cash dividends per share are the amounts applicable to the respective years, including dividends to be paid after the end of the year.

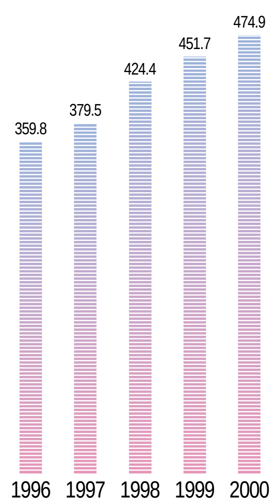
Net Sales
(Billions of yen)



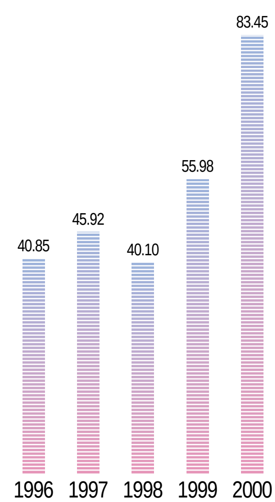
Net Income
(Billions of yen)



Total Shareholders' Equity
(Billions of yen)



Net Income per Share
(Yen)



Message from the President

I am pleased to report that Kao achieved continued excellent earnings growth and record net income in fiscal 1999, the year ended March 31, 2000. We further strengthened the profitability and capital efficiency of our core businesses and operations while initiating a new program to enhance our ability for future growth.

Takuya Goto, President

Kao's focus on improving profitability and capital efficiency resulted in continued earnings growth, with record high net income in fiscal 1999.

The withdrawal from the information technology business and a negative currency translation effect contributed to an 8.4 percent decrease in consolidated net sales to ¥846.9 billion (US$7,978.5 million). Excluding the sales generated by the information technology business in the previous fiscal year, parent company sales rose by 1.9 percent on a year-on-year basis. However, on a local currency basis, sales in both the United States and Asia fell below the levels of the previous year. In Japan, the continuing recession and uncertainties due to corporate restructuring restrained personal consumption, and the consumer products market contracted. Lower sales of cosmetics notwithstanding, Kao successfully maintained its strength in existing markets while introducing new hit products such as *Healthy Econa Cooking Oil*. Moreover, factors contributing to increased sales included exports of household cleaning mop kits and sheets, and the strong performance of our chemical products business. Overseas, Kao faced several challenges, such as a soft market for consumer products in China and lower sales of *bioré pore perfect* at U.S. subsidiary The Andrew Jergens Company as the boom in sales of that product moderated. Sales of the chemical products business, though, remained firm.

Operating income rose to a new record of ¥99.1 billion (US$934.4 million), a gain of 8.2 percent over the previous fiscal year. The operating margin also improved by 1.8 percentage points to 11.7 percent. Major factors supporting this excellent performance were ongoing cost reduction and rationalization, lower raw material prices due to the strong yen, and increased sales of consumer products in Japan.

Consolidated capital expenditures totaled ¥37.5 billion (US$353.9 million), which comprised mainly projects in Japan. Investments included the purchase of additional land adjacent to the Kawasaki Plant to strengthen operations in the Tokyo metropolitan area, and investment in logistics, research and development, and information systems. Overseas, capital investment centered on expanding the production capabilities of affiliated companies, including investment in a laundry detergent production plant in China.

Several initiatives are contributing to a stronger management structure. A management system based on EVA® (Economic Value Added)*, implemented in April 1999, gives Kao a broadly based approach for evaluating and improving operating performance, allocating capital effectively and creating value for stakeholders. Kao also executed a share redemption program totaling ¥29.5 billion (US$277.9 million). Nine Kao sales companies throughout Japan were consolidated to strengthen our organizational efficiency and our ability to serve large retail chains nationwide. Kao also restructured overseas operations to strengthen profitability and efficiency. In the personal care products business in North America and Europe, these moves included revisions to sales and distribution systems and focused evaluation to determine the relative value of outsourcing production and distribution. In the chemical products business, Kao established a regional headquarters, Kao Chemicals Europe, S.L., to unify and strengthen its European operations by consolidating management of operations in Germany, France and Spain. We also carried out an overall reorganization of our U.S. chemical products business.

Consolidated net income increased 50.2 percent to a record ¥52.1 billion (US$491.3 million). This significant

*EVA is a registered trademark of Stern Stewart & Co.

The six focal points of our medium-term management strategies will help us articulate the drivers of long-term growth, thus increasing corporate value.

increase stemmed from the improved operating income, coupled with the absence of ¥23.8 billion in restructuring charges associated with the withdrawal from the information technology business in the previous fiscal year and a decrease in corporate taxes in Japan.

In view of these results, the Company has decided to increase its annual dividend to shareholders by ¥4.00, to ¥20.00 (US$0.19) per share, the seventh consecutive increase in annual cash dividends.

A 3.4 percentage point improvement in return on equity to 11.3 percent underscored the success of Kao's program of using capital more efficiently. As a result of important improvements in our management and financial strength, we now have a solid foundation in place for further long-term profitable growth in fiscal 2000 and thereafter.

Medium-Term Management Strategies

The mission of Kao is to contribute to the wholehearted satisfaction and the enrichment of the lives of its customers throughout the world by providing products of excellent value and outstanding performance from the consumer's point of view. Our aim is to continue to achieve profitable growth in spite of the intensifying global competition, and to be a stronger and superior company. Kao's goal is to ensure that its business activities result in a long-term increase of corporate value. We will focus on the following points to achieve our goal.

Corporate Value

The Company aims to achieve continuous improvement in EVA on a long-term basis, thus increasing corporate value. Beginning in April 1999, Kao implemented an EVA management system to ensure that the Company is truly generating economic value by using its capital more effectively. We believe that an EVA-based approach, supported by an incentive compensation system linked to EVA, will make a significant contribution to enhanced corporate value.

Our Total Cost Reduction (TCR) activities, initiated in 1986, continue to support achievement of our EVA objective. TCR is geared toward creating an innovative corporate culture to improve the way Kao does business and strengthen the Company's earnings capabilities.

As this year's results demonstrate, improved capital efficiency and enhanced cost reductions at Kao have significantly contributed to increased EVA. However, as a matter of course, we also plan to emphasize sales growth for further improvement in EVA.

Change of Management and Governance Structure

Another primary focus is the creation of a superior management structure and decision-making process that can adapt quickly to the accelerating pace of change in our operating environment. Kao plans to foster a more decentralized organization in its Japanese operations with the implementation of an internal company system. This system, however, will be introduced in a careful, step-by-step manner in consideration of maintaining the total strength of the Kao Group.

Moreover, the Company is further strengthening its corporate governance for greater management efficiency and transparency. Measures include the establishment of an Advisory Committee.

Focus on Core Businesses

Our decision to withdraw from the information technology business is the result of our strategic focus on core businesses in which we can excel: consumer products, cosmetics and chemical products. In each of these businesses, Kao's strengths include an ability to discover consumers' needs, superior research and development, a strong sales force and effective profit management. Our approach will entail both strengthening the aforementioned core businesses and utilizing this solid platform to develop new businesses.

Our strategic focus on core businesses will ensure a solid foundation for expansion into new, high-potential areas such as health care and further globalization.

Our technological strengths are particularly pronounced in our core businesses, supporting our ability to provide highly functional, value-added products. We intend to build on these competitive advantages by further strengthening brand equities in the consumer products and cosmetics businesses.

Health care, including functional food products, over-the-counter drugs and nursing-care products, is a new area in which Kao is positioned to develop and excel. A representative success in this market is the highly functional product *Healthy Econa Cooking Oil*, which helps prevent fat deposits. We see excellent potential in the field of functional, healthy food products.

Continued Globalization

Overseas, Kao is emphasizing Asia in its consumer products business, and China in particular. In North America, Kao is strengthening its participation in the personal care market, while in Europe, hair care will remain a primary focus. The chemical products business operates in an increasingly borderless environment, and Kao is further globalizing its ability to provide products such as fatty alcohols, surfactants, aroma chemicals and copier and printer toner and related products.

Human Resource Value

Employees are important corporate assets. Kao strives to create a working environment in which employees have opportunities to develop their potential and excel, enjoy forthright, open-minded exchanges of opinions, and encourage each other's improvement. At the same time, the Company is implementing an improved salary and compensation system that rewards employees fairly based on their individual capabilities and performance. The Company also adopted an incentive bonus system based on improvement in EVA for its executives and employees in Japan. These personnel management measures, together with various training programs, will contribute to increasing the value of Kao's human resources.

Commitment to Society and the Environment

Kao remains committed to earning the trust of all its stakeholders. We consistently work to make management transparent by improving disclosure to stakeholders, and to comply with our basic principles for corporate activities and code of business ethics. We also consider environmental protection to be one of our most important tasks and will endeavor to further improve our environmental management.

Before closing my message, I would like to give special thanks to the five representative directors who retired today: Chairman Fumikatsu Tokiwa, Executive Vice President Shotaro Watanabe, Executive Vice President Kazuya Inbe, Senior Managing Director Michinori Mochizuki and Senior Managing Director Sumiaki Sasaki. They have made a remarkable contribution to driving Kao's continuous profitable growth over the past years and establishing the foundation for the Company's future. Dr. Tokiwa and Mr. Watanabe become members of the Advisory Committee and will provide advice to the management.

I would like to thank our shareholders, customers and associates for their past trust and ask for their continued support. I assure you we will continue working to earn it.

June 29, 2000

Takuya Goto
President

Continuous Profitable Growth for Greater Corporate Value

At **Kao**, we believe that long-term growth in **corporate value** is the key to satisfying shareholders, consumers, employees and other stakeholders. Consequently, Kao aims for **continuous profitable growth** by improving its **core businesses** and using them as a platform for entering **high-potential new fields**. The Company is developing and **strengthening its global operations** and new businesses as future profit bases with potential for growth. At the same time, the Company is striving to maximize effectiveness of **the new EVA-based management system** implemented in April 1999. These measures are helping Kao improve EVA and raise corporate value.

Generating Value by Reinforcing Core Businesses and Nurturing New Businesses

Kao concentrates resources on its core competencies in consumer products, cosmetics and chemical products, both to strengthen existing businesses and to expand into new and complementary ones. One of the new areas in which Kao is positioned to develop and excel is health care, including functional food products, over-the-counter drugs and nursing-care products. In response to the aging society and increased interest in maintaining good health, Kao aims to build health care into a new core business that is expected to make the best use of its accumulated R&D expertise and ability to discover consumer needs.

Development of New Markets

The ability to grasp consumer needs and deploy technological capabilities to develop new market-making products is a core strength and fundamental strategy for Kao. Research and development aimed at continuously improving existing products as well as creating new ones allows Kao to build further on this strength.

Expansion Based on Brand Equity

Introducing innovative, value-added products based on new concepts that win consumer acceptance is key to Kao's continued growth. Furthermore, unique methods of communicating the special characteristics of Kao products to consumers foster brand loyalty. Kao does its utmost in these areas to nurture brands that can generate long-term profits even amid intense competition.

Strategic Alliances

An increasingly competitive business environment demands speedy response. One effective method of raising speed is strategic alliances that make the most of the parties' complementary strengths. To speed its entry into the consumer health care market, Kao has entered into a strategic alliance with Novartis Consumer Health S.A., a unit of global health care leader Novartis AG. A project team has been formed and is making preparations for the scheduled establishment of a joint venture company during fiscal 2000. With this alliance, Kao's strengths in marketing, sales, distribution and product development will complement the Novartis Group's broad product line and technological strengths in consumer health care.

Development of New Markets

Next-Generation *Healthy Econa Cooking Oil* Creates a New Market Category

The introduction of the *Econa Cooking Oil* line in 1990 created a new category in the cooking oil market. Having discovered the functions of a previously existing substance called diacylglycerol, Kao researchers became the first in the world to develop technology to extract it in a highly pure form and began mass production as the main ingredient of *Healthy Econa Cooking Oil*. Using *Healthy Econa Cooking Oil* in the same fashion as conventional cooking oils reduces neutral fat in the bloodstream and helps prevent fat deposits. Responding to consumer health concerns, the product built a solid market presence in less than a year after its launch in February 1999 and created a new market under the concept of functional oil. Kao has also developed a presence in the processed foods market through mutually beneficial co-branding programs with Snow Brand Milk Products Co., Ltd. and Hagoromo Foods Corporation. Margarine and canned tuna were among the first products launched under this program in spring 2000. The products have "Made with *Healthy Econa Cooking Oil*" displayed on their packages, which will raise awareness of the brand while supporting sales of the products. Moreover, Kao is seeking and reviewing opportunities for possible future sales of diacylglycerol-based oil outside Japan, which are expected to contribute to the expansion of the Company's health care business.

Healthy Econa Cooking Oil

Expansion Based on Brand Equity

Biore: A Growing Global Brand in the Beauty Care Market

Biore brand products are marketed in Japan, Asia, North America and Europe. The *Biore* lineup demonstrates a core Kao strategy: understand consumers, innovate to satisfy them, then relaunch or build entirely new — and highly profitable — brands around winning concepts. Kao is building on the brand equity of *Biore* to create an entire line of facial care, body care and other personal care products based on innovative technologies. One example was the spring 1999 relaunch in Japan of the *Biore Facial Foam* and *Biore Body Care Foam* series with low level acidity to retain the skin's natural moisture, which made a popular brand even more popular. To gain new customers and raise the percentage of repeat customers, Kao works in its marketing to clearly define its health and beauty care brand concept. In Japan, the Company offers retailers new ways of promoting and selling products, such as Kao Beauty Harmony Corners, which are a source of in-store information for consumers.

A Kao Beauty Harmony Corner

Profitable International Growth

In international operations, Kao aims to use its product and technological strengths to contribute to the quality of life worldwide, while supporting profitable growth. Primary approaches for achieving profitable growth include further strengthening of management structure and market penetration in Asia, unified global brand strategies, strategic alliances and a focus on areas in which Kao can excel.

Consumer Products in Asia: Emphasize Growth Markets and Product Segments

Nearly one-third of the world's population lives in China and Southeast Asia. Competition is intense in these high-growth markets, and Kao is placing priority on nurturing core brands that build a solid presence for household, personal care and hygiene products in Southeast Asia, as well as achieving market penetration in China. A shift from management by country to management by region, such as ASEAN or China, is aimed at strengthening Kao's management structure and speeding the pace of development.

Consumer Products in North America and Europe: Concentrate on High-Potential Markets

Kao's primary strategy in North America and Europe is to concentrate on areas where it can display its superiority, with a focus on personal care, and then steadily build broadly based brands that augment its market position. A key issue in Europe is optimizing synergy with R&D that spans the entire hair care market from professional salon products to mass-market products. Strategic alliances speed Kao's market penetration for value-added products with unique characteristics in areas such as household cleaning products.

Chemical Products: Global Development of Distinctive Products

The increasingly borderless market for chemical products makes it necessary for Kao to develop effective global operations. While bolstering its management structure, Kao will promote cooperation among Group companies to carry out more effective R&D, production and marketing that respond speedily to market needs.

Consumer Products in Asia: Emphasize Growth Markets and Product Segments

Nurturing Core Brands and Expanding in China

In Asia, Kao is focusing on developing the strength of core brands. *Attack* is the top brand among compact-type detergents in Asian markets, and in May 1999 local subsidiary Kao Corporation Shanghai began production and marketing of *Attack* in China. The Chinese laundry detergent market, currently estimated at one million tons in the rapidly developing coastal regions, offers immense potential for expansion as washing machine usage increases. The Company is also leveraging the status of *Biore* facial cleanser as a leading brand throughout Southeast Asia to build it into a total skin care line. The successful introductions of the *Lavenus* brand in Thailand and Hong Kong in 1998 and Taiwan in 1999 are the first stages of a regional rollout of *Lavenus* as a total hair cosmetics line. Furthermore, consumers in ASEAN countries have responded to the superior performance of the *Laurier* brand of sanitary napkins by making it the number one brand by an overwhelming lead.

Attack laundry detergent

Consumer Products in North America and Europe: Concentrate on High-Potential Markets

Strategic Acquisitions and Alliances Strengthen Operations

The Andrew Jergens Company has strengthened its skin care operations and expanded on its existing hand and body lotion business with the newly added *bioré* facial care brand, which makes use of Kao's superior capabilities in product development and determining consumer needs. The success of *bioré pore perfect* was the driving force in establishing market presence for the *bioré* line. Today, *bioré* has earned a solid position in the facial cleanser market, and the expansion of the line is raising its presence in the facial care market. In addition to strengthening its operations with unique, innovative brands, Kao uses effective brand acquisitions as a springboard for further growth. Acquisition of the *Curél* brand added a premium skin lotion to Kao's portfolio that is generating solid results in the high-growth North American market and has supported the launch of a new product series for sensitive skin in Japan.

Introduced in 1994, household cleaning mop kits and sheets have become major hit products in Japan under Kao's brand name *Quickle Wiper*. As one method of ensuring a speedy global rollout, Kao supplies them to S.C. Johnson & Son, Inc., a solution that makes the most of both Kao's ability to develop unique, innovative products and S.C. Johnson's marketing capabilities and sales channels.

