Offering Value for a Global Presence

Annual Report 2014

For the year ended December 31, 2014

Enriching lives, in harmony with nature.

Kao

PROFILE

The Kao Group's operations consist of the Consumer Products Business and the Chemical Business. The Consumer Products Business encompasses the Beauty Care Business, in which we offer prestige cosmetics, premium skin care products and hair care products; the Human Health Care Business, with products such as functional health beverages, sanitary products and personal health products; and the Fabric and Home Care Business, which includes laundry detergents and household cleaners. In the Chemical Business, we develop chemical products that meet the various needs of industry.

FINANCIAL HIGHLIGHTS

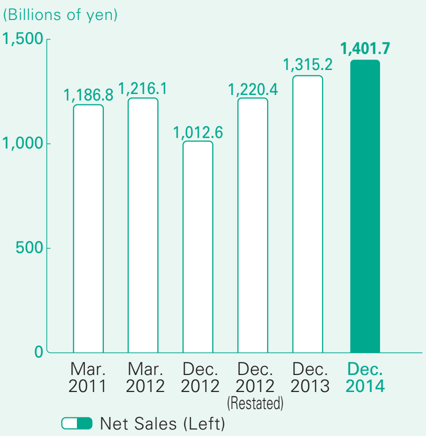
Net sales and profits*
break
previous records

Cash dividends: ¥70
25th consecutive
period of increase

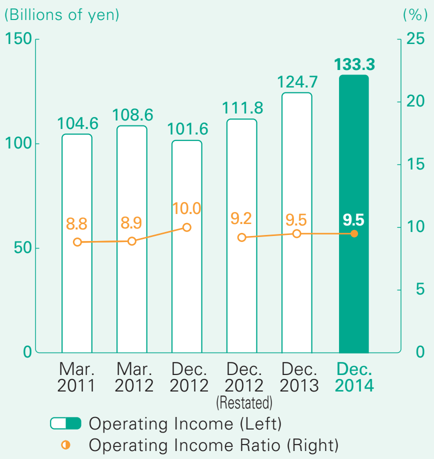
*Net sales and net income broke the previous records, and operating income broke previous records for the second year in a row.

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

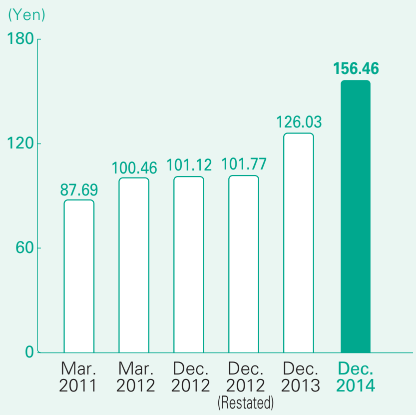
Net Sales



Operating Income / Operating Income Ratio



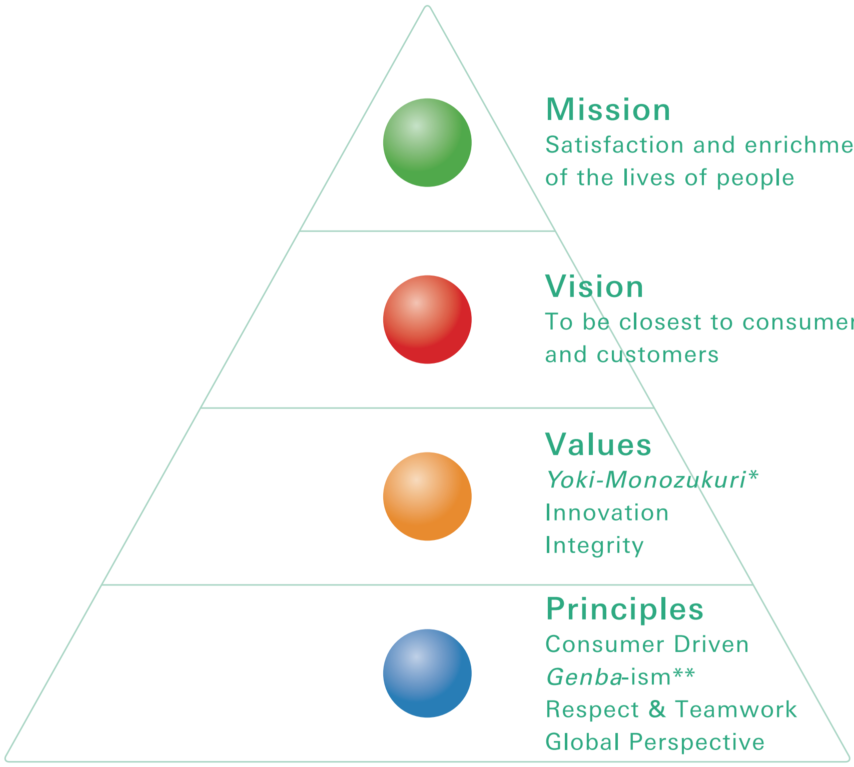
Net Income per Share



Notes: 1. Due to a change in the fiscal year end, the term of consolidation for the fiscal period ended December 31, 2012 consisted of the nine months from April to December for Kao Corporation and its subsidiaries whose fiscal year end was previously March 31 and the twelve months from January to December for subsidiaries whose fiscal year end was December 31.
2. December 2012 (Restated) represents figures for the year from January 1 to December 31, 2012 for Kao Group companies whose fiscal year end was previously March 31.

Forward-Looking Statements

Forward-looking statements such as earnings forecasts and other projections contained in this report are based on information available at the time of publication and assumptions that management believes to be reasonable. Actual results may differ materially from those expectations due to various factors.



The Kao Way explains the essence of Kao's unique corporate culture and spirit, which have been developed through our business activities since the founding of the company.

Our mission is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective. This commitment is embraced by all members of the Kao Group as we work together with passion to share joy with consumers and customers in our core domains of cleanliness, beauty, health and chemicals.

* 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 is available at:
http://www.kao.com/jp/en/corp_about/kaoway.html

CONTENTS

2 Kao's Strengths
4 Becoming a Company with a Global Presence
6 "Essential Research": Offering Value for the Future That Helps to Resolve Social Issues
8 A Message from President and CEO Michitaka Sawada
16 Research and Development
18 Corporate Governance
22 Board of Directors and Audit & Supervisory Board Members, Executive Officers and Executive Fellows
25 Compliance
26 Risk Management
27 Sustainability
31 Financial Section
76 Principal Subsidiaries and Affiliates
77 Investor Information

Kao's Strengths

For over 120 years, the Kao Group has been providing value to people by creating products that change their lives for the better. Taking advantage of the unique strengths that we have developed over this time, we continue to create value for the future that helps to resolve social issues.

Our Strengths

R&D Capabilities

Kao works to create innovative products by combining fundamental technology research, which investigates cutting-edge science in various fields for future business creation, and product development research, which seeks to understand the lifestyles and needs of consumers worldwide to create products that provide comfort and satisfaction.

Top Share of the Household and Personal Care Market* in Japan

Kao has captured a high market share with value offerings that anticipate changes in people's lifestyles. We provide strongly competitive products.

