Annual Report 2008

For the year ended March 31, 2008

Kao Corporation

Profile

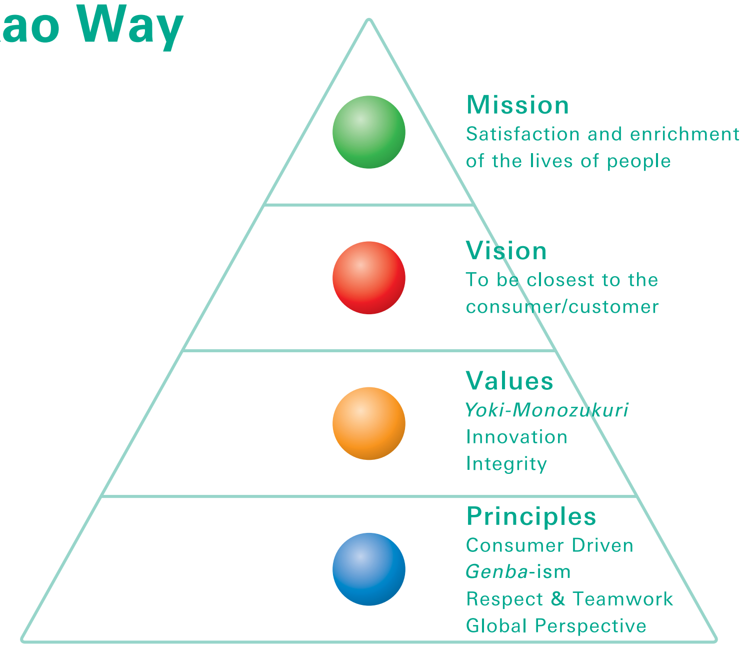
Kao Corporation conducts continuing research and development in line with its mission “to strive for the wholehearted satisfaction and enrichment of the lives of people globally.” We draw on our creative and innovative strengths to provide products and brands that offer excellent value created from the consumer/customer’s perspective. Kao constantly explores new avenues in science and technology, then integrates diverse elements in unique, ground-breaking ways to provide high-value-added products to consumers worldwide.

Further information on Kao’s CSR is available from the CSR report, which is updated in early September.

http://www.kao.co.jp/en/csr/report/

The Foundation of Our Corporate Activities:

The Kao Way



“The Kao Way” is based on “Kao Management Principles” (issued in 1995 and partly revised in 1999). We have reviewed and revised the Principles to reflect the changes that have occurred in our business environment internally and externally.

We define *Yoki-Monozukuri* as “a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction.” This core concept distinguishes Kao from all others.

Genba literally means “actual spot.” At Kao, *Genba*-ism defines the importance of observing things “on-site,” in the actual location and environment, both internally and externally, in order to maximize our understanding of the business and optimize our performance.

Further information on The Kao Way is available at
http://www.kao.co.jp/en/company/kaoway/index.html




Contents

Financial Highlights

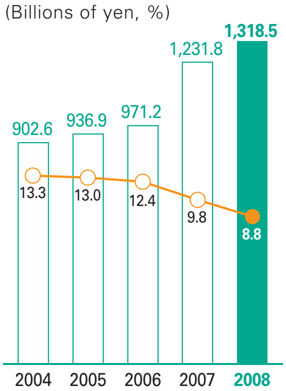
Kao Corporation and Consolidated Subsidiaries — Years ended March 31, 2008 and 2007

	Billions of yen		Millions of U.S. dollars	Change
	2008	2007	2008	2008/2007
For the year:				
Net sales	¥1,318.5	¥1,231.8	$13,160.1	7.0%
Beauty Care Business	627.9	584.3	6,267.2	7.5
Human Health Care Business	191.3	183.6	1,909.4	4.2
Fabric and Home Care Business	274.7	269.5	2,741.4	1.9
Consumer Products Business	1,093.9	1,037.4	10,918.0	5.4
Chemical Business	258.7	223.6	2,581.8	15.7
Eliminations	(34.0)	(29.2)	(339.7)	–
Japan	968.6	924.2	9,667.6	4.8
Asia & Oceania	158.3	126.0	1,579.9	25.6
North America	111.0	106.7	1,108.1	4.0
Europe	154.6	135.9	1,543.5	13.8
Eliminations	(74.0)	(61.0)	(739.0)	–
Operating income	116.3	120.9	1,160.3	(3.8)
Net income	66.6	70.5	664.4	(5.6)
EBITDA	209.7	213.0	2,093.0	(1.5)
At year-end:				
Total assets	1,232.6	1,247.8	12,302.6	(1.2)
Net worth	574.0	564.5	5,729.5	1.7
	Yen		U.S. dollars	Change
Per share:				
Net income	¥ 122.53	¥ 129.41	$ 1.22	(5.3)%
Cash dividends	54.00	52.00	0.54	3.8
Net worth	1,070.67	1,035.66	10.69	3.4

Notes:
1. The U.S. dollar amounts are translated, for convenience only, at the rate of ¥100.19=US$1, the approximate exchange rate at March 31, 2008.
2. Kao reorganized its operations effective April 2007 by integrating the former consumer products business and prestige cosmetics business into the Consumer Products Business, which is divided into three businesses (the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business). Together with the Chemical Business, Kao's business operations now consist of four business segments. Figures for 2007 have been restated to reflect the change.
3. Net sales by business segment and geographic segment include intersegment sales. Net sales of the Chemical Business include intersegment sales to the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business.
4. Cash dividends per share are the amounts applicable to the respective years, including dividends to be paid after the end of the year.
5. Yen and U.S. dollar amounts are rounded to the nearest whole number or decimal.
6. EBITDA (Earnings before interest, taxes, depreciation and amortization) = Operating income + Depreciation and amortization
7. Net worth is computed by subtracting minority interests and stock acquisition rights from equity.

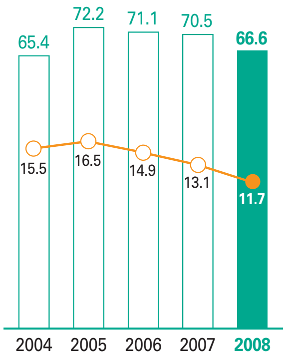
(Years ended March 31)

Net Sales and Operating Income Ratio
(Billions of yen, %)



Net Sales
Operating Income Ratio

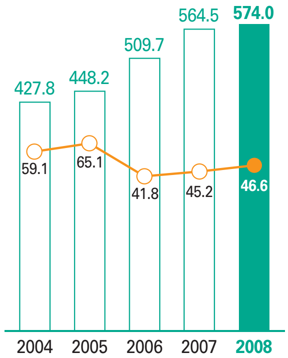
Net Income and ROE*
(Billions of yen, %)



Net Income
ROE

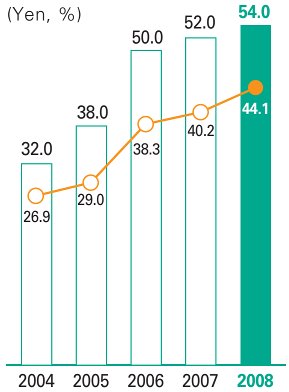
*For the purpose of comparison, in calculating ROE for the years ended March 31, 2008 and 2007, equity does not include minority interests and stock acquisition rights.

Net Worth and Net Worth Ratio
(Billions of yen, %)



Net Worth
Net Worth Ratio

Cash Dividends and Payout Ratio
(Yen, %)



Cash Dividends
Payout Ratio

Business Segment Sales

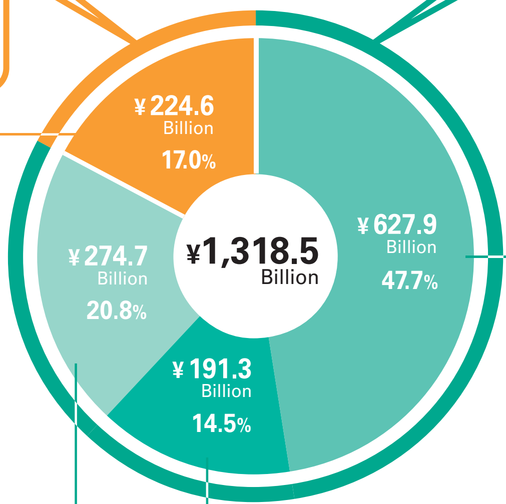
(Year ended March 31, 2008)

Chemical Business (Billions of yen)

	224.6
Japan	129.4
Asia	75.2
North America & Europe	98.8
Eliminations	(78.8)

Consumer Products Business (Billions of yen)

	1,093.9
Japan	868.4
Asia & Oceania	85.4
North America & Europe	156.2
Eliminations	(16.1)



Chemical Business

Oleo chemicals
Fatty alcohols, fatty amines, fatty acids, glycerin, commercial-use edible fats and oils

Performance chemicals
Surfactants, plastics additives, superplasticizers for concrete admixtures

Specialty chemicals
Toner and toner binder for copiers and printers, ink colorants for inkjet printers, fragrances and aroma chemicals

Fabric and Home Care Business

Fabric care products
Laundry detergents, fabric treatments

Home care products
Kitchen cleaning products, house cleaning products, paper products for cleaning, professional-use products

Beauty Care Business

Prestige cosmetics
Counseling cosmetics, self-selection cosmetics

Premium skin care products
Soaps, facial cleansers, body cleansers

Premium hair care products
Shampoos, conditioners, hair care products, hair coloring agents

Human Health Care Business

Food and beverage products
Cooking oils, beverages

Sanitary products
Sanitary napkins, diapers

Personal health products
Bath additives, oral care products, men's skin care and hair care products

Note: Figures in the graph represent net sales to outside customers only. Eliminations represent intersegment sales.

An Interview with President and CEO Motoki Ozaki

Profitable Growth Driven by High-Value-Added Products

During fiscal 2007, the year ended March 31, 2008, Kao exceeded the performance projections it made at the start of the fiscal year, despite the impact of sharply rising raw material prices, primarily because of aggressive launches of high-value-added products and successful efforts to strengthen sales capabilities by the Consumer Products Business in Japan and Asia. Looking forward, we will accelerate the development and launch of high-value-added products created from the perspective of consumers and customers. At the same time, we will focus on strongly growing Asian markets to achieve profitable growth.

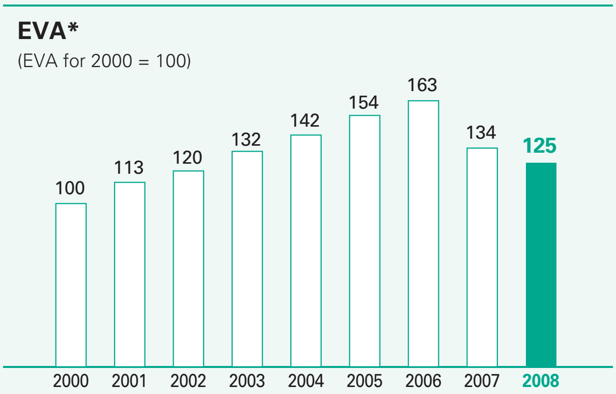
What is your assessment of Kao's performance during fiscal 2007?

In fiscal 2007, the Kao Group's net sales increased 7.0 percent compared with the previous fiscal year to ¥1,318.5 billion. Operating income decreased 3.8 percent compared with the previous fiscal year to ¥116.3 billion, primarily because of rising raw material prices and strategic investment in marketing. While net income decreased 5.6 percent compared with the previous fiscal year to ¥66.6 billion, Kao increased annual cash dividends per share by ¥2.00 to ¥54.00 in accordance with its forecast at the start of fiscal 2007.

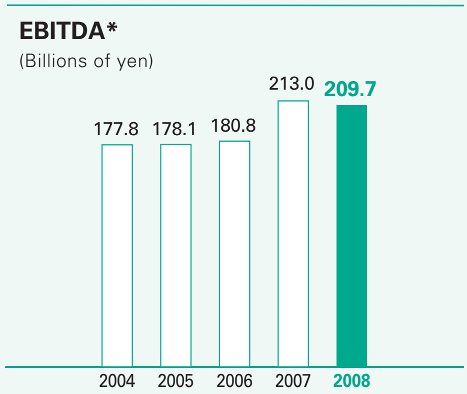
Overall, Kao energetically conducted its businesses in a challenging operating environment. Performance exceeded the initial plan for the fiscal year, demonstrating not only the effectiveness of our strategies, but also that all Kao employees in Japan and overseas gave their best each day as we took on the challenges of new ways of doing business. The robust performance of the Consumer Products Business in Japan and Kanebo Cosmetics were key factors in Kao's stable performance for fiscal 2007. Another was the solid performance of the Chemical Business, which minimized the impact of rising raw material prices.

Moreover, the system of four businesses that Kao introduced in April 2007 and the resulting reorganization of functional divisions revitalized our organization, which contributed to results in fiscal 2007. We reorganized into four businesses: Beauty Care, Human Health Care, and Fabric and Home Care, which collectively make up the Consumer Products Business, and the Chemical Business. At the same time, we reorganized R&D, production, sales and all other functional divisions. The Kao Group's goal is to further reinforce its matrix management among businesses and functional divisions, which is a core strength, in order to achieve its medium-term objectives.

Since the reorganization, we have already begun seeing the positive effects of enhanced technology sharing. Examples include the use of *Megurism* steam-generating thermo technology, which has received consumer support since its launch, in sanitary products. I am not completely satisfied with the speed at which we develop and improve products, but I can say we are faster in these areas than in the past.



* EVA (Economic Value Added) is a registered trademark of Stern Stewart & Co.



* EBITDA (Earnings before interest, taxes, depreciation and amortization) = Operating income + Depreciation and amortization

Note: EVA is expressed as an index with the year ended March 31, 2000, when it was originally introduced, as 100. EVA for the year ended March 31, 2008 decreased to 125 due to a decrease in NOPAT (Net Operating Profit After Tax) resulting from the impact of increases in raw material prices. EBITDA for the year ended March 31, 2008 decreased by ¥3.3 billion to ¥209.7 billion, compared with ¥213.0 billion for the previous fiscal year.

What are some specific examples of how the reorganization into four businesses is resulting in profitable growth?

The Consumer Products Business consists of the three businesses of Beauty Care, Human Health Care, and Fabric and Home Care. Each of these businesses has reaffirmed its commitment to product development from the perspective of consumers. As a result, we have strengthened our approaches to creating and improving products with high added value.

The Beauty Care Business operates under a "total beauty" concept that encompasses categories ranging from hair and skin care to makeup, and has succeeded at operating more comprehensively. *Bioré, Essential* and many other brands performed strongly because of enhanced cooperation between the Beauty Care Business and functional divisions. As a result, Beauty Care sales in Japan increased 7.8 percent compared with the previous fiscal year. In January 2008, the Beauty Care Business worked in unison on a new product launch, focusing advertising and product information on key players in the beauty industry, such as magazine editors and cosmetics journalists. Reviews were highly favorable.

The Chemical Business has embraced a new mission since April 2007: profitable growth and synergy with the Consumer Products Business. This mission was the basis for efforts to accurately understand customer needs in order to develop and supply distinctive products that meet the expectations of customers and earn their trust. The Chemical Business, which supplies many of the basic ingredients that the Consumer Products Business uses, is one of the Kao Group's critical strengths.

The foremost result of the organizational reforms of April 2007 was the merger of Kao Cosmetics Sales Co., Ltd. into Kao Hanbai Co., Ltd., which formerly handled only consumer products, to establish Kao Customer Marketing Co., Ltd. This created the foundation for further developing the Kao Group's comprehensive strengths in ways such as enhancing Kao's sales force. Kao has moved forward with the integration of the two companies carefully and in stages to avoid confusion at the point of sale. However, our steady progress has exceeded projections, and we have enhanced our ability to make proposals to retailers while successfully executing initiatives such as building a new in-store merchandising business model. The response in each of our distribution channels including drugstores has been excellent.

How will Kao generate profitable growth in fiscal 2008 and beyond? What initiatives will drive achievement of the targets of the medium-term business plan?

I see fiscal 2008 as the year in which Kao makes significant progress in Asia, and I want the Kao Group to use its comprehensive strengths to achieve this objective. The Japanese market is maturing; therefore the Kao Group must concentrate on high-potential markets in Asia to generate further large-scale growth and development in the future. Kao was comparatively early in entering the Asian markets over 40 years ago, but we have been a bit slow in responding to the rapidly changing consumer lifestyles and distribution patterns in the region. Our growth in Asia simply has not met our expectations. Since I became President and CEO four years ago, Kao has examined various strategies for generating growth in its Asian operations. I have concluded that the most effective and efficient approach is to deal with the changing markets of Asia head on and to spread broadly the marketing, R&D and sales capabilities we have developed in Japan in Asian markets.

Accordingly, we now view Asia as a single area that includes Japan. Our first step was sharing The Kao Way, our corporate philosophy, and dispatching employees between Japan and other Asian countries to provide assistance such as on-the-job training. We subsequently standardized business processes and promoted cooperation among businesses, and are now seeing positive results. I truly believe that developing the core Kao Group strength of matrix management among businesses and functional divisions throughout Asia will be the key to the success of Asian operations.

Brands will also be key, and we are poised to begin full-fledged efforts to build *Asience* and other brands into pan-Asian brands. By aiming to create optimum products for Asia, including Japan, while considering business development in Asia from the product development stage, I believe that we will achieve profitable growth. The time is ripe for our operations in Asia, and we would like to make significant progress during fiscal 2008 and thereafter toward generating double-digit growth in Asia.

On the other hand, we will continue to take the viewpoint of consumers and customers in launching high-value-added products in Japan. We are also working to leverage our enhanced proposal capabilities to strengthen sales. In particular, we will work to achieve further growth in the Beauty Care Business by enhancing our ability to make proposals in areas such as our lineup of products under the “total beauty” concept, sales methods and promotions. This will be a test of our decision to combine the consumer products and cosmetics businesses into Kao Customer Marketing, and I want Kao to deploy its comprehensive strengths to realize the intentions behind this move.

Consumers are going to become even more aware of their health and how to protect it because of the decision by Japan’s Ministry of Health, Labour and Welfare to make specified health examinations and guidance mandatory, among other factors. We see this as a business opportunity, and we plan to further strengthen the food and beverage category within our Human Health Care Business with products approved as Foods for Specified Health Uses (FOSHU) by the Ministry of Health, Labour and Welfare. Moreover, the Human Health Care Business will also move beyond conventional selling methods through existing distribution channels by working to use counseling to enhance one-on-one sales.

Mid-Term Growth Strategies:
Profitable Growth Driven by High-Value-Added Products

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

Where is Kao heading in North America and Europe?

In the United States, Kao Brands Company markets premium skin and hair care products, and has launched hit products in both categories. Results were strong two years ago, but other companies have created intense competition by launching similar products. Just as we are doing in Asia, we will work to exercise the comprehensive strengths of our Japanese operations in the United States by concentrating on *Yoki-Monozukuri* and unique branding.

In Europe, KPSS – Kao Professional Salon Services GmbH provides premium hair care products to salons. We are currently executing a sales innovation project in Germany, and we expect operations in Europe and the United States to improve in a short period. Moreover, Molton Brown Limited achieved double-digit growth in fiscal 2007. We intend to make every effort to further enhance the prestige of its brands with the objective of growth and development over the medium and long term.

What is the current status of the prestige cosmetics business? What are your plans for its future direction?

The future direction of the prestige cosmetics business has two aspects: top-line sales growth and cost efficiency. The Kao Group plans to achieve top-line sales growth by doubling the number of mega brands with sales of ¥10.0 billion or more to 16 by 2010. In fiscal 2007, we launched *DEW SUPERIOR, COFFRET D'OR, SOFINA beauté* and other new products that all got off to a good start. In China, we are implementing a growth strategy of expanding Kanebo Cosmetics sales. After the first year of implementation, we found that we have some room for improvement. Accordingly, we have shifted our plan from expanding the number of stores to focusing on areas with the best potential, with priority on increasing sales per store. For marketing and sales promotion, we have introduced Internet search engine optimization and continue to verify its effectiveness. These initiatives have been effective, and since fall 2007 sales per store have been growing steadily. Operations in China are central to the growth strategies for both Kanebo Cosmetics and the Kao Group as a whole. Going forward, we will concentrate on further enhancing cooperation.

The second aspect of our plans for the prestige cosmetics business involves reducing costs by generating synergies. Since Kanebo Cosmetics Inc. joined the Kao Group two years ago, our steadily successful efforts have included shared factory usage, joint purchasing of television advertising time and joint procurement of raw materials. Moreover, Kao Customer Marketing, Kao and Kanebo Cosmetics have started executing initiatives such as joint campaigns and in-store displays that have received an enthusiastic reception at drugstores and other retail outlets. Our plan is to save ¥10 to ¥15 billion by 2010 through cost-saving synergies, including by improving logistics efficiency.

What impact does Kao's approach to corporate social responsibility and its corporate philosophy, The Kao Way, have on business activities?

Our first priority in our corporate social responsibility (CSR) activities is to effectively handle the fundamentals such as product safety, compliance, environmental protection and respect for human rights.

The Kao Way forms the foundation of Kao's unique CSR activities with its clearly defined mission, vision, values and principles that call for Kao to contribute to the sustainable development of society. When I became President and CEO, I thought it was important to pass on to the next generation Kao's traditions and values. We established The Kao Way to share Kao's values and fundamental approach to its business with young employees and employees overseas. The Kao Way is the cornerstone of how we work, the point of reference we can always turn to if we have doubts, and the guide for our actions.

For our overseas employees, explanations linked to the actual work they are doing are particularly effective. When I visit group companies overseas, I look carefully at conditions in each country, including situations that may not be sufficiently in accordance with The Kao Way. I then offer specific action guidelines. We also provide training on The Kao Way at one-day workshops that we initiated and now hold overseas. These kinds of activities are ongoing. With the number of new employees increasing, steady efforts every day to make The Kao Way an integral part of daily operations will thoroughly instill Kao's core concepts in every workplace or organization, including among overseas employees, and I have seen how it works to keep us on the right track.

Kao has aggressively repurchased its shares to increase capital efficiency and enhance shareholder returns. What is Kao's stance?

Increasing Kao's corporate value is the single most important issue in shareholder returns. Quantitative issues such as market capitalization are not the only issues that define corporate value. We consider our potential for future growth as a corporation, and recognize that we must constantly emphasize efforts to increase corporate value. Corporate value is not something we can create over the short term. It takes time, and so we count on our shareholders to share our emphasis on growth over the medium and long term.

We emphasize increasing corporate value concurrently with shareholder returns. Our target for dividends is a consolidated payout ratio at the 40 percent level, and we intend to meet shareholder expectations by steadily and continuously paying dividends. In addition, as a measure to provide shareholder returns from a long-term perspective, we plan to flexibly repurchase shares to increase earnings and dividends per share over the long term. We will conduct share repurchases with due consideration to our demand for capital to fund investment in the facilities and acquisitions that will support growth while raising capital efficiency. Moreover, we intend to emphasize return on equity (ROE) so that shareholders will understand the benefits of these efforts.

Special Feature

Asia: The Key to Profitable Growth

Kao employees visit consumers' homes to ask about actual housekeeping conditions. (Japan)

The Kao Group aims to be "a global group of companies that is closest to the consumer/customer in each market." (Excerpt from the "Vision" section of The Kao Way.)