In Europe, Goldwell GmbH and Guhl Ikebana GmbH operate in the salon and mass markets, respectively. Maximizing the use of Kao's technology is key to developing operations in the hair care market. This includes making the best use of Goldwell's expertise in salon hair care products, offering tips to consumers on how to use Guhl's hair coloring and other products to best effect, and improving the products themselves.

bioré products

Chemical Products: Global Development of Distinctive Products

World-Class Fatty Chemicals and Unique Specialty Chemicals

With production bases in Malaysia and the Philippines, Kao's high-quality fatty alcohol business is world-class in terms of both volume and product quality. Scrap and build activities under way at the Philippines plant are aimed at further improving product quality. Scheduled to start production in the first half of 2001, the new facilities will be exclusively devoted to high-value-added products. This shift will support product competitiveness and the development of applications in the field of toiletries such as shampoos, and will further drive exports.

In specialty chemicals, a shift from commodities to technologically unique products is gaining pace. Technologies of aroma chemicals developed in Japan are utilized at Spanish subsidiary Kao Corporation S.A. to build successful operations in the European market. The Company is active in promoting global cooperation among Group companies in several specialty chemical segments.

A More Efficient Management System

In April 1999, Kao introduced the EVA-based management system to improve efficiency, speed up decision-making, and spell out its goal of management from the viewpoint of shareholders. With this new system, the Company aims for improved profitability and capital efficiency. In addition, various initiatives are geared toward enhancing the effectiveness of the Board of Directors in view of corporate governance.

Raising Consciousness of Efficiency in Management

Through its TCR activities, Kao is reviewing its operations and working to improve their quality throughout the entire company. However, efforts to improve profitability do not concentrate exclusively on widespread cost reductions, as evidenced by Kao's successful development of innovative manufacturing processes and products.

In April 1999, Kao implemented EVA as its main management measure to align the interests of managers and owners, with the aim of raising EVA over the long term. The Company will work to promote its use not only as a standard to evaluate business performance but also as a tool for decision-making in daily operations, including investment decisions. Employee training aims to instill awareness of the cost of capital and the most effective uses of capital. Future plans include accelerated rollout of EVA-based management to overseas operations.

Promoting Awareness of Shareholders' Perspective

The Company emphasizes creating an organization that rewards success and fostering an environment in which employees can develop their skills and deploy them effectively. Introduction of EVA-linked bonuses at the parent company will serve to strengthen employees' motivation to improve EVA and link their interests with those of shareholders. These measures are supported by a heightened emphasis on employee training.

Change of Management and Governance Structure

A dramatically changing management environment requires speedy decision-making. As one initiative aimed at enhancing the effectiveness of the Board of Directors and promoting faster decision-making, Kao decreased the number of the Board of Directors from 22 to 18. Five representative directors and three directors retired and four directors were newly appointed.

Furthermore, the establishment of an Advisory Committee is aimed at reinforcing corporate governance and enhancing the effectiveness of the Board of Directors.

Raising Consciousness of Efficiency in Management

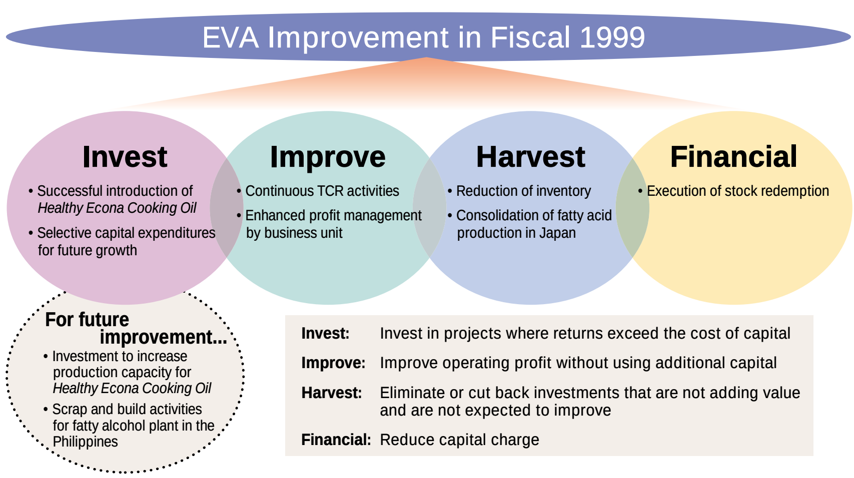
Improving Asset Efficiency and Making More Effective Use of Free Cash Flow

The implementation of EVA-based management and ongoing TCR activities have resulted in significant gains in profitability and asset efficiency. At the same time, policies to reduce fixed assets by consolidating facilities, such as making the Kyushu Plant a distribution center, and to cut working capital through methods such as widespread inventory reductions have expanded free cash flow. In using this free cash flow, Kao places priority on investment in business development and strategic M&A activities, with the aim of raising corporate value. To improve returns to shareholders, Kao redeemed 10 million common shares of its stock at a cost of ¥29.5 billion in fiscal 1999. The Company will decide on conducting future share redemptions based on consideration of its investment plans and long-term profits for shareholders.

Promoting Awareness of Shareholders' Perspective

Motivating Employees to Improve EVA

An increase in EVA in the long term raises Kao's corporate value. The Company has therefore introduced an incentive bonus system based on EVA for its executives and employees in Japan. This system is designed to foster decision-making in daily operations from the standpoint of shareholders by rewarding Kao's people in proportion to the corporate value increased. At the same time, it helps to promote understanding of the importance of long-term, continuous improvement in EVA. By aligning the interests of Kao's employees with those of shareholders, the system provides motivation to meet Kao's EVA objectives.



Change of Management and Governance Structure

Advisory Committee Supports Transparent Management

Kao is responding to an ever-faster changing management environment with the establishment of an Advisory Committee. The Committee will reinforce corporate governance, thus achieving more transparent management. Its members will provide advice and opinions to the management with respect to the effectiveness and functions of the Board of Directors and important management issues as needed.

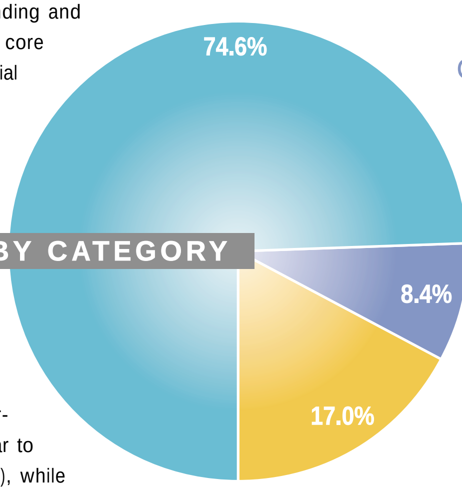
Kao at a Glance

• **Net sales**	**¥846.9 billion**	**(US$7,978.5 million)**	**-8.4% year-on-year**
• **Operating income**	**¥99.1 billion**	**(US$934.4 million)**	**+8.2% year-on-year**
• **Net income**	**¥52.1 billion**	**(US$491.3 million)**	**+50.2% year-on-year**

Consumer Products

Net sales amounted to ¥632.4 billion (US$5,957.8 million), while operating income rose to ¥86.0 billion (US$810.8 million). Sales growth in Japan was offset by a drop in net sales in the United States and the strength of the yen. Combining Consumer Products and Cosmetics *Sofina*, which is shown as a separate segment from this term, net sales declined 3.7 percent year-on-year, although operating income rose 3.0 percent. Basic strategies involve developing new products that fulfill new consumer needs while extending and improving existing lines in Japan; nurturing core brands in Asia; and focusing on high-potential markets such as personal care products in North America and Europe.

SALES BREAKDOWN BY CATEGORY



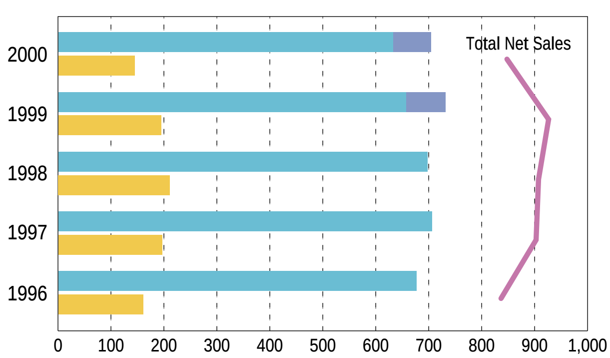
Cosmetics *Sofina*

Net sales were ¥70.8 billion (US$667.8 million) and operating income totaled ¥2.2 billion (US$21.6 million) for this segment, shown separately starting this term. Launches of basic cosmetic lines designed specifically for young skin and mature skin achieved successes in the shrinking prestige cosmetics market.

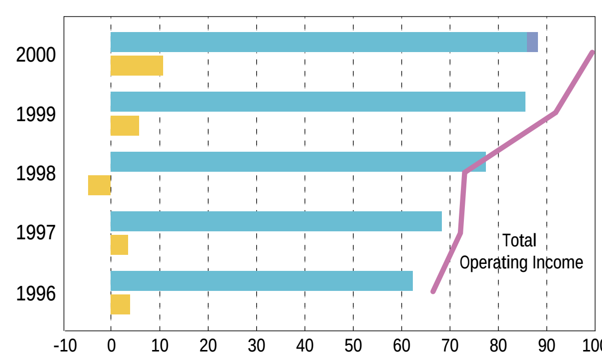
Chemical Products

Net sales decreased by 26.0 percent from the previous fiscal year to ¥143.6 billion ($1,352.9 million), while operating income rose by 84.4 percent to ¥10.8 billion ($101.9 million). Excluding the information technology business, net sales in this segment decreased year-on-year by 1.3 percent, while operating income jumped by 30.7 percent. Overseas operations recorded strong sales growth in local currency terms; however, the persistent strength of the yen caused overall sales in yen terms to decline slightly. Increased sales of copier and printer toner and related products as well as aroma chemicals were among the benefits of Kao's concentration on global development of distinctive products.

NET SALES (Billions of yen)



OPERATING INCOME (Billions of yen)



Consumer Products   Cosmetics *Sofina*   Chemical Products

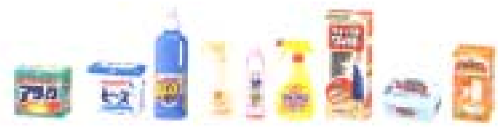
MAJOR PRODUCTS

Personal Care Products in Japan

- Soaps
- Facial cleansers
- Body cleansers
- Skin care
- Men's cosmetics
- Hair enhancer tonics
- Shampoos, conditioners and hair treatment products
- Hair styling agents
- Hair coloring agents
- Bath additives
- Toothpaste
- Toothbrushes

Laundry and Cleaning Products in Japan

- Laundry detergents
- Fabric softeners
- Bleach
- Laundry finisher
- Dishwashing detergents
- Household cleaning detergents
- Paper cleaning products
- Car care products



Hygiene Products in Japan

- Sanitary napkins
- Disposable diapers
- Baby wipes
- Incontinence products
- Hygiene care products

Food Products in Japan

- Cooking oils
- Frying oils
- Packaged cake mixes

Cosmetics *Sofina*

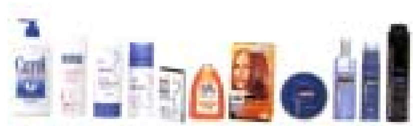
- Facial cleansers
- Basic care
- Special care
- Foundation
- Make-up

Consumer Products in Asia and Oceania

- Soaps
- Facial cleansers
- Body cleansers
- Shampoos, conditioners and hair treatment products
- Hair styling agents
- Laundry detergents
- Fabric softeners
- Bleach
- Dishwashing detergents
- Household cleaning detergents
- Paper cleaning products
- Sanitary napkins
- Disposable diapers
- Toothpaste
- Toothbrushes

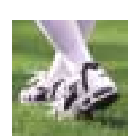
Personal Care Products in North America and Europe

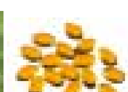
- Shampoos, conditioners and hair treatment products
- Hair coloring agents
- Hair styling agents
- Skin care (for beauty salons)
- Soaps
- Lotions
- Body cleansers
- Facial care



Chemical Products

- Fatty acids
- Fatty alcohols
- Fatty amines
- Glycerin
- Edible oils
- Concrete additives
- Asphalt emulsifiers
- De-inking agents
- Fragrances
- Agrochemical additives
- Disinfectant cleaners
- Water treatment chemicals
- Cleaners for electronic parts
- Plastics additives
- Rubber processing agents
- Copier and printer toner and related products
- Polyurethane for shoe soles





Personal Care Products in Japan

Focal Points

- Use technological expertise to develop value-added products that offer consumers new and more effective applications.
- Focus on building a powerful portfolio of market leading brands while reducing production costs.
- Target and promote effectively to expand market share.

Operating Environment and Performance

The overall Japanese personal care market contracted slightly. Sales volume increased somewhat, but unit sales prices continued to fall. Diversifying needs and greater individuation among consumers have increased market segmentation, so achieving a dominant market share for a single product has become increasingly difficult. Moreover, foreign companies have been introducing their global brands in Japan, making the market increasingly competitive.

Sales of personal care products totaled ¥175.2 billion, down 2.2 percent from the previous fiscal year. However, operating income increased as a result of product mix improvements to emphasize higher-margin products, enhanced TCR activities and efforts to minimize obsolescence at the relaunch of improved products. Stock keeping unit (SKU) rationalization also contributed to improved profitability.

Fiscal 1999 Initiatives and Results

Categorizing products as family-use or personal-use has sharpened Kao's focus on needs in clearly defined markets. Direct results of this sharper focus included moves to strengthen the *Biore* line. In the family-use category, *Biore Body Care Foam* was relaunched with a mildly acidic formulation in line with the natural pH of healthy skin in spring 1999 and new body cleanser *Biore Moisture Cream-in* was introduced in fall 1999. These successful products expanded market share strongly. Introductions in the personal-use category included *Biore Powder Sheet* and *Biore Facial Wash Pore Cleansing.* Other favorable domestic launches included *Curél Medicated* as a skin care brand, *Pur* shampoo, conditioner and hair brushes, and *Clear Clean Extra Cool* toothpaste.

Overall, the shampoo and conditioner segment contracted due to the popularity of shorter hairstyles, which decreased demand for products in this segment. However, the success of brands such as *Pur* generated growth. Sales of pouch-type refills were strong, reflecting consumer interest in environmentally-friendly products.

Skin care massage gels such as *Biore Satiny Body Esthetic* and *Biore Satiny Face Esthetic* failed to maintain the momentum created by their initial successes following their launches in 1998. Intensified competition in the men's hair care segment adversely affected sales of the *Success* line.

Fiscal 2000 Issues and Objectives

Various successful product introductions have strengthened Kao's skin care brands, and these products are expected to gain momentum in fiscal 2000. Kao is also moving to strengthen its position in the mass market for hair coloring with a spring 2000 launch of *Blaune Scented Hair Color*.

Solid Performers

Biore Powder Sheet absorbs perspiration and leaves users feeling fresh and comfortable, which helped make it a hit, particularly during the hot, humid summer months. *Biore Facial Wash Pore Cleansing* was also a success, demonstrating our ability to offer consumers new and uniquely functional products.

While the *Biore Pore Pack* boom has subsided somewhat, Kao has continued to support this brand with product development efforts and line extensions. In addition, Kao uses a web site and print media to provide consumers with tips on the most efficient and effective ways to use the products.

Pur – shampoo, conditioner and hair brush – was another success. These products revitalize hair and stimulate healthy hair growth by cleansing hair glands and refreshing the scalp.

Biore Body Care Foam **was relaunched with a mildly acidic washing agent closer to the pH of smooth, healthy skin. It was a major success, with a significant increase in market share.**

Laundry and Cleaning Products in Japan

Focal Points

- Maintain market leadership in many key categories through effective marketing.
- Understand consumer needs to propose innovative new products and usage paradigms.
- Extend core product lines to broaden market coverage and penetration.

Operating Environment and Performance

The overall market for laundry and cleaning products in Japan was basically unchanged from the previous fiscal year. Sales volume was essentially flat, though prices continued to decline.

Sales of Kao's laundry and cleaning products increased 3.9 percent to ¥262.1 billion. Factors supporting sales growth included new product introductions and the export of household cleaning mop kits and sheets, in addition to continued solid sales of laundry detergents, fabric softeners, other laundry finishers, and household cleaning detergents. Kao's dishwashing detergents achieved a market-leading share with the successful introduction of *Family Pure*.

A key Kao strength is the number of its products with large market share. Kao's success at introducing and strengthening brands has built a balanced and diversified portfolio of leading brands, which mitigated the need to compete on price alone.

Fiscal 1999 Initiatives and Results

Adroit management of high-profile brands has resulted in continued focus on high-quality, high-value-added brands.

During the fiscal year, Kao launched *New Beads*, a laundry detergent targeting consumers in their twenties and thirties. This new detergent achieved successful market penetration, which combined with solid *Attack* sales for increased market share in this segment.