*Source: INTAGE Inc. Jan. – Dec. 2014, value share in 79 categories in which Kao sells

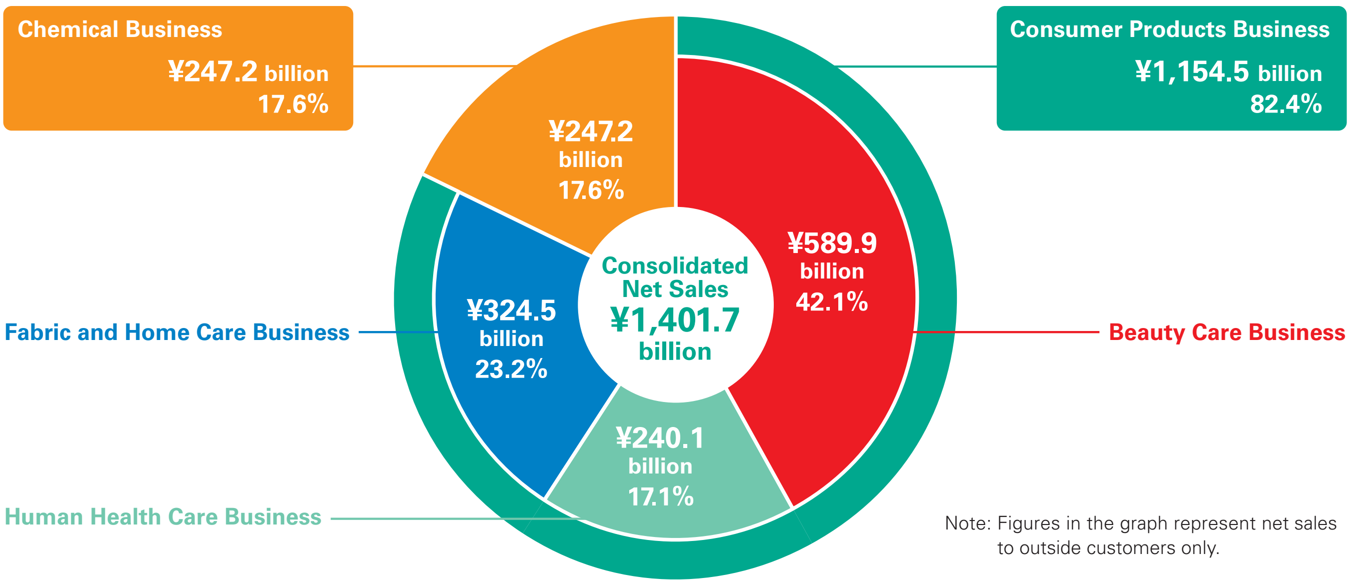
Synergy between the Chemical and Consumer Products Businesses

Having diverse research domains that range from chemicals to consumer products leads to the development of innovative products. At the same time, having both businesses reduces Kao's costs and creates high added value by broadly optimizing the total supply chain from chemicals to consumer products.

Sales and Proposal Capabilities in Japan

Kao's proposal-oriented sales activities address consumers' needs and retailers' challenges with a unique sales structure that has sales company and logistics functions to enable better communication with retailers and consumers for true customer satisfaction.

Breakdown of Business Segment Sales (Year ended December 31, 2014)



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

Segment Information

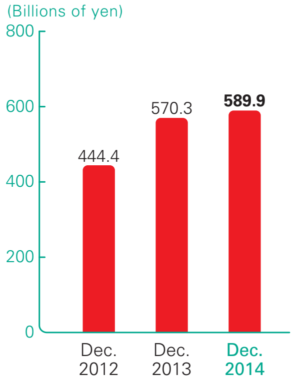
Net Sales[1]

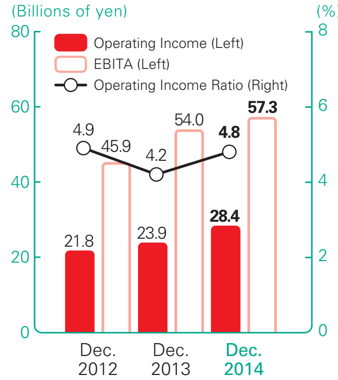
Operating Income[1] / EBITA[2]
Operating Income Ratio[1]

Beauty Care Business

Main Products

Professional hair care products / Cosmetics / Skin care (mass products) / Hair care (mass products)

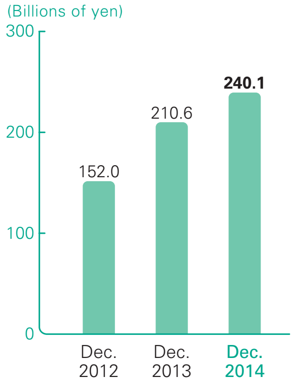


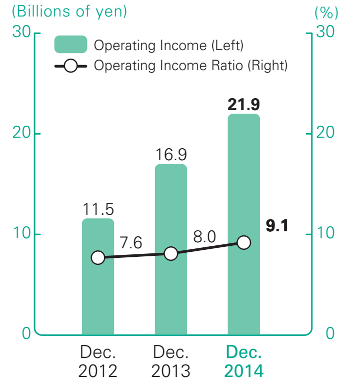


Human Health Care Business

Main Products

Beverages / Oral care / Blood circulation enhancement products (incl. bath additives and thermal pads) / Sanitary products

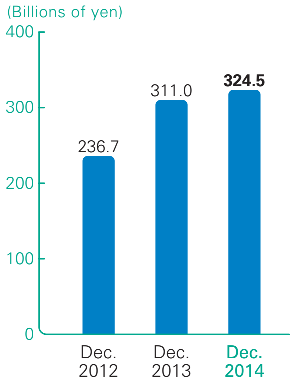


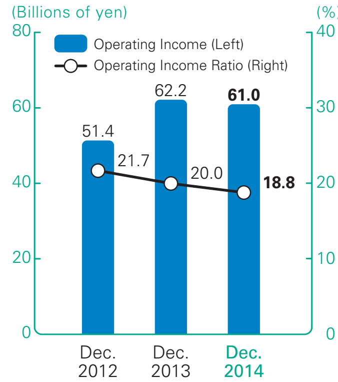


Fabric and Home Care Business

Main Products

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



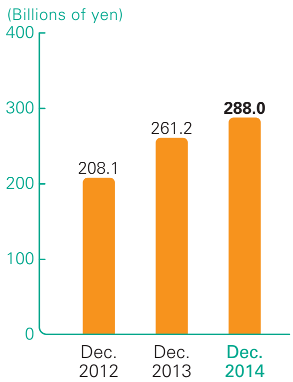


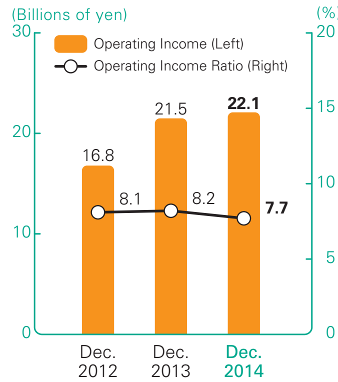
Consumer Products Business

Chemical Business

Main Products

Oleo chemicals / Performance chemicals / Specialty chemicals





Note: Net sales include intersegment sales.

Chemical Business

Notes: 1. Period ended December 31, 2012 and years ended December 31, 2013 and 2014
2. EBITA (Earnings before interest, taxes and amortization) is operating income before amortization of goodwill and other items related to acquisitions.

Becoming a Company with a Global Presence

The Kao Group's mission is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective.

We aim to become a company with a global presence by offering value for the future that helps to resolve the social issues regarding the environment, health, the aging society and hygiene through our business activities.

The Environment

Global warming, insufficient water resources and other environmental problems that significantly affect life are growing more serious each year. Kao will offer value for the future to promote environmental conservation.

Health

The number of health-conscious people is rising rapidly. We will offer value for the future that plays a role in helping people improve their own health.

