Kao Corporation

*News Release* April 22, 2004

# Kao Corporation Reports Business Results

Tokyo, April 22, 2004 — Kao Corporation today announced its consolidated and non-consolidated business results for the fiscal year ended March 31, 2004. The following summary of the business results that Kao submitted to the Tokyo Stock Exchange is unaudited and for reference only.

## Consolidated Financial Highlights (Unaudited)

(Millions of yen, millions of U.S. dollars, except per share data)

| | **2004** | 2003 | Change | **2004** |
|---|---|---|---|---|
| | Yen | | % | U.S. Dollars |
| Net sales | **902,627** | 865,247 | 4.3 | **8,540.3** |
| Operating income | **119,705** | 114,914 | 4.2 | **1,132.6** |
| Ordinary income | **122,651** | 117,487 | 4.4 | **1,160.5** |
| Net income | **65,358** | 62,462 | 4.6 | **618.4** |
| Total assets | **723,891** | 720,849 | 0.4 | **6,849.2** |
| Total shareholders' equity | **427,756** | 417,030 | 2.6 | **4,047.3** |
| Shareholders' equity/total assets | **59.1%** | 57.9% | - | **59.1%** |
| Shareholders' equity per share (Yen/US$) | **782.14** | 744.56 | 5.0 | **7.40** |
| Net income per share (Yen/US$) | **119.06** | 108.05 | 10.2 | **1.13** |
| Net income per share, fully diluted (Yen/US$) | **113.98** | 103.69 | 9.9 | **1.08** |
| | | | Yen | |
| Net cash provided by operating activities | **117,928** | 134,179 | 16,251 | **1,115.8** |
| Net cash used in investing activities | **(37,348)** | (77,568) | 40,220 | **(353.4)** |
| Net cash used in financing activities | **(49,323)** | (104,186) | 54,863 | **(466.7)** |
| Cash and cash equivalents, end of term | **107,151** | 75,684 | 31,467 | **1,013.8** |

*Notes:*

1. *Net income per share is computed based on the weighted average number of shares outstanding during the corresponding periods: 547,865,073 shares for 2004 and 576,770,019 shares for 2003*
2. *Number of shares outstanding at the end of the periods: 546,738,323 shares for 2004 and 559,913,333 shares for 2003*
3. *Changes in scope of consolidation: Consolidated subsidiaries (3 additions); Affiliates accounted for by the equity method (1 addition)*
4. *U.S. dollar amounts represent translations using the approximate exchange rate on March 31, 2004, of 105.69 yen=US$1, and are included solely for the convenience of readers.*
5. *Yen amounts are rounded down to the nearest million.*

## Forecast of Consolidated Results for the Six Months Ending September 30, 2004 and the Year Ending March 31, 2005

(Millions of yen, millions of U.S. dollars, except per share data)

| | Six-months ending September 30, 2004 | | Year ending March 31, 2005 | |
|---|---|---|---|---|
| | Yen | U.S. Dollars | Yen | U.S. Dollars |
| Net sales | 460,000 | 4,352.4 | 935,000 | 8,846.6 |
| Operating income | - | - | 123,000 | 1,163.8 |
| Ordinary income | 59,000 | 558.2 | 125,000 | 1,182.7 |
| Net income | 34,000 | 321.7 | 72,000 | 681.2 |
| Net income per share (Yen/US$) | - | - | 132.63 | 1.25 |

*Note: Net income per share is computed based on the estimated weighted average number of shares outstanding during the fiscal year.*

## Consolidated Segment Information by Industry (Unaudited)

| | Billions of Yen | | | | | | |
|---|---|---|---|---|---|---|---|
| | SALES | | | | OPERATING INCOME | | |
| YEAR ENDED MARCH 31 | **2004** | 2003 | % Change | Like-for-like | **2004** | 2003 | Incr./(Dcr.) |
| Consumer Products | **670.4** | 646.4 | 3.7 | 4.4 | **92.1** | 90.3 | 1.8 |
| Prestige Cosmetics | **77.6** | 75.8 | 2.4 | 2.5 | **7.4** | 5.2 | 2.1 |
| Chemical Products | **181.6** | 170.9 | 6.3 | 6.1 | **19.9** | 18.2 | 1.7 |
| Corporate/Eliminations | **(27.0)** | (27.9) | - | - | **0.1** | 1.0 | (0.9) |

| | Millions of U.S. Dollars | | | | | | |
|---|---|---|---|---|---|---|---|
| | SALES | | | | OPERATING INCOME | | |
| YEAR ENDED MARCH 31 | **2004** | 2003 | % Change | Like-for-like | **2004** | 2003 | Incr./(Dcr.) |
| Consumer Products | **6,343.4** | 6,116.1 | 3.7 | 4.4 | **872.3** | 854.9 | 17.4 |
| Prestige Cosmetics | **734.7** | 717.5 | 2.4 | 2.5 | **70.3** | 49.9 | 20.4 |
| Chemical Products | **1,718.4** | 1,617.3 | 6.3 | 6.1 | **188.7** | 172.2 | 16.4 |
| Corporate/Eliminations | **(256.2)** | (264.3) | - | - | **1.3** | 10.3 | (8.9) |

## Consolidated Geographic Segment Information (Unaudited)

| | Billions of Yen | | | | | | |
|---|---|---|---|---|---|---|---|
| | SALES | | | | OPERATING INCOME | | |
| YEAR ENDED MARCH 31 | **2004** | 2003 | % Change | Like-for-like | **2004** | 2003 | Incr./(Dcr.) |
| Japan | **673.6** | 654.5 | 2.9 | 2.9 | **104.8** | 98.5 | 6.3 |
| Asia/Oceania | **101.4** | 101.5 | (0.1) | 5.4 | **5.3** | 5.3 | 0.0 |
| North America | **79.9** | 75.7 | 5.4 | 15.5 | **6.7** | 7.2 | (0.5) |
| Europe | **84.8** | 67.8 | 25.1 | 13.4 | **2.7** | 2.9 | (0.1) |
| Corporate/Eliminations | **(37.2)** | (34.5) | - | - | **0.0** | 0.8 | (0.8) |

| | Millions of U.S. Dollars | | | | | | |
|---|---|---|---|---|---|---|---|
| | SALES | | | | OPERATING INCOME | | |
| YEAR ENDED MARCH 31 | **2004** | 2003 | % Change | Like-for-like | **2004** | 2003 | Incr./(Dcr.) |
| Japan | **6,373.9** | 6,193.5 | 2.9 | 2.9 | **991.7** | 932.0 | 59.7 |
| Asia/Oceania | **959.9** | 960.9 | (0.1) | 5.4 | **50.7** | 50.9 | (0.2) |
| North America | **756.0** | 717.2 | 5.4 | 15.5 | **63.7** | 68.6 | (4.9) |
| Europe | **803.3** | 641.9 | 25.1 | 13.4 | **25.8** | 27.6 | (1.8) |
| Corporate/Eliminations | **(352.8)** | (326.8) | - | - | **0.6** | 8.2 | (7.6) |