Kao has been successfully serving one of the most demanding and competitive markets in the world by providing products of true value developed from the consumer's perspective and meeting the needs of consumers in Japan. Making the most of this advantage, we will solidify our business in the Asian region by effectively expanding this wealth of knowledge and know-how in Asia. By integrating operations in Asia including Japan, we will boost our business activities in the region over the coming years.

Matrix management encourages cooperation between marketing and R&D. (Japan)

Kao aggressively develops and markets high-value-added products to achieve profitable growth. Market share in Japan has increased as a result, but the domestic market is maturing. Asia, however, provides enormous potential for Kao to benefit from its creativity and ability to add value to consumer products. With consumer product markets in Asia maintaining steady growth, Kao is energetically expanding its presence in the region.

Of course, Kao is not the only company that sees the potential of Asia. Global consumer product companies share our enthusiasm for Asian markets, which has intensified competition and accelerated market changes. We believe that viewing Japan and Asia as a single area is the optimal approach as it creates an organization that can respond quickly to changes in the markets. Kao has therefore created an information infrastructure that integrates business operations in Asia, including Japan, and has standardized business processes in individual countries.

We are now successfully enhancing communication between Japan and other Asian countries to efficiently develop high-value-added products that meet the needs of both particular countries and the broader market. A core Kao strength is its system of matrix management linking businesses with research, production and sales. Now, this matrix management system also integrates Asia, including Japan, within a system for developing high-value-added products to accelerate expansion.

Production is responding quickly to demand. (Thailand)

Standardized Processes and Shared Values

The use of Kao's enterprise resource planning (ERP) system has standardized business processes in each country. (Thailand)

Employees throughout Asia engaged in a lively discussion of the hows and whys of sharing The Kao Way.

Kao introduced an enterprise resource planning (ERP) system three years ago and standardized its widely varied business processes in Asian countries. As a result, Kao employees in Asia can quickly obtain information on the situation in any Asian country. They can also find survey results and numerical indexes via the system, which encourages discussion of issues and ideas for solutions. Examples of successes in any given country are widely available throughout Asia.

Moreover, the ERP system has enabled operations throughout Asia to keep track of sales and inventories. Efficiency has risen sharply as Kao is now better able to quickly manage raw material purchases according to its production plan, and has reduced both inventory and stockouts.

Kao has also worked to instill shared values in parallel with standardizing its business processes. Kao's corporate philosophy is stated in The Kao Way, and our efforts to enhance and deepen awareness of the importance of The Kao Way in Asian countries has established a common reference point employees can turn to if they have doubts. "Consumer Driven" approaches and "*Genba*-ism*" are key principles of The Kao Way that are critical to the ability of Asian operations to drive progress through cooperation. Ensuring that Kao's operations in each market in Asia share the same perspectives and values has laid the foundation for integration of business operations in Asia, including Japan.

* *Genba*-ism: *Genba* literally means "actual spot." At Kao, *Genba*-ism defines the importance of observing things "on-site," in the actual location and environment, both internally and externally, in order to maximize our understanding of the business and optimize our performance.

Employees from Thailand and Japan visited Thai homes to learn for themselves how people do their laundry.

Truly Consumer-Driven Product Development

The first product that resulted from integrated development among Japan and other Asian countries was *Attack Easy* laundry detergent, which we launched in Thailand. In the initial phase of product development, Kao felt it needed more insight into what would differentiate it from competitors. We went back to the starting point and interviewed consumers to listen directly to their desires. We visited households, classified water quality, looked at the laundry problems consumers face and even asked consumers for a look into their dresser drawers to learn how they keep their clothing.

This survey taught us a great deal. Thai households are large, and that means lots of laundry. And hand laundering is prominent, which means lots of work. Unique challenges abound, as water quality can inhibit foaming, hand laundering requires plenty of elbow grease, and rinsing is no easy matter.

We then started coming up with ways to use everything we had learned to make hand laundering easier. After testing numerous approaches through a process of trial and error, we finally found a formulation that creates a sort of cushion in the space between fabrics being washed. This resulted in a detergent with a unique slick feeling that removes dirt quickly and rinses out easily. Consumers tried it, and told us it was gentle on their hands, made hand laundering easier and generally reduced the drudgery of doing laundry.

Thai consumers have enthusiastically embraced *Attack Easy* since we launched it two years ago. Last year, we also launched it in Indonesia after achieving a different type of slick feeling formulated for brush washing.

All the people involved in these product development processes worked in concert with an assiduous focus on the perspective of consumers to achieve the breakthroughs that resulted in the development of this high-value-added product.

Television commercials have communicated how *Attack Easy* makes doing laundry faster and easier.

Kao has added *Asience Moisture Balance* to the *Asience* brand and created integrated displays at stores. (Hong Kong)

Building Powerful Shared Asian Brands

The *Asience* project team has worked from the premise of developing a pan-Asian brand. (Japan)

Many European, North American and Japanese brands are available in Asian consumer product markets, and the large number of products has resulted in intense competition. In order to meet consumer needs and to deploy effective marketing at the same time, it is essential to build brands based on an understanding of Asia as an integrated market that includes Japan.

We launched the *Asience* line of premium hair care products in Japan in 2003, but from the beginning we developed this brand with the aim of making it a hit throughout Asia. Its status as a blockbuster premium brand from Japan supported its launch in Taiwan and Hong Kong in 2005, and the *Asience Moisture Balance* line extension in those two markets in 2007. We based our concept on the value proposition that *Asience* would make hair supple to the core while meeting the strong consumer desire for a light, refreshing cleansing experience that leaves hair silky smooth. In spring 2008, our launches of *Asience* in Shanghai, China and in Bangkok, Thailand used the newly improved product launched the previous year in Japan under the continuing theme of the shampoo that makes hair supple enough to restore straightness even after braiding or tying. We are now selling *Asience* in five markets. A critical task in building this brand is remaining true to its core concept as we respond to the particular needs of each market.

Salespeople at Kao's sales company in Shanghai use expertise developed in Japan in negotiating with buyers.

Deploying Sales Expertise

Distribution in Asian markets is complex. Global retail chains based in Europe and the United States vie with homegrown chains, while small and medium-sized stores, often run by families, remain entrenched as the backbone of the marketplace.

Fortunately, the Kao Group's extensive sales experience in Japan is applicable to the markets of Asia. Salespeople in Japan deal with many of the same issues and pressures that impact the markets of other Asian countries. Initially, we send salespeople from Japan to work with local employees to call on retail outlets and share best practices and expertise. These teams conduct programs such as working with large global chains and local chains to develop annual product sales plans that both meet consumer needs and effectively promote sales. Senior management meetings ensure that everyone is on the same page.

Our approach is predicated on working with retail outlets to maximize their sales and profits by anticipating customer needs. Our proposals go beyond simply plugging our own products. Simultaneously, we are significantly strengthening sales functions in Asian countries by enhancing relationships with retail outlets built on trust by precisely responding to their needs. Moreover, we are sharing successful approaches in Japan and introducing the services that Kao Merchandising Services Company, Ltd. can provide to rapidly orchestrate retail outlet development as part of our broad retail outlet support menu.

Salespeople from Japan and Thailand study how to improve proposals at the point of sale. (Thailand)

Fiscal 2007 Highlights

April 2007

Start of the Kao Community Museum Program

Kao began the Kao Community Museum Program, a volunteer assistance program that supports citizens' activities at museums and art galleries to promote local culture.

August 2007

Launch of *Style Fit* for a New Type of Fabric Care

The new *Style Fit* laundry detergent and fabric softener lineup gives clothes a pleasant scent that lasts even when they are hung out to dry indoors, supporting the lifestyles of busy young people who do their laundry at night.

August 2007

Proof of Benefits of Hot Towel on Tired Eyes after VDT Work

Kao scientifically confirmed that applying a moistened towel heated to about 40°C to the eyes after work on a visual display terminal (VDT) restores decreased focusing ability and improves dry eye syndrome.

September 2007

Launch of *Bioré Shower Cream* in Southeast Asia

Kao began launches of *Bioré Shower Cream* in four countries in the ASEAN region, where the use of body soap is increasing. *Bioré Shower Cream* washes away fresh, leaving skin moist and smooth. Sales began in Thailand in September, to be followed by Indonesia, Malaysia and Vietnam.

September 2007

Thai Subsidiary Receives Tesco Value Award

Global retailer Tesco, based in the United Kingdom, presented Kao's subsidiary in Thailand with a 2007 Tesco Value Award, given to companies that contribute to raising customer satisfaction at Tesco stores.

October 2007

Million-Person Pink Ribbon Campaign for Breast Cancer Early-Detection Awareness

In-store Beauty Advisors for Kao Sofina and Beauty Counselors from Kanebo Cosmetics distributed leaflets to customers to promote awareness of the importance of early breast cancer detection in the Kao Group's Million-Person Pink Ribbon Campaign. Their goal is to reach one million customers.

December 2007

Kanebo Launches *COFFRET D'OR*

Kanebo Cosmetics launched *COFFRET D'OR*, a new total makeup brand with a clearly defined concept, as part of the second stage of the makeover of Kanebo's brands.

December 2007

Mechano-Chemical (MC) Toner Offers More Stable Color Reproduction

Kao's Techno-Chemical Research Center developed MC Toner, a small-particle laser printer toner that enables high-speed printing with high image quality and stable color reproduction. The product won the 16th Technology Award of the Imaging Society of Japan.

January 2008

Launch of *SOFINA beauté*

SOFINA beauté, a new aging skincare series, targets women in their thirties and forties. The products work on the deepest corneum, or "skin core," to bring out radiance and skin firmness from within.

January 2008

Launch of *Attack Biogel*

New liquid laundry detergent *Attack Biogel* delivers high cleaning efficiency even in water-saving washing machines. Its unique bioenzyme quickly penetrates clothing fibers to eliminate stains and odor from the core.

February 2008

2008 T de Telva Award for *John Frieda Frizz-Ease*

Kao Brands Company's *John Frieda Frizz-Ease* received the 2008 T de Telva Award from Spanish fashion magazine *Telva* for the best new hair care brand launch of 2007.

March 2008

Premium Hair Care Brand *Asience* Launched in Shanghai and Bangkok

Kao launched its premium hair care brand *Asience* in Shanghai and Bangkok, expanding sales to five areas in Asia following Taiwan, Hong Kong and Singapore.

Research & Development and Intellectual Property

Television commercial for
Megurism Steam Thermo Power Pad

A Steam-Generating Thermo Sheet Designed to Improve Circulation

Kao's approach to human health care entails developing new products with added health value with the goal of contributing to healthy everyday lifestyles. In addition to functional value, Kao seeks to deliver emotional value by providing satisfaction in the form of happiness and contentment. *Megurism Steam Thermo Power Pad* perfectly embodies this concept.

From middle age onward, many people experience problems such as stiff shoulders and back pain. However, the pain in the region where stiffness occurs is frequently the result of muscle stiffness resulting from poor blood circulation. Kao therefore chose to move forward with research into circulation. It is common knowledge that heat effectively enhances circulation and that certain sensors in the human body make a temperature of about 40°C feel good.

Researchers at Kao began considering what kind of item can hold heat, and came up with hot towels and disposable heating pads used in health care facilities. However, hot towels do not maintain the level of heat that feels good for very long. While disposable heating pads have the advantage of ease of use, they generate heat through the oxidation of iron powder, and require a large amount of iron powder to maintain heat over an extended period. As a result, these pads tend to be thick and inflexible, and are difficult to fit onto the human body.

Kao then set out to develop a thin, easy-to-use product that maintains the comfortable level of heat over time. We wanted to generate heat in the same way as a disposable heating pad, and therefore selected oxidization of iron, which produces heat using oxygen and water.

We decided to make the product thin for a supple fit on the body by uniformly dispersing the iron powder throughout the fibers of a thin sheet of paper. However, maintaining a temperature of approximately 40°C for more than five hours required iron powder to fill about 80 percent of the paper, yet no paper existed that could accommodate this much iron. Moreover, iron has an extremely heavy specific gravity, so adhesion to paper fibers was poor when iron powder was added to the paper at the pulp stage. Several research departments cooperated, drawing on Kao's diverse portfolio of technologies and expertise in areas such as surfactants, control of particle dispersal and flocculation, paper making and non-woven processing. We finally created a thin sheet with the required volume of iron powder of about 80 percent. The non-woven construction we used to control the breathability of the iron powder-impregnated sheet, and thus to control the level of heat over an extended period, came from technology Kao uses in sanitary products and disposable diapers. Through this process, we developed a sheet that was only about two millimeters thick, but could still safely provide heat over an extended period — a "steam-generating thermo sheet" with a consistent thickness.

Then we began thinking of ways to expand usage of this steam-generating thermo sheet technology in daily life, and hit upon the concept of warming the eyes. The use of devices such as personal computers (PCs) and mobile phones has put additional strain on people's eyes. Kao's laboratories conducted surveys showing that people involved in work requiring heavy PC usage every day experience reduced ability to focus their vision on Fridays compared with Mondays. This phenomenon is called weekend presbyopia, and warming the eyes with a hot towel is one way to counter it. With this survey for reference, Kao developed a steam eye mask that people could easily use to warm their eyes, and launched it under the *Megurism* brand in autumn 2007.

The results of this research were based on technologies to improve circulation that Kao has developed over some 20 years, including those used in carbonated *Bub* bath additives and *Success Hair Restoration Tonic*. The *Megurism* brand is the result of accumulated technologies in a range of fields, new technology development and consumer research.

As a result of the structural reorganization of spring 2007, personal health care research covering areas including food products such as beverages, sanitary products such as sanitary napkins and disposable diapers, these steam-generating thermo sheets, and bath additives is now integrated into the larger realm of human health care research. We will promote even better sharing and use of research technology as we work to develop new blockbuster products.

Kao has acquired patents for its steam-generating thermo sheet.

Intellectual Property

The Intellectual Property Center in the Research and Development Division promotes the acquisition and use of intellectual property rights. The staff of the Intellectual Property Center implements an intellectual property strategy consistent with Kao’s business and research strategies together with patent liaison persons in each laboratory. Patent liaison persons have a detailed knowledge of both technologies and intellectual property.

Close communication between the staff of the Intellectual Property Center and researchers or patent liaison persons in each laboratory enables the smooth unearthing of new inventions and the development of feasibility studies for filing patent applications from the initial stage of research and development. This close communication helps create comprehensive patent applications to protect technologies. For the development of the steam-generating thermo sheet, the team acquired patents for the sheet and its manufacturing methods, as well as patents and design rights related to the product. Researchers and people responsible for intellectual property shared information from the research stage and discussed the best ways to acquire intellectual property rights.

These activities expand awareness within the Company that intellectual property rights such as patents are an important corporate management asset, and help to improve the level of Kao’s activities and the management of its technology strategy.

Corporate Governance System and Activities

Basic Position on Corporate Governance

Kao's basic position on corporate governance is to develop a managerial framework and internal control system that can take the necessary measures to realize highly efficient, sound and transparent management with the aim of continuously increasing corporate value. Kao considers corporate governance to be one of its most important managerial tasks.

Directors, Board of Directors, Executive Officers and Committees

Currently, Kao has 15 Directors including two Outside Directors, and 25 Executive Officers including 13 who serve concurrently as Directors.

Kao has 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 the compensation and nominating committees of the "Company with three committees" system under the Japanese Corporation Law.

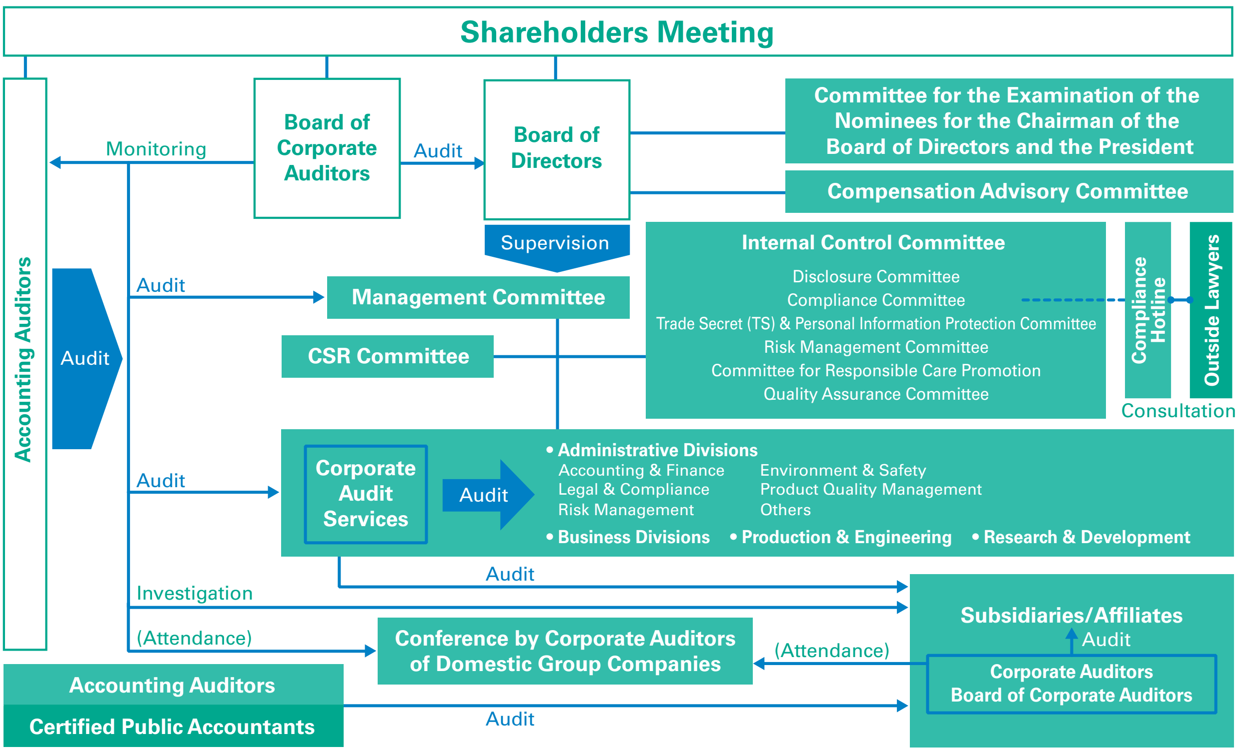
Audit System

Four Corporate Auditors including two Outside Corporate Auditors constitute the Board of Corporate Auditors. The Outside Corporate Auditors have no special interest in the Kao Group. The auditing activities of Corporate Auditors include attendance at important meetings, auditing of key operations and divisions, and investigations of affiliates. In addition, Corporate Auditors regularly conduct various meetings such as quarterly opinion exchange meetings with Representative Directors; briefing sessions on audit plans and audit results with the Accounting Auditor; and semiannual conferences of Corporate Auditors of domestic affiliates.

Furthermore, Kao's Corporate Audit Services department is responsible for conducting internal audits on the appropriateness of business processes and the propriety and efficiency of the management of Kao and its affiliates.

Kao employs the accounting firm, Deloitte Touche Tohmatsu, to perform audits in accordance with both the Japanese Corporation Law and the Japanese Financial Instruments and Exchange Law. Deloitte Touche Tohmatsu ensures that none of its engagement partners is involved in auditing Kao for more than seven years, in accordance with the Japanese Certified Public Accountants Law.

Corporate Governance Structure (As of June 2008)



Note: Our policy is to ask experts, such as lawyers, for their advice as reference in making business judgements, if necessary, concerning business management and daily operations.

Internal Control and Risk Management System

On September 1, 2005, Kao established an Internal Control Committee (Committee Chairman: President and CEO) as one of the administrative functions of the Management Committee, to hold discussions and make decisions on fundamental policy or operational planning of internal control, monitor the activities of relevant committees and confirm the effectiveness of internal control activities. Six committees have been placed under the Internal Control Committee as shown in the diagram of Kao's Corporate Governance structure on page 18.

Risks involved in business strategies are analyzed and countermeasures are discussed by the relevant departments; when necessary, discussion of these risks and countermeasures takes place in meetings of the Board of Directors or the Management Committee. Risks in business operations are managed in accordance with Kao's Risk Management Policy. The Risk Management Committee, chaired by the member of the Board of Directors in charge of risk management, promotes risk management throughout the Kao Group companies and develops countermeasures for disasters and other emergencies. In the event of a serious crisis, countermeasures headquarters, which should be headed by the President and CEO, is set up to respond to the crisis.

Status of Measures Concerning Respecting the Standpoint of Stakeholders

- *Rules for Respecting the Standpoint of Stakeholders through Internal Regulations, etc.*

  The Kao Way, an essence of the Company's corporate philosophy symbolized by the pyramid on the inside front cover, states that "Our mission is 'to strive for the wholehearted satisfaction and enrichment of the lives of people globally' through the Company's core domains of cleanliness, beauty, health and chemicals." The "Vision" section of The Kao Way stipulates that "We aim to be 'a global group of companies that is closest to the consumer/customer in each market,' earning the respect and trust of all stakeholders and contributing to the sustainable development of society." As stated in Kao's Principles of Corporate Ethics, contained in Kao's Business Conduct Guidelines, "Kao Corporation seeks to be an honest and exemplary company, guided by sensible and fair actions and driven by a fundamental adherence to ethical principles that go beyond mere compliance with laws to earn the true respect of all stakeholders." The text also describes specific details about Kao's conduct guidelines to respect the standpoint of stakeholders.

- *CSR* Committee*

  Kao has established a CSR Committee to determine the objectives the Company must fulfill in society, as well as their direction.

  * Corporate Social Responsibility

- *Policy for Information Disclosure to Stakeholders*

  Kao's Disclosure Guidelines set forth the Company's commitment to disclose information to shareholders, investors and all other stakeholders in a timely, accurate and impartial manner by continuing prompt disclosure of information that falls under the Securities Listing Regulations provided by the Tokyo Stock Exchange, in compliance with the Corporation Law, the Japanese Financial Instruments and Exchange Law and various ordinances.

Information Concerning Hostile Takeover Defenses

The Company did not submit any proposals regarding defensive measures against hostile takeovers to its Annual General Meeting of Shareholders held in June 2008. However, the Company believes that implementing defensive measures is an important task for management, and continues to study the pros and cons of introducing reasonable defensive measures against hostile takeovers. The Company also closely monitors development of the Japanese legal system and trend of business society.

The Company hopes to attract shareholders who will hold Kao's stock on a long-term basis. The Company is committed to rewarding such long-term shareholders by increasing corporate value over the long term through vigorous business activities linked to increasing EVA, and by enhancing shareholder returns, including dividends.** The Company believes that increasing corporate value and enhancing shareholder returns will be duly reflected in Kao's stock price in the market and its market value, which will in turn discourage hostile takeovers that may not be in the best interests of shareholders. At the same time, through its CSR and other activities, the Company promotes understanding of its contribution to global society among all stakeholders. By doing so, the Company expects to increase trust of stakeholders towards its management, which, it believes, will act as a major deterrent to such hostile takeovers.