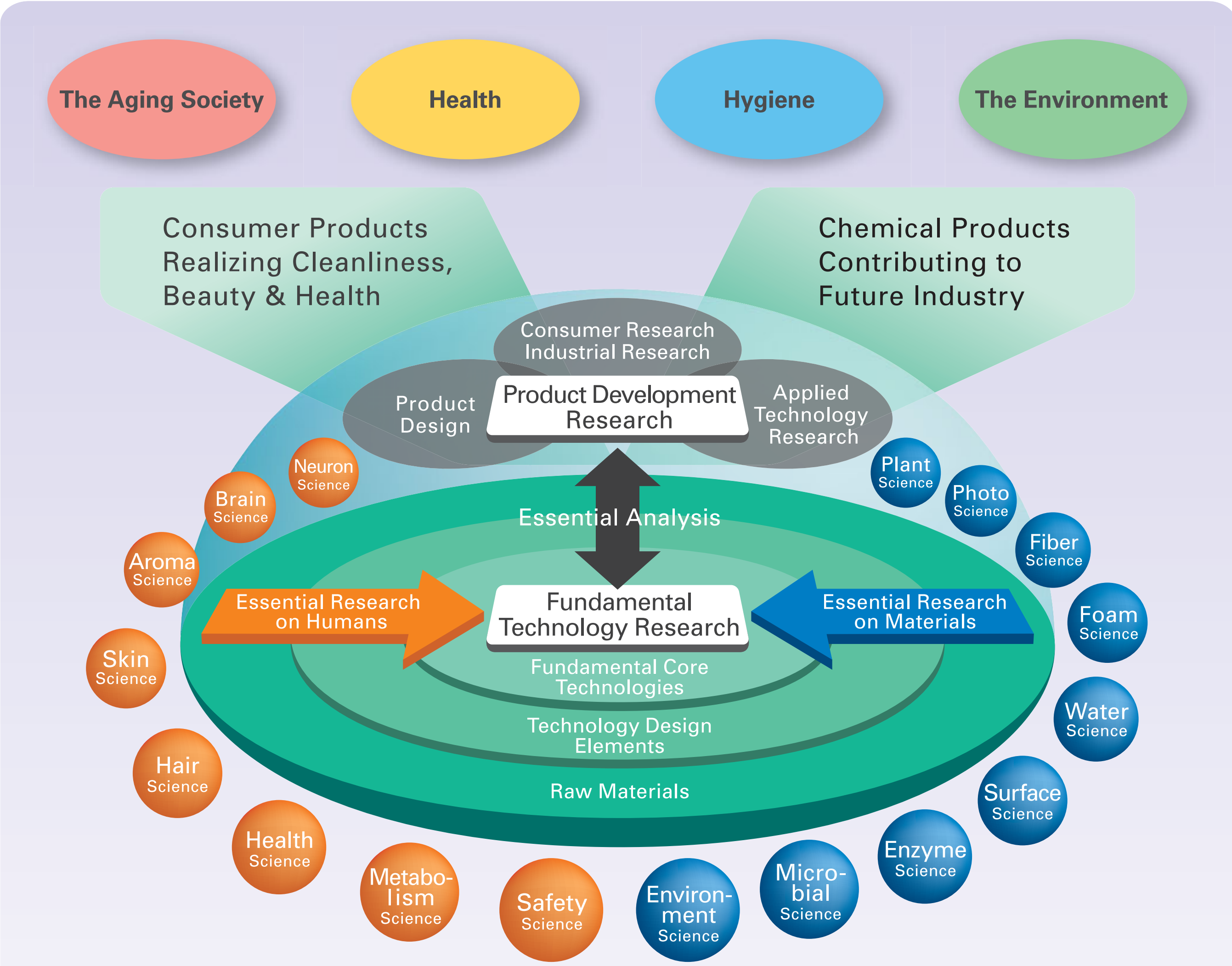
The Aging Society

With a focus on the aging society, we will offer value for the future that helps seniors remain healthy and active.

Hygiene

Infectious diseases and hygiene issues are numerous throughout the world. We will offer value for the future that facilitates hygienic lives.

Kao's Research and Development Aims to Create Value That Will Be a Foundation of Society Decades from Now.



Kao aims to advance a wide range of cutting-edge science together with industry, government and academia. Research into humans and materials derived from this science gives rise to new discoveries and inventions for the evolution of Kao's fundamental technology research. We then add new perspectives and design elements to deepen and combine our technologies to offer value that consumers and customers desire for the future. With operations consisting of the Consumer Products Business and the Chemical Business, Kao conducts "essential research" to offer value for the future that helps to resolve social issues regarding the environment, health, the aging society and hygiene.

Representative Results of Essential Research

The Aging Society
Hair Science

2013
Goldwell Kerasilk

The world's first keratin treatment with no harmful substances that transforms unruly, frizzy hair into manageable hair that is smooth like silk. Expected to also apply to hair concerns that arise with aging.

Health
Metabolism Science

2003
Healthya Green Tea

Healthya Green Tea, which contains high levels of tea catechin, is the first tea product in Japan to receive permission from the Ministry of Health, Labour and Welfare to be labeled as Food for Specified Health Use suitable for people concerned about body fat.

The Environment
Enzyme Science

2014
Algae research

As a global pioneer, Kao aims to acquire a natural raw material source of fats and oils that is not in competition with food resources.

Environment Science

1980
Toner and toner binder

Kao is a global pioneer in the development of polyester resin, which is used for printer and copier toner with superior performance in low-temperature fusing (high-speed printing) and pigment dispersion (high image quality). Kao's toner and toner binder substantially reduce electricity consumption, and are used for one out of every three copies and prints made worldwide.

Hygiene
Microbial Science

2011
Attack Neo Antibacterial EX Power

The only liquid laundry detergent formulated with bleaching agents. Suppresses odor-causing bacteria and deodorizes with each wash, while preventing mold and mildew in washing machine tubs and laundry. A single rinse saves water, electricity and time.

Look forward to the Kao Group's future growth as it makes its presence felt as a company that helps to resolve social issues.

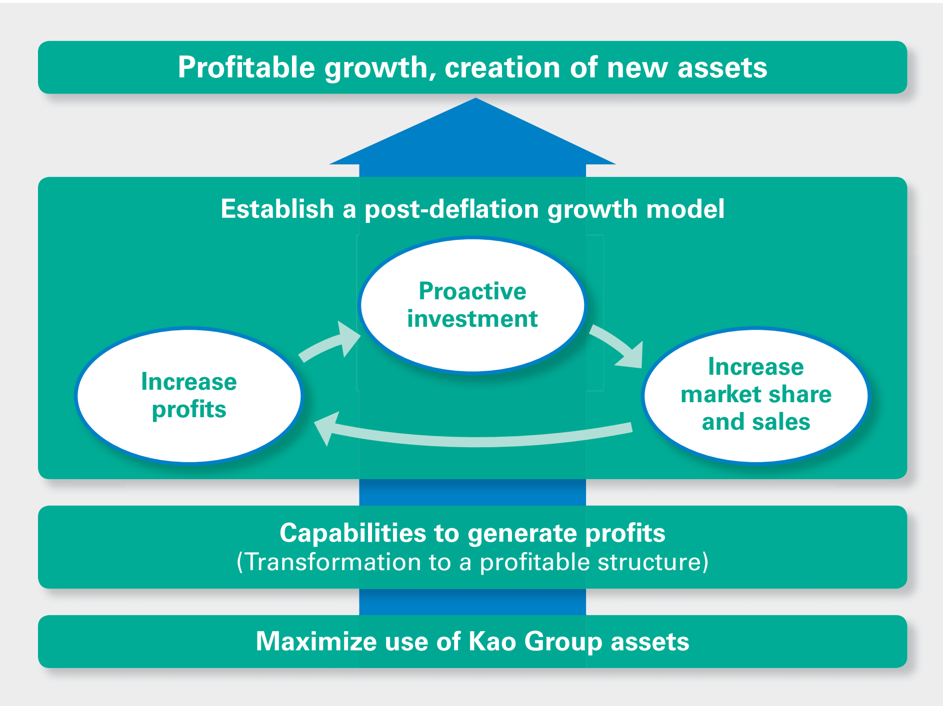
Michitaka Sawada
President and Chief Executive Officer

As stated in the "Kao Way," which is our corporate philosophy, the mission of the Kao Group is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world. Under this mission, we have made numerous value offerings through our products and services since our founding. In the future, Kao intends to become a company with a global presence, exerting a substantial impact on the world by helping to resolve social issues while continuing to take on challenges. Maximizing the use of our assets, such as our human resources, R&D assets and brands, is important for achieving this objective. We will continue to create new value for the future and offer it to the world through "essential research." Day in and day out, we will work diligently toward the realization of our goal of becoming a company with a global presence.