*Notes:*

1. *The U.S. dollar amounts included herein represent translations using the approximate exchange rate on March 31, 2004, of 105.69 yen=US$1, solely for convenience.*
2. *Like-for-like growth rates exclude the currency translation effect related to translation of local currencies into Japanese yen.*

## Non-Consolidated Financial Highlights (Unaudited)

(Millions of yen, millions of U.S. dollars, except per share data)

| | **2004** | 2003 | Change | **2004** |
|---|---|---|---|---|
| | Yen | | % | U.S. Dollars |
| Net sales | **665,914** | 661,747 | 0.6 | **6,300.6** |
| Operating income | **98,379** | 94,454 | 4.2 | **930.8** |
| Ordinary income | **105,410** | 98,300 | 7.2 | **997.4** |
| Net income | **61,041** | 49,434 | 23.5 | **577.5** |
| Total assets | **630,900** | 623,731 | 1.1 | **5,969.3** |
| Total shareholders' equity | **423,762** | 411,791 | 2.9 | **4,009.5** |
| Shareholders' equity/total assets | **67.2%** | 66.0% | - | **67.2%** |
| Shareholders' equity per share (Yen/US$) | **774.86** | 734.64 | 5.5 | **7.33** |
| Net income per share (Yen/US$) | **111.19** | 85.42 | 30.2 | **1.05** |
| Net income per share, fully diluted (Yen/US$) | **106.46** | 82.04 | 29.8 | **1.00** |

*Notes:*
1. *Net income per share is computed based on the weighted average number of shares outstanding during the corresponding periods: 547,937,548 shares for 2004 and 577,209,739 shares for 2003*
2. *Number of shares outstanding at the end of the periods: 546,738,323 shares for 2004 and 560,353,053 shares for 2003*
3. *U.S. dollar amounts represent translations using the approximate exchange rate on March 31, 2004, of 105.69 yen=US$1, and are included solely for the convenience of readers.*
4. *Yen amounts are rounded down to the nearest million.*

## Forecast of Non-consolidated Results for the Six Months Ending September 30, 2004 and the Year Ending March 31, 2005

(Millions of yen, millions of U.S. dollars, except per share data)

| | Six-months ending September 30, 2004 | | Year ending March 31, 2005 | |
|---|---|---|---|---|
| | Yen | U.S. Dollars | Yen | U.S. Dollars |
| Net sales | 340,000 | 3,217.0 | 685,000 | 6,481.2 |
| Operating income | - | - | 101,000 | 955.6 |
| Ordinary income | 52,000 | 492.0 | 105,000 | 993.5 |
| Net income | 32,000 | 302.8 | 64,000 | 605.5 |
| Dividend per share (Yen) | 19.00 | 0.18 | 19.00 | 0.18 |
| Net income per share | - | - | 117.88 | 1.12 |

*Note: Net income per share is computed based on the estimated weighted average number of shares outstanding during the fiscal year.*

**Forward-Looking Statements**

This release contains forward-looking statements that are based on management's estimates, assumptions and projections at the time of release. 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.

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# *Management Policies*

## 1. Basic Management Policies

The mission of Kao Corporation is to contribute to the wholehearted satisfaction and enrichment of the lives of customers throughout the world by providing products of excellent value and outstanding performance. Based on this mission, Kao aims to win the highest levels of trust and support from customers with consumer products for cleanliness, beauty and health to help people enrich their lives, and by contributing to industrial development in the chemical products field. Moreover, Kao views consistently augmenting corporate value based on profitable growth and becoming a more competitive and respected company as being closely linked to securing profits for shareholders.

## 2. Basic Policies Regarding Distribution of Profits

In its dividends to shareholders, Kao seeks to pay per-share dividends of approximately 30% of consolidated net income. The Company's basic policy is to increase per-share profit each year to achieve continuous increases in per-share dividends. Based on this policy, Kao plans to set a year-end dividend for this fiscal year of 16 yen per share, the same as the interim dividend. As a result, cash dividends for the full fiscal year will be 32 yen per share, an increase of two yen compared with the previous fiscal year. Including stock splits implemented in the past, this will be the fourteenth consecutive annual increase in the dividend. In its use of free cash flow, the Company strives to increase future corporate value primarily through capital investment for further expansion of existing core businesses and new business development, and through acquisitions. The Company also uses free cash flow to undertake share repurchases in a flexible manner to increase returns to shareholders, keeping investment efficiency from a long-term perspective uppermost in mind. During the past fiscal year, Kao repurchased 16 million shares of its own stock at a cost of 36.7 billion yen. All of the repurchase plans approved at previous general shareholders' meetings will be completed, including the previously announced plan for the repurchase of up to 10 million additional shares between April 1 and June 23, 2004, at a total acquisition cost of up to 25.0 billion yen.

## 3. Policy Concerning Number of Shares Constituting One Unit of Stock

Kao is aware of the need for a large number of investors to participate in the trading of its shares and for the sufficient liquidity of its shares, for them to be purchased at appropriate price levels. In terms of liquidity, Kao shares continued to rank highly during the past fiscal year among shares traded on the First Section of the Tokyo Stock Exchange. In addition, the number of shareholders increased by about 20% compared with the previous fiscal year to approximately 48,000, with individual shareholders accounting for most of the increase. The Company will continue to make wide-ranging observations of market trends and demands, and to consider whether or not reducing the number of shares in each lot would be in the best interests of shareholders and cost effective.