Floral Humming 1/3, launched in spring 1999, sold strongly, bolstering Kao's position in the fabric softener market. The three products that bear the *Humming* brand – *Humming 1/3*, *Floral Humming 1/3* and *Humming* – form a potent lineup.

Family Pure, a premium dishwashing detergent launched in spring 1999, received an enthusiastic reception from consumers. Its successful introduction helped to increase the Company's overall market share in the segment. Antibacterial ingredients were added to all compact dishwashing detergents.

Fiscal 2000 Issues and Objectives

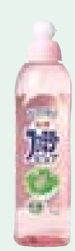
Continued recessionary conditions contributed to a sharp drop in gift sales at department stores during both of Japan's traditional gift-giving seasons, in summer and at year-end. In 2000, moves to develop new channels and an emphasis on simple gift opportunities other than the conventional gift seasons are expected to support results. Capitalizing on the momentum of *Family Pure* will help Kao expand its share of the dishwashing detergent market.

Kao and four other leading Japanese corporations in different sectors were the initial participants in *WiLL*, a joint business project to develop new marketing methods for products with a common brand name that meet the needs of "Post-Baby Boomer" consumers in their twenties and thirties. Under this project, Kao launched *WiLL Clear Mist* fabric deodorizer in fall 1999 and *WiLL Air Refreshing Mist* in spring 2000. In 2000 and beyond, *WiLL* participants and the product range are expected to expand, supporting cost-effective marketing.

Solid Performers

The Cotton Council International (CCI) recognized *Attack*'s superior sebum and soil removing power. In July 1999, *Attack* became the first laundry detergent in the world to gain approval, based on its ability to remove sebum and soil and to leave washed items whiter, to display the Cotton USA logo, which helped to further strengthen its leading market position in Japan.

Since 1997, Kao has been promoting sales of detergents for cleaning sweaters and other garments normally taken to a dry cleaner. The concept of home dry cleaning is gradually gaining acceptance among consumers. *Emal* became the top brand in the home dry cleaning segment in a comparatively short period after its relaunch.



Family Pure premium dishwashing detergent, introduced in 1999, was an immediate success, supported by its pleasant herbal fragrance and deodorizing ingredients that eliminate strong odors. It has grown into a powerful extension of Kao's *Family* dishwashing detergent product line.

***New Beads,* Kao's number-two laundry detergent brand, captured a significant market share. It appeals to consumers in the 20-to-40 age group because of its long-lasting fresh fragrance.**

Hygiene Products in Japan

Focal Points

- Offer innovative, value-added products that meet specific consumer needs.
- Ensure profitability through an improved product mix that provides value.
- Raise marketing and operating efficiency.

Operating Environment and Performance

The overall hygiene products market in Japan was flat during fiscal 1999, and was strongly influenced by demographics. Sales of incontinence products for adults expanded, driven by the increasing population of senior citizens. The markets for sanitary napkins and baby diapers, however, both contracted due to the continuing decrease in the population of relevant consumers.

Nonetheless, Kao increased both sales and market share of disposable baby diapers over the fiscal year. Sales of adult incontinence products as a whole rose solidly, increasing significantly on the strength of an expanding market. Heightened emphasis on higher-margin products, ongoing efforts to raise efficiency and various TCR activities resulted in significant gains in profitability. The contribution of pants-type baby diapers was particularly large, and Kao continued to focus on developing products based on concepts that support consumers' lifestyles as part of the Company's effort to compete on the basis of added value rather than price. This strategy paid off with a slight increase in net sales.

Fiscal 1999 Initiatives and Results

Super Merries disposable baby diapers contributed strongly to both sales and earnings. Continued improvements that increase comfort and enhance ease of use helped to build consumer support.

Sales of *Relief* adult incontinence products were a significant factor in sales growth. In this segment, Kao focused on incremental improvements in developing innovative products that are more effective and easier to use. *Relief Heavy-Duty Sheet*, an attachment to the *Relief Absorbent Pad* for the hospital and institutional markets, is an example of Kao's strategic focus on products that reduce the workload of caregivers while increasing the comfort of people who receive nursing care.

In the sanitary napkin category, the *Laurier Soft Mesh Super Guard* series of two products for heavy flow and overnight use remained the leading products in the market. This strength indicates the effectiveness of Kao's efforts to pinpoint consumer needs and deliver products that meet them.

Fiscal 2000 Issues and Objectives

The sanitary napkin lineup is slated for a thorough review, with the objective of raising productivity and marketing efficiency and thus profitability. Kao will also strengthen the *Super Merries* brand of disposable pants-type baby diapers to further increase market share in this higher-margin product segment. Another focus is the growing adult incontinence segment following the implementation of the national nursing care insurance program in April 2000.

Solid Performers

Relief incontinence products meet the diversifying needs of consumers in an aging society.

Laurier Soft Mesh Super Guard and *Laurier Soft Mesh Super Guard Extra Long* respond to increasing use of sanitary napkins with maximum protection for heavy flow and overnight use.

The *Super Merries* brand of baby diapers performed well. Sales of both tape-type and pants-type products were supported by its absorbency and the incorporation of more breathable material that increases comfort. One improvement in convenience is a pattern that appears when the diaper is saturated.

Food Products in Japan

Focal Points

- Provide uniquely functional products that offer health and lifestyle benefits.
- Strengthen *Healthy Econa Cooking Oil* through line extensions.

Operating Environment and Performance

The cooking oil market was flat during fiscal 1999, reflecting a shift from conventional cooking oils to healthier, more functional products. Despite sluggish market conditions, Kao more than doubled sales of cooking oil and achieved significant increases in profitability. *Healthy Econa Cooking Oil*, launched in February 1999, became a leading product in the newly established functional cooking oil market, contributing strongly to increased sales.

Fiscal 1999 Initiatives and Results

Healthy Econa Cooking Oil became the first cooking oil licensed by the Japanese Ministry of Health and Welfare as a "Food for Specified Health Use." Marketing for this product was clearly differentiated from Kao's conventional methods. Pre-launch presentations on the benefits of its main ingredient diacylglycerol were made at academic societies and spread through the media. This launch strategy ensured a high profile among consumers as they become increasingly health conscious, and made *Healthy Econa Cooking Oil* an instant hit. Moreover, its relatively higher unit price makes it a profitable product for both retailers and Kao.

The Nikkei Group, one of Japan's leading publishers of business and economic news, selected *Healthy Econa Cooking Oil* for a 1999 Nikkei Excellent Products and Services Award, one of the 50 winners out of a field of 12,000 entries. The award, among others, helped to further raise recognition of the product.

Fiscal 2000 Issues and Objectives

In January 2000, *Healthy Econa Cooking Oil* received the recommendation of a national organization that promotes medical check-ups, which will help to maintain this product's momentum in fiscal 2000. Kao plans to devote significant effort to building this brand's strengths.

***Healthy Econa Cooking Oil* contains more than 80 percent diacylglycerol, which helps prevent fat deposits, compared with only between 1 and 10 percent for natural vegetable fat.**

Introduced in 1994, the *AUBE* makeup line underwent a comprehensive renewal in fiscal 1999, raising its brand image and expanding its popularity among younger consumers with the addition of multipurpose color sticks and lip glosses to its mainstay lipsticks.

Cosmetics *Sofina*

Focal Points

- Streamline the cosmetics product portfolio to raise marketing efficiency and profitability.
- Renew existing products and develop new ones that generate consumer enthusiasm.

Operating Environment and Performance

Both sales and unit volume in the overall domestic cosmetics market decreased year-on-year, continuing the trend of recent years. Sales of lower priced cosmetics held steady, while prestige cosmetics were hard hit. Net sales of Kao cosmetics in Japan were ¥70.3 billion, down 4.7 percent year-on-year, though less than the decrease in the overall market. Sales of basic care products were favorable, while sales of foundation and special care products declined.

Fiscal 1999 Initiatives and Results

An SKU rationalization program is part of a strategic focus on strengthening the basic cosmetics lineup and concentrating on core products in the special care lineup. Product improvements and renewals included *Seraty* in the special care category and *AUBE* in the color makeup category. New product launches included the *Sofina Very Very* series in the basic care category and the *Grace Sofina* line for mature skin. In the spring of 2000 Kao also launched the foundation *Raycious* and the skin whitening product *Sofina Medicated Whitening Deep White*.

Fiscal 2000 Issues and Objectives

Kao is streamlining its cosmetics product portfolio to raise marketing efficiency and profitability. The Company will also renew and launch a number of products to generate greater vitality in the cosmetics business.

Solid Performers

The *Sofina Very Very* series for young skin and *Grace Sofina* for mature skin were well received. A new web site for *Sofina* is helping to increase brand loyalty by promoting two-way communication with consumers.

Consumer Products in Asia and Oceania

Focal Points

- Continue to build brand equity and enhance market position.
- Use in-market production to strengthen responsiveness to market demand.
- Implement initiatives to improve profitability.

Operating Environment and Performance

Overall, the markets of Asia began to rebound from the currency devaluations and accompanying economic challenges that began three years ago. Gains in both internal demand and exports indicate a measure of recovery.

Kao's sales in Asia and Oceania decreased, impacted by changes in transaction systems, a fall in sales of *Biore Pore Pack* and the strengthening of the yen against Asian currencies. Another factor was weak performance at Kao Corporation Shanghai due to destocking measures at distributors. Although results in other markets compared favorably with prior-year performance, they were not enough to compensate for the negative impact from China, and as a result net sales decreased. In spite of the contribution of concerted efforts to strengthen the equity of Kao's brands and manage them efficiently, operating income also fell below the level of the previous fiscal year.

Fiscal 1999 Initiatives and Results

Attack laundry detergent was launched in China in May 1999. A new laundry detergent production line began operating at Kao Corporation Shanghai, giving Kao in-market production capability. At the same time, Kao significantly reduced inventory carried by distributors in China. While this adversely impacted sales in fiscal 1999, the process was completed in February 2000.

Other efforts to respond to evolving market conditions included consolidation of logistics bases in Thailand and rationalization of SKUs. These moves supported improved asset efficiency during the fiscal year.

Throughout Asia, Kao has shifted from a management structure based on countries to one based on regions. The Company's objective is to accelerate market responsiveness.

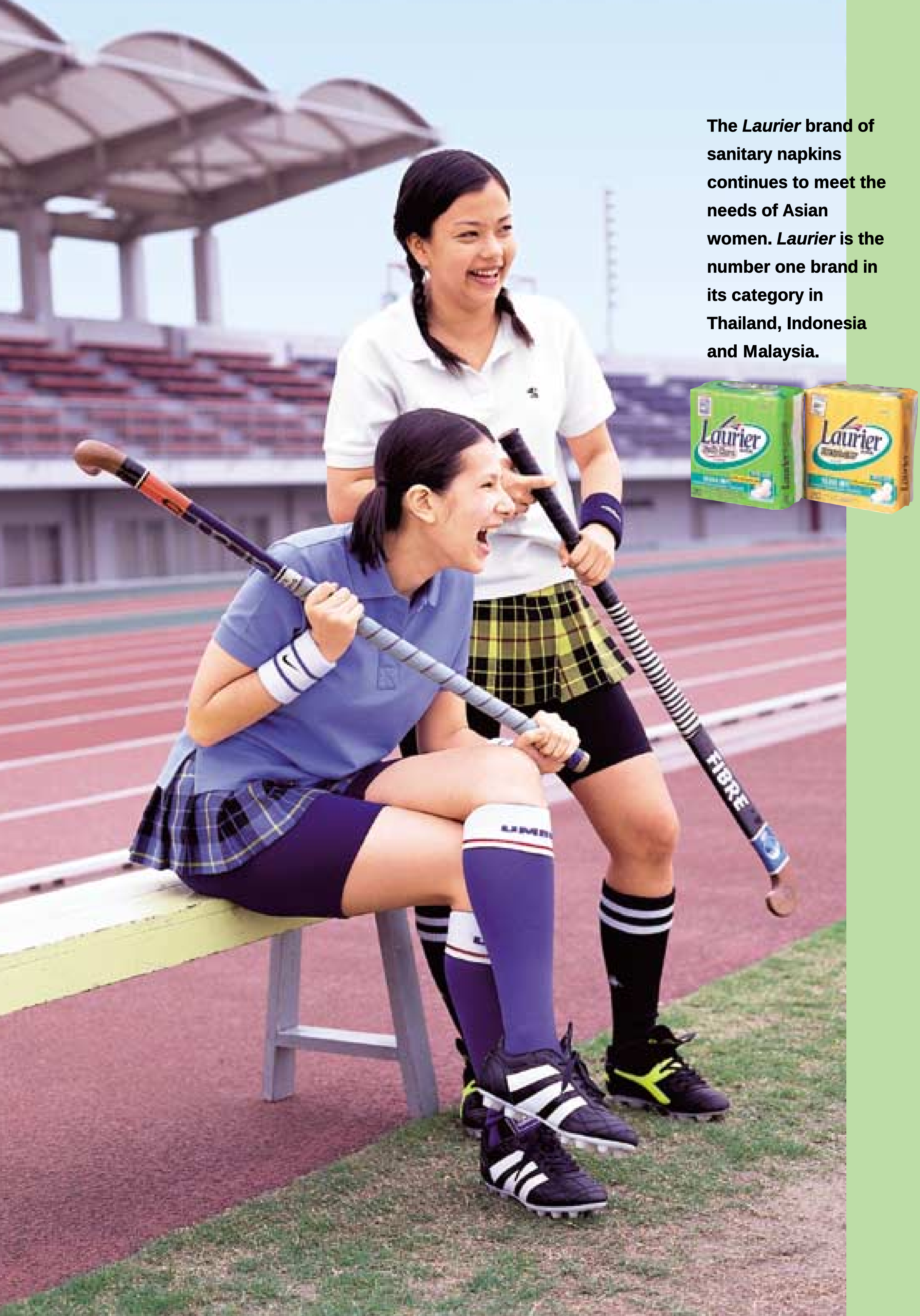
Fiscal 2000 Issues and Objectives

Kao will continue to build brand equity and enhance market position in Asia. In particular, the Company will make an intensive effort in the crucial Chinese market, with a focus on Hong Kong and southern China, centered on Shanghai.

Solid Performers

Biore facial cleanser, body cleanser and *Biore Pore Pack* have all met with solid customer response, with *Biore* facial cleanser demonstrating a high level of brand recognition among younger consumers in almost all Asian countries including Indonesia, Thailand, Taiwan and China. Newly introduced products *Biore Pore Cleansing* and *Biore Anti-Acne* also contributed strongly to results.

Attack Color performed well in Taiwan and Thailand during the fiscal year. The *Attack* brand has excellent potential as washing machine use increases in Asian markets.



The *Laurier* brand of sanitary napkins continues to meet the needs of Asian women. *Laurier* is the number one brand in its category in Thailand, Indonesia and Malaysia.

Personal Care Products in North America and Europe

Focal Points

- Focus on efficient brand and operations management to bolster profitability.
- Build Andrew Jergens into a total skin care company.
- Optimize the benefits of reforms at Goldwell and expand market penetration.

Kao participates in the North American mass market through subsidiary The Andrew Jergens Company, which markets skin care brands such as *bioré*, *Curél* and *Jergens*. Goldwell GmbH plays a key role in marketing hair care products for beauty salons, while Guhl Ikebana GmbH concentrates on marketing premium hair care products in Europe.

Operating Environment and Performance

In North America, the facial care market expanded, while the hand and body moisturizer markets were characterized by the growth of premium lotions.

Total net sales for North America and Europe decreased. A major factor was the strong yen against both the U.S. dollar and the Euro. Another was a significant drop in sales of *bioré pore perfect* at Andrew Jergens, partially offset by increased sales at both Goldwell and Guhl. Decreased sales at Andrew Jergens negatively impacted operating income.

Fiscal 1999 Initiatives and Results

In North America, a number of measures have been implemented to transform Andrew Jergens into a total skin care company. Moreover, Kao has made solid progress in building brand equity for the overall *bioré* product lineup and is moving aggressively to strengthen the *bioré* brand beyond the base established during the *bioré pore perfect* boom. *Curél* performed well in the growing market for premium hand and body lotions and contributed to strengthening Andrew Jergens' number two market position in the overall hand and body moisturizer market.

In Europe, a thorough reform program at Goldwell, which streamlined production, distribution, and sales systems, paid off by strongly enhancing profitability during the fiscal year. Guhl Ikebana is emphasizing core brands and focused management of products, marketing and sales, a move that has temporarily halted new product introductions but is strengthening existing brands. A strategic alliance with Beiersdorf AG supported rapid development of marketing and sales of *Nivea Visage Kao bioré Clear-up Strip*, helping it take the lead as top brand in the pore strip market in continental Europe.

Fiscal 2000 Issues and Objectives

Kao is making effective use of Goldwell's R&D capabilities in tandem with other group companies to strengthen the hair coloring product lineup. One result of this effort, *Guhl Living Color* hair color, was launched in January 2000, and is poised to contribute to results in fiscal 2000 and beyond.