In 2014, under Kao Group Mid-term Plan 2015 (K15) we made great strides toward our vision for the Group's future. We made progress in building the sustainable growth model we have targeted by maximizing the use of Kao Group assets to enhance our capabilities to increase profits.

We drew up Kao Group Mid-term Plan 2015 (K15) in 2013, and 2015 is its final year. In 2014, not only were we able to achieve numerical targets, but we were also able to make structural changes toward the realization of K15. We had been offering consumers high-value-added products, which became more readily accepted by consumers as the market changed. Under these circumstances, we made substantial progress toward building the sustainable growth model I have been insisting on: a post-deflation growth model for transformation to a more profitable structure, with the capabilities to generate profits by maximizing the use of our assets. It is a virtuous cycle in which the profits we generate are proactively allocated to investments that lead to growth in market share and sales, which in turn provides profit exceeding the amount of investment. For example, even if an unforeseen event occurs, we can overcome it and continue to generate profits that can be used for other investments for further growth. The Kao Group has many assets accumulated by our predecessors, in areas including research and development, human resources, goods, information and brands. To start with, we are making better use of our human resources. We have given all employees a sense of ownership and an awareness of maximizing the use of the assets they possess. As a result, among other factors, employee attitudes have changed. They are able to think and act on-site to make forward-looking proposals that utilize

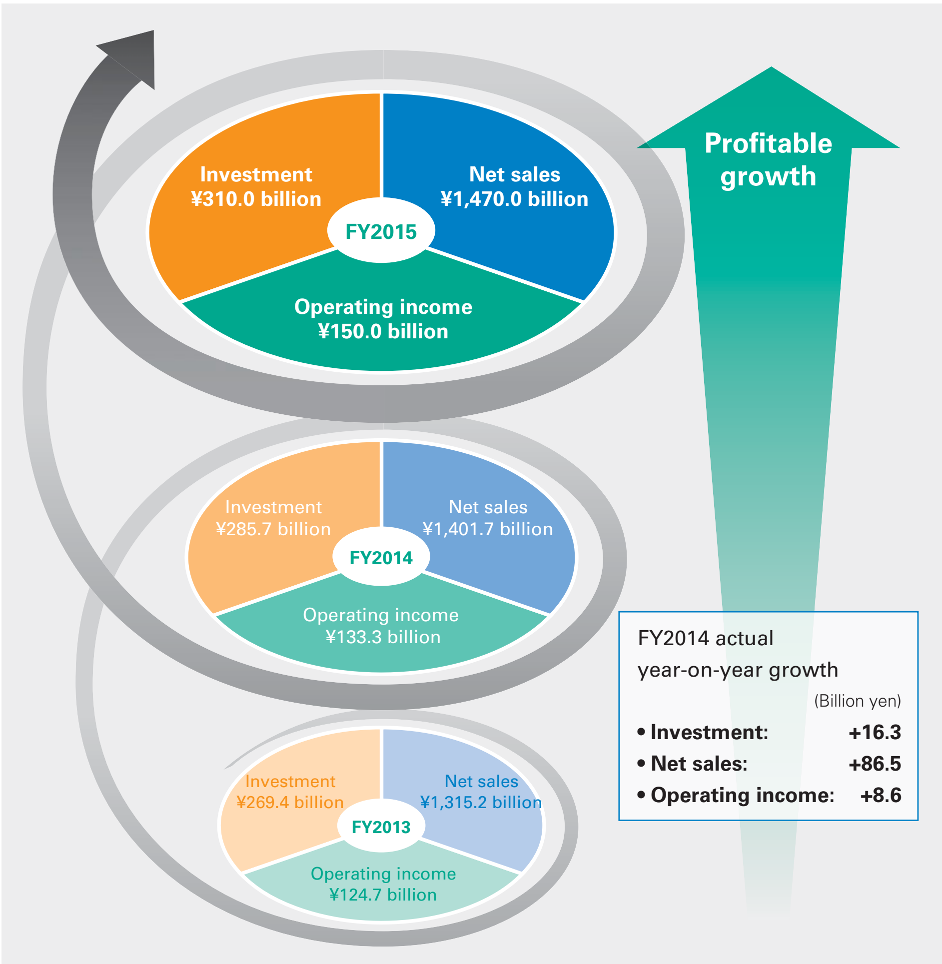
Targeted Sustainable Growth Model



their assets. In this way, we are gradually shifting to a structure that generates profits, or in other words, enhancing our capabilities to increase profits.

As maximizing use of assets has taken root throughout the Kao Group, we have enhanced our capabilities to increase profits. The result has been progress in building our sustainable growth model. At the same time, we continuously invest in research and development, including "essential research." Building the foundation for this sustainable growth model was our primary accomplishment in 2014. Capital expenditures were at the ¥50 billion level until fiscal 2012, but increased to the ¥60 billion level since K15 began. During 2014, we increased production capacity in Japan for baby diapers, which are growing in sales, and for the Fabric and Home Care Business, to reinforce this business. Outside Japan, we built our second consumer products plant in the growing market of Indonesia as part of the global expansion of the Consumer Products Business. Our efforts to strengthen the Chemical Business included the establishment of new plants in Indonesia and China. Moreover, we proactively increased investment in marketing new and improved high-value-added products, among other measures to respond to the last-minute surge in demand before the consumption tax rate increase in Japan in April 2014. As a result, the increase in profits from sales growth

Growth Model for Exiting Deflation with Proactive Investment*

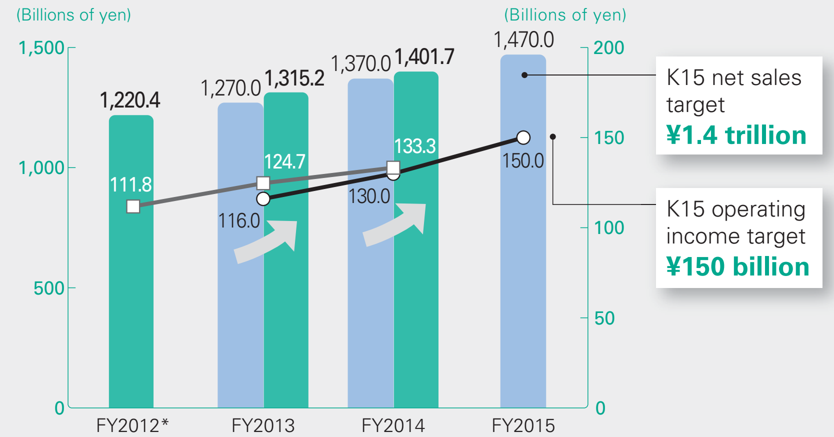


* Investment = Capital expenditures + Marketing expenditures + Research and development expenditures

exceeded the increase in investment. The Kao Group's share of the household and personal care products market in Japan has increased compared with the previous year. This is a sign that we are shifting to the sustainable growth model that I am determined to establish.