## 4. Management Measure Used as a Target

EVA (Economic Value Added),* which is used to measure true profit by including the cost of invested capital as a factor, is Kao's principal management measure. The Company links continuing growth of EVA to expansion of corporate value, which means long-term profits not only for shareholders, but for all Kao stakeholders as well. Kao views EVA growth as the purpose of its business activities. This measurement is also utilized in determining the direction of long-term management strategies, for assessments of specific businesses, for evaluation of acquisitions and capital investments, and in developing performance targets for each fiscal year. To build motivation, levels of achievement of targeted year-on-year improvement in EVA are a factor in determining bonuses for directors and employees.

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

**5. Medium- and Long-Term Management Strategies**

By positioning consumer products, prestige cosmetics and chemical products as its core business areas, Kao pursues profitable growth by emphasizing research and development and by making high-quality, innovative products that meet the true needs of consumers and customers. Based on this, Kao aims to be a competitive and respected company.

To be a profitable company that can sustain profitable growth, Kao makes focused investments of management resources in these core businesses. Additionally, Kao will pursue development in new business fields such as health care (functional food), which shares a platform with the Company's core businesses and is expected to become another core business in the future.

Overseas, Kao will seek to expand business in the Asian region, which is a growth market in the consumer products business, with a focus on China in particular. At the same time, Kao will expand the premium beauty care business in North America and Europe. In the chemical products business, Kao will strive to expand business for products such as oleochemicals, surfactants, fragrances and aroma chemicals, and toner and toner binders. To facilitate expansion of overseas business, the Company will work to broaden its research results and product development capabilities, as well as generate synergy with existing businesses, through acquisitions and strategic business alliances. In addition, Kao will continue to review and develop its management structure and business models.

The Company will also continue to aggressively reduce operating costs, take steps to raise work efficiency, and strive to achieve sustained EVA growth. To be a respected company that can generate profitable growth Kao will continue taking measures to improve its quality as a company, including enhancing corporate governance, energizing its human resources, and increasing its social value with a consciousness of its corporate social responsibility.

**6. Issues for Management**

Kao expects the operating environment to become increasingly difficult and to undergo dramatic changes. Amid such conditions, the Company must, first of all, reinforce the strength of its existing businesses. Particularly for key products in the consumer products business, the Company aims to take advantage of its brand power built over many years to expand its market share through development of products with high added value, as well as strategic, focused investments of management resources. While Kao will develop products with new functions in its existing business areas, the Company will develop and quickly foster new businesses for further growth. In the health care (functional food) business, which has steadily generated new seeds for growth during the last several years, the research and development infrastructure was further enhanced in spring 2004 with the completion of a new research facility. Moreover, with little growth expected in the domestic market, expanding and strengthening overseas business is becoming increasingly important. Kao will therefore strengthen its overseas business by deploying the full capabilities of the Kao Group in its commitment to learning from local markets and customers.

## 7. Basic Position on Corporate Governance and its Implementation

Kao's basic corporate governance policy is to develop a suitable managerial organization and system, and to take the necessary measures to realize the Company's basic management policies in order to achieve continuous increases in corporate value through profitable growth. The Company considers corporate governance to be one of its most important managerial tasks.

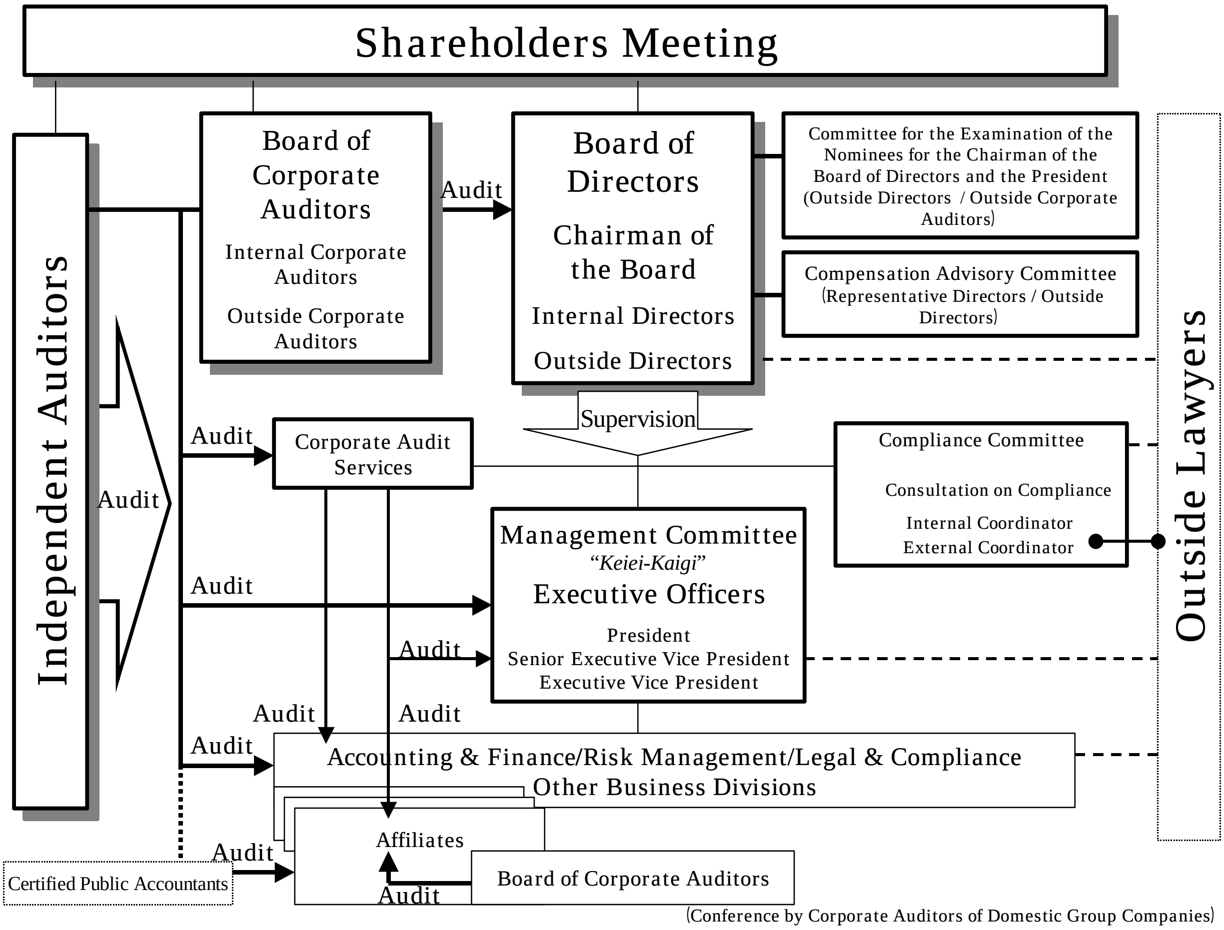
In its previous management framework of directors and corporate auditors, the Company introduced the executive officer system at the General Meeting of Shareholders held in June 2002. In its current management system, the Company has 13 directors (including 2 outside directors), 20 executive officers (including 11 who serve concurrently as directors), and 4 corporate auditors (including 2 outside corporate auditors). At the General Meeting of Shareholders held in June 2003, the Company established a system to promote the separation of supervision and execution by attaching the title of executive officer rather than director to the titles of the president, senior executive vice presidents and executive vice presidents, and by making the chairman the "Chairman of the Board of Directors," rather than an executive officer. The Company has informally approved a proposal to remove the status of representative director from the position of Chairman of the Board of Directors after the General Meeting of Shareholders scheduled to be held on June 29, 2004.