The *bioré* brand will play a crucial role in Andrew Jergens' transformation into a total skin care company. One focus during fiscal 2000 will be the smooth addition of *bioré* products to the North American portfolio.

Solid Performers

Goldwell's *Trendline* brand hairstyling products have done well in Europe, supported by useful tips for ideal hairstyling.

Differentiated marketing helped to strengthen Guhl's premium hair care products.

Andrew Jergens' skin care products comprise facial care and hand and body lotion. Facial care products include the *bioré* series, while the *Curél* and *Jergens* brands make up the family of hand and body care products. Products on the market for their first full year, including *bioré self-heating mask*, have received an enthusiastic customer response.

Chemical Products

Focal Points

- Maintain leading global position in tertiary amines and fatty alcohols while selectively focusing on profitable specialty chemical businesses.
- Offer unique and outstanding products and emphasize higher-margin operations to improve profitability.
- Shift production bases as necessary to ensure prompt response to changing market needs.

Operating Environment and Performance

In Japan, naphtha prices increased, driving petrochemical raw material prices higher. Raw material prices for fatty chemicals and edible oils, however, were stable and the appreciation of the yen exerted a beneficial effect on results. Increasing global competition continued to widen the gap between companies that have the capability to offer unique and outstanding products and those that do not.

Excluding the information technology business, net sales in the chemical products business decreased year-on-year by 1.3 percent, while operating income rose by 30.7 percent. Factors contributing to improved operating income included an increase in sales volume, stable raw material prices and successful efforts to streamline operations.

In the fatty chemicals and edible oils segment, Kao remained the leading supplier of tertiary amines and the third largest supplier of fatty alcohols in the world. Sales of surfactants were essentially unchanged from the previous fiscal year, and Kao continues to take actions to improve businesses including raw materials for toiletry products. In the specialty chemicals segment, demand for copier and printer toner and related products expanded significantly. Kao's products stand out in the market because they meet requirements for performance at higher speeds and lower fusing temperatures. World-class quality lacton contributed to favorable sales of aroma chemicals. To promote sales of polyurethane for shoe soles, Kao is moving to meet the shift in demand to lighter, higher-quality sports shoes.

Fiscal 1999 Initiatives and Results

A flexible production network is essential to meet shifting demand patterns. During the fiscal year, Kao completed the construction of a polyurethane plant at Zhongshan Kao Chemicals Limited in China in order to meet demand in one of the largest shoe manufacturing centers in the world. Another management initiative is grouping related businesses to achieve synergy, for example, between aroma chemicals and raw materials for toiletry products, or between fatty chemicals and edible oils. The chemical products business is also streamlining production and reducing overhead to raise productivity and profitability. In Europe, Kao has established a regional headquarters to unify management of operations in Germany, France and Spain, which will support an emphasis on selectivity, efficiency and profitability in business development while raising the effectiveness of currency management through integration.

Fiscal 2000 Issues and Objectives

Kao's focus on selectivity and high-margin products and businesses includes strategic capital investments in areas with sound profit potential. During fiscal 1999, investments in polyurethane production in China, surfactant production in the United States and Germany, and aroma chemical production in Spain should support market responsiveness and results in fiscal 2000 and beyond. Another area of concentration will be improving the profitability of raw materials for toiletry products in Europe. For this purpose, Kao intends to start sales to third parties of the products in this segment, which were previously limited to internal use.

Solid Performers

The high quality and performance of Kao's copier and printer toner and related products supported substantial sales growth.

Aroma chemicals produced by Spanish subsidiary Kao Corporation S.A. are sold to a wide range of leading companies in addition to being used in Kao products.

Measures to increase productivity, such as improving catalyst technology at subsidiary Fatty Chemical (Malaysia) Sdn. Bhd., help to maintain Kao's status as a world-class supplier of fatty alcohols.

Kao considers environmental protection to be one of its most important tasks. Consequently, the Company strives to develop and manufacture environmentally-friendly products that reflect its management principle of developing products that offer excellent value and performance. Kao has worked to reduce its impact on the environment over the years, and introduced Responsible Care activities in 1995. Since then, Kao has been building a comprehensive management system and promoting activities that encompass environmental protection, occupational health and safety, production process safety, disaster prevention and raw materials and product safety.

Production Process

Energy and Resource Conservation

Since the oil crisis of 1973, Kao has been aggressively working to conserve energy, reducing energy consumption by approximately 40 percent by fiscal 1990. Since then, ongoing efforts to reduce consumption have included development of simplified, energy-saving processes, increased efficiency of energy transmission and recovery and reuse of waste heat. In fiscal 1998, Kao reduced its energy consumption to 86 percent of fiscal 1990 levels on a unit-value-added basis.

Reduction of Industrial Waste

Kao aims for thorough management and reduction of industrial waste, as well as reduction and reuse of obsolete raw materials and products. Ongoing activities at Company facilities are based on analysis of data on industrial waste and rules for achieving reduction targets and carrying out waste collection. As a result, Kao reduced the amount of waste disposed in off-site landfills in fiscal 1998 to 24 percent of the amount in fiscal 1990. The Company continues to work to reduce the amount of off-site landfill by improving the on-site recycling rate for resources, such as heat recycling, and promoting off-site recycling.

Packaging and Contents

The environmentally-friendly packaging of Kao products is based on its "3 Rs" approach: reduce, reuse and recycle. Reductions in packaging materials are carried out in tandem with improvements in product performance.

Reduce

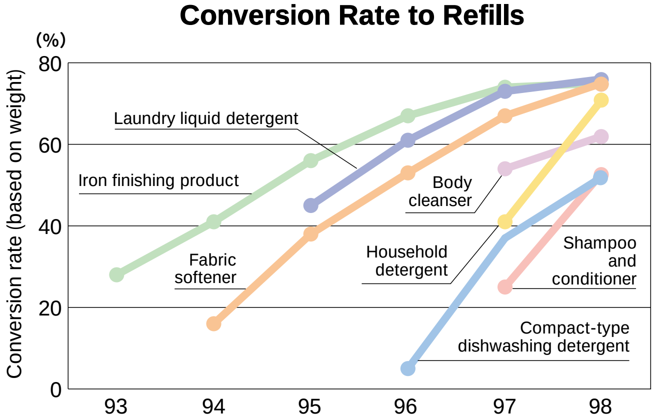
Technology to make products more compact helps Kao achieve significant reductions in packaging materials. For example, *Humming 1/3*, a compact version of *Humming* fabric softener, reduces the amount of plastic used by 44 percent, and overall volume by 67 percent.

Introduced in 1988, the 800ml *Humming 1/3* offers an alternative to the conventional 2.5-liter *Humming*, with a 44 percent reduction in plastic used for the packaging.

Reuse

Kao has introduced standing pouch-type refills for a wide range of its products. To make refills easier to use and raise the consumer switching ratio from regular products to refills, Kao is developing devices such as easy-to-refill spouts redesigned according to product type. Currently, for products where refills are available, the ratio of refill use averages about 60 percent. For those products where the nature of the contents makes standing pouch-type refills impossible, Kao is developing bottle-type refills.

Conversion Rate to Refills



By fiscal 1998, the consumer switching rate to refills had reached an average of about 60 percent among products for which standing pouch-type refills had been introduced.

This standing pouch-type refill for *Merit* shampoo, which was introduced in 1997, reduced the weight of the plastic used in its packaging by 83 percent, compared with the 550ml pump-type container at left.

Based on the properties of product contents, some products are available as bottle-type refills.

Recycle

Items such as the cardboard boxes and measuring scoops for laundry detergent are made of 100 percent recycled materials. Containers for dishwashing detergent also contain recycled plastic. In the future, Kao will also adopt chemical recycling of substances such as liquefaction and blast furnace reduction agents as well as thermal energy recycling through refuse derived fuel.

Environmental Protection

Reducing Air Pollution

Efforts to reduce emissions of sulfur oxides (SOx) include desulfurization of exhaust from large boilers and conversion of the fuel used in small boilers from type C heavy oil to kerosene or type A heavy oil, which has a lower sulfur content. In addition, the Wakayama and Kawasaki plants are shifting to the cleaner energy of liquefied natural gas (LNG). Conversion to type A heavy oil and installation of low-emission burners are helping to reduce emissions of gaseous nitrogen oxides (NOx).

Reducing Water Pollution

Comprehensive effluent treatment measures were intensified in 1972 with the introduction of coagulation, biological and activated carbon treatments. Despite an increase in production in recent years, Kao has been able to reduce its emissions of chemicals contributing to Chemical Oxygen Demand (COD) to between 80 and 90 tons per year. Through the introduction of compact detergents in 1987 and ongoing improvements to formulas, Kao has reduced the burden on public sewage and waste water treatment systems by about 30 percent, based on a comparison of the amount of detergent used by consumers in 1993 and 1997.

Fiscal 1999 Initiatives and Results

Pollutant Release and Transfer Register (PRTR)

The Pollutant Release and Transfer Register (PRTR) law of Japan requires reporting of emissions of certain chemical substances. Before the law became effective in 1999, Kao had already formulated a program to reduce atmospheric emissions, based on the results of a comprehensive survey encompassing effluence, soil, and the atmosphere. Kao handles 59 of the 284 substances listed by the Japan Chemical Industry Association as subject to PRTR reporting, and plans to end large-scale emissions of listed substances in fiscal 2000. For example, annual emissions of propyl alcohol, which totaled 82 tons in fiscal 1998, are scheduled to be ten tons in fiscal 2000 and less than one ton in fiscal 2001.

The Container and Packaging Recycling Law

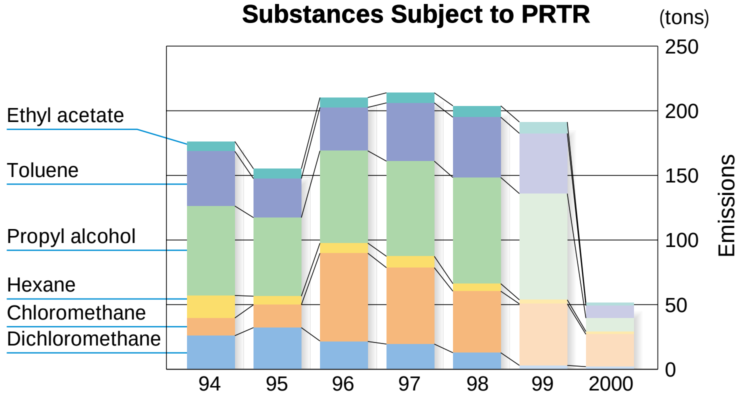
First introduced in 1997 for glass and polyethylene bottles, the Container and Packaging Recycling Law of Japan went into full effect in April 2000, when its provisions were extended to cover plastic and paper containers and packaging. The law requires consumers to separate their garbage, municipalities to collect various types of garbage separately and manufacturers to recycle and reuse containers and packaging materials. Kao complies with the law by outsourcing the required recycling and reuse activities; however, the related cost in fiscal 2000 will not be significant. Activities will focus on further reductions in packaging based on Kao's "3 Rs" approach.

Acquisition of ISO 14001 Certification

ISO 14001 is a set of international standards for environmental management systems. Kao utilizes it as a tool to enhance its Responsible Care activities. The Company is working to obtain certification for each of its facilities that encompasses a plant and a research center, and expects all eight domestic plants to have received certification by the end of fiscal 2000.

Performance data related to environmental activities refer to operations in Japan.

Emissions and Planned Reductions of Substances Subject to PRTR



(tons/year)

Substance	Emissions in fiscal 1998	Estimate for fiscal 2000
Ethyl acetate	9	2
Toluene	47	10
Propyl alcohol	82	10
Hexane	6	2
Chloromethane	48	25
Dichloromethane	13	1

Management's Discussion and Analysis

Six-Year Summary

Kao Corporation and Consolidated Subsidiaries

Years ended March 31

	Millions of yen					
	2000	1999	1998	1997	1996	1995
For the year:						
Net sales	**¥846,922**	¥924,596	¥907,249	¥901,402	¥835,597	¥796,730
Consumer Products	**632,423**	656,197	—	—	—	—
Cosmetics *Sofina*	**70,890**	74,450	—	—	—	—
Subtotal	**703,313**	730,647	696,800	705,332	675,883	653,541
Chemical Products	**143,609**	193,949	210,449	196,070	159,714	143,189
Japan	**673,456**	672,123	674,640	696,022	673,051	654,177
Asia and Oceania	**86,176**	104,694	101,726	83,588	69,589	59,274
North America and Europe	**111,043**	178,933	162,092	148,171	118,004	107,559
Subtotal	**870,675**	955,750	938,458	927,781	860,644	821,010
Elimination	**(23,753)**	(31,154)	(31,209)	(26,379)	(25,047)	(24,280)
Operating income	**99,182**	91,664	72,868	72,101	66,509	61,926
Net income	**52,147**	34,714	24,495	27,594	24,531	23,686
Capital expenditures	**37,564**	69,016	59,012	65,283	79,254	72,241
Depreciation and amortization	**67,270**	71,202	81,405	73,592	70,623	73,648
Cash flows	**108,158**	96,310	97,046	93,073	87,950	90,739
Research and development expenditures	**38,062**	36,062	37,843	37,929	37,544	40,037
(% of Sales)	**4.5%**	3.9%	4.2%	4.2%	4.5%	5.0%
Advertising expenditures	**64,354**	71,752	65,404	61,012	58,592	55,574
(% of Sales)	**7.6%**	7.8%	7.2%	6.8%	7.0%	7.0%
At year-end:						
Total assets	**750,016**	751,725	778,762	807,124	756,849	709,264
Total shareholders' equity	**474,979**	451,777	424,430	379,552	359,812	342,003
	Yen					
Per share:						
Net income	**¥ 83.45**	¥ 55.98	¥ 40.10	¥ 45.92	¥ 40.85	¥ 39.49
Cash dividends	**20.00**	16.00	15.00	14.00	12.50	11.50
Total shareholders' equity	**765.59**	727.01	684.90	631.54	598.71	569.74
Weighted average number of shares outstanding during the period (in thousands)	**624,917**	620,171	610,857	600,978	600,454	599,810
Key financial ratios:						
Return on sales (%)	**6.2**	3.8	2.7	3.1	2.9	3.0
Return on equity (%)	**11.3**	7.9	6.1	7.5	7.0	7.1
Equity ratio (%)	**63.3**	60.1	54.5	47.0	47.5	48.2

Notes:
1. Net sales by geographic segment include interarea transfers.
2. Due to the change in the presentation requirements in Japan, certain reclassifications have been made to operating income for 1998 and prior years to conform to the presentation of the current year's results.
3. Cash flows are defined as net income plus depreciation and amortization minus cash dividends.
4. Net income per share is computed based on the weighted average number of shares outstanding during the respective years.
5. Cash dividends per share are the amounts applicable to the respective years, including dividends to be paid after the end of the year.

Analysis of Income Statements

For the fiscal year ended March 31, 2000, consolidated net sales decreased 8.4 percent to ¥846.9 billion (US$7,978.5 million). Primary factors in the decrease were a negative currency translation effect of approximately ¥30.1 billion due to the appreciation of the yen during the fiscal year, and a ¥48.4 billion decrease in sales as a result of Kao's withdrawal from the information technology business.

Excluding revenues generated by the information technology business in the previous fiscal year, overseas sales, particularly in North America, declined from the previous fiscal year on a local currency basis. However, parent company sales rose 1.9 percent year-on-year, which contributed to the steady performance in Japan.

Cost of sales decreased 12.7 percent to ¥381.1 billion (US$3,591.1 million). Despite the fall in net sales, the significant decrease in cost of sales helped to reduce the drop in gross profit. The cost of sales ratio was 45.0 percent, down 2.2 points from the previous fiscal year. Major factors behind the 1.5-point improvement at the parent company included TCR activities and lower prices for raw materials due to the strong yen. The withdrawal from the information technology business, with its high cost of sales ratio, also had a positive impact. These factors were partially offset by the decreased sales of the high-margin *Biore Pore Pack*[1] outside Japan.

Selling, general and administrative (SG&A) expenses decreased 7.6 percent to ¥366.5 billion (US$3,453.1 million), due largely to the success of efforts to raise operating efficiency and reduce costs. In addition, significant reductions in advertising and marketing expenses as a result of lower sales of *Biore Pore Pack* and savings following withdrawal from the information technology business contributed positively.

Operating income therefore increased 8.2 percent to ¥99.1 billion (US$934.4 million). The ratio of operating income to net sales rose to 11.7 percent from 9.9 percent for the previous fiscal year, indicating the effectiveness of management initiatives to improve profitability.

Other expenses decreased 80.8 percent year-on-year to ¥6.0 billion (US$56.5 million). Foreign currency exchange loss increased by ¥2.8 billion and the Company booked an extraordinary loss in connection with the nearly complete restructuring at Goldwell GmbH amounting to ¥2.6 billion, following restructuring expenses of ¥2.4 billion in the previous fiscal year. However, these charges were offset by the absence of ¥23.8 billion in charges associated with the withdrawal from the information technology business in the previous fiscal year. Interest expense decreased by ¥3.0 billion due to reduction of debt. The restructuring measures have contributed measurably to the Company's operating efficiency, competitiveness and profitability.