Regarding Kanebo Cosmetics brightening products containing the ingredient Rhododenol, the Kao Group continues to respond in a sincere manner. Kanebo Cosmetics has been making individual visits to people who have experienced vitiligo-like symptoms and offering support for their recovery and compensation.

K15 Net Sales and Operating Income



	FY2012*	FY2013	FY2014	FY2015
Overseas sales ratio	26.8%	30.9%	33.1%	30% or more (Target)

Net Sales (Actual) (Left)
Net Sales (Forecast) (Left)
Operating Income (Actual) (Right)
Operating Income (Forecast) (Right)

* Excludes the impact of the change in financial term in 2012.

In 2015, we will build our foundation for the future. We are poised for a major leap to achieve the targets of K15, particularly the operating income target of ¥150 billion.

K15 has reached its final year in 2015. The plan was drawn up by visualizing the Kao Group's desired state, then looking backward to plot out the steps to get there. This will be a year of looking a decade or two into the future to establish a foundation for long-term application of the sustainable growth model we have been building.

In 2015, as the final year of K15, it is imperative that we (1) break previous records for net sales and profits and (2) achieve the numerical management targets of ¥1.4 trillion in net sales, ¥150 billion in operating income and an overseas sales ratio of 30 percent or more. These key performance indicators have not changed since the initial announcement.

Growth Strategies to Achieve K15

1. Expand the Consumer Products Business globally

- Growth markets: Expand the business significantly by proposing products in the domain of "cleanliness" including laundry detergents, baby diapers and sanitary napkins that target the growing middle-class consumer segments
- Mature markets: Accelerate growth with high-value-added products

2. Further reinforce the Fabric and Home Care Business, and accelerate profitable growth in the Beauty Care and Human Health Care Businesses

Fabric and Home Care Business

- Maintain or capture the top share in each product category

Beauty Care Business and Human Health Care Business

- Move the cosmetics business to a phase of profitable growth
- Propose products and services through new approaches focused on health and the aging society

3. Reinforce the Chemical Business

- Promote higher added value
- Strengthen synergy with the Consumer Products Business

Profitable growth and the creation of new assets are priority themes for achieving these targets, with a sustainable growth model driven by making maximum use of the Kao Group's assets and capabilities to generate profits. To reinforce our Consumer Products Business in Japan, we will proactively launch new and improved products and invest in marketing. We will also work to restore the cosmetics business through growth of the distinctive Sofina and Kanebo brands, and take measures to reinforce the *Healthya* brand of functional drinks. For further growth in the Consumer Products Business in Asia, we will enhance our efforts for the premium segment while proactively conducting business targeting the middle-class consumer segment. In the Consumer Products Business in the Americas and Europe, where we are facing challenges, we will improve profitability. In the Chemical Business, we will respond to changes in the global operating environment by proposing high-value-added products and further reinforcing oleo chemicals.

We will focus on "essential research" with our sights set decades into the future to help resolve social issues globally.

Setting its sights on the future, the Kao Group will focus efforts on the social issues where it can best maximize its assets: the environment, health and the aging society, to which we have added hygiene.

In the area of the environment, for example, Eco-Technology Research Center in Wakayama Prefecture in Japan, has been conducting research on algae as a next-generation energy source. In the area of health, we have already begun developing health promotion solutions including health-related products and measuring instruments. For the aging society, we have been conducting a business that provides a wide range of products for active seniors, not only incontinence products, employing universal design and other measures. For hygiene, the new area on our list, we intend to use the technologies we have accumulated in Japan to make a contribution to consumers worldwide.

Moreover, to achieve our vision of becoming a company with a global presence, we will refine our current strategies to set the direction of our mid-term growth strategies following K15. There are still countries where the Kao Group does not do business, and we want to enter those markets with all due speed to accelerate the global expansion of the Consumer Products Business. Growth in Japan will be indispensable for this expansion. Japan's low birthrate and aging society are said to be causing the market to contract, but I believe we can generate growth by anticipating changes in lifestyles and making value offerings that are a half-step ahead of those changes. Consumer spending is improving, and we should be able to grow by further enhancing the market positions we have already established. In Japan, we are facing the social issues of a low birthrate and an aging society ahead of other countries. By successfully dealing with these issues and accumulating expertise under these conditions in Japan, we will be equipped to tackle them on a global scale. We also intend to quickly return the cosmetics business to a growth path. In the Chemical Business, we aim to achieve sales expansion and stable profitability.

I recognize that these strategies will require the training of expert personnel and continuous investment in "essential research." By expert personnel, I mean employees who can link related parts of our functions: research with operations, technologies with business, local sites with the head office, and so on. The key will be to train expert personnel who can generate comprehensive value by bringing together other employees who display value in specialized fields. We are already conducting measures for this purpose within the Kao Group, such as the Innovation Creation Project and the Global Expansion Project. In addition, "essential research" is the most important element in creating value for the future. Without a doubt, the Kao Group's lifestyle proposals to date have originated from this research. It is one of the strengths we must maximize for future growth, and we will continue to prioritize investment in it to develop our ability to create value for the future.

In 2014, we made substantial changes to our corporate governance structure to attain our initial objectives: enhancing discussions of strategies from a global perspective by the Board of Directors, speedy decision-making and separation of supervision and execution.

To continue sustainable development, the Kao Group has been working to enhance its corporate governance through innovation.* Our new structure has been in operation since March 2014. We have reinforced the outside perspective of the Board of Directors with an equal number of inside and outside members, and an Independent Outside Director as chairman. Moreover, two of the Outside Directors are Independent Directors. We have also accelerated decision-making, further clarified the division of roles between supervision and execution, and delegated authority. Receiving valuable opinions from the diverse perspectives of the Outside Directors and Outside Audit & Supervisory Board Members has deepened discussions of the Kao Group's future direction and other matters. It also leads to engagement with our investors from a long-term perspective, which in turn increases our corporate value.

* "Innovation" is one of the values of the Kao Way.

Look forward to Kao's growth decades into the future.

The targeted sustainable growth model based on maximizing the use of the Kao Group's assets and our capabilities to generate profits has begun to function, and we are now able to invest for our future growth. We will continue to prioritize the uses of the cash flow we generate each year as we have in the past.

Moreover, the Kao Group was the first in Japan to introduce Economic Value Added (EVA)* as a management indicator to increase corporate value. We believe EVA management generates and improves "true" profit that exceeds the cost of capital. We will work to increase corporate value by continuously improving EVA through profitable growth. Furthermore, because EVA management keeps us aware of the cost of capital at all times, it improves ROE.

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

Direction of Mid-term Growth Strategies (3 to 5 Years) after K15

- Accelerate global expansion of the Consumer Products Business
- High-value-added offerings that resolve social issues including the environment, health, the aging society and hygiene
- Return the cosmetics business to a growth path
- Achieve sales expansion and stable profitability in the Chemical Business

The Kao Group will voluntarily implement International Financial Reporting Standards from 2016 based on its judgment that standardizing accounting within the Group will help to improve the quality of Group management. The implementation will enable management based on standardized frameworks and information in each Kao Group company and business, thus strengthening our management foundation to improve our corporate value as a global company.