** The Company has set a target payout ratio of approximately 40 percent of consolidated net income.

Further information on Kao's approach to corporate governance is available at
http://www.kao.co.jp/en/company/governance/index.html

Directors, Corporate Auditors and Executive Officers

Board of Directors

* Holds the post of Executive Officer concurrently ** Outside Director

Motoki Ozaki*

Representative Director, President and Chief Executive Officer

Takuo Goto*

Representative Director, Senior Executive Vice President, Global Production & Engineering, Global Environment and Safety

Hiroshi Kanda*

Representative Director, Executive Vice President, Global Consumer Products, Global Marketing Development

Norihiko Takagi*

Executive Vice President, President, International Business – Consumer Products

Shunichi Nakagawa*

Executive Vice President, Global Legal & Compliance, Global Corporate Communications, Global Information Systems

Tatsuo Takahashi*

Executive Vice President, Representative Director, President and Chief Executive Officer, Kao Customer Marketing Co., Ltd.

Toshiharu Numata*

Executive Vice President, Global R&D, Product Quality Management

Toshihide Saito*

President, Global Chemical Business

Shinichi Mita*

Vice President, Global Accounting & Finance

Masato Hirota*

President, Global Beauty Care Business

Shinichiro Hiramine*

Chairman of Board of Directors and Chief Executive Officer, Kao (China) Holding Co., Ltd.

Ken Hashimoto*

Vice President, Global Procurement

Michitaka Sawada*

Vice President, Global R&D (Human Health Care)

Atsushi Takahashi**

Representative Director Chairman of the Board, The Sumitomo Trust & Banking Co., Ltd.

Osamu Shoda**

Representative Director Chairman of the Board, Nisshin Seifun Group Inc.

Corporate Auditors

*** Outside Corporate Auditor

Shoichi Otake
Full-time Corporate Auditor

Takashi Matsuzaka
Full-time Corporate Auditor

Tadashi Oe***
Corporate Auditor, Attorney at Law

Yutaka Yogo***
Corporate Auditor, Certified Public Accountant

Executive Officers

Yoshitaka Nakatani
Vice President, Global Production & Engineering (Beauty Care and Human Health Care SCM)

Hisao Mitsui
Vice President, Global Production & Engineering (Fabric & Home Care and Chemical SCM)

Shigeru Koshiba
President, Global Fabric & Home Care Business

Shoji Kobayashi
Vice President, Global Chemical Business

Takuji Yasukawa
President, Global Food & Beverage

Yasushi Aoki
Vice President, Global Human Capital Development

Masumi Natsusaka
President, Global Prestige Cosmetics & Global Premium Skin Care

William Gentner
President and Chief Executive Officer, Kao Brands Company

Katsuhiko Yoshida
President, Global Human Health Care Business

Naohisa Kure
Vice President, Global R&D (Beauty)

Mikio Nakano
Representative Director, Senior Executive Vice President, Kao Customer Marketing Co., Ltd. (Prestige Cosmetics)

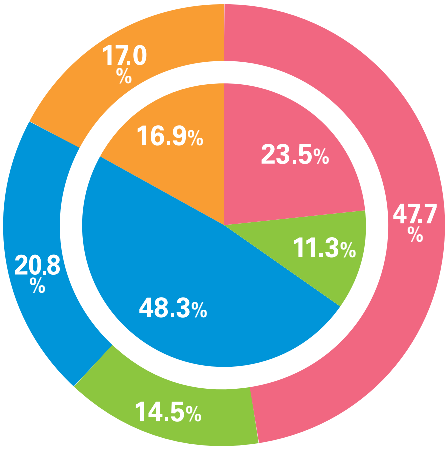
Akira Yoshimatsu
Vice President, Global R&D (Fabric & Home Care and Chemical)

(As of June 27, 2008)

Review of Operations

Contents

Kao at a Glance (As of March 31, 2008)

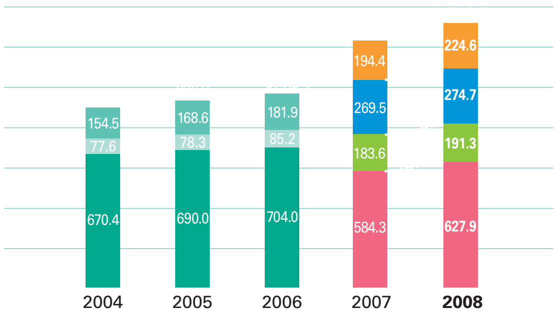


Outer circle: Net Sales* **Inner circle:** Operating Income**

Consumer Products Business	Beauty Care Business
	Human Health Care Business
	Fabric and Home Care Business
Chemical Business	Chemical Business
Former Business Segments	Consumer Products
	Prestige Cosmetics
	Chemical Products

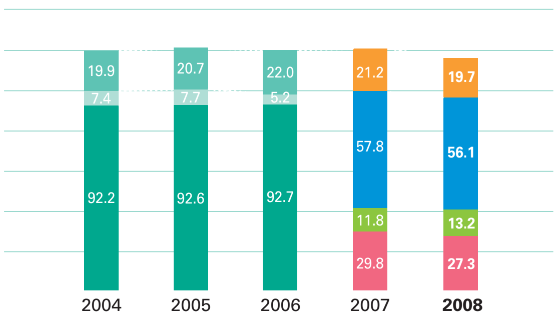
Net Sales*
(Billions of yen)

(Years ended March 31)



Operating Income**
(Billions of yen)

(Years ended March 31)



Note: Kao reorganized its operations effective April 2007 by integrating the former consumer products business and prestige cosmetics business into the Consumer Products Business, which is divided into three businesses (the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business). Together with the Chemical Business, Kao's business operations now consist of four business segments. Figures for 2007 have been restated to reflect the change.

* Net sales to outside customers only.

** Operating income excludes eliminations.

Consumer Products Business

Beauty Care Business

Kao's goal in Beauty Care is to generate significant value for those who wish to bring out their own beauty by providing distinctive products that deliver differentiated functions developed using Kao's technology.

Human Health Care Business

In Human Health Care, we provide comprehensive solutions and services for daily health care to help consumers live healthier and more comfortable lives. We are also extending our knowledge of health care acquired in Japan to foreign markets.

Fabric and Home Care Business

The goal of the Fabric and Home Care Business is to make household chores such as cleaning and laundry easier and to provide pleasure and joy through products that suit the lifestyles of consumers in Asia and other countries.

Chemical Business

Chemical Business

We strive to develop and market unique and remarkable products that earn the trust of customers and meet their expectations by deepening and extending our core technologies in developing materials. Synergy between the Chemical and Consumer Products businesses is critical to uncovering customer needs and developing new product ideas.

Major Products		Fiscal 2007 Results and Overview
Prestige cosmetics	Counseling cosmetics, self-selection cosmetics	• Net sales increased 7.5 percent to ¥627.9 billion; sales in Japan increased 7.8 percent to ¥448.7 billion. • New prestige cosmetics launches *DEW SUPERIOR, COFFRET D'OR* and *SOFINA beauté* each got off to a strong start. • Sales of premium hair care products grew with the launch of the new *Segreta* brand and a renewal of *Asience*. • Sales in Asia were strong. In prestige cosmetics, Kao aggressively expanded business in the department store and high-end drugstore channels in China. • Sales in North America and Europe were essentially unchanged. • The *John Frieda* premium hair care brand launched new and improved products, and growth was steady in Europe, but difficult in the U.S.
Premium skin care products	Soaps, facial cleansers, body cleansers	
Premium hair care products	Shampoos, conditioners, hair care products, hair coloring agents	

Food and beverage products	Cooking oils, beverages	• Net sales increased 4.2 percent to ¥191.3 billion; sales in Japan increased 2.6 percent to ¥174.5 billion. • In food and beverage products, sales decreased, due in part to diversifying consumer preferences. Kao attracted new customers by extending the *Healthya* lineup with *Healthya Green Tea Mellow Flavor*. • Sales of baby diapers increased with continued consumer support due to marketing activities based on the products' increased gentleness on the skin. • In Asia, overall sales expanded as *Laurier* sanitary napkins sold strongly in Thailand, Malaysia, China and other countries.
Sanitary products	Sanitary napkins, diapers	
Personal health products	Bath additives, oral care products, men's skin care and hair care products	

Fabric care products	Laundry detergents, fabric treatments	• Net sales increased 1.9 percent to ¥274.7 billion; sales in Japan were essentially unchanged at ¥245.3 billion. • In the laundry detergent category, sales were flat as market competition remained severe and the gift market substantially contracted. • Sales of home care products increased, with high-value-added product line extensions such as *CuCute Power Gel* dishwasher detergent and *Resesh Antiseptic EX* fabric freshener. • Sales in Asia and Oceania increased. In China, Kao launched *Attack Softener-in* in regions where it has been selling *Attack* and began sales of the *Attack* series in northern China, including Beijing.
Home care products	Kitchen cleaning products, house cleaning products, paper products for cleaning, professional-use products	

Oleo chemicals	Fatty alcohols, fatty amines, fatty acids, glycerin, commercial-use edible fats and oils	• Net sales increased 15.7 percent to ¥258.7 billion; sales in Japan increased 10.6 percent to ¥129.4 billion. • In oleo chemicals, fatty alcohols and tertiary amines posted strong sales. • In performance chemicals, sales of plastics additives increased. • In specialty chemicals, sales of polishing agents for hard disks and ink colorants for inkjet printers increased. • In Asia, sales increased 34.7 percent to ¥75.2 billion. • In North America and Europe, sales increased 19.2 percent to ¥98.8 billion. Fatty alcohols, tertiary amines and toner and toner binder for copiers and printers performed well.
Performance chemicals	Surfactants, plastics additives, superplasticizers for concrete admixtures	
Specialty chemicals	Toner and toner binder for copiers and printers, ink colorants for inkjet printers, fragrances and aroma chemicals	

Major Products

Prestige cosmetics

Premium skin care products

Premium hair care products

Food and beverage products

Sanitary products

Personal health products

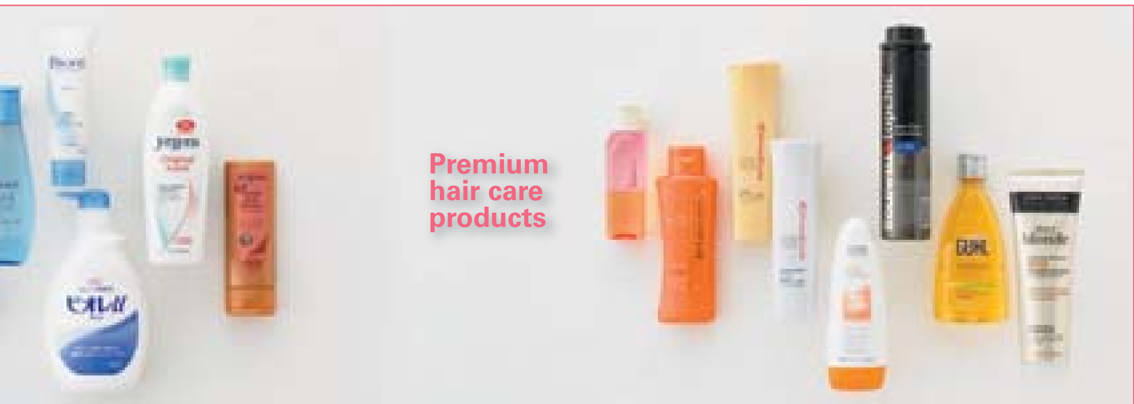
Fabric care products

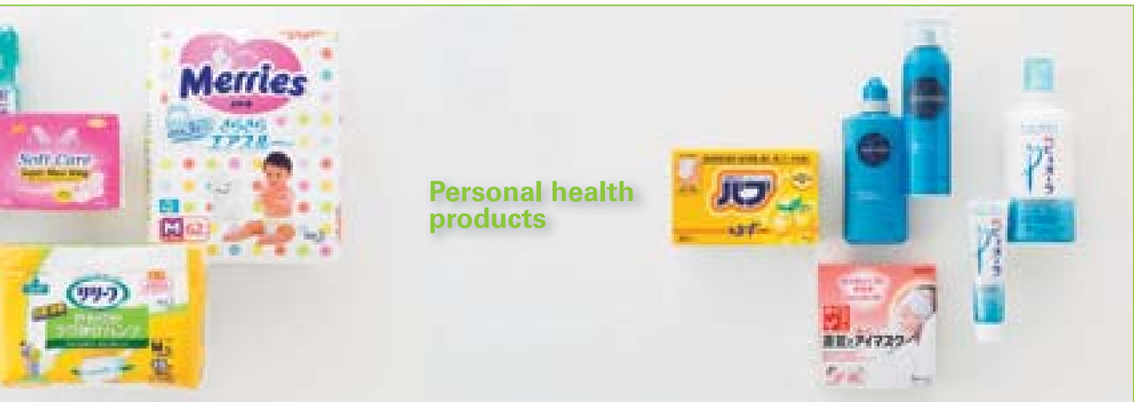
Home care products

Oleo chemicals

Performance chemicals

Specialty chemicals


Premium
hair care
products
GUHL


Merries
Personal health
products


Specialty
chemicals

Consumer Products Business

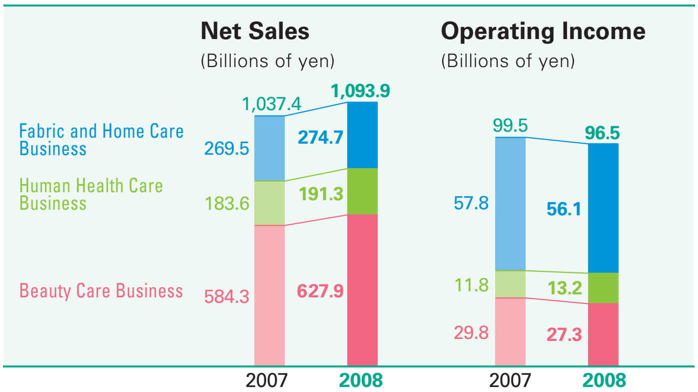
Sales increased 5.4 percent compared with the previous fiscal year to ¥1,093.9 billion.

In the Japanese market, consumer purchase prices for major products in this business increased compared with the previous fiscal year with the launch of higher-priced products. Under these conditions, the Kao Group launched new, high-value-added products and extended the product lines of its brands in response to changes in market needs, increased its ability to make comprehensive proposals to retailers by merging its sales companies for consumer products and for Kao Sofina prestige cosmetics, and strengthened its sales system in ways such as building a new business model for in-store merchandising. As a result, sales in Japan increased 4.5 percent to ¥868.4 billion.

In Asia and Oceania, sales increased 18.5 percent to ¥85.4 billion, as the Kao Group realized the benefits of integrating business operations in Asia, including Japan, in the contribution of new products and the strengthening of joint initiatives with retailers. Excluding the effect of currency translation, sales in Asia and Oceania would have increased 11.3 percent.

In North America and Europe, despite greater competition, sales increased 5.0 percent to ¥156.2 billion. Excluding the effect of currency translation, sales in North America and Europe would have increased 0.2 percent.

Operating income was ¥96.5 billion, down ¥3.0 billion from the previous fiscal year. Profits were strongly affected by rising prices for raw materials, mainly natural oils and fats and petrochemicals, although new products contributed to sales growth in Japan and overseas, and the Kao Group continued its cost reduction activities and other initiatives.



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Beauty Care Business

Overview

During fiscal 2007, net sales in the Beauty Care Business increased 7.5 percent compared with the previous fiscal year to ¥627.9 billion. As a result of a decrease in sales of Sofina and strategic investments for future growth, operating income decreased 8.6 percent compared with the previous fiscal year to ¥27.3 billion. The Beauty Care Business, including Kanebo Cosmetics, continued to raise the level of activities to promote synergy, and worked toward profitable growth over the medium and long term by investing to add high value to each brand, increase scale and globalize.

Overall, the prestige cosmetics market in Japan was basically unchanged year-on-year during fiscal 2007. Growth was stable in the high-priced market segment, centered on department stores, and the low-priced segment, primarily self-selection products. On the other hand, the mid-priced segment (¥2,000 to ¥5,000) continued to contract.

In the premium skin care market, extreme summer heat drove substantial growth in the market for UV care products and antiperspirants. Use of makeup remover also expanded. As a result, the market increased a solid 6 percent. Companies in the premium hair care market launched large-scale new products and improved products, which revitalized the shampoo and conditioner market and resulted in steady market growth of 4 percent.

Kao's sales in Japan increased 7.8 percent year-on-year to ¥448.7 billion. Kanebo Cosmetics covers every price segment of the prestige cosmetics market and performed well in both the department store and self-selection channels. In addition, Kanebo Cosmetics launched mega brands *DEW SUPERIOR* and *COFFRET D'OR*, generating steady

New Kanebo Cosmetics skin care brand *DEW SUPERIOR*

growth in an essentially flat market. Sofina is based in the mid-priced segment and its sales decreased because of the impact of contraction in that market. However, sales of *FINE-FIT* increased, and *SOFINA beauté*, a new skin care brand, got off to a strong start.

Premium skin care products *Bioré* and *Bioré U* performed extremely well. The number of loyal users of the *Curél* brand for sensitive skin expanded steadily. The addition of the new *Segreta* brand to the premium hair care product portfolio strengthened Kao's top position in the shampoo and conditioner market. New product proposals including *Liese* and other hair styling products as well as hair coloring products generated strong growth, particularly those for young women.

Kanebo Cosmetics brands have become the core of Kao's prestige cosmetics lineup in Asia, and Kao is emphasizing expansion in China. Kao achieved double-digit growth in sales of the *Bioré* premium skin care brand by conducting detailed marketing linked to particular needs in each region, and operating income increased substantially. The Kao Group initiated a groupwide program to integrate business operations in Asia including Japan in 2006, and it is making a strong contribution to performance. We are promoting the premium hair care product *Asience* under a unified brand strategy including Japan.

In North America and Europe, sales of Kanebo Cosmetics' prestige cosmetics and Molton Brown's brands continued to grow strongly. However, sales of premium brands at Kao Brands Company, such as *John Frieda* and *Jergens*, were sluggish because of intense competition from similar products. In the salon business, sales did not increase despite the efforts of KPSS - Kao Professional Salon Services to strengthen its brands with an emphasis on hair coloring products.

Segreta premium hair care brand for the beauty of adult women

SOFINA beauté has been developed as a new core Kao Sofina skin care brand.

Key Initiatives and Results in Fiscal 2007

Japan and Asia

Prestige Cosmetics

Department store sales of core Kanebo Cosmetics counseling brands *LUNASOL* and *Impress* increased, and sales of the self-selection brands *EVITA* and *KATE* continued the strong growth of the previous fiscal year. Kanebo Cosmetics is currently focusing on the creation of strong brands that are highly marketable. It launched its first such brand, *DEW SUPERIOR* skin care, in October 2007, and its second, the *COFFRET D'OR* point makeup brand, in December 2007. Both sold well. Interest in these high-value-added brands is strong throughout their distribution channels, and effective use of mass media is expanding awareness and understanding of the high value of Kanebo brands among consumers. In addition, sales divisions have effectively and assiduously followed up with retail outlets. Kanebo Cosmetics has been working to strengthen beauty counselor training in Japan and overseas by creating a training structure for customer service that goes beyond merely providing information to include counseling, which we refer to as *omotenashi*.

GRACE SOFINA has enjoyed strong performance following renewal of its brand image.

Sales of Sofina slipped due to the impact of the contraction of the mid-priced market segment. However, *FINE-FIT* increased its share of every demographic segment, particularly women in their 30s. Moreover, Kao launched *SOFINA beauté* in January 2008 to strengthen the *Sofina* brand. This new aging care brand for women in their 30s and 40s has gotten off to a strong start as a core *Sofina* brand. The *GRACE SOFINA* brand for women over 50 has received stronger support than in the past after its improvement in March 2008. *est* is the Kao Sofina brand for department stores. Against the backdrop of a firm department store market, sales of *est* grew strongly as it evolved into a total beauty care brand with the November 2007 addition of point makeup products and further steady expansion of user segments.

Expansion in the Chinese market is critical to the Asian prestige cosmetics business, and Kanebo Cosmetics initiated investment in earnest in 2007. Sales development at department stores centered on the *LUNASOL* and *Impress* brands, and also included the development of the *freeplus* brand sold in upscale drugstores. Sales of each brand were strong. Sales of Kao Sofina also increased substantially, particularly in Shanghai.

FINE-FIT takes five years off skin's appearance.

Premium Skin Care Products

The *Bioré* brand ranges from facial cleansers to makeup removers and encompasses a full line of products including lotions and packs. It has the top share of Japan's facial cleanser market and has strengthened its leading share of the makeup remover market with new products including *Melting, Liquid Makeup Remover*. Kao also launched *Bioré Deep Moisturizing Cotton Lotion* in January 2008. This novel product proposal created a new lotion market and has performed well. *Bioré U* body cleanser sold strongly and increased market share, supported by continuous product proposals and the hot weather of summer 2007. In addition, Kao added to its lineup of hand soaps and bath additives by launching body care products during fiscal 2007, which synergistically enhanced awareness of *Bioré U* as a total body care brand.

Kao has extended the *Curél* brand for sensitive skin into hair care products. Initiatives including enhanced distribution of information at retail outlets resulted in further expansion in both loyal and new users.

Premium skin care products generated substantial growth in Asia despite fierce competition. Key factors included category expansion through the launch of UV care products, makeup removers and *Bioré Shower Cream* body cleanser in the core *Bioré* brand.

Sales of a new hair care product expanded the *Curél* sensitive skin care brand.

Premium Hair Care Products

In the shampoo and conditioner market, in April 2007 Kao launched a new aging care brand, *Segreta*, as a fourth major brand that strengthens its existing core *Asience*, *Essential* and *Merit* brands. As a result, Kao further increased its leading market share despite intense competition. In addition, *Essential* hair treatment, *Segreta* hair esthetic treatment and other products received strong consumer support, which made a strong contribution to enhancing brand value.

Kao created a new hair styling market in spring 2007 with the launch of *Yuzusui* fine mist styling spray for chignon hairstyles under the *Liese* brand, and added products such as *Hair Cocktail*, a two-layer hair oil shaken before use, which was launched in February 2008. As a result, Kao further strengthened its support among young consumers. *Cape* hairspray, which has a strong market presence, and the October 2007 launch of *Air Arrange*, a light styling product for feathery hairstyles, enhanced Kao's share among younger generations.

In the hair coloring market, *Prettia* hair lightener for black hair is the first foam product in the industry. Its proposal of simplicity and excellent results resonated particularly well among young women and contributed strongly to expanding the market.

In Asia, *Asience*, which had been introduced in Taiwan and Hong Kong in 2005, performed strongly following launches in Singapore in July 2006, and in Shanghai and Bangkok in March 2008. We have also launched *Asience Moisture Balance* in those initial markets of Taiwan and Hong Kong, and sales have been robust.

Kanebo Cosmetics' *freeplus* brand is sold in upscale drugstores in China.

Two-layer hair oil *Liese Hair Cocktail* has enjoyed strong sales.

North America and Europe

In prestige cosmetics, Kanebo Cosmetics executed a total renewal of the *SENSAI* super prestige skin care brand, its core skin care line, which further expanded support among high-class cosmetics users in North America and Europe for continued year-on-year growth. Modern British luxury lifestyle brand *Molton Brown* also performed well, primarily in the U.K. market. Further expansion of overseas sales channels resulted in continued strong growth.

Kao Brands Company offers premium brands in North America and Europe. The premium skin care brands *Curél* and *Bioré* performed well, but *Jergens natural glow* was beset by competition from similar products and seasonal factors, and sales trended downward despite the launch of new products with added value. Core premium hair care brand *John Frieda* also met with intense competition, particularly in the U.S. market. Despite initiatives to enhance its brand strength, sales were sluggish. In September 2007, Kao executed a total renewal of the *Guhl* brand sold in Europe with the objective of attracting new users, particularly in younger demographics. Sales have expanded steadily.