The Company will give ongoing consideration as to whether it should become a "Company with three committees" as defined by the amended Commercial Code, as it believes it is a management issue of great importance. However, the Company has established a "Compensation Advisory Committee" and a "Committee for the Examination of the Nominees for the Chairman of the Board of Directors and the President," which perform functions similar to those of the Compensation Committee and the Nomination Committee in a "Company with three committees." In the "Compensation Advisory Committee," the Company's representative directors obtain the opinions of outside directors with respect to the compensation system for the directors and executive officers and its level. The compensation system and its level, including the new management structure after the General Meeting of Shareholders in June 2004, are expected to be quickly examined and evaluated. The "Committee for the Examination of the Nominees for the Chairman of the Board of Directors and the President" consists exclusively of all outside directors and all outside corporate auditors. This committee will examine the nominees prior to the election or re-election of the chairman of the board and or the president and will submit its evaluation of the nominees' qualifications to the board of directors. The candidates for Chairman of the Board of Directors and President and CEO that were announced on April 12, 2004, had previously been informally approved by the Board of Directors and examined by the committee.

Issues regarding the Company's compensation system for executives have included introducing a stock option plan, clarifying the performance-linked bonus system based on EVA, and abolishing the provision for retirement allowances for executives.

In addition, the Company has established a "Compliance Committee" for the promotion of ethical corporate conduct and compliance with laws and regulations, and has routinely implemented activities for securing compliance with laws and regulations, fairness, and ethics. The Company has also recently revised the former "Corporate Ethics of Kao Corporation" to "Kao Business Conduct Guidelines" to further promote business conduct based on compliance with laws and regulations and ethics, as of April 2003. All of the Company's executives and all employees in Japan have signed pledges to comply with these guidelines.

The Company's corporate governance structure is shown in the following diagram.




One of Kao's two outside directors, Mr. Akishige Okada, is Chairman of the Board of Sumitomo Mitsui Financial Group, Inc. Transactions such as regular banking transactions, loans and guarantees take place between the Company, its affiliates and Sumitomo Mitsui Financial Group affiliates. Our other outside director, Ms. Sakie Tachibana Fukushima, is Representative Director of Korn/Ferry International and its affiliates provide recruiting services to the Company. All of the aforementioned are typical transactions among such companies, and the outside directors have no direct personal interest in the Company.

There are no transactions between outside corporate auditors and the Company. Moreover, the independent auditors that audit the Company's accounts and their employees involved in the auditing process have no direct personal interest in the Company. The independent auditors voluntarily ensure that any of their employees who become involved in our company's audit, will not be involved in the audit for more than a certain period of time. The Company and the independent auditors enter into an audit contract for the Commercial Code audit and the Securities and Exchange Law audit, and the Company pays a fee to them based on the contract.

In addition to the aforementioned "Compliance Committee," the Company has also established the "Corporate Audit Services Department," which is responsible for the Company's internal audit on the appropriateness of daily business operations, and validity and efficiency of management, including the Company's affiliates in Japan and abroad. Besides this, a number of important affiliated companies have voluntarily assigned audits of their accounting to outside accounting firms. Furthermore, corporate auditors of the Company and its related domestic group companies have periodic meetings to exchange information concerning audit practices and procedures. The

Company also seeks counsel and advice as necessary from outside experts such as lawyers with regard to management and business operations for managerial decision-making.

Details of remuneration, etc. to directors, corporate auditors and independent auditors are as follows:

Payment of Remuneration, etc. to Directors and Corporate Auditors

1. Remuneration to directors and corporate auditors

Directors: 328 million yen to 13 directors
Corporate Auditors: 66 million yen to 4 corporate auditors

Note: Upper limits of remuneration:
Directors: 450 million yen per year (not including amounts in item 2)
Corporate Auditors: 85 million yen per year

2. Aggregate amount of salaries, etc., paid to directors concurrently holding the position of employee for services rendered as an employee:

113 million yen (including bonuses)

3. Aggregate amount of directors' bonuses paid as appropriation of retained earnings:

132 million yen to 13 directors

4. Aggregate amount of retirement allowances paid to executives pursuant to resolutions made at shareholders meetings during the fiscal year:

3 million yen to 2 corporate auditors

Note: The Company ceased the practice of maintaining a reserve fund for retirement allowances in July 2001. Accordingly, the retirement allowances above were only for the period from assumption of office until June 30, 2001.

Payment of Remuneration, etc., to Independent Auditors

Remuneration paid to Tohmatsu & Co., the account auditors of the Company

Amount of remuneration for audit certification based on audit contract:
59 million yen

Amount of remuneration for other services: 100 million yen

Remuneration other than audit remuneration is for services such as due diligence, accounting and tax consultation related to business integration and other matters.

# *Consolidated Business Results and Financial Condition*

## 1. Consolidated Business Results

### (1) Summary of Business Results for the Period under Review

In the fiscal year ended March 31, 2004, although positive signs appeared in the Japanese economic environment, such as a rebound in corporate earnings and improvement in economic indicators, household income growth – the backbone of consumer spending – was weak, while the elements necessary to declare a full-scale recovery were lacking and the emergence from deflation was still uncertain.