The Kao Group will increase its corporate value by creating value for the future from the perspective of consumers and working to help resolve social issues, primarily in the areas of the environment, health, the aging society and hygiene. By increasing value for our customers, employees and shareholders in a balanced fashion, we aim to achieve profitable growth and contribute to a sustainable society. The Kao Group is in the process of building its sustainable growth model to drive future growth. Our shareholders can look forward to Kao's growth as we set our sights decades into the future.

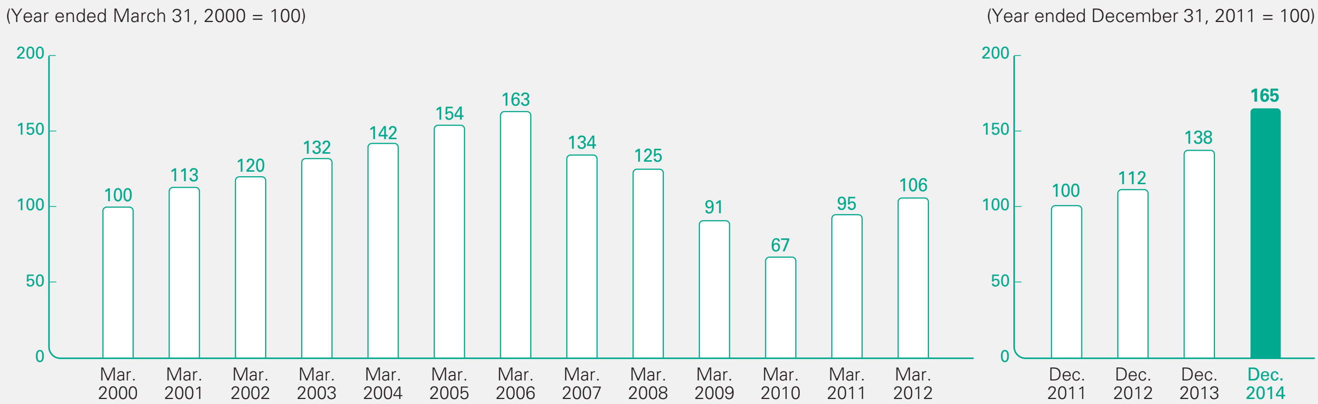
Use of Cash Flow* and Shareholder Returns

Use steadily generated cash flow effectively in order of priority shown below from an EVA standpoint toward further growth.

1. **Investment for future growth** (capital expenditures, M&A, etc.)
2. **Steady and continuous cash dividends**
3. **Share repurchases and early repayment of interest-bearing debt including borrowings**

* Net cash provided by operating activities

EVA



Note: Due to the change in the fiscal year end, EVA has been restated on a calendar year basis for periods ended December 31, 2011 and 2012.

Basic Policy

Kao's mission is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective. Based on this mission, Kao's research and development division combines original ideas with an understanding of the various cultures and needs of consumers in diverse countries and regions to develop innovative products and technologies that create new value and new markets.

Approximately 2,800 Kao Group personnel conduct research and development. R&D expenditures for the entire Kao Group in 2014 were ¥51.7 billion, equivalent to 3.7% of net sales.

Topics Thomson Reuters Names Kao One of the 2014 Top 100 Global Innovators

Kao regards its patents and other intellectual property (IP) rights as important management resources, and in 2014 it was selected for the fourth time by Thomson Reuters as one of the "2014 Top 100 Global Innovators." The award is given to innovative companies recognized for having developed inventions with a global impact and for working to protect their IP rights. Based on Thomson Reuters' patent database, IP search and analysis platform and criteria established by its IP solutions business, companies are selected using metrics such as overall patent volume, patent grant success rate, global reach of the portfolio and patent influence as evidenced by citations.

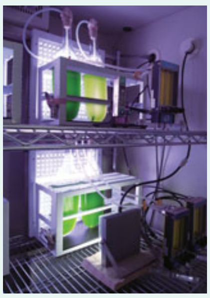
Receiving an award as one of the "2014 Top 100 Global Innovators"

Topics In Research on Algae, Kao Finds Some Strains That Produce Medium Chain Fatty Acids, and Identifies an Enzyme That Plays an Important Role in the Biosynthesis Pathway

Kao has succeeded in finding an enzyme that can produce a large number of medium chain fatty acids, which are the main components of natural fats and oils (such as palm kernel oils and coconut oils) used as raw materials for surfactants in detergents, shampoos, and other related products. This finding presents a strong possibility that Kao could become a world pioneer in acquiring a natural raw material source of fats and oils that is not in competition with food resources.

Reportedly, the potential for algae to produce fats and oils is more than ten times that of natural resources such as palm. In recent years, many research cases to acquire new raw materials for fuels (biofuels) to replace fossil fuels have reported on the production of fats and oils that contain C16 to 18 fatty acids as a main component. However, surfactants in detergents and the base substances of various raw materials are C12 to 14 medium chain fatty acids. Therefore, there have been virtually no examples of relevant research within the conventional scope of research on algae.

Through research on biotechnologies that evolved from technologies for enzymes for detergents, Kao found some strains that contained a large number of C12 medium chain fatty acids among C12 to 14 medium chain fatty acids. Additionally, as a first in the field of algae, we identified a novel acyl-ACP thioesterase with high specificity to medium chain fatty acids from the genus *Nannochloropsis*. We expect that these findings will dramatically accelerate the breeding development of algae for large-scale production of medium chain fatty acids.



Algae research

Beauty Care Business

Kao conducts research for a deep understanding of the true nature of the skin and hair of people around the world and develops materials and formulations that give rise to new functions. By doing so, we aim to help consumers achieve healthy, beautiful skin and hair and to offer beauty proposals tailored to diverse lifestyles. To maximize the use of the Kao Group's assets and reinforce the cosmetics category of the Beauty Care Business, we integrated our research organizations for Kao Sofina and Kanebo Cosmetics. We have reorganized the Kanebo Cosmetics Laboratories in Odawara, Japan as the Kao Odawara Research Laboratories, which will conduct full-scale research as the Kao Group's comprehensive R&D facility for cosmetics.

In hair care, we renewed the *Essential* hair care brand in Japan, Taiwan, Singapore and Hong Kong. Using fine cuticle care technology for uniform adsorption of hair care ingredients (lanolin fatty acids that repair, moisturize and preserve) that include 18-methyleicosanoic acid, the improved shampoos and conditioners reduce hair friction to enhance the smoothness of fingers running through the hair and make washing, drying and setting easier.

R&D expenditures in the Beauty Care Business totaled ¥22.3 billion.

Human Health Care Business

Kao researches the body and mind to improve the quality of life by making the most of people's natural vitality.

In sanitary products, we launched an improved version of *Laurier Super Absorbent Guard* from the *Laurier* brand of sanitary napkins in Japan. Using a new technology for an absorbent pad with localized blocking properties both reduces unpleasant stiffness and makes it comfortable to wear while also increasing absorbency. In Thailand, we launched *Laurier Super Gentle Plus*, which uses a topsheet material with a gentle touch and reduces the surface area in direct contact with the skin to one-third that of conventional products, thus reducing chafing, the primary cause of irritation.

R&D expenditures in the Human Health Care Business totaled ¥12.1 billion.

Fabric and Home Care Business

Kao's research and development spans a wide range of fields from household products that meet the diverse needs of consumers to products for professional use where a high level of cleanliness and hygiene is required.

In home care, we launched an improved version of *CuCute* dishwashing detergent. Kao's original hybrid wash formulation, which combines two types of surfactant, creates thick suds from the start of washing to rapidly remove tough, congealed grease and fat and rinses off immediately, thus saving water.