KPSS - Kao Professional Salon Services has accumulated a wealth of hair coloring and styling know-how.

Sales at KPSS - Kao Professional Salon Services GmbH (KPSS), which serves the hair salon market, trended downward. The company worked to strengthen the *Goldwell* brand with emphasis on hair coloring products, launching *Goldwell Color Glow IQ*, a product for colored hair, in European markets in September 2007. Furthermore, it moved to strengthen U.S. sales channels from July 2007, and is working to raise the efficiency of sales activities and expand penetration.

	Kao Brands Company	KPSS—Kao Professional Salon Services
Premium Skin Care Products	Jergens, Curél, Bioré, ban	
Premium Hair Care Products	John Frieda Collection, Guhl	Goldwell, kms california

Issues for Fiscal 2008 and Beyond

Japan and Asia

Prestige Cosmetics

Kanebo Cosmetics will further enhance the value and scale of each of its brands while using the technological strengths of the Kao Group to concentrate on creating new value through new product development. The March 2008 launch of *CHICCA* in Tokyo and Osaka aims to create a new market with the first point makeup for women in their fifties and sixties. In China, Kanebo Cosmetics continues to work aggressively to expand its business under a strategy that emphasizes growth in sales per store.

Kao Sofina is working to further enhance the scale and value of the *Sofina* brand, encompassing the core *SOFINA beauté*, *GRACE SOFINA* and other foundation products. For *est*, which has built a foundation as a comprehensive beauty care brand with the expansion of its makeup line, Kao Sofina will further enhance its high-value-added proposals to department store customers.

For sales in Japan, Kao Customer Marketing and Kao Merchandising Services will strengthen cooperation and work together with Kanebo Cosmetics to promote further improvements in their comprehensive distribution proposal and point-of-sale capabilities.


Staff promoting the *Asience* concept in-store (Shanghai, China)

Kanebo Cosmetics' new prestige brand *CHICCA*

Improved European premium hair care brand *Guhl*

Premium Skin Care Products

Kao will continue to concentrate on developing high-value-added products for the *Bioré* and *Bioré U* brands. *Bioré* will strengthen makeup removers and UV care products, and expand its share of the male market with *Men's Bioré*. Moreover, additional line extensions will strengthen *Bioré U* into a total body care brand. Kao is also energetically executing its *Curél* strategy in the sensitive skin care market.

In Asia, Kao continues to concentrate on *Bioré*, and expanded this category with the addition of a body cleanser. Investment in efficient marketing that precisely meets the needs of each area will help to further strengthen Kao's Asian business.

Premium Hair Care Products

Competition is intensifying in the market for shampoos and conditioners, in which Kao is executing a potent four-brand strategy for *Asience*, *Essential*, *Merit* and *Segreta*. In the hair styling market, Kao will continue to make fresh proposals for *Liese* and *Cape*.

In Asia, Kao is working to further enhance its strengths with the aim of energizing Asian premium hair care markets. In particular, we are focusing on urban areas in marketing to position *Asience* as a pan-Asian brand.

North America and Europe

Kao will further cultivate prestige cosmetics, with *SENSAI* from Kanebo Cosmetics and *Molton Brown* as its core brands for upscale consumers.

To accelerate growth for premium skin care products, innovative launches for the *Jergens*, *Bioré* and *Curél* brands will aim to achieve further differentiation and enhance brand strength.

For its technology-driven premium hair care products, Kao Brands Company will concentrate on developing high-value-added products for the *John Frieda* brand and enhancing brand strength.

In the beauty salon business, KPSS will develop hair care products for the core *Goldwell* brand that continue to apply its strengths in the hair color category. While enhancing the sales organization in each country, KPSS will work to further strengthen its business.

The *est* brand, sold exclusively in department stores, added to and further enhanced the makeup lineup.

Modern British luxury lifestyle brand *Molton Brown*

Human Health Care Business

Overview

Net sales increased 4.2 percent year-on-year to ¥191.3 billion, and operating income increased 11.4 percent to ¥13.2 billion. In Japan, rising prices for oil and pulp, which are major raw materials, directly impacted food and beverage products such as *Econa* healthy cooking oils and sanitary products such as disposable diapers. However, their performance was solid, with continued share growth for *Merries* baby diapers and strong sales of *Medicated Pyuora* oral care products and *Bub* bath additives. In Asia, Kao achieved strong sales growth on good results for *Laurier* sanitary napkins in Thailand, China, Malaysia and other countries.

Key Initiatives and Results in Fiscal 2007

In the food and beverage products business, the *Healthya* functional beverage brand sought new customers with the launch of the new *Healthya Water Muscat Flavor* variant and *Healthya Green Tea Mellow Flavor,* which is less bitter than original *Healthya Green Tea*. However, sales decreased due to intensified beverage market competition. Greater differentiation of *Econa* healthy cooking oils, which prevent fat buildup and lower cholesterol, strengthened the brand.

The sanitary products business performed well in Japan, gaining consumer support for baby diaper brand *Merries* with marketing emphasizing the product's gentleness on the skin. Kao achieved strong sales growth in Asia as a result of detailed regional analysis of sanitary products, thorough marketing by product type, including slim and night-use variants of *Laurier*, and new product releases that met regional consumer preferences.

In the personal health products business, strong consumer support led to significant sales growth for *Medicated Pyuora* in its second year of sales under the "cleaning the oral environment" concept. The February 2008 launch of a cassis and mint-flavored product targets younger consumers than the traditional core of adult customers. The *Check* lineup of ultra-compact and tapered slim toothbrushes for women also performed well.

Men's brand *Success* achieved double-digit growth on substantially higher sales of shampoo, scalp cleansing brushes and hair tonic that promote "health care for the scalp." In February 2008, Kao further strengthened the *Success* brand with *Medicated Vital Charge*, which protects against hair loss and thinning.

In bath additives, the October 2007 launch of carbonated *Bub Rich* contributed to the success of the *Bub* lineup. *Bub* sales reflected support for Kao's more effective products for relieving stress.

A successful marketing strategy and substantial mass media coverage gained numerous trial customers for the newly launched *Megurism Steam Eye Mask*.

Merries has grown to be Japan's top disposable baby diaper brand.

Issues for Fiscal 2008 and Beyond

Mandatory special health examinations and specified health guidance began in April 2008 in Japan for those aged 40 to 74. Consequently, the food and beverage business will leverage this opportunity by positioning *Econa* and *Healthya* as recommended products for people with metabolic syndrome. Improvements to *Healthya Water* and the limited-time offering of an acerola-flavored product will aim to strengthen the brand and expand its share.

In the sanitary products business in Japan, Kao will improve *Merries* by launching a renewed product that uses mesh to triple breathability. Promoting high added value will mitigate the impact of rising raw material prices. In Asia, Kao will continue country-by-country analysis of sanitary napkin types and introduce new products that fit market needs in order to increase the *Laurier* brand's penetration.

In the personal health products business, Kao will promote market expansion by working to make *Megurism Steam Eye Mask* a year-round product. Efforts to expand family use of *Clear Clean* toothpaste will emphasize its microparticles that break down in the spaces between teeth for deep cleaning. Kao will also further promote scalp care with *Success* to establish it as the top men's hair care brand.

Megurism Steam Eye Mask has created a new custom.

Fabric and Home Care Business

Overview

As the Kao Group's revenue base, the Fabric and Home Care Business aims to increase sales and income by 1) developing and launching high-value-added products, 2) establishing mega brands and effectively deploying marketing expenditures, and 3) further promoting Total Cost Reduction (TCR) activities. As a result of these efforts, net sales increased 1.9 percent year-on-year to ¥274.7 billion, but rising raw material prices resulted in a 3.0 percent decrease in operating income to ¥56.1 billion.

Announcement of the launch of *Attack Easy* laundry detergent in Indonesia

Key Initiatives and Results in Fiscal 2007

Japan

The market for fabric and home care products returned to gradual growth, with a general turnaround from declining consumer purchase prices. However, prices in some categories continued to fall, and competition remained intense. In addition to changes in demographics, distribution and other aspects of the operating environment, rising prices for goods directly affecting consumer lifestyles are causing pronounced shifts in attitudes and practices related to shopping and housework. Under these circumstances, Kao gained widespread consumer support and made solid progress in strengthening its brands by developing new high-value-added products that respond to consumers' changing attitudes and household realities, thus invigorating the market.

Laundry detergent launches included *Style Fit*, a joint development of *Attack* and *Humming* for the growing number of busy people who do their laundry at night and dry it indoors. *Attack Biogel* liquid detergent, developed for use in increasingly popular water-saving washing machines, performed well following its January 2008 launch. However, intense market competition continued, and laundry detergent sales were essentially unchanged year-on-year. In fabric softeners, the introduction of *Humming Flair Flower Blossom Essence* and *Humming Flair Shining Essence* increased sales and stimulated the market by meeting diversifying consumer needs.


Attack Biogel liquid detergent stimulated the market.

In the dishwashing detergent category of home care products, the launch of *CuCute Power Gel* for dishwashers expanded the market and increased Kao's share. In fabric fresheners, Kao launched *Resesh Antiseptic EX* with enhanced antibacterial properties in response to growing consumer consciousness of sanitation and antibacterial cleaning. The product gained the support of consumers and sold strongly.

Asia

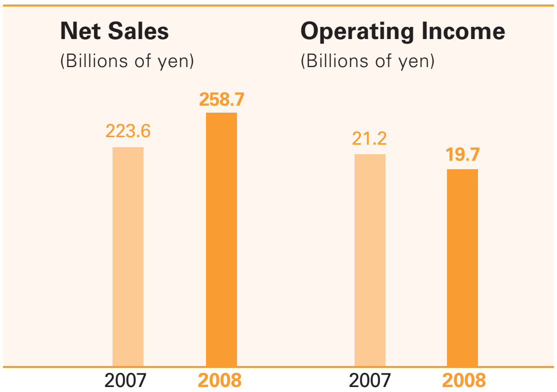
The key to business growth in Asia is product development and marketing that anticipate the rapid shifts in consumer values, attitudes and practices with regard to housework resulting from changes in housing conditions, the standard of living and lifestyle diversity occurring in tandem with economic development. Under these circumstances, Kao is realizing the benefits of integrating business operations in Asia, including Japan. *Attack Easy* laundry detergent for hand washing, launched in Thailand in 2006, recorded its second consecutive year of double-digit sales growth. *Attack Easy* also made a strong start in Indonesia since its launch there in December 2007. Moreover, Kao strengthened the *Attack* brand with the launch in Thailand and China of a new product with a fabric softening effect.


CuCute Power Gel for dishwashers increased Kao's market share.

Issues for Fiscal 2008 and Beyond

In Japan, Kao will work to accurately understand changing consumer needs in order to develop high-value products that offer cleanliness, comfort and enjoyment in a variety of lifestyle situations. In Asia, Kao will continue to emphasize scaling up sales of the *Attack* laundry detergent brand. Meanwhile, TCR activities and more effective deployment of marketing expenditures will help to mitigate the impact of rising raw material prices and strengthen profitability.

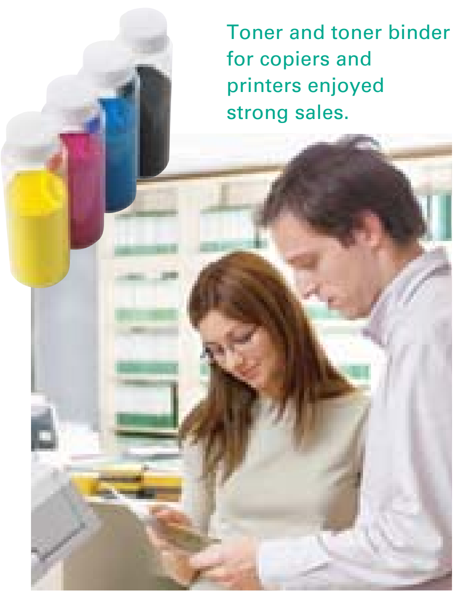
Chemical Business



Note: Net sales include intersegment sales.

Chemical Business sales increased 15.7 percent compared with the previous fiscal year to ¥258.7 billion. Operating income decreased 7.1 percent to ¥19.7 billion.

Protracted high prices for natural oils and fats and petrochemical raw materials had a substantial impact on corporate earnings, and inventory adjustments in information technology industries affected sales of some specialty chemicals. Under these circumstances, the Chemical Business continued to strengthen its global management system for its three business areas of oleo chemicals, performance chemicals and specialty chemicals to stably and efficiently supply high-quality products. As a result, sales were firm. However, despite efforts to adjust selling prices and reduce costs, operating income fell year-on-year due to rising raw material prices.



Toner and toner binder for copiers and printers enjoyed strong sales.

Key Initiatives and Results in Fiscal 2007

In the oleo chemicals business, fatty alcohol sales increased with expansion of manufacturing facilities in the Philippines to meet higher demand. Sales of tertiary amines remained strong in North America and Europe.

In the performance chemicals business, sales of plastics additives and superplasticizers for concrete admixtures increased.

In the specialty chemicals business, sales were firm for toner and toner binder for copiers and printers. While sales of polishing agents for hard disks and ink colorants for inkjet printers grew, sales of cleaners for electronic parts were sluggish due to inventory adjustments in the relevant industries and the market entry of a new competitor.

Kao adjusted prices for products including fatty alcohols and performance chemicals in response to raw material price increases.

Issues for Fiscal 2008 and Beyond

Kao will work to achieve high product performance and low-cost operation by further promoting global integration of research, production and marketing.

For performance chemicals, Kao will review existing businesses and products and concentrate its efforts on high-value-added and highly competitive areas and offerings. In specialty chemicals, Kao will strive to further develop proprietary core technologies to deliver high-quality, high-performance products in response to the fast-paced operations of customers.

Also, as an important part of its mission the business will work to create synergies with the Consumer Products Business including technologies to promote the stable supply of high-quality basic materials and product development.

Kao expanded fatty alcohol manufacturing facilities in the Philippines.

Sales of highly evaluated polishing agents for hard disks continued to grow.

Financial Section

Contents

Management's Discussion and Analysis

11-Year Summary

Kao Corporation and Consolidated Subsidiaries

Years ended March 31	2008	2007	2006	2005
	Millions of yen			
For the year:				
Net sales	¥1,318,514	¥1,231,808	¥ 971,230	¥936,851
New Business Segments				
Beauty Care Business	627,914	584,284	—	—
Human Health Care Business	191,300	183,608	—	—
Fabric and Home Care Business	274,657	269,519	—	—
Consumer Products Business	1,093,871	1,037,411	—	—
Chemical Business	258,674	223,609	—	—
Eliminations/Corporate	(34,031)	(29,212)	—	—
Former Business Segments				
Consumer Products	—	744,748	704,034	690,007
Prestige Cosmetics	—	292,663	85,247	78,294
Chemical Products	—	223,609	208,890	196,989
Eliminations/Corporate	—	(29,212)	(26,941)	(28,439)
Geographic Segments				
Japan	968,594	924,196	708,056	703,085
Asia and Oceania	158,295	125,989	110,898	100,282
North America and Europe	—	—	—	—
North America	111,017	106,731	95,168	83,638
Europe	154,648	135,918	109,486	93,804
Eliminations	(74,040)	(61,026)	(52,378)	(43,958)
Operating income	116,253	120,858	120,135	121,379
Net income	66,562	70,528	71,140	72,180
Capital expenditures	49,045	70,143	203,595	54,318
Depreciation and amortization	93,444	92,171	60,758	56,794
Cash flows	131,114	134,906	107,943	109,704
Research and development expenditures	45,070	44,389	40,262	39,764
(% of Sales)	3.4%	3.6%	4.1%	4.2%
Advertising expenditures	99,176	96,892	83,770	84,157
(% of Sales)	7.5%	7.9%	8.6%	9.0%
At year-end:				
Total assets	1,232,601	1,247,797	1,220,564	688,974
Net worth	574,038	564,532	509,676	448,249
Number of employees	32,900	32,175	29,908	19,143
	Yen			
Per share:				
Net income	¥ 122.53	¥ 129.41	¥ 130.58	¥ 131.16
Cash dividends	54.00	52.00	50.00	38.00
Net worth	1,070.67	1,035.66	935.11	821.47
Weighted average number of shares outstanding during the period (in thousands)	543,228	544,996	544,127	549,626
	%			
Key financial ratios:				
Return on sales	5.0%	5.7%	7.3%	7.7%
Return on equity	11.7	13.1	14.9	16.5
Net worth ratio	46.6	45.2	41.8	65.1

Notes: 1. Kao reorganized its operations effective April 2007 by integrating the former consumer products business and prestige cosmetics business into the Consumer Products Business, which is divided into three businesses (the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business). Together with the Chemical Business, Kao's business operations now consist of four business segments. Figures for 2007 have been restated to reflect the change.

2. Net sales by business segment include intersegment sales starting from the year ended March 31, 2000. Under the former business segments, net sales of Chemical Products include intersegment sales to Consumer Products and Prestige Cosmetics. Under the new business segments, net sales of the Chemical Business include intersegment sales to the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business.

3. Prestige Cosmetics results for 1998 are consolidated under Consumer Products.

4. Kanebo Cosmetics Inc. and its consolidated subsidiaries are included in the consolidated statements of income from the year ended March 31, 2007, and in the consolidated balance sheets as of March 31, 2008, 2007 and 2006. The results of Kanebo Cosmetics Inc., which has a fiscal year ending December 31, are included for the eleven months starting in February 2006, after the company was added to the Kao Group.

2004	2003	2002	2001	2000	1999	1998
¥902,628	¥865,247	¥839,026	¥821,629	¥846,922	¥924,596	¥907,249
—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
670,438	646,413	626,047	607,826	632,423	656,197	696,800
77,648	75,833	74,176	72,579	70,890	74,450	—
181,621	170,935	162,802	167,893	172,401	193,949	210,449
(27,079)	(27,934)	(23,999)	(26,669)	(28,792)	—	—
673,657	654,595	648,188	655,470	673,456	672,123	674,640
101,452	101,555	93,499	84,137	86,176	104,694	101,726
—	—	—	105,287	111,043	178,933	162,092
79,907	75,796	70,274	—	—	—	—
84,899	67,845	57,625	—	—	—	—
(37,287)	(34,544)	(30,560)	(23,265)	(23,753)	(31,154)	(31,209)
119,706	114,915	111,728	107,099	99,182	91,664	72,868
65,359	62,462	60,275	59,427	52,147	34,714	24,495
51,823	84,544	49,537	60,741	37,564	69,016	59,012
58,166	58,310	58,484	58,856	67,270	71,202	81,405
106,430	104,436	103,657	104,702	108,158	96,310	97,046
38,506	37,713	37,543	37,049	38,062	36,062	37,843
4.3%	4.4%	4.5%	4.5%	4.5%	3.9%	4.2%
82,773	74,277	66,069	65,758	64,354	71,752	65,404
9.2%	8.6%	7.9%	8.0%	7.6%	7.8%	7.2%
723,891	720,849	772,145	783,760	750,016	751,725	778,762
427,757	417,031	459,731	462,988	474,979	451,777	424,430
19,330	19,807	19,923	19,068	16,088	—	—
¥ 119.06	¥ 108.05	¥ 100.43	¥ 96.69	¥ 83.45	¥ 55.98	¥ 40.10
32.00	30.00	26.00	24.00	20.00	16.00	15.00
782.14	744.56	779.44	760.05	765.59	727.01	684.90
547,865	576,770	600,150	614,608	624,917	620,171	610,857
7.2%	7.2%	7.2%	7.2%	6.2%	3.8%	2.7%
15.5	14.2	13.1	12.7	11.3	7.9	6.1
59.1	57.9	59.5	59.1	63.3	60.1	54.5

5. Net sales by geographic segment include intersegment sales. Net sales in North America and Europe are presented separately from 2002.
6. Cash flows are defined as net income plus depreciation and amortization minus cash dividends.
7. Net income per share is computed based on the weighted average number of shares outstanding during the respective years. From the year ended March 31, 2003, the portion of net income unavailable to common shareholders, such as directors' bonuses, which is included in the appropriation of retained earnings, is deducted from net income for the calculation of net income per share. The same method is applied to the calculation of net worth per share.
8. Cash dividends per share are the amounts applicable to the respective years, including dividends to be paid after the end of the year.
9. Net worth is computed by subtracting minority interests and stock acquisition rights from equity.
10. For the purpose of comparison, in calculating return on equity for the years ended March 31, 2008 and 2007, equity does not include minority interests and stock acquisition rights.

Overview of Consolidated Results

During the fiscal year ended March 31, 2008, the recovery of the Japanese economy stalled. The moderate recovery in progress at the start of the period, with improved corporate earnings and growth in exports amid flat overall consumer spending, was impacted by further price increases for crude oil and raw materials and the strengthening of the yen against the dollar by the end of the fiscal year. Overseas, although the risk of slowdown caused by the U.S. subprime mortgage crisis increased, economies were firm in China and other Asian countries.

In the market for the Consumer Products Business, consumer purchase prices shifted upward in Japan, while markets in other parts of Asia expanded, although competition continued to intensify. The market for the Chemical Business was impacted by factors including high prices for natural oils and fats, petrochemicals and other raw materials.

Under these market conditions, the Kao Group reviewed its framework for conducting its operations and reorganized into four new business units in April 2007. In addition, Kao Cosmetics Sales Co., Ltd. was merged into Kao Hanbai Co., Ltd. to establish Kao Customer Marketing Co., Ltd. These measures were aimed at speedily and forcefully implementing a consumer-driven growth strategy in response to three major shifts: changes in the fundamental structure of society, including the low birth rate and aging of society, later marriages and single-person households; changes in consumer attitudes toward product selection and purchasing; and associated changes in retailing.

As a result, the Kao Group will further enhance its product development capabilities, which are based on "*Yoki-Monozukuri*," concentrate its management resources for aggressive new product launches and marketing and sales activities to strengthen its core brands, and stimulate the market with high-value-added brands, with the aim of achieving profitable growth globally.

Analysis of Income Statements

Net Sales and Operating Income

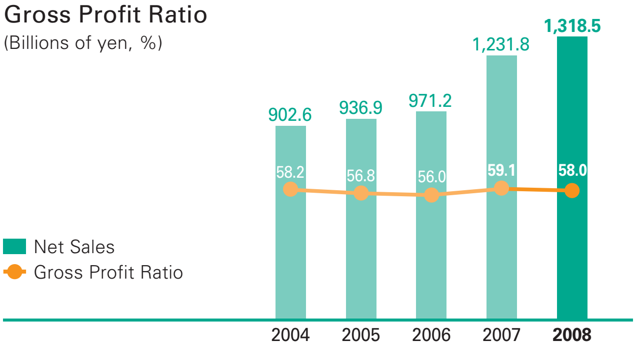
Net sales rose ¥86.7 billion to ¥1,318.5 billion (US$13,160.1 million), a 7.0 percent increase compared with the previous fiscal year. Excluding the positive currency translation effect of ¥20.2 billion on overseas sales, net sales would have increased 5.4 percent.