Consequently, income before income taxes and minority interests increased 54.2 percent to ¥93.1 billion (US$877.8 million), and net income increased 50.2 percent to ¥52.1 billion (US$491.3 million). Net income per share rose to ¥83.45 (US$0.79) from ¥55.98 for the previous fiscal year, and Kao increased cash dividends per share by ¥4.00 to ¥20.00 (US$0.19).

Costs, Expenses and Income as Percentages of Net Sales

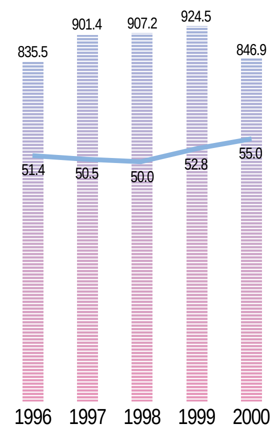
	2000		1999		1998
Cost of sales	**45.0%**		47.2%		50.0%
Gross profit	**55.0**	**(2.2)**	52.8	(2.8)	50.0
Selling, general and administrative expenses	**43.3**	**(0.4)**	42.9	(1.0)	41.9
Operating income	**11.7**	**(1.8)**	9.9	(1.9)	8.0
Income before income taxes and minority interests	**11.0**	**(4.5)**	6.5	(0.7)	5.8
Net income	**6.2**	**(2.4)**	3.8	(1.1)	2.7

Note: Figures in parentheses represent change in percentage points from the previous year.

1. *Biore Pore Pack* is marketed under the product name *"bioré pore perfect"* in the United States and the United Kingdom and *"Nivea Visage Kao bioré Clear-up Strip"* in continental European countries.

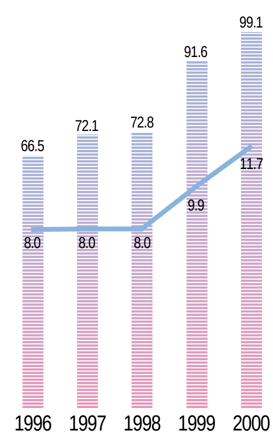
Net Sales/
Gross Profit Ratio

(Billions of yen, %)



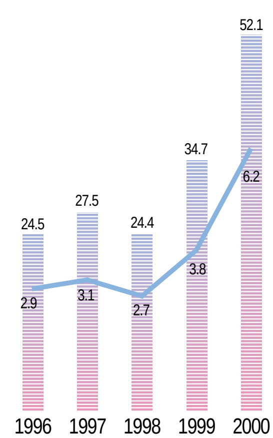
Operating Income/
Operating Income Ratio

(Billions of yen, %)



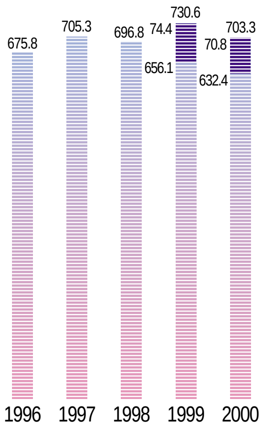
Net Income/
Return on Sales

(Billions of yen, %)



Net Sales by Business Segment: Consumer Products/ Cosmetics *Sofina*

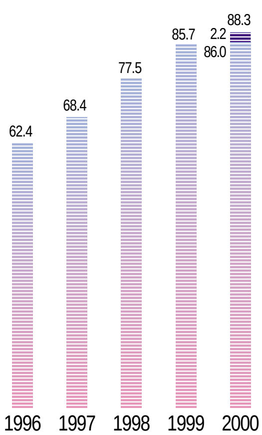
(Billions of yen)



■ Cosmetics *Sofina*

Operating Income by Business Segment: Consumer Products/ Cosmetics *Sofina*

(Billions of yen)



■ Cosmetics *Sofina*

Information by Business Segment[2]

Consumer Products

In Japan, sales and operating income both grew steadily. A drop in net sales in the United States and the strength of the yen, however, caused significant decreases in net sales and operating income in the consumer products business overseas. Consolidated net sales of consumer products totaled ¥632.4 billion (US$5,957.8 million), while consolidated operating income rose to ¥86.0 billion (US$810.8 million).

Japan

The consumer products business in Japan was marked by a continued downward trend in prices and sluggish consumer demand. Kao worked to develop new products that fulfill new consumer needs. At the same time, the Company strove to increase its brand power by adding new product lines and improving the quality and performance of existing ones. As a result, sales of consumer products increased 2.1 percent to ¥516.8 billion (US$4,869.3 million). In addition, Kao achieved substantial increases in operating income, supported by lower materials costs due in part to the strength of the yen, and by continued efforts to reduce expenses and raise cost efficiency.

Sales of personal care products in Japan amounted to ¥175.2 billion (US$1,650.8 million), a 2.2 percent year-on-year decrease. The main reason for this decline was a sharp decrease in exports of *Biore Pore Pack* to overseas subsidiaries; domestic sales were largely on a par with the previous fiscal year. In the skin care products category, *Biore Facial Wash Pore Cleansing* and *Biore Powder Sheet* both contributed to higher sales. In the hair care products category, while the new products *Pur* shampoo and conditioner were well received by consumers, total sales of hair care products slipped below the level of the previous fiscal year. Sales of oral care products increased, but sales of soap and men's toiletries fell year-on-year.

Sales of laundry and cleaning products rose 3.9 percent from the previous fiscal year to ¥262.1 billion (US$2,469.9 million). Responding to intensified market competition, Kao launched a new laundry detergent, *New Beads*, as well as *WiLL Clear Mist*, a deodorizing spray for fabrics. Sales of these lines and other new products, such as the fabric softener *Floral Humming 1/3*, were strong. Moreover, exports of household cleaning mop kits and sheets, which went on sale in the United States and Europe through the U.S. company S.C. Johnson & Son, Inc., exceeded expectations. These factors helped to offset a decrease in domestic sales of dishwashing detergents and other cleaning products.

Sales of hygiene and other products increased by 6.3 percent to ¥79.4 billion (US$748.6 million). Disposable baby diapers *Super Merries* and adult incontinence products contributed strongly to the sales gain. Sales of sanitary napkins were lower than in the previous fiscal year, due partly to a decline in the target population.

Kao's new *Healthy Econa Cooking Oil*, which helps to prevent body fat from increasing, enjoyed strong support among consumers due to its unique benefits and achieved favorable sales growth.

Asia and Oceania

Although Asian economies have weathered their currency crises and are now recovering, competition between global peer companies in consumer goods markets remains fierce amid sluggish growth in demand. In response to these difficult business conditions, Kao focused on further nurturing its core brands in the region, including *Biore* facial cleanser, *Laurier* sanitary napkins, *Attack* laundry detergent, and *Lavenus* and *Sifone* hair care products. In addition, Kao established new operations in the laundry detergent business in China in May 1999.

2. The business segment Household Products has been renamed Consumer Products. Also, Cosmetics *Sofina*, which was classified within Consumer Products until the previous fiscal year, is dealt with as a separate segment from this fiscal year. Bath additives, which were previously classified among hygiene and other products within Consumer Products, were transferred to personal care products.

In Thailand and Taiwan, new *Biore* brand products strengthened the Company's range of facial cleansers. At the same time, a number of improvements to the *Laurier* range of sanitary products are being marketed across the region.

During the fiscal year, sales of consumer products in Asia were negatively affected by a number of factors, including a fall in sales of *Biore Pore Pack*, weak sales due to a contraction in inventory carried by distributors in China, and the further appreciation of the yen. Also, operating income fell below the level of the previous fiscal year.

North America and Europe

In the United States, sales of *Biore Pore Pack*, which is marketed through The Andrew Jergens Company, declined significantly as demand fell below the peak of the previous fiscal year. Even so, a number of new lines, including a facial cleanser, were successfully launched to further develop the *Biore* brand.

The premium skin care brand *Curél*, acquired in the previous fiscal year, continued to record good sales performance. However, as a result of the fall in sales of *Biore Pore Pack* and the negative currency translation effect of the strong yen, both net sales and operating income at Andrew Jergens fell sharply compared with the previous fiscal year.

In Europe, sales at Goldwell, which markets hair care products for beauty salons, grew satisfactorily in terms of local currencies as the ongoing restructuring program produced substantial improvements in this subsidiary's profitability. However, the negative currency translation effect of the strong yen and a drop in sales of *Biore Pore Pack* in continental Europe caused both sales and operating income to fall, in yen terms, below the levels of the previous fiscal year.

Cosmetics *Sofina*

Net sales of *Sofina* cosmetics were ¥70.8 billion (US$667.8 million), while operating income totaled ¥2.2 billion (US$21.6 million). A variety of factors, such as increased economizing on the part of consumers, a shift towards lower-priced products and a general fall in retail prices, all conspired to cause a contraction in the overall prestige cosmetics market during the fiscal year. Despite a shrinking total market, Kao achieved successes with launches of new basic cosmetic lines such as the *Sofina Very Very* series, designed for young skin, and *Grace Sofina*, designed for more mature skin. However, sales of facial cleansers, special care lines and foundation all declined.

Chemical Products

Net sales in the chemical products business decreased by 26.0 percent from the previous fiscal year to ¥143.6 billion (US$1,352.9 million), while operating income rose by 84.4 percent to ¥10.8 billion (US$101.9 million).

Excluding the information technology business, net sales in the chemical products business decreased 1.3 percent year-on-year, while operating income rose by 30.7 percent.

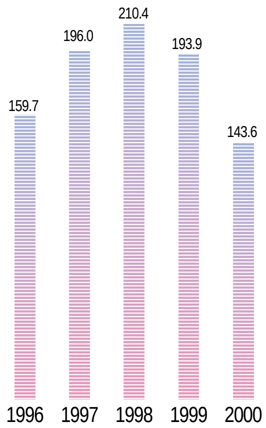
Japan

With the exception of certain market segments, a turnaround in demand spurred solid growth in sales of chemical products in Japan. Exports also increased over the previous year due to higher demand in North America, Europe and Southeast Asia. Sales of copier toner and related products, aroma chemicals, edible oils for industrial use and various surfactants increased.

Operating income for the domestic chemical products business increased strongly, supported by efforts to rationalize production and sales. Moreover, prices of materials derived from natural fats and oils remained soft, mitigating the effect of rising naphtha prices on earnings.

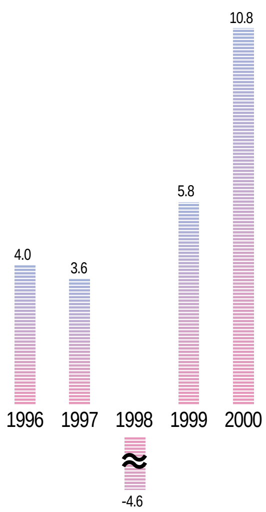
Net Sales by Business Segment: Chemical Products

(Billions of yen)



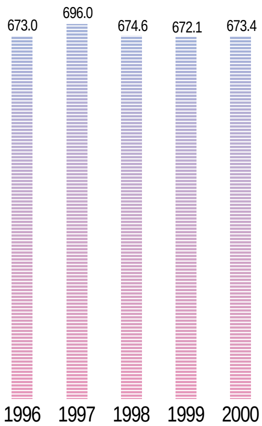
Operating Income by Business Segment: Chemical Products

(Billions of yen)



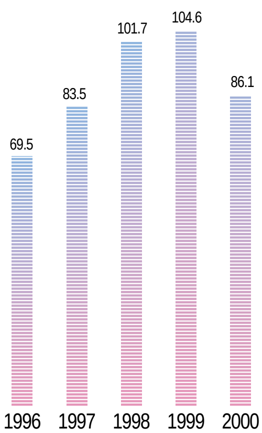
Net Sales by Geographic Segment: Japan

(Billions of yen)



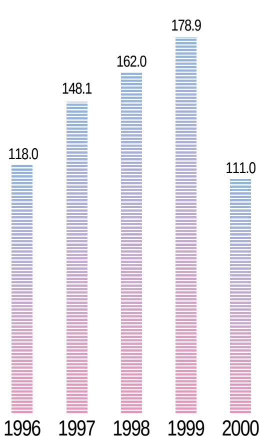
Net Sales by Geographic Segment: Asia and Oceania

(Billions of yen)



Net Sales by Geographic Segment: North America and Europe

(Billions of yen)



Asia

With economies across the region generally recovering well, on the whole, sales in local currency terms expanded favorably. However, the persistent strength of the yen and its further appreciation, along with the influence of a fixed exchange rate system in Malaysia, caused total Asian sales in yen terms to decline. For similar reasons, operating income also fell year-on-year.

North America and Europe

On a local currency basis, strong growth continued in sales of copier and printer toner and related products in the United States, fatty amines in Germany, and aroma chemicals and toner related products in Spain. However, due to Kao's withdrawal from the information technology business and to the further appreciation of the yen, in yen terms total sales in North America and Europe fell compared with the previous fiscal year. However, operating income increased, due largely to the absence of operating losses generated from the information technology business.

In September 1999, to adapt to increased integration within the European market, Kao established Kao Chemicals Europe, S.L. in Spain to serve as a regional headquarters for its European chemical products operations. This move served to unify the Company's various businesses in Europe, while also raising business efficiency and contributing to speedier decision-making.

Information by Geographic Segment

Japan

In Japan, Kao posted total sales, including interarea transfers, amounting to ¥673.4 billion (US$6,344.4 million), an increase of 0.2 percent from the previous fiscal year. Operating income rose ¥10.7 billion, or 13.3 percent, to ¥91.7 billion (US$863.9 million). The strong yen lowered raw material prices, while rationalization and cost reductions supported gains in consumer and chemical products.

Asia and Oceania

The Company elsewhere in Asia and Oceania recorded total sales, including interarea transfers, of ¥86.1 billion (US$811.8 million), a decrease of 17.7 percent from the previous fiscal year. However, in terms of local currency and adjusting for the effects of the withdrawal from the information technology business, the decline in net sales was 5.9 percent. Operating income decreased ¥1.4 billion, or 27.1 percent, to ¥3.9 billion (US$36.8 million). Lower sales of consumer products in China as well as both higher raw materials costs for chemical products in Malaysia and a fixed exchange rate system there affected operating income negatively.

North America and Europe

Sales by Kao's North America- and Europe-based companies, including interarea transfers, totaled ¥111.0 billion (US$1,046.1 million), down 37.9 percent year-on-year, although accounting for the effects of currency translation and the withdrawal from the information technology business limits the decrease to 4.5 percent. Operating income fell 35.7 percent to ¥3.4 billion (US$32.6 million). Lower sales of *Biore Pore Pack* significantly impacted results for consumer products, while the absence of expenses related to withdrawal from the information technology business supported gains in the chemical products sector.

Financial Position

Net cash provided by operating activities increased to ¥157.6 billion (US$1,484.9 million) from ¥151.6 billion for the previous fiscal year. Significant increase in income before income taxes and minority interests in the amount of ¥32.7 billion was offset by a decrease in extraordinary losses of noncash items. Other negative factors compared to the previous term included a decline in total depreciation and amortization due to the reduced capital spending.

Net cash used in investing activities decreased to ¥41.4 billion (US$390.4 million) from ¥74.1 billion. As a result of lower overall capital spending, purchases of property, plant and equipment decreased sharply to ¥38.0 billion (US$358.8 million) from ¥50.8 billion. Moreover, Kao did not book major acquisitions, such as that of the *Curél* skin care brand in the United States in the previous fiscal year. Main capital spending items were the purchase of land adjacent to Kao's Kawasaki Plant, a plant relocation in Japan, and expansion of production capacity in certain product segments. Purchases of marketable securities increased, reflecting short-term investment of free cash flow.

Net cash used in financing activities increased to ¥61.5 billion (US$579.8 million) from ¥48.1 billion for the previous fiscal year. Kao paid down debt and redeemed corporate bonds in the amount of ¥20.6 billion. The Company also executed share redemption totaling 10 million shares valued at ¥29.5 billion. Payments of cash dividends increased from ¥9.7 billion in the previous fiscal year to ¥11.4 billion (US$107.4 million), reflecting higher dividends paid.

As a result, cash and cash equivalents at the end of the year increased ¥50.5 billion from a year earlier to ¥147.9 billion (US$1,394.1 million). Noncash financing activities consisted of ¥11.9 billion (US$112.9 million) in convertible bonds converted into common stock and additional paid-in capital, compared with ¥2.3 billion in the previous fiscal year. Given the Company's solid liquidity, the use of internal resources and cash flow to reduce debt and redeem outstanding shares creates a more efficient capital structure that is better able to generate returns for shareholders. The Company maintains stable, broadly based access to external funding.

Total assets decreased marginally to ¥750.0 billion (US$7,065.6 million), compared to ¥751.7 billion at March 31, 1999.