Consolidated net sales rose by 37.3 billion yen to 902.6 billion yen, a 4.3% increase from the previous fiscal year. Excluding a negative currency translation effect of 4.6 billion yen from overseas sales due to the stronger yen, actual sales growth was 4.9%. Sales in Japan increased by 2.9%. In the consumer products business, which was affected by declining sales prices due to stronger market competition, as well as a long rainy season and cool summer, the Company worked to expand sales through the launch of new high-value-added products and aggressive marketing measures. In the chemical products business, although sales of established products were flat due to the sluggish economy, exports were favorable, as were sales of newly developed products. Overseas sales increased 8.6%, supported by the benefit from acquisitions. The consumer products business acquired in September 2002 in the U.S. and the chemical products business performed well, but sales of existing consumer products in the U.S. and Europe affected by the economic slowdown and sales of consumer products in Asia were weak amid increasing market competition.

Cost of sales increased to 377.7 billion yen from 365.5 billion yen in the previous fiscal year, along with the increase in net sales. As a percentage of net sales, cost of sales decreased 0.5 percentage points to 41.8% despite higher prices for natural oils and fats and other raw materials. Market launches of new high-value-added products and a continuing focus on cost-cutting activities offset higher raw material prices.

Selling, general and administrative (SG&A) expenses increased 5.3%, or 20.4 billion yen, from the previous fiscal year to 405.1 billion yen. The Company aggressively deployed marketing expenses for the launch of new products aimed at business expansion. As a result, advertising and promotional expenses increased by 8.4 billion yen. *John Frieda*, a premium hair care brand in the U.S. that the Company acquired in September 2002, contributed to consolidated business results for the first full fiscal year, and related marketing costs also increased. Reflecting the Company's focus on R&D activities to launch creative, value-added products, research and development expenses were 38.5 billion yen, equivalent to 4.3% of net sales.

Operating income rose by 4.2% from 114.9 billion yen in the previous fiscal year to 119.7 billion yen due to higher net sales and efforts to reduce costs, and exceeded the original projection of 119.0 billion yen. In Japan, operating income rose by 6.3 billion yen to 104.8 billion yen. In particular, operating income in the prestige cosmetics business increased substantially. Overseas, the cost of test marketing for functional cooking oil in the U.S. and decreased profit from weak sales of consumer products in Asia resulted in a 0.7 billion yen decrease in operating income to 14.8 billion yen.

In non-operating income and expenses, net non-operating income of 2.5 billion yen in the previous fiscal year increased to net non-operating income of 2.9 billion yen. The principal reason was that, while investment income decreased 0.7 billion yen, the foreign currency exchange effect improved by 1.1 billion yen to a 0.3 billion yen gain from a 0.8 billion yen loss in the previous fiscal year. Extraordinary gain and loss totaled a net loss of 5.5 billion yen, compared with a net loss of 4.9 billion yen in the previous fiscal year. Principal factors were a gain of 8.0 billion yen on the return of the proxy portion of pension funds and a loss of 7.1 billion yen on valuation of land in the previous fiscal year, and a gain of 1.5 billion yen on the sale of land due to the restructuring of distribution centers and a loss of 2.7 billion yen on valuation of land in the fiscal year under review.

As a result, ordinary income rose by 5.1 billion yen from the previous fiscal year to 122.6 billion yen, and income before income taxes and minority interests rose by 4.5 billion yen from the previous fiscal year to 117.1 billion yen.

Income taxes increased from 47.6 billion yen in the previous fiscal year to 50.4 billion yen. Although R&D expenses were applied toward decreasing the tax rate in Japan, the tax effect of certain overseas subsidiaries that posted losses could not be recognized. As a result, the tax rate after application of tax-effect accounting increased slightly, from 42.3% in the previous fiscal year to 43.0%.

Net income was 65.3 billion yen, an increase of 4.6% from the previous fiscal year. Net income per share increased 10.2% from the previous fiscal year to 119.06 yen, in part because the Company repurchased 16 million shares of its own stock from the market.

Because the Company achieved its expected profit, it will pay a year-end cash dividend of 16 yen per share, an increase of 1 yen per share, as planned.

EVA increased steadily, as profit rose while the Company controlled increases in capital charges through measures including share buybacks. EVA was 142, against the benchmark of 100 in the fiscal year ended March 31, 2000, when Kao adopted EVA management.

### (2) Summary of Results by Business Segment

Sales of consumer products and prestige cosmetics in Japan were firm. In the chemical products business, sales were generally solid, although some products were affected by the sluggish economy. Overseas, Kao expanded sales in each business, due in part to the benefit of acquisitions in the consumer products business in North America and Europe.

Operating income in the consumer products business declined overseas, but increased in Japan. In the prestige cosmetics business, operating income increased steadily. In addition, the chemical products business achieved an increase in income in Japan and overseas, as rising raw material prices were offset by expansion of sales volume and steady growth of newly developed products.

### Consumer Products Business

Net sales of consumer products were 670.4 billion yen, an increase of 3.7% over the previous fiscal year. Excluding the effect of currency translation, sales growth in real terms was 4.4%. Sales in Japan increased 2.6% over the previous fiscal year. Overseas, sales also increased despite the effects of currency translation. Total operating income for consumer products increased by 1.8 billion yen to 92.1 billion yen. Although Kao was able to secure profits in Japan, overseas profits decreased due to a slowdown in sales in established businesses and test marketing expenses for functional cooking oil.

1) Japan

Retail sales in the market as a whole remained lower than in the previous fiscal year, due to lower selling prices at stores and the effects of the long rainy season and cool summer. By channel, sales at drugstore chains increased, while sales at large supermarket chains trended downward, and sales at convenience stores and home improvement centers were essentially unchanged. Kao conducted integrated marketing and sales activities for each chain and area, and worked to invigorate the market by introducing new and improved products. In terms of profits, however, although factors such as increased advertising and promotional expenses and lower selling prices reduced profits, higher sales volume of newly launched products and cost-cutting efforts resulted in an increase in profits.

Sales Composition of Consumer Products

| | Billions of yen | | |
|---|---|---|---|
| YEAR ENDED MARCH 31 | **2004** | 2003 | % change |
| Personal Care | **171.5** | 165.5 | 3.6 |
| Fabric and Home Care | **241.0** | 248.9 | (3.2) |
| Feminine Care, Baby Care and Others | **101.5** | 86.2 | 17.6 |
| Total | **514.1** | 500.8 | 2.6 |

In the personal care products market, sales volume showed little growth, leading to a further increase in competition and a decline in selling prices at stores.