Sales in Japan increased 4.8 percent. In the market for the Consumer Products Business, consumer purchase prices shifted upward. In response to the market change, Kao increased sales by launching new, high-value-added products and extending the product lines of its brands, by increasing its ability to make comprehensive proposals to retailers with the merger of its sales companies, and by raising the effectiveness of its in-store merchandising.

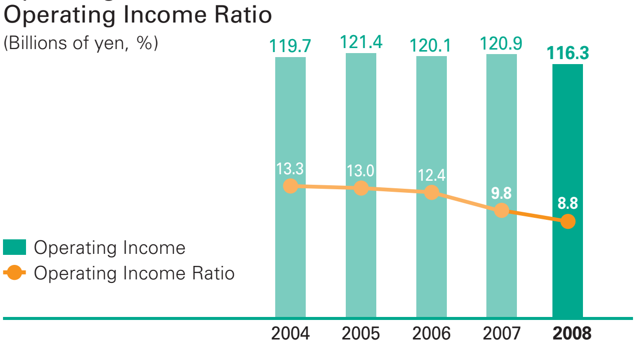
Chemical Business results were firm, with growth in sales of mainstay products.

Overseas sales increased 15.0 percent. Excluding the

Net Sales/ Gross Profit Ratio
(Billions of yen, %)



Operating Income/ Operating Income Ratio
(Billions of yen, %)



effect of currency translation, overseas sales increased 8.5 percent. In the Consumer Products Business in Asia and Oceania, the Kao Group realized the benefits of integrating operations in Asia, including Japan, in the contribution of new products and the strengthening of joint initiatives with retailers, while sales in Europe remained steady. In addition, the Chemical Business recorded strong sales overseas.

Cost of sales increased from ¥503.3 billion in the previous fiscal year to ¥554.2 billion (US$5,531.0 million). The increase in cost of sales was due to growth in sales volume, in addition to factors including a substantial rise in prices for raw materials, mainly natural oils and fats and petrochemicals. However, the Kao Group promoted further cost reduction activities, and consequently gross profit was ¥764.4 billion (US$7,629.1 million), an increase of 4.9 percent, or ¥35.8 billion, from the previous fiscal year.

Selling, general and administrative (SG&A) expenses were ¥648.1 billion (US$6,468.8 million), a year-on-year increase of 6.7 percent, or ¥40.4 billion. The main factors in the increase were strategic investment in marketing, freight and warehouse expenses associated with higher sales volume and rising fuel costs, and the impact of the one month longer period of consolidation of Kanebo Cosmetics Inc. compared with the previous fiscal year.

As a result of the above factors, operating income was ¥116.3 billion (US$1,160.3 million), a decrease of 3.8 percent from ¥120.9 billion in the previous fiscal year.

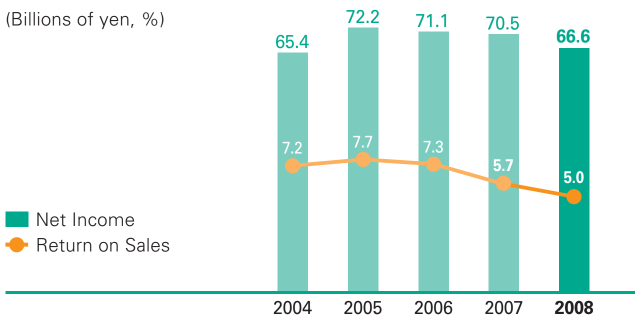
Non-Operating Expenses and Net Income

Other expenses increased to ¥5.9 billion (US$58.4 million) from ¥3.7 billion for the previous fiscal year. The main factors in the change were an increase in interest expense on borrowings and bonds, and a shift to a foreign currency exchange loss from a gain in the previous fiscal year.

Consequently, income before income taxes and minority interests decreased 5.7 percent from the previous fiscal year to ¥110.4 billion (US$1,101.9 million). Total income taxes were ¥42.8 billion (US$426.9 million), compared with ¥45.1 billion in the previous fiscal year. The effective tax rate after application of tax effect accounting was 38.7 percent, compared with 38.5 percent in the previous fiscal year. Net income was ¥66.6 billion (US$664.4 million), a decrease of 5.6 percent from ¥70.5 billion in the previous fiscal year. Net income per share was ¥122.53 (US$1.22), a ¥6.88 decrease from ¥129.41 in the previous fiscal year due to the decrease in net income.

Net Income/ Return on Sales

(Billions of yen, %)



Costs, Expenses and Income as Percentages of Net Sales

	2008		2007		2006
Cost of sales	42.0%		40.9%		44.0%
Gross profit	58.0	(-1.1)	59.1	(+3.1)	56.0
Selling, general and administrative expenses	49.2	(-0.1)	49.3	(+5.7)	43.6
Operating income	8.8	(-1.0)	9.8	(-2.6)	12.4
Income before income taxes and minority interests	8.4	(-1.1)	9.5	(-2.5)	12.0
Net income	5.0	(-0.7)	5.7	(-1.6)	7.3

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

Information by Business Segment

Formerly, the operations of the Kao Group were classified into three business segments: Consumer Products, Prestige Cosmetics and Chemical Products. As of April 1, 2007, Kao reorganized into four business segments: the Beauty Care Business, the Human Health Care Business, and the Fabric and Home Care Business, which together make up the Consumer Products Business, and the Chemical Business. This reorganization was conducted to speedily and forcefully implement a consumer-driven growth strategy in response to three major shifts: changes in the fundamental structure of society; changes in consumer attitudes toward product selection and purchasing; and associated changes in retailing. The reorganization and accompanying reclassification of businesses more accurately reflect the actual management of the Kao Group.

Consumer Products Business

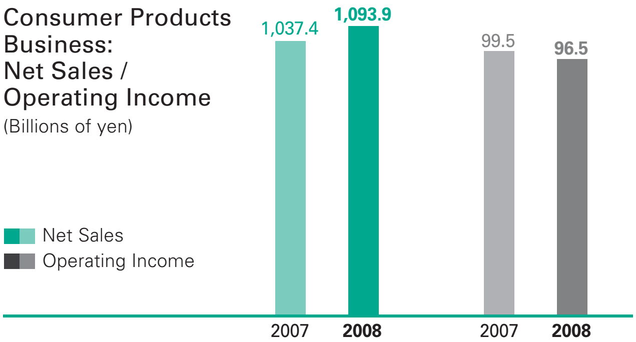
Sales of the Consumer Products Business increased 5.4 percent compared with the previous fiscal year to ¥1,093.9 billion (US$10,918.0 million). Excluding the effect of currency translation, sales would have increased 4.3 percent. In Japan, the Kao Group responded to market changes by launching new, high-value-added products and extending the product lines of its brands, by increasing its ability to make comprehensive proposals to retailers with the merger of its sales companies for consumer products and for Kao Sofina prestige cosmetics, and by raising the effectiveness of its in-store merchandising. As a result, sales in Japan increased 4.5 percent to ¥868.4 billion (US$8,667.8 million).

In Asia and Oceania, sales increased 18.5 percent to ¥85.4 billion (US$852.0 million), as the Kao Group realized the benefits of integrating business operations in Asia, including Japan, in the contribution of new products and the strengthening of joint initiatives with retailers. Excluding the effect of currency translation, sales in Asia and Oceania would have increased 11.3 percent.

In North America and Europe, despite greater competition, sales increased 5.0 percent to ¥156.2 billion (US$1,559.2 million). Excluding the effect of currency translation, sales in North America and Europe would have increased 0.2 percent.

Despite the Kao Group's aggressive launches of new products, cost reductions and other initiatives in Japan and overseas, operating income was strongly affected by rising prices for raw materials, decreasing ¥3.0 billion from the previous fiscal year to ¥96.5 billion (US$963.2 million).

Consumer Products Business: Net Sales / Operating Income
(Billions of yen)



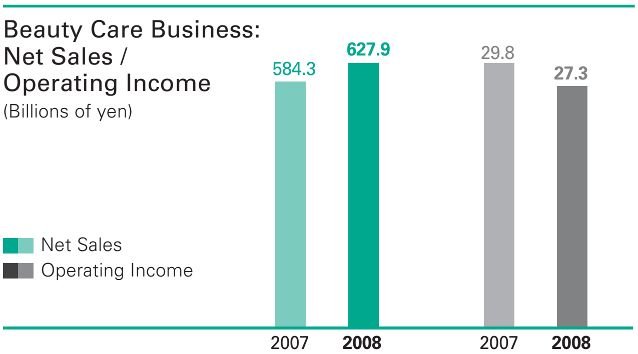
Beauty Care Business

Beauty Care Business sales increased 7.5 percent compared with the previous fiscal year to ¥627.9 billion (US$6,267.2 million). Although profits rose in tandem with the increase in sales volume, operating income decreased ¥2.6 billion year-on-year to ¥27.3 billion (US$272.3 million) as a result of a decrease in sales of Sofina and strategic investments for future growth.

Sales in Japan increased 7.8 percent compared with the previous fiscal year to ¥448.7 billion (US$4,478.2 million). In a flat market for prestige cosmetics, product launches included *SOFINA beauté*, as well as *DEW SUPERIOR* and *COFFRET D'OR* from Kanebo Cosmetics, each of which got off to a strong start. In addition, department store brand *est*, which added a makeup line, and the Kanebo Cosmetics brands *EVITA*, high-end prestige brand *Impress* for department stores and the *KATE* makeup series also performed well. In premium skin care products, the *Bioré* brand and the *Curél* brand for sensitive skin performed strongly with launches of new and improved products. Sales of premium hair care products grew with the launch of the new *Segreta* brand and a renewal of *Asience*.

Sales in Asia and Oceania were also strong. In prestige cosmetics, the Kao Group aggressively expanded business in the department store and high-end drugstore channels in China. Moreover, in premium skin care products, sales of *Bioré* brand body cleanser expanded to other countries in the ASEAN region, and in premium hair care products, a new line was added to the *Asience* brand in Taiwan and Hong Kong.

Sales in North America and Europe were essentially unchanged from the previous fiscal year, excluding the effect of currency translation. The *Molton Brown* prestige cosmetics brand performed well, mainly in the U.K. market. *Jergens*, *Curél* and other premium skin care brands added new products. The *John Frieda* premium hair care brand also launched new and improved products, and growth was steady in Europe, but slower in the U.S. due to the impact of intensifying competition. Sales to hair salons were essentially flat.

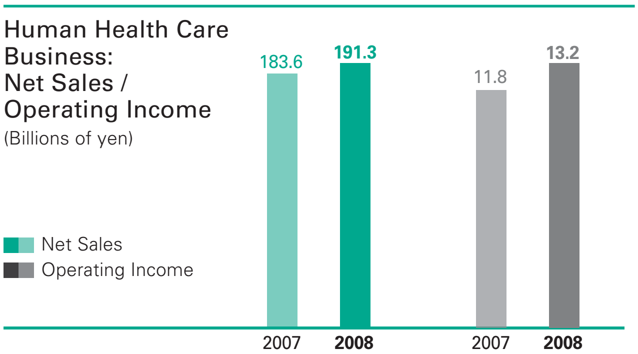


Human Health Care Business

Human Health Care Business sales increased 4.2 percent compared with the previous fiscal year to ¥191.3 billion (US$1,909.4 million). Operating income increased ¥1.3 billion year-on-year to ¥13.2 billion (US$131.3 million), due to higher sales volume and other factors.

In Japan, sales increased 2.6 percent to ¥174.5 billion (US$1,741.4 million). In food and beverage products, the Kao Group worked to attract new customers by extending the *Healthya* brand functional drink lineup with *Healthya Green Tea Mellow Flavor*, which is less bitter and astringent than original *Healthya Green Tea*. However, sales decreased due to diversifying consumer preferences in the beverage market. Sales of sanitary products increased, with continued consumer support due to marketing activities for *Laurier Super Guard* sanitary napkins that base the product's appeal on a secure night's sleep even on days with heavy flow, and marketing activities for disposable baby diapers that base their appeal on their increased gentleness on the skin. Personal health product sales increased substantially with a cassis and mint flavored extension of the *Medicated Pyuora* lineup of oral care products, the addition of new *Success Medicated Shampoo with Double Conditioning Effects* to the *Success Medicated Shampoo* lineup, and the launch of *Megurism Steam Eye Mask*.

In Asia, sales expanded as *Laurier* sanitary napkins sold strongly in Thailand, Malaysia, China and other countries.



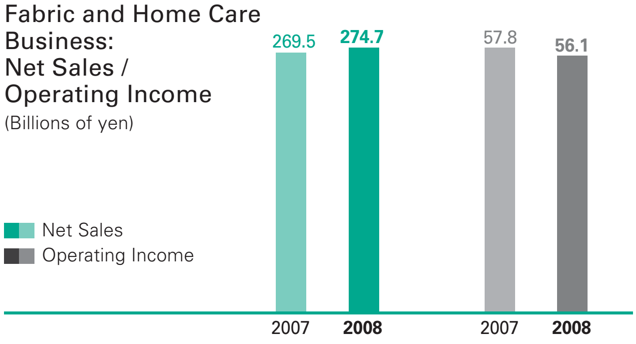
Fabric and Home Care Business

Fabric and Home Care Business sales increased 1.9 percent compared with the previous fiscal year to ¥274.7 billion (US$2,741.4 million). Although sales volume increased and the Kao Group promoted high-added-value products and cost reductions, operating income decreased ¥1.8 billion year-on-year to ¥56.1 billion (US$559.5 million) due to higher raw material prices.

In Japan, sales were essentially unchanged from the previous fiscal year at ¥245.3 billion (US$2,448.2 million). In fabric care products, the Kao Group stimulated the market by launching *Attack Biogel* liquid detergent, which delivers high cleaning efficiency even when using the increasingly prevalent method of washing with a small amount of water relative to the load size. However, in the laundry detergent category, although the decline in retail prices appears to be bottoming out in some sectors, sales decreased slightly as market competition remained severe and the gift market substantially contracted. Sales of fabric softeners grew with the addition of two new scent varieties to *Floral Humming*, whose pleasant scents linger even when a garment is being worn, due to its blend of long-lasting fragrances. Sales of home care products increased, with the launch of high-value-added products such as *CuCute Power Gel* dishwasher detergent and *Resesh Antiseptic EX* fabric freshener.

Sales in Asia and Oceania increased. In Thailand, the Kao Group added *Attack Soft Plus* with a fabric softening effect to strong-selling laundry detergent *Attack Easy*. The Kao Group also launched *Attack Easy* in Indonesia in December 2007. Moreover, in China the Kao Group launched *Attack Softener-in* in regions where it has been selling *Attack* and began sales of the *Attack* series in northern China, including Beijing.

Fabric and Home Care Business: Net Sales / Operating Income
(Billions of yen)



Chemical Business

Sales of the Chemical Business increased 15.7 percent compared with the previous fiscal year to ¥258.7 billion (US$2,581.8 million). Excluding the effect of currency translation, sales would have increased 11.9 percent.

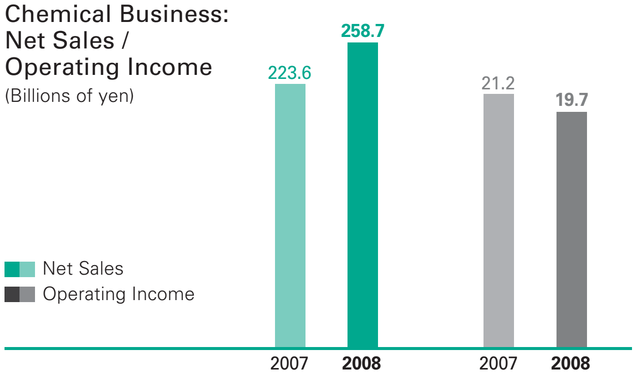
Operating income decreased ¥1.5 billion year-on-year to ¥19.7 billion (US$196.5 million) due to the impact of rising raw material prices for natural oils and fats and petrochemicals, although the Kao Group stepped up its efforts to adjust sales prices of oleo chemical and performance chemical products and to reduce costs.

In Japan, sales increased 10.6 percent compared with the previous fiscal year to ¥129.4 billion (US$1,291.4 million). In oleo chemicals, fatty alcohols and tertiary amines posted strong sales. In performance chemicals, sales of plastics additives increased. In specialty chemicals, while sales of cleaners for electronic parts were affected by inventory adjustments in their target industries, sales for polishing agents for hard disks and ink colorants for inkjet printers increased.

In Asia, sales increased 34.7 percent compared with the previous fiscal year to ¥75.2 billion (US$750.5 million). Excluding the effect of currency translation, sales would have increased 27.1 percent. Sales of fatty alcohols increased substantially, as sales volume increased due to production capacity expansion at a plant in the Philippines to meet growing demand while the Kao Group worked to adjust sales prices.

In North America and Europe, sales increased 19.2 percent compared with the previous fiscal year to ¥98.8 billion (US$986.4 million). Excluding the effect of currency translation, sales would have increased 11.5 percent. Fatty alcohols, tertiary amines and toner and toner binder for copiers and printers performed well.

Chemical Business: Net Sales / Operating Income
(Billions of yen)

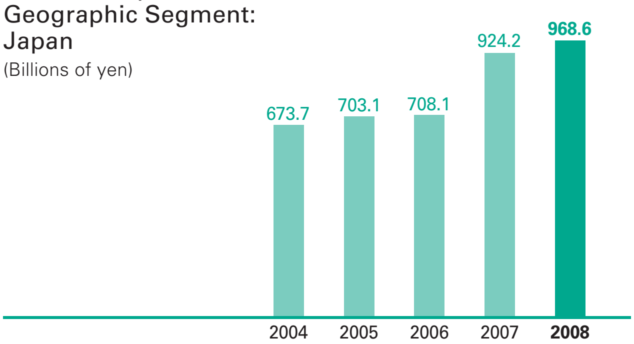


Information by Geographic Segment

Japan

Sales in Japan, including intersegment sales, increased 4.8 percent compared with the previous fiscal year to ¥968.6 billion (US$9,667.6 million). The increase was due to aggressive introductions of high-value-added products and strengthening of the sales organization in response to market changes. Although the Kao Group increased sales volume and worked to reduce costs, operating income decreased 3.8 percent year-on-year to ¥98.4 billion (US$981.7 million) due to factors including higher raw material prices.

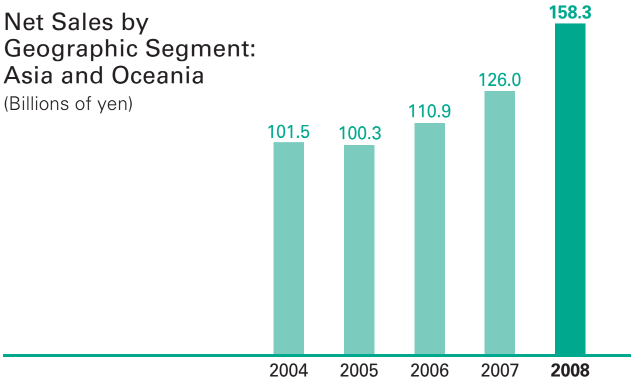
Net Sales by Geographic Segment: Japan
(Billions of yen)



Asia and Oceania

Sales in Asia and Oceania, including intersegment sales, increased 25.6 percent compared with the previous fiscal year to ¥158.3 billion (US$1,579.9 million). Excluding the effect of currency translation, sales would have increased 18.2 percent. Sales volume increased because the Consumer Products Business realized the benefits of integrating business operations in Asia, including Japan, and the Chemical Business augmented its fatty alcohol production facilities in the Philippines to meet growth in demand. Operating income decreased ¥1.5 billion year-on-year to ¥1.1 billion (US$10.8 million) due to factors including investment in strategic marketing in the Consumer Products Business and higher prices of raw materials for fatty alcohols produced in Malaysia and the Philippines.

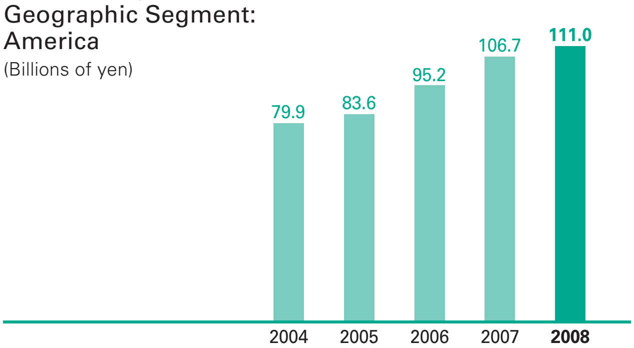
Net Sales by Geographic Segment: Asia and Oceania
(Billions of yen)



America

Sales in America, including intersegment sales, increased 4.0 percent compared with the previous fiscal year to ¥111.0 billion (US$1,108.1 million). Excluding the effect of currency translation, sales would have increased 2.8 percent. In the Beauty Care Business, the Kao Group launched new premium skin care products, but sales of premium hair care products weakened due to intensified competition. In the Chemical Business, sales of fatty alcohols, tertiary amines, toner and toner binder and other products were strong. Operating income decreased 11.7 percent year-on-year to ¥6.8 billion (US$68.3 million).

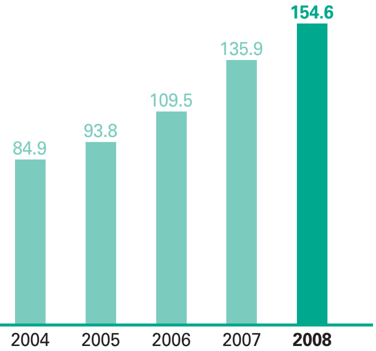
Net Sales by Geographic Segment: America
(Billions of yen)



Europe

Sales in Europe, including intersegment sales, increased 13.8 percent compared with the previous fiscal year to ¥154.6 billion (US$1,543.5 million). Excluding the effect of currency translation, sales would have increased 4.1 percent. The Beauty Care Business performed well, with strong sales of the *Molton Brown* prestige cosmetics brand, mainly in the U.K. market, and launches of new and improved premium hair care products from *John Frieda*. In the Chemical Business, sales of fatty alcohols and tertiary amines were strong. Operating income increased 3.8 percent year-on-year to ¥9.0 billion (US$90.0 million) due to firm sales in the Chemical Business.

Net Sales by Geographic Segment: Europe
(Billions of yen)



Financial Structure

Total assets decreased ¥15.2 billion from the previous fiscal year-end to ¥1,232.6 billion (US$12,302.6 million). Principal factors increasing assets were a ¥13.5 billion increase in inventories due to business expansion and higher raw material prices, and a ¥20.7 billion increase in short-term investments. The principal factor reducing assets was a ¥41.4 billion decrease in intangible assets associated with depreciation and amortization.

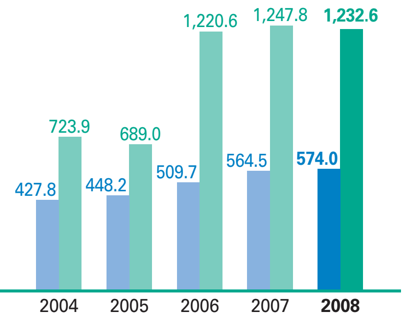
Total liabilities decreased ¥25.2 billion from the previous fiscal year-end to ¥647.9 billion (US$6,466.6 million). The principal factor increasing liabilities was a ¥17.7 billion increase in accrued income taxes, and the principal factor decreasing liabilities was repayment of long-term debt totaling ¥42.0 billion.

The balance of bank borrowings and bonds as of March 31, 2008 was ¥313.6 billion (US$3,130.4 million).