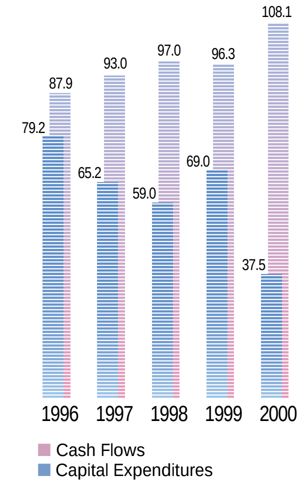
Shareholders' equity increased 5.1 percent to ¥474.9 billion (US$4,474.6 million) compared to ¥451.7 billion at March 31, 1999. Additions to retained earnings and an increase in common stock due to conversion of convertible debt into shares compensated for the effect on equity of the share redemption conducted during fiscal 1999. Return on average total shareholders' equity improved to 11.3 percent from 7.9 percent for the previous fiscal year, and the shareholders' equity ratio, defined as the ratio of shareholders' equity to total assets, stood at 63.3 percent, compared to 60.1 percent a year earlier.

EVA

Beginning in April 1999, Kao implemented EVA (Economic Value Added) in its management systems for the parent company. EVA supports profitable growth by measuring how much economic value the Company has created. It is calculated by deducting a charge (cost of capital) for the capital employed from net operating profit after taxes (NOPAT). One of the most important benefits of EVA-based management is that it engenders a strong focus on using capital with optimum effectiveness, which helps Kao operate more efficiently and competitively. The Company aims to achieve continuous improvement in EVA on a long-term basis which will lead to increasing corporate value. For this purpose Kao introduced an incentive compensation system based on EVA for its executives and employees in Japan.

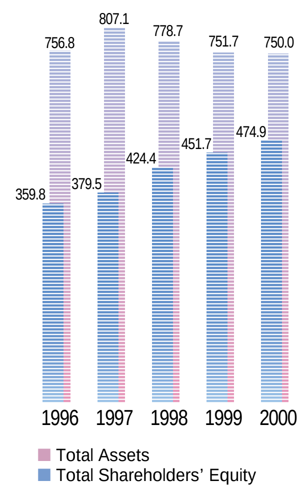
Cash Flows/ Capital Expenditures

(Billions of yen)



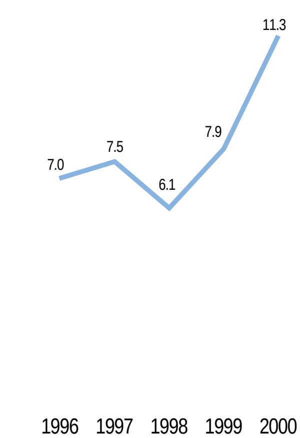
Total Assets/Total Shareholders' Equity

(Billions of yen)

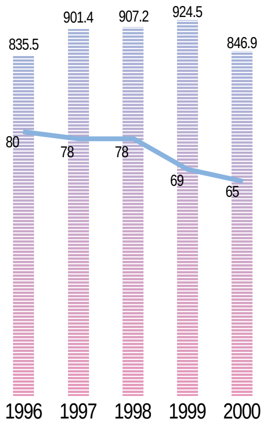


Return on Equity

(%)



Net Sales/
Inventory Turnover
(Billions of yen, days)



At the corporate level, EVA is a main management measure for making strategic investment decisions and evaluating Company performance. Kao is also disseminating EVA at the tactical level for use in making daily operating decisions. This effort includes training employees in the use of EVA and calculating and evaluating EVA at the business unit level. As a result, management expects that EVA will become an integral component of management throughout Kao's entire organization and earnings structure, which will reinforce the Company's longstanding emphasis on profitability.

In addition, management intends to expand the use of EVA to each company in the Kao Group. This will contribute to higher productivity and profitability throughout the Kao Group.

There are four ways to increase EVA. Kao worked on all four.

Invest: This is one of the most important measures for the improvement of EVA and comprises investment in projects where the return exceeds the cost of capital. Initiatives during the fiscal year included the successful introduction of *Healthy Econa Cooking Oil* and selective capital expenditures for further growth.

Improve: Kao strives to improve operating profit without using additional capital. Continuous TCR activities and enhanced profit management by business unit contributed to increasing operating profit, thus improving EVA. Another representative initiative was the export of household mop kits and sheets. In the mutually productive partnership with S.C. Johnson & Son, Inc., Kao achieved significant sales efficiently without using additional capital.

Harvest: This measure is to divert or liquidate capital from business activities that do not meet the cost-of-capital hurdle and are not expected to improve. Initiatives executed during the fiscal year included the reduction of inventory amounting to ¥14.7 billion due to enhanced supply chain management and the consolidation of fatty acid production in Japan.

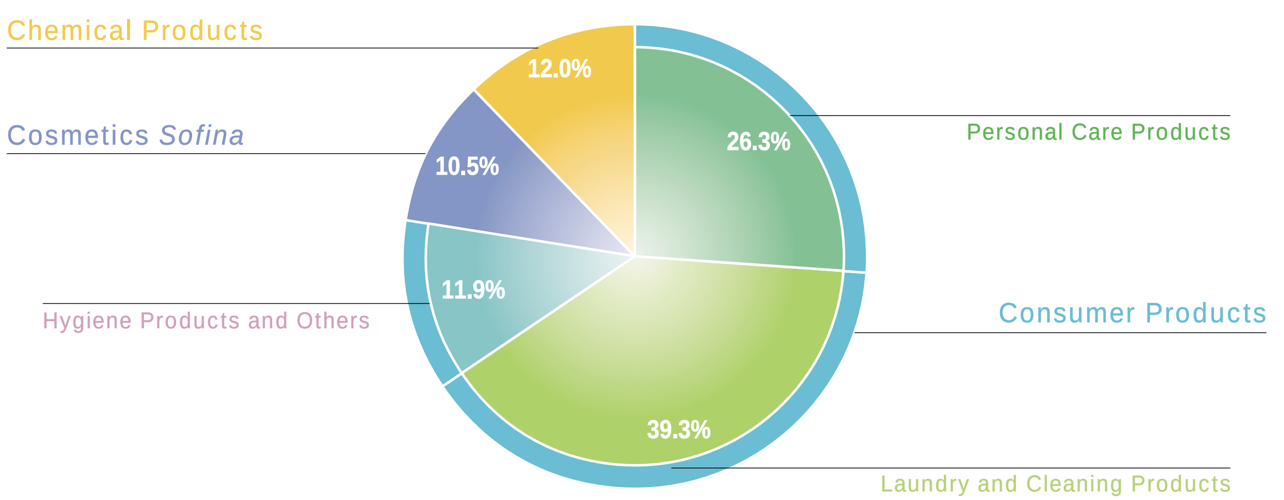
Financial: This is a financial initiative to reduce capital charges. Kao executed a share redemption amounting to ¥29.5 billion during the fiscal year.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's estimates, assumptions and projections at the time of publication. Some factors, which include, but are not limited to, the risks and uncertainty associated with the worldwide economy, competitive activity and currency fluctuation, could cause actual results to differ materially from expectations.

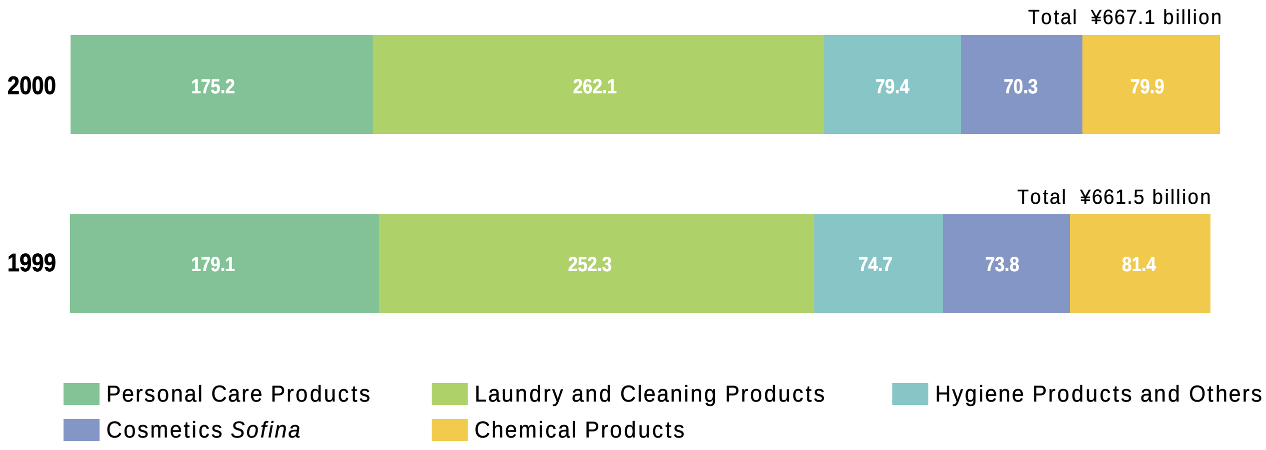
Overview of Operations (Nonconsolidated Basis)

SALES BREAKDOWN BY CATEGORY



(Year ended March 31, 2000)

NET SALES (Billions of yen)



Consolidated Balance Sheets

Kao Corporation and Consolidated Subsidiaries
March 31, 2000 and 1999

Assets	Millions of yen 2000	Millions of yen 1999	Thousands of U.S. dollars (Note 2) 2000
Current assets:			
Cash and time deposits	**¥ 21,004**	¥ 37,704	**$ 197,871**
Short-term investments (Notes 3 and 4)	**139,194**	60,977	**1,311,295**
Notes and accounts receivable:			
Trade (Note 11)	**57,745**	63,482	**543,994**
Nonconsolidated subsidiaries and affiliates	**31,250**	29,803	**294,395**
Inventories (Note 5):			
Finished goods	**44,024**	53,110	**414,734**
Work in process and raw materials	**23,790**	29,426	**224,117**
Deferred income taxes (Note 6)	**6,980**	4,912	**65,756**
Other current assets	**9,009**	11,749	**84,871**
Allowance for doubtful receivables	**(1,676)**	(2,108)	**(15,789)**
Total current assets	**331,320**	289,055	**3,121,244**
Property, plant and equipment, at cost (Note 5):			
Land	**61,096**	57,556	**575,563**
Buildings and structures	**252,167**	258,065	**2,375,572**
Machinery, equipment and other	**633,514**	672,961	**5,968,102**
Construction in progress	**7,243**	10,905	**68,234**
	954,020	999,487	**8,987,471**
Accumulated depreciation	**(671,067)**	(677,371)	**(6,321,875)**
	282,953	322,116	**2,665,596**
Intangible assets:			
Goodwill	**25,096**	28,585	**236,420**
Trademarks	**13,093**	14,776	**123,344**
Excess of investment cost over net equity of consolidated subsidiaries acquired, net	**1,054**	3,525	**9,929**
Other intangible assets	**7,367**	10,259	**69,402**
	46,610	57,145	**439,095**
Investments and other assets:			
Investment securities (Note 4)	**9,226**	9,227	**86,915**
Investments in and advances to nonconsolidated subsidiaries and affiliates	**15,341**	19,466	**144,522**
Deferred income taxes (Note 6)	**10,920**	12,541	**102,873**
Other assets	**8,917**	9,600	**84,004**
	44,404	50,834	**418,314**
Foreign currency translation adjustments	**44,729**	32,575	**421,375**
	¥750,016	¥751,725	**$7,065,624**

See notes to consolidated financial statements.

Liabilities and Shareholders' Equity	Millions of yen 2000	Millions of yen 1999	Thousands of U.S. dollars (Note 2) 2000
Current liabilities:			
Short-term debt (Note 5)	**¥ 17,059**	¥ 19,384	**$ 160,707**
Current portion of long-term debt (Note 5)	**10,196**	13,942	**96,053**
Notes and accounts payable:			
Trade	**71,886**	71,343	**677,211**
Nonconsolidated subsidiaries and affiliates	**2,446**	1,569	**23,043**
Other	**16,983**	20,730	**159,991**
Accrued income taxes	**26,146**	12,949	**246,312**
Accrued expenses	**53,742**	56,292	**506,284**
Other current liabilities	**7,925**	6,925	**74,657**
Total current liabilities	**206,383**	203,134	**1,944,258**
Long-term liabilities:			
Long-term debt (Note 5)	**58,960**	86,946	**555,440**
Liability for retirement benefits (Note 8)	**3,300**	3,539	**31,088**
Other	**744**	926	**7,009**
	63,004	91,411	**593,537**
Minority interests	**5,650**	5,403	**53,227**
Contingent liabilities (Note 9)			
Shareholders' equity (Notes 5, 10 and 16):			
Common stock:			
Authorized — 990,000,000 shares;			
Issued — 620,433,369 shares in 2000 and 621,439,401 shares in 1999, with par value of ¥50 per share	**85,147**	79,148	**802,138**
Additional paid-in capital	**108,612**	102,622	**1,023,194**
Retained earnings	**281,282**	270,056	**2,649,854**
	475,041	451,826	**4,475,186**
Treasury stock, at cost (20,947 shares in 2000 and 19,557 shares in 1999)	**(62)**	(49)	**(584)**
	474,979	451,777	**4,474,602**
	¥750,016	¥751,725	**$7,065,624**

Consolidated Statements of Income

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2000	1999	**2000**
Net sales (Notes 11 and 12)	**¥846,922**	¥924,596	**$7,978,540**
Cost of sales	**381,191**	436,437	**3,591,060**
Gross profit	**465,731**	488,159	**4,387,480**
Selling, general and administrative expenses (Note 13)	**366,549**	396,495	**3,453,123**
Operating income (Note 12)	**99,182**	91,664	**934,357**
Other (income) expenses (Note 14):			
Interest and dividend income	**(1,801)**	(1,998)	**(16,967)**
Interest expense	**2,852**	5,894	**26,868**
Foreign currency exchange loss	**3,096**	237	**29,166**
Equity in earnings of nonconsolidated subsidiaries and affiliates	**(1,836)**	(1,172)	**(17,296)**
Restructuring charges related to:			
Information technology business	**—**	23,883	**—**
Consumer products business in North America and Europe	**2,647**	2,446	**24,936**
Other, net	**1,043**	1,942	**9,826**
	6,001	31,232	**56,533**
Income before income taxes and minority interests	**93,181**	60,432	**877,824**
Income taxes (Note 6):			
Current	**41,214**	27,524	**388,262**
Deferred	**(650)**	(2,648)	**(6,123)**
	40,564	24,876	**382,139**
Income before minority interests	**52,617**	35,556	**495,685**
Minority interests in earnings of consolidated subsidiaries	**470**	842	**4,427**
Net income	**¥ 52,147**	¥ 34,714	**$ 491,258**
Per share of common stock (Note 1.m):	Yen		U.S. dollars (Note 2)
Net income	**¥83.45**	¥55.98	**$0.79**
Fully diluted net income	**80.01**	53.21	**0.75**
Cash dividends applicable to the year	**20.00**	16.00	**0.19**

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

	Thousands	Millions of yen			
	Number of shares of common stock issued	Common stock	Additional paid-in capital	Retained earnings	Treasury stock, at cost
Balance at April 1, 1998	619,710	¥77,994	¥101,470	¥244,986	¥(20)
Retained earnings of consolidated subsidiaries previously not consolidated at beginning of year				58	
Net income				34,714	
Cash dividends, ¥15.50 per share (Note 10)				(9,606)	
Directors' and corporate auditors' bonuses				(96)	
Conversion of convertible bonds	1,729	1,154	1,152		
Treasury stock acquired, net (7,774 shares)					(29)
Balance at March 31, 1999	621,439	79,148	102,622	270,056	(49)
Retained earnings of affiliates previously not accounted for by the equity method				**(35)**	
Net income				**52,147**	
Cash dividends, ¥18.00 per share (Note 10)				**(11,260)**	
Directors' and corporate auditors' bonuses				**(124)**	
Conversion of convertible bonds	**8,994**	**5,999**	**5,990**		
Purchase and redemption of treasury stock	**(10,000)**			**(29,502)**	
Treasury stock acquired, net (1,390 shares)					**(13)**
Balance at March 31, 2000	**620,433**	**¥85,147**	**¥108,612**	**¥281,282**	**¥(62)**