R&D expenditures in the Fabric and Home Care Business totaled ¥7.4 billion.

Consumer Products Business

Chemical Business

In this business, Kao's research and development strives for more substantive R&D results in areas including oils and fats, surfactants and polymers to produce chemical products distinguished by their ability to meet diverse needs in a wide range of industries.

Kao conducts research on forward-looking environmental technologies, centering on advanced use of biomass. In our research on algae, we have succeeded in finding an enzyme that can produce a large number of medium chain fatty acids. We are pursuing technological development with the aim of large-scale production of fats and oils from algae as a natural raw material source of fats and oils that is not in competition with food resources.

In performance chemicals, we are developing value-added products with a reduced environmental burden. In collaboration with Bridgestone Corporation, we have developed a sustainable dispersion improving agent that distributes silica more evenly in rubber. This enables the addition of more silica to the rubber raw material than in conventional tires, thus improving fuel economy and wet grip performance.

In specialty chemicals, development efforts include raising the ratio of bio-ingredients in our toner binder.

R&D expenditures in the Chemical Business totaled ¥9.9 billion.

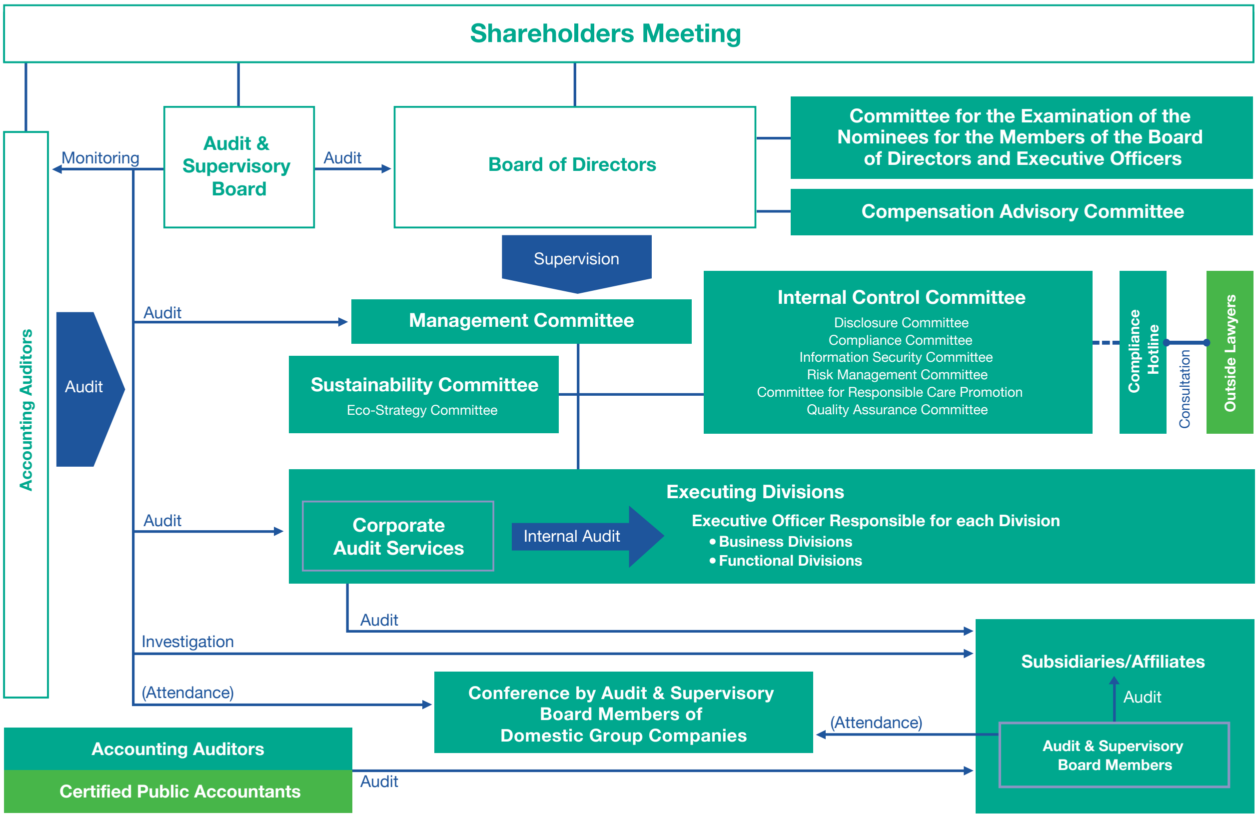
Chemical Business

Basic Policy and Structure

For Kao, the basis of corporate governance is separating the functions of supervision and execution to strengthen supervision of execution and transferring authority to the Executive Officers to strengthen and accelerate execution with the aim of continuously enhancing corporate value.

In accordance with this position, Kao works to improve governance as a company with an Audit & Supervisory Board by strengthening the supervisory function of the Board of Directors and the auditing function of the Audit & Supervisory Board. An overview of Kao's governance structure is given in the following chart.

Corporate Governance Structure



Note: Our policy is to ask lawyers and other experts, as necessary, when making business decisions concerning business management and daily operations.

Board of Directors

The Board of Directors ensures diversity, independence and lively discussions by inviting people from outside the Company with diverse experiences and knowledge and by having a committee structure with an appropriate and equal number of inside and outside members.

Number of Members	6
Outside Directors Included in Above	3 (50%)
Independence	The Company has reported two of the three Outside Directors to the Tokyo Stock Exchange as Independent Outside Directors who have met the qualifications for independence in the Standards for Independence of Outside Directors/ Audit & Supervisory Board Members of Kao Corporation (the "Standards"). The Standards, which have been established with reference to the Independence Tests of the New York Stock Exchange, can be found at: http://www.kao.com/jp/en/corp_imgs/corp_info/governance_002.pdf
Chairman	Independent Outside Director
Term of Office	1 year (voluntarily shorter than the statutory period)
Number of Meetings	15 times/year
Average Attendance Rate of Outside Directors	95%

Audit & Supervisory Board

The Audit & Supervisory Board ensures the effectiveness of its audits through the collaboration of the Full-time Audit & Supervisory Board Members with the Outside Audit & Supervisory Board Members, a majority of whom have qualifications such as attorney-at-law or certified public accountant, who maintain independence and expertise as outside parties.

Number of Members	5
Outside Audit & Supervisory Board Members Included in Above	3 (60%)
Independence	The Company has reported all three Outside Audit & Supervisory Board Members to the Tokyo Stock Exchange as Independent Outside Audit & Supervisory Board Members who have met the qualifications in the Standards.
Chairman	Full-time Audit & Supervisory Board Member
Term of Office	4 years (statutory period: prohibited by the law to shorten the period)
Number of Meetings	10 times/year
Average Attendance Rate of Outside Audit & Supervisory Board Members	Board of Directors Meetings: 100% Audit & Supervisory Board Meetings: 98% Meetings to exchange opinions with Representative Directors: 100% (3 times/year)

Committee for the Examination of the Nominees for the Members of the Board of Directors and Executive Officers

This committee examines the nominees prior to election or re-election as Representative Director, Director, Executive Officer and title of Executive Officer as proposed to the General Meeting of Shareholders and the Board of Directors, and submits its evaluation of the nominees' qualifications to the Board of Directors.

Number of Members	6
Composition	All Outside Directors and all Outside Audit & Supervisory Board Members
Chairman	Chosen by committee members. The chairman was the President and Chief Executive Officer in 2014.
Number of Meetings	Held for each election or re-election. Held once in 2014.
Attendance Rate	100%

Compensation Advisory Committee

This committee examines the compensation system and remuneration levels for Directors and Executive Officers and submits the results of its examinations to the Board of Directors.