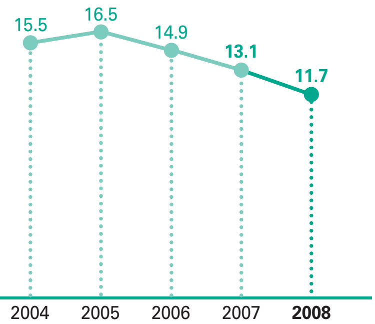
Total equity increased ¥10.0 billion compared with the previous fiscal year-end to ¥584.7 billion (US$5,836.0 million). The principal factor increasing equity was net income of ¥66.6 billion (US$664.4 million), and the principal factors decreasing equity were shareholder returns, including a ¥28.9 billion payment from retained earnings for dividends and a ¥29.1 billion increase in treasury stock mainly due to the repurchase of the Company's shares.

As a result, net worth per share increased ¥35.01 from the previous fiscal year-end to ¥1,070.67 (US$10.69), and the net worth ratio increased to 46.6 percent from 45.2 percent a year earlier.

Total Assets/ Net Worth
(Billions of yen)



Return on Equity*
(%)



*For the purpose of comparison, in calculating ROE for the years ended March 31, 2007 and 2008, equity does not include minority interests and stock acquisition rights.

Cash Flows

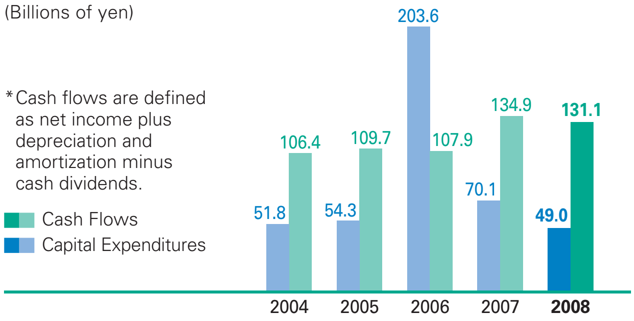
During the fiscal year ended March 31, 2008, although the Kao Group made expenditures for investments for the Group's global growth, to repay borrowings and other interest-bearing debt, and to repurchase shares of the Company's stock, operating activities provided a steady source of net cash, and cash and cash equivalents increased by ¥24.5 billion to ¥112.6 billion (US$1,124.2 million) at the fiscal year-end.

Cash Flows from Operating Activities

Net cash provided by operating activities during the fiscal year ended March 31, 2008 was ¥180.3 billion (US$1,799.8 million) compared with ¥165.0 billion for the previous fiscal year. Income before income taxes and minority interests

Cash Flows*/
Capital Expenditures
(Billions of yen)

*Cash flows are defined as net income plus depreciation and amortization minus cash dividends.



was ¥110.4 billion (US$1,101.9 million) compared with ¥117.1 billion for the previous fiscal year, and depreciation and amortization totaled ¥93.4 billion (US$932.7 million) compared with ¥92.2 billion for the previous fiscal year. On the other hand, income taxes paid totaled ¥30.0 billion (US$299.1 million) compared with ¥42.3 billion for the previous fiscal year, change in inventories decreased cash by ¥13.2 billion (US$131.5 million) compared with ¥3.2 billion in the previous fiscal year, change in liability for retirement benefits added ¥1.1 billion (US$11.0 million) to cash compared with ¥1.2 billion in the previous fiscal year, and change in prepaid pension cost increased cash by ¥6.0 billion (US$59.7 million) compared with decreasing cash by ¥10.2 billion in the previous fiscal year.

Cash Flows from Investing Activities

Net cash used in investing activities during the fiscal year ended March 31, 2008 was ¥52.4 billion (US$522.9 million), compared with ¥63.2 billion in the previous fiscal year. This primarily consisted of ¥38.1 billion (US$380.7 million) for purchase of property, plant and equipment used for capital expenditures in connection with handling new and improved products and expanding production facilities in Japan and overseas.

Cash Flows from Financing Activities

Net cash used in financing activities during the fiscal year ended March 31, 2008 was ¥101.8 billion (US$1,016.3 million), compared with ¥83.7 billion in the previous fiscal year. This primarily consisted of a net total of ¥42.9 billion (US$428.5 million) in decrease in short-term debt, proceeds from long-term loans and repayments of long-term loans, compared with ¥154.3 billion in the previous fiscal year, payments of cash dividends, including to minority shareholders, totaling ¥29.7 billion (US$296.4 million) compared with ¥29.1 billion in the previous fiscal year, and ¥31.0 billion (US$309.0 million) for purchase of treasury stock, compared with ¥1.1 billion in the previous fiscal year.

Basic Policies Regarding Distribution of Profits and Dividends for the Period

In order to achieve profitable growth, the Company sets policies regarding allocation of profits between its internal reserve for growth and dividends from a medium-to-long-term management perspective. Considering it important to provide shareholders with stable and continuous dividends, the Company currently has a target payout ratio of approximately 40 percent of consolidated net income. In order to increase earnings per share and dividends over the long term, the Company will consider flexibly implementing share repurchases as a measure for shareholder returns from a long-term perspective, taking into account both fund requirements such as capital investment for growth and acquisition initiatives, and capital efficiency improvement.

In accordance with these policies, the Company increased the year-end dividend for the fiscal year ended March 31, 2008 by ¥1.00 compared with the previous fiscal year to ¥27.00 (US$0.27) per share, the same as the interim dividend. As a result, dividends for the fiscal year increased by ¥2.00 per share compared with the previous fiscal year, for a total of ¥54.00 (US$0.54) per share, and a consolidated payout ratio of 44.1 percent. To increase capital efficiency, the Company also repurchased 9,315,000 shares during the fiscal year ended March 31, 2008 for a total of approximately ¥30.0 billion, based on a resolution of the Board of Directors. These dividend payments and share repurchases represent a return to shareholders of ¥58.9 billion, or 89 percent of net income.

In addition, for the fiscal year ending March 31, 2009, the Company plans to increase total dividends by ¥2.00 to ¥56.00 per share, taking into account achievement of its income forecast based on these basic policies, resulting in a projected consolidated payout ratio of 43.5 percent.

EVA

Economic Value Added (EVA) is Kao's main management measure for evaluating business performance and for operational and strategic decision-making. EVA is defined as net operating profit after tax (NOPAT) less a charge for the cost of capital employed in the business. EVA provides managers with a tool for evaluating the trade-offs inherent between increasing profits and covering the cost of capital required to generate such profits. The aim of employing EVA is to create an organization focused on the enhancement of corporate value. During the fiscal year ended March 31, 2008, EVA decreased to 125 from 134 for the previous fiscal year, expressed as an index with the year ended March 31, 2000 as 100. Since introducing EVA as a management metric, Kao has focused attention on the three key areas outlined below:

Investing for Growth: With the aim of accelerating growth in its Beauty Care Business, Kao acquired Kanebo Cosmetics Inc. in January 2006 after valuing its operations at ¥410.0 billion. In order to maximize the benefits of this investment, Kao initiated aggressive business activities including proactive marketing investments in the growing Chinese market. Kao has also invested in other businesses and research activities to improve EVA in the future.

Increasing Profit: In its initial plan for the fiscal year ended March 2008, Kao forecast a decrease in NOPAT due to investments in marketing to support growth and other factors. In addition, the impact of rising prices for natural oils and fats and crude oil resulted in an increase in costs that significantly exceeded Kao's forecast by ¥21.0 billion (US$209.6 million). Kao responded to higher costs by increasing sales in the Consumer Products Business in Japan and Asia as a result of strengthened sales capabilities, and reduced expenses by ¥8.0 billion (US$785.1 million) through Total Cost Reduction (TCR) activities. Consequently, although NOPAT for the fiscal year ended March 2008 decreased, it was higher than Kao's forecast.

Financial Improvement: Kao is able to generate approximately ¥100.0 billion in free cash flow each year as a result of factors including the addition of Kanebo Cosmetics Inc. to the scope of consolidation. In the fiscal year ended March 2008, free cash flow* totaled ¥127.9 billion (US$1,276.6 million). Kao gives priority to using free cash flow for mergers and acquisitions and additional capital expenditures for future growth, followed by payment of stable, continuous cash dividends. Kao uses the remaining free cash flow for share repurchases or repayment of borrowings, after considering its capital plans and interest rate trends. In the year ended March 2008, Kao repurchased its shares at a total cost of ¥30.0 billion (US$299.4 million) and paid cash dividends totaling ¥29.7 billion (US$296.4 million), together representing returns to shareholders totaling 89 percent of net income. Kao also repaid long-term loans totaling ¥42.0 billion (US$419.6 million).

Business Conduct Guidelines

Kao has established the 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. In addition, Kao has formulated and adheres to a code of conduct, "Kao's Business Conduct Guidelines." Kao has also announced its support for and undertaking of the ten principles of the Global Compact advocated by the United Nations and its continued intention to behave responsibly in international society. The Global Compact is a voluntary corporate citizenship initiative consisting of ten principles related to human rights, labor standards, the environment and anti-corruption, aiming for the sustainable growth of society.

Business Risks and Other Risks

The Kao Group takes measures to mitigate risk by minimizing exposure to and hedging risks. However, unanticipated situations may occur that exert a significant impact on the Kao Group's business results and financial condition. Any statements made in this text concerning the future are judgments made by Kao as of the submission of its securities report to the Ministry of Finance on June 27, 2008.

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

Product Quality

To reduce risk, the Kao Group designs and manufactures products from the viewpoint of consumers, in compliance with related laws and regulations. In the development stage prior to market launch, the Kao Group conducts thorough safety testing and survey research to confirm the safety of products. After market launch, the Kao Group works to further improve quality by incorporating the opinions and desires of consumers through its consumer communication offices. However, the unanticipated occurrence of a serious quality problem would not only cause difficulties for the relevant brand, but would also have a major impact on the reputation of all of the Kao Group's products, and might cause sales to decline. This could have an adverse effect on the business results and financial condition of the Kao Group.

Earthquakes and Other Incidents

It is widely believed that there is a high probability that a major earthquake will occur in Japan. The Kao Group has implemented various countermeasures, including earthquake resistance diagnoses; seismic retrofitting; emergency drills simulating crisis situations; and systems to confirm employee safety at all of its domestic production facilities and primary offices, and is formulating a business continuity plan (BCP). In spite of these measures, however, in the event of a major earthquake surpassing expectations, the Kao Group's ability to secure raw materials, maintain continuity of production or supply products to the market may be disrupted, which could have a significant impact on the Kao Group's business results and financial condition. Furthermore, inability to continue production, secure raw materials, or supply products to markets due to factors including an explosion or fire at production facilities, problems at a supplier of raw materials, terrorism overseas, political change, riots and other incidents could have a significant impact on the Kao Group's business results and financial condition.

Currency Exchange Rate Fluctuations

Foreign currency-denominated transactions are affected by changes in currency exchange rates. The Kao Group hedges foreign exchange risk through various measures such as settlement of transactions through foreign currency accounts, foreign exchange contracts and currency swaps to mitigate the effect on business results. The Kao Group does not engage in derivative transactions for the purpose of speculation. However, items denominated in local currencies, including the sales, expenses and assets of overseas subsidiaries, are translated into Japanese yen for preparation of the consolidated financial statements. If the exchange rate at the time of conversion differs substantially from the expected rate, the value after translation into yen will change significantly, which will affect the Kao Group's business results and financial condition.

Raw Material Prices

Market prices for fats and oils used as raw materials for products of the Kao Group, petroleum-related raw materials and fuels and other items may change for various reasons including geopolitical risks, the balance between supply and demand, and climate change. The Kao Group has moved to reduce the affect of increases in raw material prices through measures including cost reductions and passing on increases or decreases in raw material costs into product prices. However, unexpectedly large changes in market conditions and pricing could have a significant impact on the Kao Group's business results and financial condition.

Environmental Issues

The Kao Group focuses on developing products that have a low environmental burden throughout the product lifecycle from raw material procurement to production, product transportation, consumption and disposal. In addition, the Kao Group carries out various measures to deal with environmental regulations in areas including chemical substances, and to reduce greenhouse gases and energy consumption. Current regulations are not expected to have an adverse effect on the business results and financial condition of the Kao Group; however, changes to current regulations or additional new regulations could have an impact on the Kao Group's business results and financial condition.

Consolidated Balance Sheets

Kao Corporation and Consolidated Subsidiaries
March 31, 2008 and 2007

Assets	Millions of yen 2008	Millions of yen 2007	Thousands of U.S. dollars (Note 2) 2008
Current assets:			
Cash and time deposits (Note 3)	¥ 53,786	¥ 49,911	$ 536,840
Short-term investments (Notes 3 and 4)	58,960	38,248	588,482
Notes and accounts receivable:			
Trade (Note 6)	152,716	155,900	1,524,264
Nonconsolidated subsidiaries and affiliates	2,910	3,968	29,045
Other	6,381	7,006	63,689
Inventories:			
Finished goods	82,830	75,452	826,729
Work in process and raw materials	42,758	36,662	426,769
Deferred tax assets (Note 7)	22,218	20,644	221,759
Other current assets	15,402	16,824	153,728
Allowance for doubtful receivables	(2,395)	(2,395)	(23,905)
Total current assets	435,566	402,220	4,347,400
Property, plant and equipment (Note 5):			
Land	68,576	69,626	684,459
Buildings and structures	322,456	317,058	3,218,445
Machinery, equipment and other	719,806	707,589	7,184,410
Construction in progress	9,037	7,645	90,199
Total	1,119,875	1,101,918	11,177,513
Accumulated depreciation	(838,128)	(812,902)	(8,365,386)
Net property, plant and equipment	281,747	289,016	2,812,127
Intangible assets:			
Goodwill	238,500	256,327	2,380,477
Trademarks	127,329	147,880	1,270,875
Other intangible assets	35,258	38,262	351,912
Total intangible assets	401,087	442,469	4,003,264
Investments and other assets:			
Investment securities (Note 4)	11,817	12,737	117,946
Investments in and advances to nonconsolidated subsidiaries and affiliates	4,457	4,631	44,485
Deferred tax assets (Note 7)	54,829	50,536	547,250
Other assets (Note 9)	43,098	46,188	430,163
Total investments and other assets	114,201	114,092	1,139,844
	¥1,232,601	¥1,247,797	$12,302,635

See Notes to Consolidated Financial Statements.

Liabilities and Equity	Millions of yen 2008	Millions of yen 2007	Thousands of U.S. dollars (Note 2) 2008
Current liabilities:			
Short-term debt (Note 6)	¥ 21,828	¥ 21,877	$ 217,866
Current portion of long-term debt (Notes 6 and 17)	22,049	22,062	220,072
Notes and accounts payable:			
Trade	107,514	108,055	1,073,101
Nonconsolidated subsidiaries and affiliates	3,205	2,610	31,989
Other	31,571	28,425	315,111
Accrued income taxes	29,344	11,673	292,884
Accrued expenses	85,583	85,797	854,207
Other current liabilities (Notes 6 and 7)	22,877	28,148	228,336
Total current liabilities	323,971	308,647	3,233,566
Long-term liabilities:			
Long-term debt (Notes 6 and 17)	269,761	311,770	2,692,494
Liability for employee retirement benefits (Note 9)	32,041	30,988	319,802
Liability for director and corporate auditor retirement benefits	163	163	1,627
Other (Notes 6 and 7)	21,955	21,478	219,134
Total long-term liabilities	323,920	364,399	3,233,057
Commitments and contingent liabilities (Notes 8, 10 and 16)			
Equity (Notes 11 and 12):			
Common stock:			
Authorized — 1,000,000,000 shares in 2008 and 2007			
Issued — 549,443,701 shares in 2008 and 2007	85,424	85,424	852,620
Capital surplus	109,561	109,565	1,093,532
Stock acquisition rights	599	302	5,979
Retained earnings	426,206	388,585	4,253,977
Unrealized gain on available-for-sale securities	3,395	4,650	33,886
Foreign currency translation adjustments	(11,387)	(13,660)	(113,654)
Treasury stock, at cost			
(13,296,218 shares in 2008 and 4,349,692 shares in 2007)	(39,161)	(10,033)	(390,867)
Total	574,637	564,833	5,735,473
Minority interests	10,073	9,918	100,539
Total equity	584,710	574,751	5,836,012
	¥1,232,601	¥1,247,797	$12,302,635

Consolidated Statements of Income

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2008	2007	2008
Net sales (Note 13)	¥1,318,514	¥1,231,808	$13,160,136
Cost of sales	554,154	503,271	5,531,031
Gross profit	764,360	728,537	7,629,105
Selling, general and administrative expenses (Note 14)	648,107	607,679	6,468,780
Operating income (Note 13)	116,253	120,858	1,160,325
Other income (expenses):			
Interest and dividend income	3,121	2,297	31,151
Interest expense (Note 17)	(6,627)	(5,032)	(66,144)
Foreign currency exchange gain (loss)	(479)	505	(4,781)
Equity in losses of nonconsolidated subsidiaries and affiliates	(648)	(704)	(6,468)
Other, net (Notes 5 and 15)	(1,222)	(797)	(12,197)
Other income (expenses), net	(5,855)	(3,731)	(58,439)
Income before income taxes and minority interests	110,398	117,127	1,101,886
Income taxes (Note 7):			
Current	46,881	37,268	467,920
Deferred	(4,111)	7,854	(41,032)
Total income taxes	42,770	45,122	426,888
Income before minority interests	67,628	72,005	674,998
Minority interests in earnings of consolidated subsidiaries	1,066	1,477	10,640
Net income	¥ 66,562	¥ 70,528	$ 664,358
Per share of common stock (Notes 1.q and 18):	Yen		U.S. dollars (Note 2)
Basic net income	¥122.53	¥129.41	$1.22
Diluted net income	122.41	129.29	1.22
Cash dividends applicable to the year	54.00	52.00	0.54

See Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

	Thousands	Millions of yen									
	Outstanding number of shares of common stock	Common stock	Capital surplus	Stock acquisition rights	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock, at cost	Total	Minority interests	Total equity
Balance at March 31, 2006	544,946	¥85,424	¥109,561	¥ —	¥345,941	¥5,861	¥(26,945)	¥(10,166)	¥509,676	¥ 8,904	¥518,580
Net income					70,528				70,528		70,528
Cash dividends, ¥51.00 per share					(27,793)				(27,793)		(27,793)
Directors' and corporate auditors' bonuses					(91)				(91)		(91)
Purchase of treasury stock	(341)							(1,085)	(1,085)		(1,085)
Disposal of treasury stock	489		4					1,218	1,222		1,222
Net change in the year				302		(1,211)	13,285		12,376	1,014	13,390
Balance at March 31, 2007	545,094	85,424	109,565	302	388,585	4,650	(13,660)	(10,033)	564,833	9,918	574,751
Net income					66,562				66,562		66,562
Cash dividends, ¥53.00 per share					(28,892)				(28,892)		(28,892)
Purchase of treasury stock	(9,604)							(30,958)	(30,958)		(30,958)
Disposal of treasury stock	657		(4)		(49)			1,830	1,777		1,777
Net change in the year				297		(1,255)	2,273		1,315	155	1,470
Balance at March 31, 2008	536,147	¥85,424	¥109,561	¥599	¥426,206	¥3,395	¥(11,387)	¥(39,161)	¥574,637	¥10,073	¥584,710

	Thousands	Thousands of U.S. dollars (Note 2)									
	Outstanding number of shares of common stock	Common stock	Capital surplus	Stock acquisition rights	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock, at cost	Total	Minority interests	Total equity
Balance at March 31, 2007	545,094	$852,620	$1,093,572	$3,014	$3,878,481	$46,412	$(136,341)	$(100,140)	$5,637,618	$ 98,992	$5,736,610
Net income					664,358				664,358		664,358
Cash dividends, US$0.529 per share					(288,373)				(288,373)		(288,373)
Purchase of treasury stock	(9,604)							(308,992)	(308,992)		(308,992)
Disposal of treasury stock	657		(40)		(489)			18,265	17,736		17,736
Net change in the year				2,965		(12,526)	22,687		13,126	1,547	14,673
Balance at March 31, 2008	536,147	$852,620	$1,093,532	$5,979	$4,253,977	$33,886	$(113,654)	$(390,867)	$5,735,473	$100,539	$5,836,012

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2008	2007	2008
Operating activities:			
Income before income taxes and minority interests	¥ 110,398	¥ 117,127	$ 1,101,886
Adjustments for:			
Income taxes paid	(29,969)	(42,270)	(299,122)
Depreciation and amortization	93,444	92,171	932,668
Loss on impairment of long-lived assets (Note 5)	1,314	1,246	13,115
Loss on sales or disposals of property, plant and equipment, net	1,722	2,089	17,187
Equity in losses of nonconsolidated subsidiaries and affiliates	648	704	6,468
Unrealized foreign currency exchange gain	(377)	(1,257)	(3,763)
Change in trade receivables	5,687	(24,308)	56,762
Change in inventories	(13,178)	(3,190)	(131,530)
Change in prepaid pension cost	5,985	(10,163)	59,737
Change in trade payables	(752)	11,316	(7,506)
Change in liability for retirement benefits	1,107	1,220	11,049
Other, net	4,293	20,293	42,849
Net cash provided by operating activities	180,322	164,978	1,799,800
Investing activities:			
Purchase of property, plant and equipment	(38,147)	(49,589)	(380,746)
Proceeds from sales of property, plant and equipment	705	2,079	7,037
Increase in intangible assets	(5,445)	(15,882)	(54,347)
Proceeds from the redemption and sales of investment securities	3,101	12	30,951
Increase in investments in and advances to nonconsolidated subsidiaries and affiliates	(1,093)	(4,175)	(10,909)
Change in other investments	(11,511)	4,328	(114,892)
Net cash used in investing activities	(52,390)	(63,227)	(522,906)
Financing activities:			
Decrease in short-term debt	(893)	(146,729)	(8,913)
Proceeds from long-term loans	—	30,638	—
Repayments of long-term loans (Note 17)	(42,035)	(38,229)	(419,553)
Proceeds from issuance of unsecured bonds	—	99,677	—
Purchase of treasury stock	(30,958)	(1,085)	(308,993)
Payments of cash dividends	(29,696)	(29,147)	(296,397)
Other, net	1,760	1,209	17,567
Net cash used in financing activities	(101,822)	(83,666)	(1,016,289)
Translation adjustments on cash and cash equivalents	(1,628)	2,542	(16,249)
Net increase in cash and cash equivalents	24,482	20,627	244,356
Cash and cash equivalents, beginning of year (Note 3)	88,154	67,527	879,868
Cash and cash equivalents, end of year (Note 3)	¥ 112,636	¥ 88,154	$ 1,124,224

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

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 Financial Instruments and Exchange Law (formerly, the Japanese Securities and Exchange Law) and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing the consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued in Japan in order to present them in a form that is more familiar to readers outside Japan. Certain 2007 financial statement items were reclassified to conform to the presentation for 2008.

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, 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 accounting for investments in nonconsolidated subsidiaries and affiliates

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

Under the control or influence concept, companies in which the parent company and/or its consolidated subsidiaries, directly or indirectly, are able to exercise control over operations are fully consolidated, and other companies over which the Company and/or its consolidated subsidiaries have the ability to exercise significant influence are accounted for by the equity method.