	Thousands	Thousands of U.S. dollars (Note 2)			
	Number of shares of common stock issued	Common stock	Additional paid-in capital	Retained earnings	Treasury stock, at cost
Balance at March 31, 1999	621,439	$745,624	$ 966,764	$2,544,098	$(462)
Retained earnings of affiliates previously not accounted for by the equity method				**(330)**	
Net income				**491,258**	
Cash dividends, US$0.170 per share (Note 10)				**(106,077)**	
Directors' and corporate auditors' bonuses				**(1,168)**	
Conversion of convertible bonds	**8,994**	**56,514**	**56,430**		
Purchase and redemption of treasury stock	**(10,000)**			**(277,927)**	
Treasury stock acquired, net (1,390 shares)					**(122)**
Balance at March 31, 2000	**620,433**	**$802,138**	**$1,023,194**	**$2,649,854**	**$(584)**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2000	1999	**2000**
Operating activities:			
Income before income taxes and minority interests	**¥ 93,181**	¥ 60,432	**$ 877,824**
Adjustments for:			
Income taxes paid	**(27,832)**	(23,911)	**(262,195)**
Depreciation and amortization	**67,270**	71,202	**633,726**
Restructuring charges related to information technology business	**—**	20,282	**—**
Loss on sales or disposals of property, plant and equipment	**1,513**	627	**14,253**
Equity in earnings of nonconsolidated subsidiaries and affiliates	**(1,836)**	(1,172)	**(17,296)**
Unrealized foreign currency exchange loss	**3,048**	602	**28,714**
Change in trade receivables	**(169)**	12,147	**(1,592)**
Change in inventories	**10,385**	13,342	**97,833**
Change in trade payables	**2,705**	(9,439)	**25,483**
Other, net	**9,354**	7,499	**88,120**
Net cash provided by operating activities	**157,619**	151,611	**1,484,870**
Investing activities:			
Purchase of marketable securities	**(11,087)**	(21)	**(104,447)**
Purchase of property, plant and equipment	**(38,086)**	(50,879)	**(358,794)**
Proceeds from sales of property, plant and equipment	**2,250**	8,133	**21,196**
Increase in intangible assets	**(1,825)**	(18,391)	**(17,193)**
Increase in investment in and advances to nonconsolidated subsidiaries and affiliates	**(787)**	(1,548)	**(7,414)**
Change in other investments	**8,094**	(11,489)	**76,252**
Net cash used in investing activities	**(41,441)**	(74,195)	**(390,400)**
Financing activities:			
Change in short-term debt	**(3,632)**	(12,544)	**(34,216)**
Proceeds from long-term loans	**—**	3,420	**—**
Repayments of long-term loans	**(4,732)**	(3,623)	**(44,578)**
Repayments of medium-term notes	**(12,258)**	(25,604)	**(115,478)**
Purchase of treasury stock	**(29,514)**	—	**(278,041)**
Payments of cash dividends	**(11,405)**	(9,786)	**(107,442)**
Net cash used in financing activities	**(61,541)**	(48,137)	**(579,755)**
Translation adjustments on cash and cash equivalents	**(4,065)**	(3,201)	**(38,294)**
Net increase in cash and cash equivalents	**50,572**	26,078	**476,421**
Cash and cash equivalents, beginning of year (Note 3)	**97,414**	71,336	**917,701**
Cash and cash equivalents, end of year (Note 3)	**¥147,986**	¥ 97,414	**$1,394,122**
Noncash financing activities:			
Convertible bonds converted into common stock and additional paid-in capital	**¥ 11,989**	¥ 2,306	**$ 112,944**

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

1. Summary of Significant Accounting Policies

a) Basis of presenting consolidated financial statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards. The consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

Effective April 1, 1999, consolidated statements of cash flows are required to be prepared under Japanese accounting standards; therefore, that for the year ended March 31, 1999 is restated in accordance with the new standards.

In preparing the consolidated financial statements, certain reclassifications and rearrangement have been made to the consolidated financial statements issued in Japan in order to present them in a form which is more familiar to readers outside Japan. Certain 1999 financial statement items were reclassified to conform to the presentation for 2000.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates.

b) Consolidation and investments in nonconsolidated subsidiaries and affiliates

The accompanying consolidated financial statements include the accounts of Kao Corporation (the "Company") and its significant majority-owned subsidiaries (collectively, the "Companies"). Investments in most of nonconsolidated subsidiaries and affiliates over which the Companies have the ability to exercise significant influence (mainly 20-50 percent owned companies) are accounted for the equity method.

Effective April 1, 1999, the Japanese new accounting standards for consolidation requires the control or influence concept for the consolidation scope of subsidiaries and affiliates. Under the control or influence concept, a company in which the parent company or its consolidated subsidiaries, directly or indirectly, is able to exercise control over operations are fully consolidated, and another company over which the parent company and/or its consolidated subsidiaries have the ability to exercise significant influence are accounted for by the equity method. There was no change in the scope of consolidation and adoption of equity method by the application of the control or influence concept for the Companies.

Investments in the remaining subsidiaries and affiliates are stated at cost except that write-downs are recorded for the value of investments which have been permanently impaired. If the equity method of accounting had been applied to these investments, the effect of the accompanying consolidated financial statements would not be material.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Companies is eliminated. The excess of cost of investments in the subsidiaries and affiliates over their equity in the net assets at the dates of acquisition is being amortized over their estimated useful lives, or five years in situation in which the useful lives cannot be estimated.

c) Cash equivalents

For purposes of the statements of cash flows, cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits and investment trusts in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

d) Inventories

Inventories are stated at the lower of cost or market. Cost is determined principally by the average method. The cost of inventories held by certain foreign consolidated subsidiaries is determined by the first-in, first-out method.

e) Short-term investments and investment securities

Short-term investments and investment securities are stated at cost determined by the average method.

The carrying values of investments are written down to fair value when management determines there has been a significant impairment.

f) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is computed under the declining-balance method for the assets located in Japan and principally under the straight-line method for the assets located outside Japan, using rates based upon the estimated useful lives of the assets.

Effective April 1, 1999, the Company has shortened useful lives of buildings. The effect of the change was to increase depreciation expense by ¥2,498 million and to decrease income before income taxes and minority interests by ¥2,341 million.

g) Intangible assets

Goodwill is amortized on a straight-line basis principally over 20 years except that appropriate write-downs are recorded for the value of goodwill which has been permanently impaired. Amortization of trademarks is computed on a straight-line basis principally over 10 years.

h) Retirement benefits

The Company has a funded contributory pension plan covering substantially all of its employees. The pension plan also covers employees of certain subsidiaries and affiliates in Japan. Directors and corporate auditors are partially covered by the pension plan. It is the Company's policy to fund and charge to income normal pension costs as incurred.

Certain foreign subsidiaries have local pension plans covering their employees. The policies for the funded pension plans are to fund and charge to income the pension costs determined on an actuarial method.

Certain foreign subsidiaries also have local employees' retirement benefit plans and provide for the amount to state the liability for these employees' retirement benefits, primarily determined on an actuarial method.

The provision for retirement benefits to directors and corporate auditors is recorded to state the liability at the amount which would be required, based on the Company's regulations, if all directors and corporate auditors terminated their offices at each balance sheet date. The accrued provisions are not funded and any amounts payable to directors and corporate auditors upon retirement are subject to the approval of the shareholders.

i) Income taxes

The Companies provide for income taxes applicable to all items included in the consolidated statements of income regardless of when such taxes are payable. Income taxes based on temporary differences between tax and financial reporting purposes are reflected as deferred income taxes in the consolidated financial statements using the asset and liability method.

j) Leases

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

k) Appropriation of retained earnings

Appropriation of retained earnings at each year end is reflected in the financial statements for the following year upon shareholders' approval.

l) Foreign currency items

Short-term receivables and payables denominated in foreign currencies are translated into Japanese yen at the current exchange rates as of each balance sheet date. Long-term receivables and payables denominated in foreign currencies are generally translated at historical rates. Assets and liabilities which are converted at the foreign exchange rate or swap rate are translated using the exchange rates set forth in the applicable exchange contract and relevant currency swap agreement. In the case where there is significant fluctuation of currencies with possible exchange losses, long-term receivables or payables denominated in foreign currencies are translated at the current exchange rates as of each balance sheet date.

Balance sheet accounts of the foreign consolidated subsidiaries are translated into yen at the current exchange rates as of the balance sheet date except in relation to shareholders' equity, which is translated at the historical rates. Revenue and expense accounts of the foreign consolidated subsidiaries are translated into yen at the annual average rates. Differences arising from such translations are shown as foreign currency translation adjustments in the accompanying consolidated balance sheets.

m) Per share of common stock

Net income per share is computed on the basis of the weighted average number of shares of common stock outstanding during the respective years. Fully diluted net income per share of common stock assumes full conversion of the outstanding convertible bonds at the beginning of the year or at the date of issuance with an applicable adjustment for related interest expense.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

2. Translation into United States Dollars

The Companies' accounts are maintained in or translated into Japanese yen. The United States dollar ($) amounts included herein represent translations using the approximate exchange rate at March 31, 2000 of ¥106.15 = US$1, solely for convenience. The translations should not be construed as representations that Japanese yen have been, could have been or could in the future be converted into United States dollars at that or any other rate.

3. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2000 and 1999 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Cash and time deposits	**¥ 21,004**	¥37,704	**$ 197,871**
Short-term investments	**139,194**	60,977	**1,311,295**
Less: cash deposits and short-term investments which mature or become due over three months of the date of acquisition	**(12,212)**	(1,267)	**(115,044)**
Cash and cash equivalents	**¥147,986**	¥97,414	**$1,394,122**

4. Short-Term Investments and Investment Securities

Short-term investments and investment securities mainly include money management fund, investment trust, marketable equity security, government and corporate bond and commercial paper.

The book values of current and noncurrent debt securities and equity securities with market prices and the related aggregate market values at March 31, 2000 and 1999 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Current:			
Book value	**¥ 1,778**	¥ 1,267	**$ 16,750**
Aggregate market value	**1,849**	1,317	**17,419**
Net unrealized gains	**71**	50	**669**
Noncurrent:			
Book value	**¥ 8,741**	¥ 8,716	**$ 82,346**
Aggregate market value	**25,439**	21,405	**239,651**
Net unrealized gains	**16,698**	12,689	**157,305**

The difference between the above carrying amounts and the amounts shown in the accompanying balance sheets principally consists of money management funds and nonmarketable securities and bonds for which there is no readily-available market from which to obtain or calculate the market value thereof.

5. Short-Term and Long-Term Debt

Short-term debt at March 31, 2000 and 1999 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Bank borrowings	**¥ 8,914**	¥14,856	**$ 83,976**
Other current debt	**8,145**	4,528	**76,731**
	¥17,059	¥19,384	**$160,707**

The weighted average interest rates applicable to the bank borrowings were 5.80% and 5.81% at March 31, 2000 and 1999, respectively. Those applicable to the other current debt were 0.41% and 0.95% at March 31, 2000 and 1999, respectively.

Long-term debt at March 31, 2000 and 1999 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Unsecured convertible bonds due 2006, 0.95%	**¥35,357**	¥ 47,346	**$333,085**
Euro medium-term notes issued by the Company and certain consolidated subsidiaries, due 1999–2003, 2.11% in 2000 and 2.73% in 1999	**20,949**	35,333	**197,353**
Mortgage loans principally from banks	**526**	1,548	**4,955**
Unsecured loans principally from banks	**12,324**	16,661	**116,100**
	69,156	100,888	**651,493**
Less current portion	**10,196**	13,942	**96,053**
	¥58,960	¥ 86,946	**$555,440**

The weighted average interest rates applicable to the Euro medium-term notes shown above were interest rates at March 31, 2000 and 1999, respectively.

The aggregate annual maturities of long-term debt as of March 31, 2000 were as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2001	¥10,196	$ 96,053
2002	15,449	145,539
2003	2,593	24,428
2004	5,204	49,025
2005	357	3,363
2006 and thereafter	35,357	333,085

The mortgage loans are collateralized by land and buildings having a book value of ¥440 million (US$4,145 thousand) and by inventories of ¥206 million (US$1,941 thousand) at March 31, 2000.

The conversion price of the convertible bonds is ¥1,333.00 as of March 31, 2000, subject to adjustment to reflect stock splits and certain other events.

Convertible bonds outstanding at March 31, 2000 were convertible into 26,524,381 shares of common stock of the Company on the basis of the above conversion price.

6. Income Taxes

The Company and its domestic subsidiaries are subject to Japanese national and local taxes based on income, which in the aggregate resulted in a normal statutory tax rates of approximately 42% for 2000 and 47% for 1999. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

The effective rates of income taxes reflected in the consolidated statements of income differed from the statutory rate above principally due to (1) expenses not permanently deductible for tax purposes, (2) tax benefits not recognized on losses of certain foreign subsidiaries, (3) utilization of loss carry forwards and tax benefits recognized on losses of subsidiaries because of the recovery in their profitability, (4) tax benefit of the loss carry forwards realized on liquidation of other subsidiaries, which were considered not to be tax deductible in the prior year and (5) lower income tax rates applicable to income of certain foreign subsidiaries.

Tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets or liabilities at March 31, 2000 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2000	**2000**
Deferred tax assets:		
Depreciation	**¥16,119**	**$151,851**
Accrued expenses	**4,574**	**43,090**
Enterprise taxes	**2,429**	**22,883**
Tax loss carryforwards	**7,959**	**74,979**
Other	**5,207**	**49,053**
Less valuation allowances	**(9,009)**	**(84,870)**
Deferred tax assets	**¥27,279**	**$256,986**
Deferred tax liabilities:		
Gains on sales of property	**¥ (4,869)**	**$ (45,869)**
Undistributed foreign earnings	**(3,031)**	**(28,554)**
Other	**(1,896)**	**(17,862)**
Deferred tax liabilities	**¥ (9,796)**	**$ (92,285)**
Net deferred tax assets	**¥17,483**	**$164,701**

7. Leases

a) Finance leases:

The Companies lease certain machinery, computer equipment and other assets. Total rental expenses under the above leases for the years ended March 31, 2000 and 1999 were ¥540 million (US$5,087 thousand) and ¥1,587 million, respectively.

Pro forma information of lease property of which ownership is deemed not to be transferred to the lessee on an “as if capitalized” basis for the years ended March 31, 2000 and 1999 was as follows:

	Millions of yen		Thousands of U.S. dollars
	Buildings, structures and other assets	Machinery, equipment and other assets	Buildings, structures and other assets
	2000	1999	**2000**
Acquisition cost	**¥3,494**	¥6,976	**$32,916**
Accumulated depreciation	**1,900**	4,351	**17,899**
Net leased property	**¥1,594**	¥2,625	**$15,017**

Pro forma depreciation expense computed by the straight-line method is ¥540 million (US$5,087 thousand) and ¥1,587 million for the years ended March 31, 2000 and 1999, respectively.

Obligations under finance leases as of March 31, 2000 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2000	**2000**
Due within one year	**¥ 482**	**$ 4,541**
Due after one year	**1,112**	**10,475**
	¥1,594	**$15,016**

Pro forma information above does not exclude the imputed interest portion because the remaining financial lease obligations are not material compared with the book values of property, plant and equipment.

b) Operating leases:

The minimum rental commitments under noncancellable operating leases as of March 31, 2000 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2000	**2000**
Due within one year	**¥1,658**	**$15,619**
Due after one year	**3,404**	**32,068**
	¥5,062	**$47,687**

8. Retirement Benefits

Liability for retirement benefits as of March 31, 2000 and 1999 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Directors and corporate auditors	**¥ 973**	¥ 900	**$ 9,166**
Employees of certain foreign subsidiaries	**2,327**	2,639	**21,922**
	¥3,300	¥3,539	**$31,088**

Total charges to income for the pension and retirement plans for the years ended March 31, 2000 and 1999 were ¥6,881 million (US$64,823 thousand) and ¥8,450 million, respectively.

9. Contingent Liabilities

Contingent liabilities as of March 31, 2000 for guarantees of borrowings, principally of affiliates and employees, were ¥4,909 million (US$46,246 thousand).

10. Shareholders' Equity

Under the Commercial Code of Japan (the "Code"), at least 50% of the issue price of new shares, with a minimum of the par value thereof, is required to be designated as stated capital. The portion which is to be designated as stated capital is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as stated capital are credited to additional paid-in capital.

The Code provides that a portion of retained earnings equivalent to at least 10% of cash payments which are made as an appropriation of retained earnings shall be appropriated as a legal reserve until such reserve equals 25% of stated capital. The Code also provides that neither additional paid-in capital nor the legal reserve is available for cash dividends, but both may be used to reduce a deficit by resolution of shareholders or may be transferred to stated capital by resolution of the Board of Directors.

Dividends are paid semi-annually. Year-end dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. In addition, semi-annual interim dividends may be paid upon resolution of the Board of Directors, subject to limitations imposed by the Code. Year-end dividends are reflected in the consolidated statements of shareholders' equity when authorized.

Under the Code, the amount available for dividends is based on retained earnings as recorded on the Company's books. At March 31, 2000, retained earnings recorded on the Company's books were ¥258,717 million (US$2,437,277 thousand).

On June 29, 1999, shareholders approved a stock repurchase program under which the Company repurchase and retire up to 62 million shares of common stock subject to authorization by the Board of Directors. The Company repurchased 10 million shares of common stock during the fiscal year ended March 31, 2000 at an aggregate cost of ¥29,502 million according to the resolution of the Board of Directors on October 22, 1999.

11. Related Party Transactions

A significant portion of the Company's consumer products except for cosmetics is distributed through a nonconsolidated subsidiary and an affiliate.