Under these conditions, Kao focused on enhancing its position in the market. In the shampoo, conditioner and treatment category, Kao launched *Asience*, a new premium brand that brings out the beauty of hair from within, and received enthusiastic support from consumers, particularly young women, increasing sales substantially. As a result, Kao regained the top share of the hair care market. For *Bioré*, which the Company is nurturing into a total skin care brand, newly added products *Bioré Mild-Acid UV Cut* lotion, *Bioré Perfect Oil* makeup remover and *Bioré u* body cleanser were well received by consumers and contributed to sales growth.

As a result, sales of personal care products increased 3.6% over the previous fiscal year.

Principal new products:
*Asience* shampoo, conditioner and treatment
*Bub Milky* bath additives – White Rose Scent
*Biore u Foam* hand soap

The mature fabric and home care products market gradually contracted due to declining prices despite the easing of deflationary conditions, and competition continued to intensify.

Under these conditions, the Company aggressively proposed new products to meet changing consumer lifestyles. In the laundry detergent category, Kao introduced *Attack with Bleach*, an antibacterial product that can remove food stains and other tough dirt. However, a decline in selling prices due to competition and the effects of an unusually cool, rainy summer resulted in a decrease in sales. At the same time, the Company began marketing *Allerclean* home hygiene care products for easy removal of minute dust particles and waste generated by mites, which are hard to eliminate in daily cleaning. This product was well received by consumers and is creating a new market.

As a result, sales of fabric and home care products in Japan decreased 3.2% compared with the previous fiscal year.

Principal new products:
*Attack with Bleach* laundry detergent
*Allerclean* home hygiene spray
*Toilet Magiclean Power Liquid* toilet bowl cleaner

In the area of feminine care and baby care products, the Company worked to raise brand value and improve products in the *Merries* disposable baby diaper category by improving basic product performance. However, selling prices in the market dropped further and competition intensified. Consequently, sales declined substantially compared with the previous fiscal year. Sales of *Relief* adult incontinence products increased as their brand image improved among consumers.

*Healthya Green Tea*, a tea drink launched at the end of May 2003, received strong support from consumers concerned about body fat, and sold well after its market debut despite the many other health-oriented products on the market, contributing significantly to the increase in sales. Sales of the *Econa Healthy* cooking oil series, which maintains a high share of the market for healthy cooking oil, continued to grow strongly in the gift market.

As a result, sales of feminine care, baby care and other products increased 17.6% compared with the previous fiscal year.

Principal new products:
*Laurier Super Guard Powerful Daytime Use* sanitary napkins
Econa Dressing Sauce Salad and Seafood
*Healthya Green Tea*

2) Asia and Oceania

In Asian markets, the increasing concentration of sales at large chain stores has made building strong brands critical. For this reason, Kao focused its management resources on core brands. For *Bioré*, Kao enhanced its line of facial cleansers while working to reorient *Bioré* as a total skin care brand. In the *Laurier* line of sanitary napkins, the Company launched products with distinctive features. However, *Feather* and *Sifoné* hair care products and *Merries* baby diapers struggled in an increasingly competitive market. Sales were essentially unchanged in the ASEAN region, but decreased from the previous fiscal year in greater China, resulting in overall sales of 59.9 billion yen, a 6.6% decrease from the previous fiscal year.

In addition, Kao decided to establish a new plant in the suburbs of Bangkok, Thailand to optimize its production network in Thailand and the ASEAN region. This new plant will begin operations starting in 2005. In China, the sales division of Kao Corporation Shanghai was separated and established as a sales company in spring 2003. This company will enhance Kao's sales capabilities while strengthening cooperation with Kao Transfar (Hangzhou) Co., Ltd.

3) North America and Europe

Conditions remained severe in the markets of North America and Europe because of factors including weak consumer spending at the start of the period. Sales of existing brands were unchanged at The Andrew Jergens Company in the U.S. and KPSS-Kao Professional Salon Services GmbH. However, the *John Frieda* premium hair care business acquired by The Andrew Jergens Company in September 2002 achieved growth significantly higher than initial projections. Guhl Ikebana GmbH, which handles premium hair care products in Germany, launched *ReVité* in fall 2003. This product, which incorporates Kao's hair beautifying technology, was well received by consumers. As a result, overall sales were 102.0 billion yen, a 16.6% increase from the previous fiscal year.

**Prestige Cosmetics Business**

The cosmetics market has entered a mild recovery phase from the year-on-year declines up to the previous fiscal year. Under these conditions, sales of prestige cosmetics increased 2.4% compared with the previous fiscal year to 77.6 billion yen. *Grace Sofina,* which uses a superior medicinal effect to help mature skin maintain a glowing, healthy appearance, and *Wrinkle Seraty*, which promotes, smooth, supple skin around the eyes, mouth and the entire face, both performed well. Kao continued to conduct energetic marketing and sales promotion efforts for *est*, a brand sold exclusively at department stores, and maintained healthy sales growth. In addition, Kao expanded its *Raycious* series of oil- and perspiration-resistant foundation cosmetics. Operating income in the prestige cosmetics business increased by 2.1 billion yen compared with the previous fiscal year, due to factors such as Kao's efforts to reduce manufacturing costs and deploy expenses more efficiently.

Principal new products:
*Rise UV Cut* **-** Milk, Cream
*Wrinkle Seraty* essence gel
*Raycious Ray Select Powder* foundation

**Chemical Products Business**

In Japan, although the economy showed signs of a recovery toward the end of the fiscal year, the manufacturing industry as a whole displayed little strength and was affected by rising prices for natural fats and oils and petrochemicals. In this environment, Kao worked to expand its business in the core fields of oleochemicals, surfactants and specialty chemicals. In Japan, an industry slowdown continued to affect existing products, but sales of newly developed products grew steadily. Main areas of growth during the fiscal year included the fatty alcohol business, for which the Company expanded production capacity in Malaysia in the previous fiscal year. In Japan, North America and Europe, specialty chemicals performed well, including toner and toner binder products for copiers and printers as well as fragrances and aroma chemicals. As a result, sales totaled 181.6 billion yen, a growth rate of 6.3%, or 6.1% excluding the effect of translation rate changes. Operating income rose 1.7 billion yen from the previous fiscal year to 19.9 billion yen as increased sales volume, cost reductions and more efficient use of expenses offset the increase in depreciation expenses of capital investments and higher raw material costs.