Investments in the remaining subsidiaries and affiliates are stated at cost except for write-downs recorded for the value of investments that have been permanently impaired. If the equity method of accounting had been applied to these investments, the effect on 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 the fair value of the net assets of the acquired subsidiary at the dates of acquisition, consolidation goodwill, is being amortized over an estimated period not exceeding 20 years, or 5 years in situations in which the useful lives cannot be estimated.

c) Business combination

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

d) 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, commercial paper, investment trusts in bonds and receivables that are represented as short-term investments, all of which mature or become due within three months of the date of acquisition.

e) 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.

f) Short-term investments and investment securities

Short-term investments and investment securities are classified and accounted for, depending on management's intent, as follows: i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost and ii) available-for-sale securities, which are not classified as the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of equity.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

g) 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, principally ranging from

21 to 35 years for buildings and structures and 7 or 9 years for machinery and equipment.

h) Intangible assets

Goodwill and trademarks are amortized on a straight-line basis over 15 or 20 years, and 10 years, respectively.

i) Long-lived assets

The Companies review their long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

j) Retirement and pension plans

The Company and most domestic consolidated subsidiaries have a defined benefit pension plan and a defined contribution pension plan covering substantially all of their employees. The pension plan also covers employees of certain nonconsolidated subsidiaries and affiliates in Japan. Directors and corporate auditors are partially covered by the pension plan. Effective from June 1, 2003, the Company and its domestic consolidated companies amended the Kao retirement plan to establish the cash balance plan and implement a defined contribution pension plan for a portion of the future reserved amount.

Certain domestic consolidated subsidiaries have a defined benefit plan that provides for a lump-sum payment to terminated employees.

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 basis.

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 basis.

The unrecognized transitional obligation, the unrecognized net actuarial gain or loss and the unrecognized prior service cost are being amortized over 15, 10 and 15 years, respectively. These amortizations are presented as cost of sales and selling, general and administrative expenses in the consolidated statements of income. Retirement benefits for directors and corporate auditors are provided at the amount which would be required if all directors and corporate auditors retired at the balance sheet date. However, no additional provisions have been recorded for retirement benefits to be paid to the Company's directors and corporate auditors since July 2001. The liability for director and corporate auditor retirement benefits is the amount provided in proportion to the term that directors as of March 31, 2008 had been in place before July 2001.

k) Stock options

The accounting standard for stock options requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

l) 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 (See Note 8). All other leases are accounted for as operating leases.

m) 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.

n) Foreign currency transactions

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statements of income to the extent that they are not hedged by foreign exchange derivatives.

o) Foreign currency financial statements

The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for equity, which is translated at the historical rate. Differences arising from such translation are shown as "Foreign currency translation adjustments" in a separate component of equity. Revenue and expense accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the annual average exchange rate.

p) Derivatives and hedging activities

The Companies use derivative financial instruments to manage their exposures to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts, foreign currency swaps, interest rate swaps are utilized by the Companies to reduce foreign currency exchange and interest rate risks. The Companies do not enter into derivatives for trading purposes or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: a) all derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the consolidated statements of income, and b) for derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

Short-term and long-term loan receivables denominated in foreign currencies, for which foreign exchange forward contracts or foreign currency swaps are used to hedge the foreign currency fluctuations, are translated at the contracted rate if the forward contracts or the swap contracts qualify for specific hedge accounting.

The interest rate swaps which qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements are recognized and included in interest expense or income as incurred.

q) Per share information

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share of common stock reflects the potential dilution that could occur if securities or other contracts to issue common stock were converted or exercised into common stock or resulted in the issuance of common stock.

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.

r) New accounting pronouncements

Measurement of inventories

Under generally accepted accounting principles in Japan ("Japanese GAAP"), inventories are currently measured either by the cost method, or at the lower of cost or market. On July 5, 2006, the Accounting Standards Board of Japan (the "ASBJ") issued ASBJ Statement No. 9, *Accounting Standard for Measurement of Inventories*, which is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

This standard requires that inventories held for sale in the ordinary course of business be measured at the lower of cost or net selling value, which is defined as the selling price less additional estimated manufacturing costs and estimated direct selling expenses. The replacement cost may be used in place of the net selling value, if appropriate. The standard also requires that inventories held for trading purposes be measured at the market price.

Lease accounting

On March 30, 2007, the ASBJ issued ASBJ Statement No. 13, *Accounting Standard for Lease Transactions*, which revised the former accounting standard for lease transactions issued on June 17, 1993. The revised accounting standard for lease transactions is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted for fiscal years beginning on or after April 1, 2007.

Under the former accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, however, other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the note to the lessee's financial statements. The revised accounting standard requires that all finance lease transactions shall be capitalized recognizing lease assets and lease obligations in the balance sheet.

Unification of accounting policies applied to foreign subsidiaries for the consolidated financial statements

Under Japanese GAAP, a company currently can use the financial statements of its foreign subsidiaries which have been prepared in accordance with generally accepted accounting principles in their respective jurisdictions for its consolidation process unless they are clearly unreasonable. On May 17, 2006, the ASBJ issued ASBJ Practical Issues Task Force (PITF) No. 18, "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements."

The new task force prescribes: 1) the accounting policies and procedures applied to a parent company and its subsidiaries for similar transactions and events under similar circumstances should in principle be unified for the preparation of the consolidated financial statements, 2) financial statements prepared by foreign subsidiaries in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States tentatively may be used for the consolidation process, 3) however, the following items should be adjusted in the consolidation process so that net income is accounted for in accordance with Japanese GAAP unless they are not material:

(1) Amortization of goodwill
(2) Actuarial gains and losses of defined benefit plans recognized outside profit or loss
(3) Capitalization of intangible assets arising from development phases
(4) Fair value measurement of investment properties, and the revaluation model for property, plant and equipment, and intangible assets
(5) Retrospective application when accounting policies are changed
(6) Accounting for net income attributable to a minority interest

The new task force is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

2 Translation into United States Dollars

The Companies' accounts are maintained in or translated into Japanese yen. The United States dollar (US$) amounts included herein represent translations using the approximate exchange rate at March 31, 2008 of ¥100.19=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, 2008 and 2007 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Cash and time deposits	¥ 53,786	¥49,911	$ 536,840
Short-term investments	58,960	38,248	588,482
Less: time deposits and short-term investments which mature or become due over three months after the date of acquisition	(110)	(5)	(1,098)
Cash and cash equivalents	¥112,636	¥88,154	$1,124,224

4 Short-Term Investments and Investment Securities

Short-term investments and investment securities as of March 31, 2008 and 2007 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Short-term investments:			
Government and corporate bonds	¥ —	¥ 2,996	$ —
Investment trust funds and other	58,960	35,252	588,482
Total	¥58,960	¥38,248	$588,482
Investment securities:			
Marketable equity securities	¥ 8,547	¥10,249	$ 85,308
Investment trust funds and other	3,270	2,488	32,638
Total	¥11,817	¥12,737	$117,946

The carrying amount and aggregate fair value of the securities classified as available-for-sale and held-to-maturity at March 31, 2008 and 2007 were as follows:

	Millions of yen			
	2008			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥3,326	¥5,398	¥177	¥8,547
Debt securities and other	2,908	1	0	2,909

	Millions of yen			
	2007			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥3,074	¥7,257	¥82	¥10,249
Debt securities and other	2,247	1	—	2,248
Held-to-maturity:				
Debt securities and other	2,996	0	—	2,996

	Thousands of U.S. dollars			
	2008			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	$33,197	$53,878	$1,767	$85,308
Debt securities and other	29,025	10	—	29,035

Available-for-sale securities whose fair values are not readily determinable as of March 31, 2008 and 2007 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Available-for-sale:			
Equity securities	¥ 1,224	¥ 1,467	$ 12,217
Other	48,407	30,431	483,152
Total	¥49,631	¥31,898	$495,369
Held-to-maturity:			
Debt securities and other	¥ 9,690	¥ 3,594	$ 96,716
Total	¥ 9,690	¥ 3,594	$ 96,716

Proceeds from sales of available-for-sale securities for the years ended March 31, 2008 and 2007 were ¥3,101 million (US$30,951 thousand) and ¥12 million, respectively. Gross realized gains and losses on these sales, computed on the moving average cost basis, for the year ended March 31, 2008 were ¥17 million (US$170 thousand) and ¥15 million (US$150 thousand), and for the year ended March 31, 2007 were ¥7 million and ¥0 million, respectively.

The carrying values of debt securities by contractual maturities for securities classified as held-to-maturity at March 31, 2008 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2008	2008
	Held-to-maturity	Held-to-maturity
Due within one year	¥11,345	$113,235
Total	¥11,345	$113,235

5 Long-Lived Assets

The Companies reviewed their long-lived assets for impairment as of the year ended March 31, 2008 and 2007. As a result, the Companies recognized impairment loss of ¥1,314 million (US$13,115 thousand) and ¥1,246 million as other expense for the year ended March 31, 2008 and 2007, respectively. The details of the impairment loss for the year ended March 31, 2008 and 2007 were as follows:

(Year ended March 31, 2008)

	Millions of yen	Thousands of U.S. dollars
	2008	2008
Land to be sold and others	¥1,314	$13,115

(Year ended March 31, 2007)
Consolidated Subsidiary: Kao Corporation Shanghai

Location	Use	Type	Millions of yen 2007
Kao Corporation Shanghai	Production facility for laundry detergent	Buildings	¥331
		Machinery & equipment and others	611
		Total	¥942

To clarify this impairment loss, Kao Corporation Shanghai grouped assets according to their business classification under the management accounting system, which continuously monitors income and expenditures. Kao Corporation Shanghai has reduced the carrying value of the assets to the recoverable amount because fierce market competition in China has eroded profits. The recoverable amount of the assets was measured at its value in use and the discount rate used for computation of present value of future cash flows was 9%.

Other Consolidated Subsidiaries

	Millions of yen
	2007
Land to be sold and others	¥304

6 Short-Term and Long-Term Debt

Short-term debt at March 31, 2008 and 2007 was comprised of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Mortgage loans principally from banks	¥ 78	¥ 105	$ 778
Bank borrowings	21,750	21,772	217,088
Total	¥21,828	¥21,877	$217,866

The weighted average interest rates applicable to the bank borrowings were 3.76% and 4.21% at March 31, 2008 and 2007, respectively. In addition to the above short-term debt, deposits payable to affiliates, included in other current liabilities, were ¥5,544 million (US$55,335 thousand) and ¥5,261 million at March 31, 2008 and 2007, respectively, and the applicable interest rates were 0.77% and 0.40% at March 31, 2008 and 2007, respectively.

The mortgage loans are collateralized by trade accounts receivable of ¥216 million (US$2,156 thousand) at March 31, 2008.

Long-term debt at March 31, 2008 and 2007 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Unsecured bonds due 2011, 1.60% and due 2013, 1.91%	¥ 99,996	¥ 99,996	$ 998,064
Unsecured loans principally from banks, weighted average rate 1.18% in 2008, 1.0% in 2007	191,814	233,836	1,914,502
	¥291,810	¥333,832	$2,912,566
Less current portion	(22,049)	(22,062)	(220,072)
Total	¥269,761	¥311,770	$2,692,494

In addition to the above long-term debt, deposits payable to customers, included in other long-term liabilities, were ¥5,727 million (US$57,161 thousand) and ¥5,231 million at March 31, 2008 and 2007, respectively, and the applicable interest rates were 0.45% and 0.38% at March 31, 2008 and 2007, respectively.

The aggregate annual maturities of long-term debt as of March 31, 2008 were as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2009	¥ 22,049	$ 220,072
2010	22,559	225,162
2011	96,850	966,663
2012	80,013	798,613
2013	20,343	203,044
2014 and thereafter	49,996	499,012
Total	¥291,810	$2,912,566

Each amount for the period from 2009 to 2011 is the minimum amount of the scheduled payment.

7 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 rate of approximately 41% for both 2008 and 2007.

Foreign subsidiaries are subject to income taxes of the countries in which they operate.

Tax effects of significant temporary differences and tax loss carryforwards that resulted in deferred tax assets or liabilities at March 31, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Deferred tax assets:			
Depreciation and amortization	¥ 48,058	¥ 67,182	$ 479,669
Pension and severance costs	11,956	11,603	119,333
Accrued expenses	12,065	11,593	120,421
Enterprise taxes	2,175	1,166	21,709
Tax loss carryforwards	49,226	38,226	491,326
Other	17,456	18,235	174,230
Less valuation allowance	(36,354)	(46,058)	(362,851)
Deferred tax assets	¥104,582	¥101,947	$1,043,837
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities	¥ (2,175)	¥ (2,940)	$ (21,709)
Undistributed foreign earnings	(16,172)	(14,804)	(161,413)
Deferred gains on sales of property	(4,559)	(4,598)	(45,504)
Prepaid pension cost	(6,313)	(8,996)	(63,010)
Other	(6,129)	(6,320)	(61,174)
Deferred tax liabilities	¥ (35,348)	¥ (37,658)	$ (352,810)
Net deferred tax assets	¥ 69,234	¥ 64,289	$ 691,027

8 Leases

a) Finance leases:

The Companies lease certain buildings, machinery, computer equipment and other assets.

The pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2008 and 2007 was as follows:

	Millions of yen					
	2008			2007		
	Buildings and structures	Machinery, equipment and other assets	Total	Buildings and structures	Machinery, equipment and other assets	Total
Acquisition cost	¥9,520	¥4,341	¥13,861	¥8,632	¥6,866	¥15,498
Accumulated depreciation	2,429	3,425	5,854	1,881	4,831	6,712
Net leased property	¥7,091	¥ 916	¥ 8,007	¥6,751	¥2,035	¥ 8,786

	Thousands of U.S. dollars		
	2008		
	Buildings and structures	Machinery, equipment and other assets	Total
Acquisition cost	$95,019	$43,328	$138,347
Accumulated depreciation	24,244	34,185	58,429
Net leased property	$70,775	$ 9,143	$ 79,918

Obligations under finance leases as of March 31, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Due within one year	¥1,134	¥1,677	$11,318
Due after one year	6,873	7,109	68,600
Total	¥8,007	¥8,786	$79,918

Total rental expenses for the above leases were ¥1,744 million (US$17,407 thousand) and ¥1,955 million for the years ended March 31, 2008 and 2007, respectively.

The pro forma depreciation expense computed by the straight-line method was ¥1,744 million (US$17,407 thousand) and ¥1,955 million for the years ended March 31, 2008 and 2007, respectively.

The 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, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Due within one year	¥ 5,679	¥ 4,451	$ 56,682
Due after one year	25,304	22,739	252,560
Total	¥30,983	¥27,190	$309,242

9 Retirement Benefits

The Company and most domestic consolidated subsidiaries have a defined benefit pension plan and a defined contribution pension plan covering substantially all of their employees. Effective from June 1, 2003, the Company and most domestic consolidated companies amended their retirement plan to establish the cash balance plan and implement a defined contribution pension plan for a portion of the future reserved amount.

Certain domestic consolidated subsidiaries have a defined benefit plan that provides for a lump-sum payment to terminated employees.

Certain foreign consolidated subsidiaries have local pension plans covering their employees. Certain foreign consolidated 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 basis.

The liability for employees' retirement benefits at March 31, 2008 and 2007 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Projected benefit obligation	¥ 223,669	¥ 227,691	$ 2,232,448
Fair value of plan assets	(194,327)	(206,102)	(1,939,585)
Unrecognized prior service cost	18,904	20,155	188,682
Unrecognized actuarial loss	(19,276)	(19,097)	(192,394)
Unrecognized transitional obligation	(13,567)	(14,334)	(135,413)
Prepaid pension cost	16,638	22,675	166,064
Net liability for retirement benefits	¥ 32,041	¥ 30,988	$ 319,802

The components of net periodic benefit costs for the years ended March 31, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Service cost	¥ 9,122	¥ 8,716	$ 91,047
Interest cost	4,573	4,425	45,643
Expected return on plan assets	(4,421)	(3,905)	(44,126)
Amortization of prior service cost (credit)	(2,415)	(2,311)	(24,104)
Recognized actuarial loss	6,258	5,869	62,461
Amortization of transitional obligation	1,878	1,790	18,745
Net periodic benefit costs	¥14,995	¥14,584	$149,666

Assumptions used for the years ended March 31, 2008 and 2007 are set forth as follows:

	2008	2007
Discount rate	Primarily 2.0%	Primarily 2.0%
Expected rate of return on plan assets	Primarily 2.0%	Primarily 2.0%
Amortization period of prior service cost	Primarily 15 years	Primarily 15 years
Recognition period of actuarial gain/loss	Primarily 10 years	Primarily 10 years
Amortization period of transitional obligation	15 years	15 years

In addition to the above net periodic benefit costs, the costs for other retirement and pension plans such as a defined contribution plan and for supplemental retirement benefits were ¥2,385 million (US$23,805 thousand) for the year ended March 31, 2008 and ¥2,267 million for the year ended March 31, 2007.

10 Contingent Liabilities

At March 31, 2008, the Companies had the following contingent liabilities:

	Millions of yen	Thousands of U.S. dollars
Trade notes discounted	¥ 10	$ 100
Guarantees of borrowings, principally of affiliates and employees	2,685	26,799

The Companies are parties to pending litigation arising in the normal course of business. While it is not possible to predict the outcome of pending litigation, the Company believes, after consultation with counsel, that the results of such proceedings will not have a material adverse effect upon the Company's consolidated financial position and the results of its operations and its cash flows.

11 Equity

Significant provisions in the Corporation Law of Japan (the "Corporation Law") that affect financial and accounting matters are summarized below:

(a) Dividends

Under the Corporation Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting.

For companies that meet certain criteria such as having: (1) a board of directors, (2) independent auditors, (3) a board of corporate auditors, and (4) terms of service of directors prescribed as one year under the articles of incorporation rather than the normal term of two years, the boards of directors of such companies may declare dividends (except for dividends in kind) at any time during the fiscal year if the companies have prescribed so in their articles of incorporation. The Company's present governance system meets the first three criteria but the two-year service period of the members of the Board of Directors does not meet the fourth criterion. The Company pays the dividend semi-annually as a year-end dividend and an interim dividend.

Semiannual interim dividends may also be paid once a year upon resolution by the board of directors if the articles of incorporation of the company so stipulate. The Company pays semiannual interim dividends upon the resolution by the Board of Directors because the articles of incorporation of the Company so stipulate.

The Corporation Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements. The Corporation Law provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

(b) Increases / decreases and transfer of common stock, reserve and surplus

The Corporation Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Corporation Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Corporation Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

The Company's legal reserve amount, which is included in retained earnings, totals ¥14,117 million (US$140,902 thousand) at both March 31, 2008 and 2007. The Company's additional paid-in capital amount, which is included in capital surplus, totals ¥108,889 million (US$1,086,825 thousand) at both March 31, 2008 and 2007.

The accompanying consolidated financial statements do not include any provision for the year-end dividend of ¥27.0 (US$0.27) per share, aggregating ¥14,491 million (US$144,635 thousand) which the Company will subsequently propose at the 102nd Annual General Meeting of Shareholders to be held on June 27, 2008 as an appropriation of retained earnings in respect of the year ended March 31, 2008.

(c) Treasury stock and treasury stock acquisition rights

The Corporation Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the board of directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporation Law, stock acquisition rights are presented as a separate component of equity.

The Corporation Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

The Company repurchased 9.3 million shares of common stock from the market during the fiscal year ended March 31, 2008, at an aggregate cost of ¥29,999 million (US$299,421 thousand).

12 Stock-Based Compensation Plans

The stock options outstanding as of March 31, 2008 are as follows:

Name	Persons originally granted	Number of options originally granted	Date of grant	Exercise price	Exercise period
Stock option 2001	18 Directors of the Company	168,000 shares	July 27, 2001	¥3,275 ($32.69)	July 28, 2003 through July 25, 2008
Stock option 2002	11 Directors of the Company 31 Employees of the Company 4 Directors of subsidiaries of the Company	540,000 shares*	July 8, 2002	¥2,955 ($29.49)	July 1, 2004 through June 30, 2009
Stock option 2003	11 Directors of the Company 81 Employees of the Company 3 Directors of subsidiaries of the Company	1,052,000 shares*	July 8, 2003	¥2,372 ($23.68)	July 1, 2005 through June 30, 2010
Stock option 2004	13 Directors of the Company 89 Employees of the Company 5 Directors of subsidiaries of the Company	1,163,000 shares*	July 8, 2004	¥2,695 ($26.90)	July 1, 2006 through June 30, 2011
Stock option 2005	13 Directors of the Company 90 Employees of the Company 5 Directors of subsidiaries of the Company	1,167,000 shares*	July 8, 2005	¥2,685 ($26.80)	July 1, 2007 through June 29, 2012
Stock option 2006 I	12 Executive Officers of the Company**	12,000 shares*	September 29, 2006	¥1 ($0.01)	July 1, 2008 through June 28, 2013
Stock option 2006 II	14 Directors of the Company	26,000 shares*	September 29, 2006	¥1 ($0.01)	July 1, 2008 through June 28, 2013
Stock option 2006 III	79 Employees of the Company 4 Directors of subsidiaries of the Company	437,000 shares*	September 29, 2006	¥3,211 ($32.05)	July 1, 2008 through June 28, 2013
Stock option 2007 I	13 Directors of the Company	25,000 shares*	August 31, 2007	¥1 ($0.01)	July 1, 2009 through June 30, 2014
Stock option 2007 II	14 Executive Officers of the Company***	14,000 shares*	August 31, 2007	¥1 ($0.01)	July 1, 2009 through June 30, 2014
Stock option 2007 III	78 Employees of the Company 4 Directors of subsidiaries of the Company	430,000 shares*	August 31, 2007	¥3,446 ($34.39)	September 1, 2009 through August 29, 2014

* The number of options originally granted converts into number of shares of common stock.
** The 12 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
*** The 14 Executive Officers were not members of the Board of Directors of the Company at the date of grant.