Transactions with the nonconsolidated subsidiary and the affiliate for the years ended March 31, 2000 and 1999 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Sales	**¥484,060**	¥479,057	**$4,560,151**
Accounts receivable-trade	**28,600**	26,868	**269,430**

12. Segment Information

The Companies operate in three reportable segments: Consumer Products, Cosmetics *Sofina* and Chemical Products. Operations within the Consumer Products segment include the manufacture and sale of personal care products such as shampoos and conditioners, laundry and cleaning products, and hygiene products. The Cosmetics *Sofina* segment manufactures and sells cosmetics under the brand name, *Sofina*. The Chemical Products segment manufactures and sells fatty chemicals and specialty chemicals such as surface active agents.

Effective April 1, 1999, the Cosmetics *Sofina* segment was separated from the Consumer Products for the purpose of making segment information more useful.

Segment information by business of the Companies for the years ended March 31, 2000 and 1999 was as follows:

	Millions of yen				
	2000				
	Consumer Products	Cosmetics *Sofina*	Chemical Products	Corporate/ Eliminations	Consolidated
Sales	**¥632,423**	**¥70,890**	**¥143,609**	**¥ —**	**¥846,922**
Operating income	**86,065**	**2,296**	**10,821**	**—**	**99,182**
Assets	**¥405,509**	**¥27,689**	**¥118,698**	**¥198,120**	**¥750,016**
Depreciation and amortization	**52,190**	**3,179**	**11,901**	**—**	**67,270**
Capital expenditures	**28,301**	**1,810**	**7,453**	**—**	**37,564**

	Millions of yen			
	1999			
	Consumer Products	Chemical Products	Corporate/ Eliminations	Consolidated
Sales	¥730,647	¥193,949	¥ —	¥924,596
Operating income	85,798	5,866	—	91,664
Assets	¥501,451	¥131,617	¥118,657	¥751,725
Depreciation and amortization	54,755	16,447	—	71,202
Capital expenditures	57,900	11,116	—	69,016

	Thousands of U.S. dollars				
	2000				
	Consumer Products	Cosmetics *Sofina*	Chemical Products	Corporate/ Eliminations	Consolidated
Sales	**$5,957,824**	**$667,829**	**$1,352,887**	**$ —**	**$7,978,540**
Operating income	**810,787**	**21,630**	**101,940**	**—**	**934,357**
Assets	**$3,820,151**	**$260,848**	**$1,118,210**	**$1,866,415**	**$7,065,624**
Depreciation and amortization	**491,663**	**29,948**	**112,115**	**—**	**633,726**
Capital expenditures	**266,614**	**17,051**	**70,212**	**—**	**353,877**

Geographic segment information of the Companies for the years ended March 31, 2000 and 1999 was as follows:

	Millions of yen				
	2000				
	Japan	Asia/ Oceania*	America/ Europe**	Corporate/ Eliminations	Consolidated
Sales to customers	**¥664,242**	**¥73,651**	**¥109,029**	**¥ —**	**¥846,922**
Interarea transfer	**9,214**	**12,525**	**2,014**	**(23,753)**	**—**
Total sales	**673,456**	**86,176**	**111,043**	**(23,753)**	**846,922**
Total expenses	**581,750**	**82,265**	**107,580**	**(23,855)**	**747,740**
Operating income	**¥ 91,706**	**¥ 3,911**	**¥ 3,463**	**¥ 102**	**¥ 99,182**
Assets	**¥407,729**	**¥63,492**	**¥ 96,465**	**¥182,330**	**¥750,016**

	Millions of yen				
	1999				
	Japan	Asia/ Oceania*	America/ Europe**	Corporate/ Eliminations	Consolidated
Sales to customers	¥658,316	¥90,180	¥176,100	¥ —	¥924,596
Interarea transfer	13,807	14,514	2,833	(31,154)	—
Total sales	672,123	104,694	178,933	(31,154)	924,596
Total expenses	591,184	99,330	173,546	(31,128)	832,932
Operating income	¥ 80,939	¥ 5,364	¥ 5,387	¥ (26)	¥ 91,664
Assets	¥454,052	¥76,513	¥124,026	¥97,134	¥751,725

	Thousands of U.S. dollars				
	2000				
	Japan	Asia/ Oceania*	America/ Europe**	Corporate/ Eliminations	Consolidated
Sales to customers	**$6,257,579**	**$693,839**	**$1,027,122**	**$ —**	**$7,978,540**
Interarea transfer	**86,802**	**117,993**	**18,973**	**(223,768)**	**—**
Total sales	**6,344,381**	**811,832**	**1,046,095**	**(223,768)**	**7,978,540**
Total expenses	**5,480,452**	**774,988**	**1,013,472**	**(224,729)**	**7,044,183**
Operating income	**$ 863,929**	**$ 36,844**	**$ 32,623**	**$ 961**	**$ 934,357**
Assets	**$3,841,064**	**$598,135**	**$ 908,761**	**$1,717,664**	**$7,065,624**

*Asia/Oceania: Asia and Australia
**America/Europe: North America, Europe and South Africa

Sales to foreign customers were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	2000
Asia/Oceania	**¥ 76,912**	¥ 92,644	**$ 724,560**
America/Europe	**118,103**	177,522	**1,112,604**
Sales to foreign customers	**¥195,015**	¥270,166	**$1,837,164**

13. Selected Operating Expenses

Selling, general and administrative expenses principally consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	2000
Sales commission	**¥95,659**	¥89,276	**$901,168**
Advertising	**64,354**	71,752	**606,255**
Promotion	**27,209**	38,675	**256,326**
Research and development	**38,062**	36,062	**358,568**

14. Other (Income) Expenses

Other, net consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	2000
Loss on sales or disposals of property, plant and equipment, net	**¥1,513**	¥1,590	**$14,253**
Other, net	**(470)**	352	**(4,427)**
	¥1,043	¥1,942	**$ 9,826**

15. Derivatives

The Companies enter into foreign exchange forward contracts and currency swaps to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies. The Companies also enter into interests rate swap contracts to manage interest rate exposures on certain liabilities.

The Companies have purchased interest rate caps to limit the unfavorable impact from increases in interest rates on floating-rate long-term debt.

The interest rate caps effectively limit the Companies' interest exposures of floating-rate long-term borrowings to the maximum rate.

All derivative transactions are entered into to hedge interest and foreign currency exposures incorporated within the Companies' business. Accordingly, market risk in these derivatives is basically offset by opposite movements in the value of hedge assets or liabilities.

The Companies do not hold or issue derivatives for trading purposes. Because the counterparties to these derivatives are limited to major international financial institutions, the Companies do not anticipate any losses arising from credit risk.

Derivative transactions entered into by the Companies have been made in accordance with internal policies which regulate the authorization and credit limit amounts.

The Companies had the following derivatives contracts outstanding at March 31, 2000.

	Millions of yen		
	2000		
	Contracts or Notional amount	Fair value	Net unrealized gain (loss)
Forward Exchange Contracts:			
Buying U.S. Dollar	**¥293**	**¥286**	**¥(7)**
Buying Japanese Yen	**168**	**166**	**(2)**
Buying Swiss Franc	**69**	**69**	**—**
Selling Swiss Franc	**262**	**257**	**5**
Selling Argentine Peso	**179**	**188**	**(9)**

	Thousands of U.S. dollars		
	2000		
	Contracts or Notional amount	Fair value	Net unrealized gain (loss)
Forward Exchange Contracts:			
Buying U.S. Dollar	**$2,760**	**$2,694**	**$(66)**
Buying Japanese Yen	**1,583**	**1,564**	**(19)**
Buying Swiss Franc	**650**	**650**	**—**
Selling Swiss Franc	**2,468**	**2,421**	**47**
Selling Argentine Peso	**1,686**	**1,771**	**(85)**

	Millions of yen		
	2000		
	Contracts or Notional amount	Fair value	Net unrealized gain (loss)
Interest Rate Swaps:			
Fixed rate receipt,floating rate payment	**¥18,526**	**¥952**	**¥952**
Fixed rate payment,floating rate receipt	**526**	**(1)**	**(1)**
Interest Rate Caps:			
Buying	**2,368**	**29**	**29**
Selling	**526**	**0**	**0**

	Thousands of U.S. dollars		
	2000		
	Contracts or Notional amount	Fair value	Net unrealized gain (loss)
Interest Rate Swaps:			
Fixed rate receipt,floating rate payment	**$174,527**	**$8,968**	**$8,968**
Fixed rate payment,floating rate receipt	**4,955**	**(9)**	**(9)**
Interest Rate Caps:			
Buying	**22,308**	**273**	**273**
Selling	**4,955**	**0**	**0**

16. Subsequent Event

At the ordinary general meeting of shareholders held on June 29, 2000, the Company's shareholders approved the appropriation of retained earnings.

Appropriation of retained earnings

	Millions of yen	Thousands of U.S. dollars
Ordinary year-end cash dividends, ¥10.00 (US$0.094) per share	**¥6,204**	**$58,446**
Directors' and corporate auditors' bonuses	**144**	**1,357**

Independent Auditors' Report

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Deloitte Touche Tohmatsu

To the Board of Directors of
Kao Corporation

We have examined the consolidated balance sheets of Kao Corporation and consolidated subsidiaries as of March 31, 2000 and 1999, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Kao Corporation and consolidated subsidiaries as of March 31, 2000 and 1999, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis.

Our examinations also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 2. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 29, 2000

Board of Directors and Corporate Auditors

President
and Representative Director
Takuya Goto

Senior Managing Director
and Representative Director
Toshio Hoshino

Managing Director
and Representative Director
Takahiko Kagawa

President
Takuya Goto*

Senior Managing Director
Toshio Hoshino*

Managing Directors
Takahiko Kagawa*
Masanori Sakata
Kunihiko Hachiya
Yasuo Idemitsu

Directors
Toshio Hirasaka
Moriyasu Murata
Akio Tsuruoka
Shigeo Yamada
Shozo Tanaka
Masatoshi Kitahara
Tadao Matsumoto
Kuniaki Watanabe
Nobuatsu Higuchi
Naotake Takaishi
Iwao Inoue
Tetsuya Imamura

Corporate Auditors
Kikuhiko Okamoto
Katsuhiko Hiraoka
Takashi Tajima

(As of June 29, 2000)

*Representative Director

Principal Subsidiaries and Affiliates

CONSUMER PRODUCTS, COSMETICS *SOFINA* AND CHEMICAL PRODUCTS BUSINESSES

Area	Country	Company	Consumer Products/Cosmetics *Sofina*	Chemical Products
Asia	Japan	Kao Cosmetics Sales Co., Ltd.	●	
	Japan	Kao Hanbai Company, Ltd.	●	
	Japan	Nivea-Kao Co., Ltd.	●	
	Japan	Kao-Quaker Co., Ltd.		●
	China	Kao Corporation Shanghai	●	
	China	Kao Chemical Corporation Shanghai		●
	China	Zhongshan Kao Chemicals Limited		●
	Hong Kong	Kao (Hong Kong) Limited	●	
	Hong Kong	Kao Chemicals (Hong Kong) Limited		●
	Indonesia	PT. Kao Indonesia	●	
	Indonesia	PT. Kao Indonesia Chemicals		●
	Malaysia	Kao (Malaysia) Sdn. Bhd.	●	
	Malaysia	Kao Trading (M) Sdn. Bhd.	●	
	Malaysia	Fatty Chemical (Malaysia) Sdn. Bhd.		●
	Malaysia	Kao Soap (Malaysia) Sdn. Bhd.	●	
	Malaysia	Kao Oleochemical (Malaysia) Sdn. Bhd.		●
	Malaysia	Kao Plasticizer (Malaysia) Sdn. Bhd.		●
	Philippines	Pilipinas Kao Inc.		●
	Singapore	Kao (Southeast Asia) Pte. Ltd.		●
	Singapore	Kao (Singapore) Private Limited	●	
	Taiwan	Kao (Taiwan) Corporation	●	●
	Thailand	Kao Industrial (Thailand) Co., Ltd.	●	●
	Thailand	Kao Commercial (Thailand) Co., Ltd.	●	
	Vietnam	Kao Vietnam Co., Ltd.	●	
Oceania	Australia	Kao (Australia) Marketing Pty. Ltd.	●	
America	Canada	Jergens Canada Inc.	●	
	Mexico	Quimi-Kao, S.A. de C.V.		●
	United States	The Andrew Jergens Company	●	
	United States	Kao Chemicals Americas Corporation		●
	United States	High Point Textile Auxiliaries LLC		●
	United States	Kao Specialties Americas LLC		●
Europe	Austria	Guhl Ikebana Kosmetika GmbH	●	
	France	Kao Corporation (France) SARL		●
	Germany	Kao Corporation GmbH	●	
	Germany	Kao Chemicals GmbH		●
	Germany	Guhl Ikebana GmbH	●	
	Netherlands	Guhl Ikebana Cosmetics B.V.	●	
	Spain	Kao Corporation S.A.		●
	Spain	Kao Chemicals Europe, S.L.		●
	Switzerland	Guhl Ikebana AG	●	

● Consumer Products/Cosmetics *Sofina*
● Chemical Products

GOLDWELL PRODUCTS FOR PROFESSIONAL HAIR SALONS

Country	Company
Austria	Goldwell Handelsgesellschaft mbH
Belgium	N.V. Goldwell Belgium S.A.
Czech Republic	Goldwell Cosmetics (CZ) S.R.O.
Denmark	Goldwell A/S
Finland	Goldwell Oy
Germany	Goldwell GmbH
Germany	Goldwell Vertriebs GmbH
Italy	Goldwell Italia S.p.A.
Netherlands	Goldwell Nederland B.V.
Switzerland	Goldwell AG
United Kingdom	Goldwell (Hair Cosmetics) Ltd.
Canada	Goldwell Cosmetics (Canada) Ltd.
United States	Goldwell Cosmetics (USA), Inc.
South Africa	Goldwell South Africa (Pty.) Ltd.
Hong Kong	Goldwell Cosmetics (Hong Kong) Ltd.
Singapore	Goldwell Cosmetics (Singapore) Pte. Ltd.
Taiwan	Goldwell Cosmetics Taiwan Co., Ltd.
Australia	Goldwell Cosmetics (Australia) Pty. Ltd.

Investor Information

Kao Corporation

Head Office
14-10, Nihonbashi Kayabacho 1-chome,
Chuo-ku, Tokyo 103-8210, Japan
Telephone: 81-3-3660-7111
Facsimile: 81-3-3660-7103

Date of Establishment
June 19, 1887

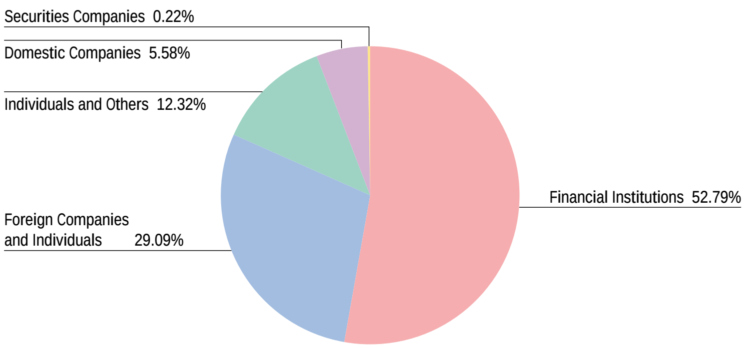
Common Stock (As of March 31, 2000)
Authorized: 990,000,000 shares
Outstanding: 620,433,369 shares
Number of Shareholders: 42,587

Stock Listings
Tokyo Stock Exchange, Osaka Stock Exchange

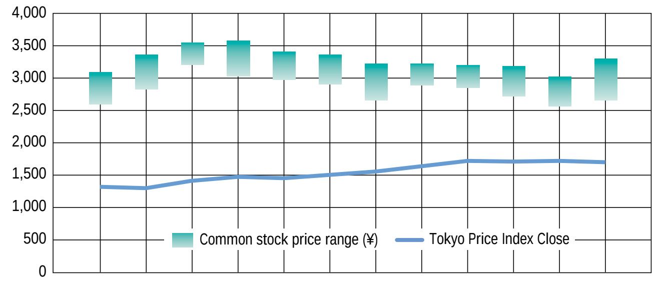
Ticker Symbol Number
4452

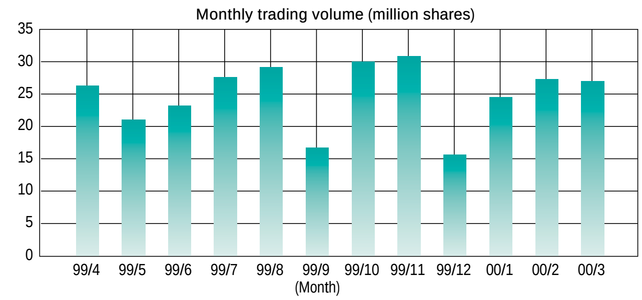
Transfer Agent
The Chuo Mitsui Trust and Banking Company, Limited
8-4, Izumi 2-chome,
Suginami-ku, Tokyo 168-0063, Japan

Composition of Shareholders (As of March 31, 2000)



Stock Price Range & Trading Volume
(Tokyo Stock Exchange)





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