1) Japan

The automobile and IT industries and some material industries such as steel performed well, but production was weak in industries that rely on domestic demand. As a result, the overall low growth rate continued.

Under these conditions, Kao made further efforts to expand sales of products with unique features and newly developed products. In businesses related to specialty chemical products, sales of toner showed solid growth. In particular, the market for color toner expanded significantly. In the industrial materials business, sales of cleaners for the electronic components industry expanded strongly. However, sales of high-performance concrete additives that dramatically strengthen raw concrete were affected by a continued decrease in public investment in the construction sector. Sales of a pigment auxiliary for color inkjet printer ink, which went on the market in 2002, were favorable, reflecting high regard for the product's features. In addition, sales and exports of slurries for use in polishing hard disks increased substantially as Kao worked to swiftly meet customer needs. As a result, sales increased by 2.9% compared with the previous fiscal year to 104.8 billion yen.

2) Asia

After expanding fatty alcohol production capacity in Malaysia in 2002, Kao worked on a global basis to promote sales, which increased sharply. Sales of high-performance concrete additives rose steadily in China, where massive construction projects are generating brisk demand, as well as in Taiwan and countries elsewhere in Asia. As a result, sales increased by 9.0% compared with the previous fiscal year to 41.8 billion yen.

3) North America and Europe

Sales increased in the business of toners and toner binder products for copiers and printers, as Kao fortified its global business infrastructure in Japan, North America and Europe. In the aroma chemicals business, in which several Kao products hold the top global market share, the Company increased sales by extending its product line with a business acquisition from a European chemical manufacturer in May 2003. As a result, overall sales increased by 10.7% compared with the previous fiscal year to 56.8 billion yen.

The translation rates used to calculate income and expenses for consolidated subsidiaries and other companies outside Japan for the fiscal year were one U.S. dollar to 115.73 yen, one euro to 131.68 yen, and one new Taiwan dollar to 3.36 yen.

## 2. Forecast for the Fiscal Year Ending March 31, 2005

| | Billions of Yen | | | Millions of U.S. Dollars |
|---|---|---|---|---|
| YEAR ENDED MARCH 31 | **2005** | 2004 | % change | **2005** |
| Net sales | **935.0** | 902.6 | 3.6 | **8,846.6** |
| Operating income | **123.0** | 119.7 | 2.8 | **1,163.8** |
| Ordinary income | **125.0** | 122.6 | 1.9 | **1,182.7** |
| Net income | **72.0** | 65.3 | 10.2 | **681.2** |
| Net income per share (Yen/US$) | **132.63** | 119.06 | 11.4 | **1.25** |

*Note: U.S. dollar amounts represent translations using the approximate exchange rate on March 31, 2004, of 105.69 yen=US$1, and are included solely for the convenience of readers.*

### (1) Forecast of Results for the Fiscal Year

In the Japanese economy, corporate revenues are expected to maintain a firm footing for growth, and capital investment is trending toward growth. Moreover, consumer spending has been showing positive signs of an upturn, although the employment situation remains unclear. Overall demand in Kao's industry is expected to show no growth in terms of volume, and continue declining slightly in terms of value. In the U.S. economy, tax cuts and monetary easing are driving growth in consumer spending, but the delay in recovery of employment conditions and the situation in the Middle East are among the destabilizing elements that will cause great uncertainty to persist.

Under these conditions, in the Japanese consumer products business, Kao will strengthen its product development capabilities, the starting point of manufacturing, and will focus its resources on aggressive marketing and sales promotion activities to further strengthen core brands. Through these measures, Kao will work to stimulate the sluggish market and expand sales. In Asia, Kao will further concentrate its management resources on core categories, particularly in China, where it will build a business model to increase market share and grow strong brands by selling premium brands in selected cities and creating a sales organization that makes effective use of the wholesale channel. In the consumer products market in North America and Europe, Kao will work to launch new products and expand sales of hair care and skin care brands. Furthermore, the Company will promote unified management through The Andrew Jergens Company, which will be renamed Kao Brands Company in August, to generate maximum synergy between the *John Frieda* and *Guhl* brands.

In the prestige cosmetics business, Kao will work to further raise brand value and reinforce its business foundation by introducing distinctive new products. The Company also plans to begin business development in the growing Chinese market.

In the chemical products market, although results are improving in some customer industries, an overall recovery in market conditions is not expected, and sales in existing fields are forecast to remain flat. However, the Company will focus on expanding sales of products with unique features and newly developed products. Overseas, the Company forecasts continued strong performance, owing to higher sales of fatty alcohols, high-performance concrete additives, and specialty chemicals including toners and toner binder products for copiers and printers, as well as contributions from the aroma chemical business in Spain.

As a result of the above, Kao projects that net sales for the fiscal year will increase 3.6%, or 32.3 billion yen, to 935.0 billion yen, and that operating income will rise 2.8% to 123.0 billion yen. Ordinary income is expected to rise 1.9% to 125.0 billion yen, and net income is forecast to increase 10.2% to 72.0 billion yen. The Company anticipates an increase in marketing expenses and a rise in the cost of raw materials for fatty alcohols. Therefore, the Company will make efforts to secure profit by implementing further cost-cutting measures not only in Japan, but also overseas.

Assuming achievement of the projected profit figures, the Company expects to pay cash dividends of 38 yen per share for the fiscal year, an increase of 6 yen over the previous fiscal year.

Kao will work to increase profits and improve capital efficiency to meet market expectations and achieve continuous improvement in EVA.

Companies incur a variety of risks in conducting business. The Kao Group takes reasonable measures to reduce risk by preventing the occurrence of, dispersing and hedging risks. For example, in areas including the occurrence of a major quality-related problem or a large-scale earthquake, or substantial fluctuation in the currency exchange rate, unanticipated situations may arise that exert a significant impact on the Kao Group’s business results and financial condition.

**(2) Underlying Assumptions of the Forecasts for the Fiscal Year Ending March 31, 2005**

The above forecasts were made assuming exchange rates of one U.S. dollar to 110.0 yen, one euro to 130.0 yen, and one New Taiwan dollar to 3.3 yen.