The activity of stock options is as follows: (Number of shares)

	Stock option 2001	Stock option 2002	Stock option 2003	Stock option 2004	Stock option 2005	Stock option 2006 I	Stock option 2006 II	Stock option 2006 III	Stock option 2007 I	Stock option 2007 II	Stock option 2007 III
For the year ended March 31, 2007											
Non-vested											
Outstanding at March 31, 2006	—	—	—	—	—	—	—	—	—	—	—
Granted	—	—	—	—	—	12,000	26,000	437,000	—	—	—
Expired	—	—	—	—	—	—	—	—	—	—	—
Vested	—	—	—	—	—	12,000	26,000	437,000	—	—	—
Outstanding at March 31, 2007	—	—	—	—	—	—	—	—	—	—	—
Vested											
Outstanding at March 31, 2006	99,000	438,000	696,000	1,151,000	1,167,000	—	—	—	—	—	—
Vested	—	—	—	—	—	12,000	26,000	437,000	—	—	—
Exercised	—	38,000	254,000	132,000	—	—	—	—	—	—	—
Expired	24,000	82,000	20,000	40,000	9,000	—	—	—	—	—	—
Outstanding at March 31, 2007	75,000	318,000	422,000	979,000	1,158,000	12,000	26,000	437,000	—	—	—
For the year ended March 31, 2008											
Non-vested											
Outstanding at March 31, 2007	—	—	—	—	—	—	—	—	—	—	—
Granted	—	—	—	—	—	—	—	—	25,000	14,000	430,000
Expired	—	—	—	—	—	—	—	—	—	—	—
Vested	—	—	—	—	—	—	—	—	25,000	14,000	430,000
Outstanding at March 31, 2008	—	—	—	—	—	—	—	—	—	—	—
Vested											
Outstanding at March 31, 2007	75,000	318,000	422,000	979,000	1,158,000	12,000	26,000	437,000	—	—	—
Vested	—	—	—	—	—	—	—	—	25,000	14,000	430,000
Exercised	6,000	104,000	152,000	200,000	151,000	—	—	—	—	—	—
Expired	—	16,000	—	21,000	12,000	—	—	7,000	—	—	—
Outstanding at March 31, 2008	69,000	198,000	270,000	758,000	995,000	12,000	26,000	430,000	25,000	14,000	430,000
Exercise price	¥3,275	¥2,955	¥2,372	¥2,695	¥2,685	¥1	¥1	¥3,211	¥1	¥1	¥3,446
	($32.69)	($29.49)	($23.68)	($26.90)	($26.80)	($0.01)	($0.01)	($32.05)	($0.01)	($0.01)	($34.39)
Average stock price at exercise	¥3,380	¥3,342	¥3,344	¥3,323	¥3,277	—	—	—	—	—	—
	($33.74)	($33.36)	($33.38)	($33.17)	($32.71)						
Fair value price at grant date	—	—	—	—	—	¥2,932	¥2,932	¥435	¥3,063	¥3,063	¥420
						($29.26)	($29.26)	($4.34)	($30.57)	($30.57)	($4.19)

The fair value price for 2007 stock options is estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	Stock option 2007 I	Stock option 2007 II	Stock option 2007 III
Volatility of stock price	19.440%	19.440%	19.440%
Estimated remaining outstanding period	4.5 years	4.5 years	4.5 years
Estimated dividend per share	¥52	¥52	¥52
	($0.52)	($0.52)	($0.52)
Risk-free interest rate	1.146%	1.146%	1.146%

Subsequently, at the 102nd Annual General Meeting of Shareholders to be held on June 27, 2008, the Company will propose a resolution to delegate to the Board of Directors of the Company the determination of matters for offering stock acquisition rights to be issued as stock options to the Company's employees and the members of the board of directors and employees of the Company's affiliated companies. Under this proposal, the maximum number of shares to be newly issued or transferred from treasury stock on the exercise of stock options is 600,000 shares of common stock of the Company, and the exercise period is from September 1, 2010 to August 31, 2015.

13 Segment Information

The Companies' operation consists of Consumer Products Business and Chemical Business. The Consumer Products Business has three segments: Beauty Care Business, Human Health Care Business and Fabric and Home Care Business. The Beauty Care Business segment manufactures and sells prestige cosmetics, premium skin care and premium hair care products. The Human Health Care Business segment manufactures and sells food and beverage, sanitary and personal health products. The Fabric and Home Care Business segment manufactures and sells fabric care and home care products. The Chemical Business segment manufactures and sells oleo chemicals, performance chemicals and specialty chemicals.

Effective April 1, 2007, the Companies changed their segmentation by business from Consumer Products, Prestige Cosmetics and Chemical Products to Beauty Care Business, Human Health Care Business, Fabric and Home Care Business and Chemical Business because of the reorganization of their business structure. The change in segmentation is to disclose the segment information by business correctly.

Segment information by business of the Companies for the years ended March 31, 2008 and 2007 was as follows:

	Millions of yen						
	2008						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Eliminations/ Corporate	Consolidated
Sales to customers	¥627,914	¥191,300	¥274,657	¥1,093,871	¥224,643	¥ —	¥1,318,514
Intersegment sales	—	—	—	—	34,031	(34,031)	—
Total sales	627,914	191,300	274,657	1,093,871	258,674	(34,031)	1,318,514
Operating expenses	600,630	178,144	218,596	997,370	238,989	(34,098)	1,202,261
Operating income	¥ 27,284	¥ 13,156	¥ 56,061	¥ 96,501	¥ 19,685	¥ 67	¥ 116,253
Assets	¥742,856	¥ 93,950	¥119,859	¥ 956,665	¥223,339	¥ 52,597	¥1,232,601
Depreciation and amortization	58,224	9,598	10,606	78,428	15,016	—	93,444
Loss on impairment of long-lived assets	321	189	240	750	564	—	1,314
Capital expenditures	18,479	7,816	8,395	34,690	14,355	—	49,045

	Millions of yen						
	2007						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Eliminations/ Corporate	Consolidated
Sales to customers	¥584,284	¥183,608	¥269,519	¥1,037,411	¥194,397	¥ —	¥1,231,808
Intersegment sales	—	—	—	—	29,212	(29,212)	—
Total sales	584,284	183,608	269,519	1,037,411	223,609	(29,212)	1,231,808
Operating expenses	554,442	171,796	211,703	937,941	202,429	(29,420)	1,110,950
Operating income	¥ 29,842	¥ 11,812	¥ 57,816	¥ 99,470	¥ 21,180	¥ 208	¥ 120,858
Assets	¥794,287	¥ 89,358	¥120,056	¥1,003,701	¥210,782	¥ 33,314	¥1,247,797
Depreciation and amortization	56,820	10,323	11,947	79,090	13,081	—	92,171
Loss on impairment of long-lived assets	111	118	879	1,108	138	—	1,246
Capital expenditures	35,168	6,861	9,907	51,936	18,207	—	70,143

	Thousands of U.S. dollars						
	2008						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Eliminations/ Corporate	Consolidated
Sales to customers	$6,267,232	$1,909,372	$2,741,362	$10,917,966	$2,242,170	$ —	$13,160,136
Intersegment sales	—	—	—	—	339,664	(339,664)	—
Total sales	6,267,232	1,909,372	2,741,362	10,917,966	2,581,834	(339,664)	13,160,136
Operating expenses	5,994,909	1,778,062	2,181,815	9,954,786	2,385,358	(340,333)	11,999,811
Operating income	$ 272,323	$ 131,310	$ 559,547	$ 963,180	$ 196,476	$ 669	$ 1,160,325
Assets	$7,414,473	$ 937,718	$1,196,317	$ 9,548,508	$2,229,155	$ 524,972	$12,302,635
Depreciation and amortization	581,136	95,798	105,859	782,793	149,875	—	932,668
Loss on impairment of long-lived assets	3,204	1,886	2,396	7,486	5,629	—	13,115
Capital expenditures	184,439	78,012	83,791	346,242	143,278	—	489,520

Geographic segment information of the Companies for the years ended March 31, 2008 and 2007 was as follows:

	Millions of yen					
	2008					
	Japan	Asia/ Oceania*	America**	Europe***	Eliminations/ Corporate	Consolidated
Sales to customers	¥949,816	¥120,600	¥110,238	¥137,860	¥ —	¥1,318,514
Intersegment sales	18,778	37,695	779	16,788	(74,040)	—
Total sales	968,594	158,295	111,017	154,648	(74,040)	1,318,514
Operating expenses	870,234	157,216	104,170	145,631	(74,990)	1,202,261
Operating income	¥ 98,360	¥ 1,079	¥ 6,847	¥ 9,017	¥ 950	¥ 116,253
Assets	¥869,201	¥136,156	¥ 83,291	¥147,752	¥ (3,799)	¥1,232,601

	Millions of yen					
	2007					
	Japan	Asia/ Oceania*	America**	Europe***	Eliminations/ Corporate	Consolidated
Sales to customers	¥906,790	¥ 99,737	¥106,247	¥119,034	¥ —	¥1,231,808
Intersegment sales	17,406	26,252	484	16,884	(61,026)	—
Total sales	924,196	125,989	106,731	135,918	(61,026)	1,231,808
Operating expenses	821,974	123,422	98,977	127,230	(60,653)	1,110,950
Operating income	¥102,222	¥ 2,567	¥ 7,754	¥ 8,688	¥ (373)	¥ 120,858
Assets	¥908,197	¥122,118	¥ 86,294	¥144,360	¥ (13,172)	¥1,247,797

	Thousands of U.S. dollars					
	2008					
	Japan	Asia/ Oceania*	America**	Europe***	Eliminations/ Corporate	Consolidated
Sales to customers	$9,480,148	$1,203,713	$1,100,289	$1,375,986	$ —	$13,160,136
Intersegment sales	187,424	376,235	7,775	167,562	(738,996)	—
Total sales	9,667,572	1,579,948	1,108,064	1,543,548	(738,996)	13,160,136
Operating expenses	8,685,837	1,569,179	1,039,724	1,453,549	(748,478)	11,999,811
Operating income	$ 981,735	$ 10,769	$ 68,340	$ 89,999	$ 9,482	$ 1,160,325
Assets	$8,675,527	$1,358,978	$ 831,330	$1,474,718	$ (37,918)	$12,302,635

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

Sales to foreign customers were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Asia/Oceania	¥135,046	¥112,275	$1,347,899
America	113,816	108,684	1,136,002
Europe	131,859	114,558	1,316,089
Sales to foreign customers	¥380,721	¥335,517	$3,799,990

14 Selling, General and Administrative Expenses

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

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Advertising	¥ 99,176	¥ 96,892	$ 989,879
Promotion	77,181	69,091	770,346
Research and development	45,070	44,389	449,845
Salaries and bonuses	129,072	118,851	1,288,272
Packing and delivery expenses	74,197	68,664	740,563

15 Other Income (Expenses)

"Other, net" consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Gain on sales of investment securities	¥ 17	¥ 7	$ 169
Loss on sales or disposals of property, plant and equipment, net	(1,722)	(2,089)	(17,187)
Loss on impairment of long-lived assets	(1,314)	(1,246)	(13,115)
Other, net	1,797	2,531	17,936
Total	¥(1,222)	¥ (797)	$(12,197)

16 Derivatives

The Companies enter into foreign exchange forward contracts and foreign currency swaps to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies.

All derivative transactions are entered into to hedge foreign currency exposures incorporated within the Companies' business. Accordingly, market risk in these derivatives is basically offset by opposite movements in the value of hedged assets or liabilities. The Companies do not hold or issue derivatives for trading or speculative 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, 2008 and 2007:

	Millions of yen					
	2008			2007		
	Contract amount	Fair value	Unrealized gain/(loss)	Contract amount	Fair value	Unrealized gain/(loss)
Foreign exchange forward contracts:						
Buying U.S. Dollar	¥ 416	¥ 417	¥ 1	¥ 1,708	¥ 1,688	¥ (20)
Buying Japanese Yen	82	79	(3)	10	10	(0)
Buying British Pound	937	873	(64)	848	866	18
Buying other currencies	—	—	—	39	39	(0)
Selling U.S. Dollar	4,721	4,661	60	2,621	2,581	40
Selling other currencies	1,114	1,088	26	1,868	1,859	9
Foreign currency swaps:						
Receiving Japanese Yen, paying U.S. Dollar	739	55	55	1,567	(68)	(68)
Receiving Japanese Yen, paying Euro	—	—	—	1,565	(277)	(277)
Receiving Japanese Yen, paying British Pound	14,649	603	603	15,501	(1,691)	(1,691)
Receiving U.S. Dollar, paying Euro	5,385	(756)	(756)	3,787	(358)	(358)
Receiving U.S. Dollar, paying Thai Baht	1,125	(148)	(148)	3,063	(89)	(89)

	Thousands of U.S. dollars		
	2008		
	Contract amount	Fair value	Unrealized gain/(loss)
Foreign exchange forward contracts:			
Buying U.S. Dollar	$ 4,152	$ 4,162	$ 10
Buying Japanese Yen	818	789	(29)
Buying British Pound	9,352	8,713	(639)
Selling U.S. Dollar	47,120	46,522	598
Selling other currencies	11,119	10,859	260
Foreign currency swaps:			
Receiving Japanese Yen, paying U.S. Dollar	7,376	549	549
Receiving Japanese Yen, paying British Pound	146,212	6,019	6,019
Receiving U.S. Dollar, paying Euro	53,748	(7,546)	(7,546)
Receiving U.S. Dollar, paying Thai Baht	11,229	(1,477)	(1,477)

17 Related Party Transactions

Transactions of the Company with related parties for the years ended March 31, 2008 and 2007 were as follows:

Mr. Atsushi Takahashi is outside director of the Company and these transactions were conducted with The Sumitomo Trust & Banking Co., Ltd., of which he is Representative Director and Chairman of the Board, on general terms and conditions the same as those of other financial institutions. Mr. Takahashi directly owns 0.0% of the shares (3,000 shares) of the Company.

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Partial repayment of long-term debt	¥3,800	¥3,400	$37,928
Payment of interest	131	73	1,308

The balances of the Company due to related parties for the year ended March 31, 2008 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Current portion of long-term debt	¥ 2,000	¥ 2,000	$ 19,962
Long-term debt	10,800	14,600	107,795

On October 17, 2006, the ASBJ issued ASBJ Statement No. 11, *Accounting Standard for Related Party Disclosures* and related guidance. The new accounting standard for related party disclosures is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted. The Company adopted the new standard from the year ended March 31, 2008.

18 Net Income per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2008 and 2007 is as follows:

	Millions of yen	Thousands of shares	Yen	U.S. dollars
For the year ended March 31, 2008:	Net income	Weighted average shares	EPS	
Basic EPS				
Net income available to common shareholders	¥66,562	543,228	¥122.53	$1.22
Effect of dilutive securities				
Warrants	—	539		
Diluted EPS				
Net income for computation	¥66,562	543,767	¥122.41	$1.22

	Millions of yen	Thousands of shares	Yen
For the year ended March 31, 2007:	Net income	Weighted average shares	EPS
Basic EPS			
Net income available to common shareholders	¥70,528	544,996	¥129.41
Effect of dilutive securities			
Warrants	—	520	
Diluted EPS			
Net income for computation	¥70,528	545,516	¥129.29

Independent Auditors' Report

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To the Board of Directors of
Kao Corporation

We have audited the accompanying consolidated balance sheets of Kao Corporation and consolidated subsidiaries as of March 31, 2008 and 2007, and the related consolidated statements of income, changes in equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kao Corporation and consolidated subsidiaries as of March 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 13 to the consolidated financial statements, the Companies changed their segmentation by business effective April 1, 2007.

Our audits 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 9, 2008

Member of
Deloitte Touche Tohmatsu

Principal Subsidiaries and Affiliates (As of July 1, 2008)

Country/Area	Business				Company	Principal Officer
Japan	●	●	●		Kao Customer Marketing Co., Ltd.	Tatsuo Takahashi, President and CEO
	●				Kanebo Cosmetics Inc.	Toshio Takayama, Chairman; Kenji Chishiki, President
	●				Kanebo Cosmetics Sales Inc.	Tadashi Uematsu, President
	●				Nivea-Kao Company Limited	Masanori Sunaga, President
			●		Kao Professional Services Company, Limited	Mitsuo Kimura, President
				●	Kao-Quaker Company, Limited	Tadashi Kusube, President
China	●	●	●	●	Kao (China) Holding Co., Ltd.	Shinichiro Hiramine, President and CEO
	●	●	●		Kao Corporation Shanghai	
	●	●	●		Kao Commercial (Shanghai) Co., Ltd.	
				●	Kao Chemical Corporation Shanghai	Mitsutoshi Nakajima, President and CEO
	●	●	●		Kao (Hong Kong) Limited	Tomoharu Matsuda, President and CEO
Indonesia	●	●	●		P.T. Kao Indonesia	Tsuneo Oba, President and CEO
				●	P.T. Kao Indonesia Chemicals	Yasusuke Ochi, President and CEO
Malaysia	●	●	●		Kao (Malaysia) Sdn. Bhd.	Hiroaki Taki, President and CEO
				●	Fatty Chemical (Malaysia) Sdn. Bhd.	Osamu Tabata, Managing Director
	●				Kao Soap (Malaysia) Sdn. Bhd.	
				●	Kao Oleochemical (Malaysia) Sdn. Bhd.	
				●	Kao Plasticizer (Malaysia) Sdn. Bhd.	
Philippines				●	Pilipinas Kao, Incorporated	Yoshinari Umehara, President and CEO
Singapore				●	Kao (Singapore) Private Limited	Mikio Mori, Chairman and CEO
	●	●	●			Hiroshi Yamaguchi, President and COO
Taiwan	●	●	●	●	Kao (Taiwan) Corporation	Kozo Saito, President and CEO
Thailand	●	●	●		Kao Consumer Products (Southeast Asia) Co., Ltd.	Norihiko Takagi, President and CEO
	●	●	●		Kao Commercial (Thailand) Co., Ltd.	Minoru Tokita, President and CEO
	●	●	●	●	Kao Industrial (Thailand) Co., Ltd.	
Vietnam	●	●			Kao Vietnam Co., Ltd.	Fumiaki Iwasaki, President and CEO
Australia			●		Kao (Australia) Marketing Pty. Ltd.	Douglas French, Director and CEO
Mexico				●	Quimi-Kao, S.A. de C.V.	Francisco Pujadas, President and CEO
United States	●				Kao Brands Company	William Gentner, President and CEO
				●	Kao Specialties Americas LLC	Kazuhiro Nakamura, President and CEO
		●		●	Kao Health and Nutrition LLC	Hideyo Nakamura, President and CEO
Germany	●				KPSS – Kao Professional Salon Services GmbH	Thomas Diekhoff, President and CEO
				●	Kao Chemicals GmbH	Herbert Tripp, President and CEO
Spain				●	Kao Chemicals Europe, S.L.	Takatoshi Kobayashi, President and CEO
				●	Kao Corporation S.A.	Antoni Prat, President and CEO
United Kingdom	●				Molton Brown Limited	Sara Halton, CEO

Consumer Products Business
- ● Beauty Care Business
- ● Human Health Care Business
- ● Fabric and Home Care Business

Chemical Business
- ● Chemical Business

Investor Information (As of March 31, 2008)

Kao Corporation

Head Office
14-10, Nihonbashi Kayabacho 1-chome
Chuo-ku, Tokyo 103-8210, Japan
Telephone: 81-3-3660-7111
Facsimile: 81-3-3660-8978

Founded
June 19, 1887

Common Stock
Authorized: 1,000,000,000 shares
Issued: 549,443,701 shares
Outstanding: 536,703,707 shares
Number of Shareholders: 38,897

Stock Listing
Tokyo Stock Exchange

Ticker Symbol Number
4452

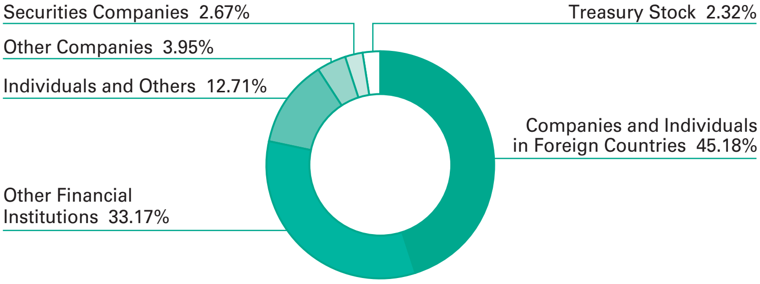
Administrator of Shareholder Register
The Chuo Mitsui Trust and Banking Company, Limited
8-4, Izumi 2-chome, Suginami-ku, Tokyo 168-0063, Japan

Depositary and Registration for American Depositary Receipts (ADR Ticker Symbol: KCRPY)
JP Morgan Chase Bank, N.A.
4 New York Plaza, New York, NY 10004, U.S.A.

Major Shareholders

Name of Shareholders	Investment in Kao by the Shareholders	
	Number of shares (thousand shares)	Ratio of shareholding (percentage)
Japan Trustee Services Bank, Ltd. (Trust Account)	29,036	5.28
The Master Trust Bank of Japan, Ltd. (Trust Account)	28,352	5.16
Moxley and Company	21,090	3.83
State Street Bank and Trust Company	17,529	3.19
Tokio Marine & Nichido Fire Insurance Co., Ltd.	17,402	3.16

Composition of Shareholders



Investor Relations
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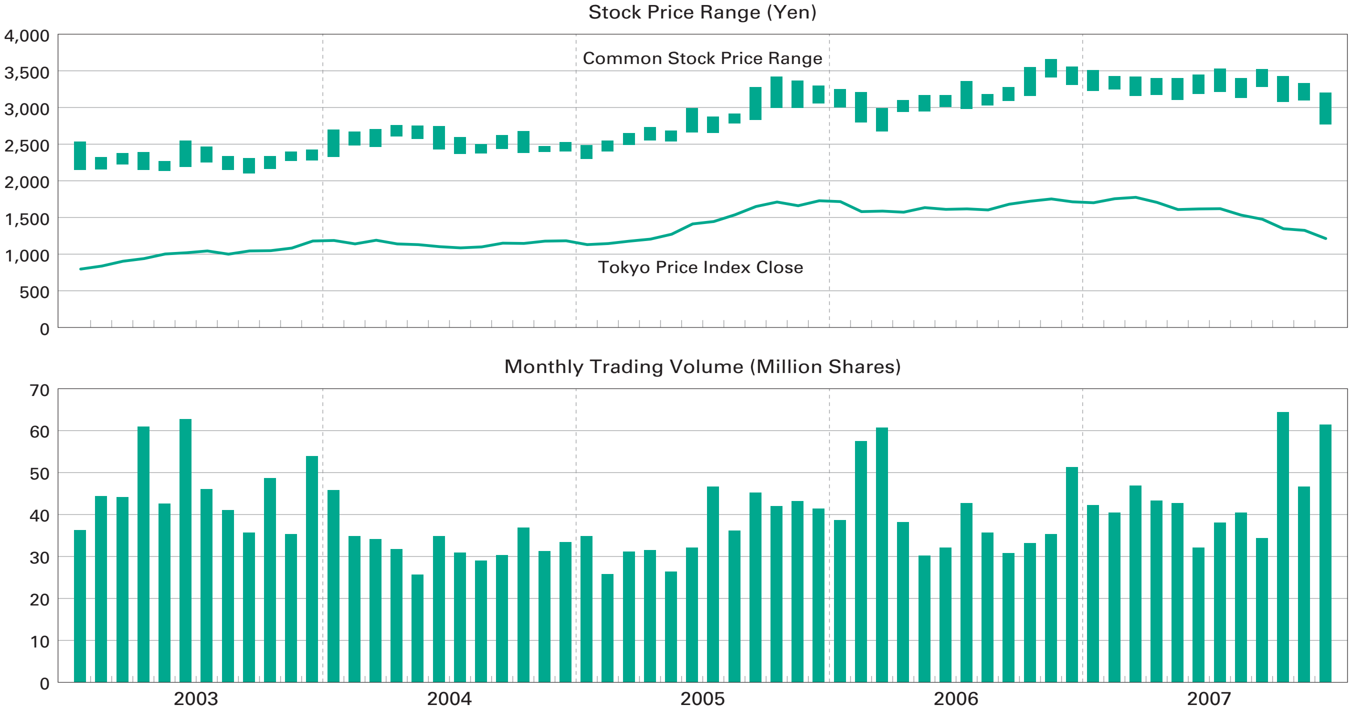
Web site: http://www.kao.co.jp/en/ir/

Stock Price Range & Trading Volume (Tokyo Stock Exchange)



Note: Fiscal years beginning April and ending March the following calendar year

Kao Corporation

http://www.kao.co.jp/en/

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