# 3. Financial Condition

## (1) Summarized Consolidated Cash Flows (Unaudited)

### Consolidated Financial Condition (Unaudited)

| | Billions of Yen | | | Millions of U.S. Dollars |
|---|---|---|---|---|
| YEAR ENDED MARCH 31 | **2004** | 2003 | Incr/(Decr) | **2004** |
| Total assets | **723.8** | 720.8 | 3.0 | **6849.2** |
| Total shareholders' equity | **427.7** | 417.0 | 10.7 | **4,047.3** |
| Equity ratio (%) | **59.1%** | 57.9% | - | **59.1%** |
| Shareholders' equity per share (Yen/US$) | **782.14** | 744.56 | 37.58 | 7.40 |

### Summarized Consolidated Cash Flow (Unaudited)

| | Billions of Yen | | | Millions of U.S. Dollars |
|---|---|---|---|---|
| YEAR ENDED MARCH 31 | **2004** | 2003 | Incr./(Dcr.) | **2004** |
| Operating activities | **117.9** | 134.1 | (16.2) | **1,112.3** |
| Investing activities | **(37.3)** | (77.5) | 40.2 | **(349.8)** |
| Financing activities | **(49.3)** | (104.1) | 54.8 | **(466.7)** |
| Translation adjustments | **(2.4)** | (2.6) | 0.1 | **(23.5)** |
| Net increase | **28.7** | (50.2) | 79.0 | **272.2** |
| Beginning balance of newly consolidated companies | **2.6** | 0.9 | 1.7 | **25.5** |
| Cash and cash equivalents | **107.1** | 75.6 | 31.4 | **1,013.8** |
| Total debt | **49.6** | 49.0 | 0.6 | **469.8** |

*Note: The U.S. dollar amounts included herein represent translations using the approximate exchange rate on March 31 2004, of 105.69 yen=US$1, solely for convenience.*

Total assets increased 3.0 billion yen compared with the previous fiscal year to 723.8 billion yen. The total of property, plant and equipment and intangible assets decreased by 21.2 billion yen. Factors included capital expenditures during the fiscal year remaining within the scope of depreciation expenses, the sale and disposal of assets in connection with activities including the restructuring of distribution centers, and the amortization of trademarks and goodwill resulting from an acquisition in the previous fiscal year. Moreover, deferred income tax assets decreased by 7.1 billion yen, for reasons including an increase in tax-deductible cash contributions to the employees' pension fund. Cash and cash equivalents, as covered in the discussion of cash flow below, increased by 31.4 billion yen.

Shareholders' equity increased 10.7 billion yen compared with the previous fiscal year to 427.7 billion yen. Although net income increased solidly to 65.3 billion yen, a 28.4 billion yen increase in treasury stock and appropriation of profits to pay cash dividends totaling 17.0 billion yen were factors that limited the increase in shareholders' equity. As a result, shareholders' equity per share increased 37.58 yen compared with the previous fiscal year to 782.14 yen, and the shareholders' equity ratio increased from 57.9% to 59.1%.

Net cash provided by operating activities decreased 16.2 billion yen compared with the previous fiscal year to 117.9 billion yen. The change was mainly due to a negative effect on cash flow of a decrease in liability for retirement benefits as a result of an increase in cash contributions to the employees' pension fund, which had a positive effect in the previous fiscal year. Income before income taxes and minority interests increased by 4.5 billion yen to 117.1 billion yen. Depreciation and amortization was 58.1 billion yen, about the same as the previous fiscal year. Income taxes paid totaled 53.5 billion yen.

Net cash used in investing activities decreased 40.2 billion yen compared with the previous fiscal year to 37.3 billion yen. This decrease was mainly the result of the previous year's acquisition of John Frieda Professional Hair Care, Inc., including its trademarks. The Company also invested in production facilities for new products in Japan and overseas, as well as expansion of R&D and distribution facilities, the installation of a new information system and acquisition of an aroma chemicals and fragrance compound business in Europe. Proceeds from sales of property, plant and equipment due to restructuring of distribution sites and other facilities totaled 4.5 billion yen.

Net cash used in financing activities decreased 54.8 billion yen to 49.3 billion yen. Free cash flow, which equals net cash provided by operating activities minus net cash used in investing activities, was 80.5 billion yen. The Company purchased its own stock in the amount of 37.1 billion yen, following the purchases of the previous fiscal year, and paid cash dividends totaling 18.2 billion yen.

As a result of these activities, the balance of cash and cash equivalents at the end of the fiscal year was 107.1 billion yen, an increase of 31.4 billion yen from the end of the previous fiscal year.

**(2) Forecast for the Fiscal Year ending March 31, 2005**

In net cash provided by operating activities, income before income taxes and minority interests is expected to increase slightly despite a severe operating environment. Depreciation and amortization is projected to be 57.0 billion yen.

In net cash used in investing activities, capital investment in Japan is projected to remain the same as in the previous fiscal year despite plans to increase production capacity and promote streamlining. The level of investment outside Japan is projected to increase due to full-fledged construction of a new plant in Thailand.

In net cash used in financing activities, the Company plans to use any excess cash flow generated to flexibly repurchase shares of its own stock, taking into account business investment projects and other factors, in order to improve capital efficiency, increase returns to shareholders and allow the execution of timely and flexible capital policy measures. Because net income is projected to increase, the Company plans to raise cash dividends to 38.00 yen per share, which will be the fifteenth consecutive annual increase. Interest-bearing debt is projected to remain the same, totaling approximately 50.0 billion yen at the end of the fiscal year.

As a result of the above, the balance of cash and cash equivalents as of March 31, 2005 is forecast to increase from March 31, 2004, to 110.0 billion yen.

**(3) Cash Flow Indices**

| YEAR ENDED MARCH 31 | **2004** | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Shareholders' equity/Total assets (%) | **59.1** | 57.9 | 59.5 | 59.1 | 63.3 |
| Market capitalization/Total assets (%) | **179.8** | 186.0 | 186.0 | 245.6 | 259.7 |
| Interest-bearing debt/Operating cash flow (years) | **0.5** | 0.4 | 0.5 | 0.6 | 0.5 |
| Operating cash flow/Interest paid (times) | **91.3** | 85.8 | 72.2 | 54.7 | 72.4 |

*Notes:*
*1. All indices are computed based on consolidated data.*
*2. Market capitalization equals the stock price at the end of the fiscal year multiplied by the number of shares outstanding at the end of the fiscal year (excluding treasury stock).*
*3. Operating cash flow is stated in the consolidated statements of cash flows. Interest-bearing debt is all debt included in the consolidated balance sheets on which interest is paid.*