Number of Members	9
Composition	All Representative Directors, all Outside Directors and all Outside Audit & Supervisory Board Members
Chairman	Chosen by committee members. The chairman was the President and Chief Executive Officer in 2014.
Number of Meetings	Held once in 2014.
Compensation System	See next page

Support System for Outside Directors and Outside Audit & Supervisory Board Members

To allow for active discussions at meetings of the Board of Directors, the Board of Directors Secretariat provides Outside Directors with sufficient explanations on matters such as the background, purposes and content of the respective agenda items prior to each meeting of the Board of Directors. Furthermore, under this support system, in addition to support staff nominees, administrative divisions such as Global Internal Audit, the Legal and Compliance Department and the Accounting and Finance Department provide Outside Audit & Supervisory Board Members with assistance upon request.

Compensation System for Officers

The Company's fundamental position on remuneration of Directors, Audit & Supervisory Board Members and Executive Officers is (1) a compensation system that attracts diverse and excellent candidates to establish and improve competitive advantages; (2) a compensation system that promotes continuous improvement of corporate value and shares interests with shareholders; and (3) an objective and transparent decision-making process regarding compensation.

Based on data from an outside research institution on Directors' and Executive Officers' remuneration, the Company decides on compensation by setting a benchmark each year with other well-known manufacturing companies of a similar business size and in a similar business category as companies of the same rank, and comparing their remuneration systems and levels of remuneration with those of the Company.

The composition of remuneration of Inside Directors and Executive Officers is as shown above right, and remuneration is determined based on their roles as Directors and Executive Officers and positions concurrently held.

Type of Remuneration	Composition[1]
Base salary	60 – 70%
Short-term incentive[2] (bonus)	20%
Long-term incentive (remuneration-type stock options)	10 – 20%

Notes: 1. Composition is the percentage allocated in estimated annual standard remuneration.
2. Short-term incentive is set to fluctuate between 0% and 200% depending on the achievement of targets for EVA, net sales and operating income.
3. The Company has no retirement bonus system for Directors.
4. Compensation for Outside Directors, who are independent of the Company's operations, consists of base salary and stock options only.
5. Compensation of Audit & Supervisory Board Members consists of base salary only.

Comment from Chairman of the Board of Directors Sonosuke Kadonaga (Independent Outside Director)

As chairman of the Board of Directors, I am pleased that the effects of changes to the Board have gradually become apparent. I intend to ensure that Kao continues working to enhance its corporate governance.

Sonosuke Kadonaga
Chairman of the Board of Directors
Independent Outside Director

In March 2014, Kao made substantial changes to its Board of Directors to enhance its corporate governance structure. The number of Directors changed from seven Inside Directors and three Outside Directors to a total of six Directors, consisting of an equal number of Inside and Outside Directors, two of whom are Independent Directors. In addition, as an Independent Outside Director, I assumed the position of chairman of the Board of Directors. Now that about a year has passed, I feel we are attaining our initial objectives, including enhancing discussions of strategies from global perspectives, speedy decision-making and separation of supervision and execution.

The Board of Directors conducts lively discussions, as the three Outside Directors with rich overseas working experience offer opinions from multifaceted perspectives that make the most of their respective experiences and knowledge. The team of Audit & Supervisory Board Members, including members from outside with many years of corporate experience as an attorney-at-law or certified public accountant, adds to these discussions from specialist perspectives. The Board of Directors mainly decides the direction of matters such as long-term business strategies and organizational structure, and entrusts their execution to the Executive Officers. In addition, the separation of supervision and execution is promoted by enhanced supervision and audits, including checks by Outside Directors and Outside Audit & Supervisory Board Members of the periodic reports made by the Executive Officers to the Board of Directors on the status of execution. Moreover, granting a wide range of authority to Executive Officers has accelerated decision-making for faster execution and management.

Of course, our efforts to enhance corporate governance are by no means finished with the current structure. Appropriately dealing with the rapid changes in our business environment in recent years requires constant innovation, including innovation of the corporate governance structure. I believe more active management discussion by the Board of Directors will be vital in setting the course for our management and businesses from holistic and long-term perspectives.

Board of Directors and Audit & Supervisory Board Members

(As of April 1, 2015)

Board of Directors

Michitaka Sawada[1]

Representative Director

Apr. 1981 Joined the Company
Jun. 2006 Executive Officer
Jun. 2008 Member of the Board, Executive Officer
Jun. 2012 Representative Director, President and Chief Executive Officer (current)
Jan. 2014 Responsible for Product Quality Management

Sonosuke Kadonaga[2]

Independent [4]

President, Intrinsics

Apr. 1976 Joined Chiyoda Corporation
Jun. 1981 Master of Science in Chemical Engineering, Massachusetts Institute of Technology, School of Engineering, U.S.A.
Aug. 1986 Joined McKinsey & Company, Inc., Japan
Jul. 2009 President, Intrinsics (current)
Jun. 2012 Member of the Board, Kao Corporation (current)
Mar. 2014 Chairman of the Board of Directors

Katsuhiko Yoshida[1]

Representative Director

Apr. 1979 Joined the Company
Apr. 2007 President, Human Health Care Business Unit
Jun. 2007 Executive Officer
Apr. 2010 President, Fabric and Home Care Business Unit
Jun. 2012 Managing Executive Officer (current)
Mar. 2014 Member of the Board, Representative Director, President, Consumer Products; Responsible for Kao Professional Services Co., Ltd. (current)

Toru Nagashima[2]

Independent [4]

Senior Advisor, Teijin Limited

Apr. 1965 Joined Teijin Limited
Jul. 1974 Courses taken in the MBA Program, University of Utah, U.S.A.
Oct. 1975 Seconded to Polynova S.A., Mexico
Jun. 2000 Member of the Board, and CESHO (Chief Environment, Safety & Health Officer), Teijin Limited
Apr. 2001 Member of the Board, CMO (Chief Marketing Officer) and General Manager of Corporate Strategy & Planning Office, Teijin Limited
Jun. 2001 Managing Director, CMO (Chief Marketing Officer) and General Manager of Corporate Strategy & Planning Office, Teijin Limited
Nov. 2001 President & Representative Director, COO, Teijin Limited
Jun. 2002 President & Representative Director, CEO, Teijin Limited
Jun. 2008 Chairman of the Board, Teijin Limited
Mar. 2013 Member of the Board, Kao Corporation (current)
Apr. 2013 Senior Advisor, Member of the Board, Teijin Limited
Jun. 2013 Senior Advisor, Teijin Limited (current)

Toshiaki Takeuchi[1]

Representative Director

Apr. 1981 Joined the Company
Mar. 2009 Vice President, Corporate Planning, Kao Customer Marketing Co., Ltd.
Mar. 2010 Member of the Board, Executive Officer, Kao Customer Marketing Co., Ltd.
May 2011 Member of the Board, Senior Managing Executive Officer, Kao Customer Marketing Co., Ltd.
May 2012 Representative Director, Senior Managing Executive Officer, Kao Customer Marketing Co., Ltd.
Jun. 2012 Executive Officer
Apr. 2013 Representative Director, Executive Vice President, Kao Customer Marketing Co., Ltd.
Mar. 2014 Member of the Board, Representative Director, Managing Executive Officer, President and Chief Executive Officer, Kao Customer Marketing Co., Ltd. (current)

Masayuki Oku[2]

Chairman of the Board, Sumitomo Mitsui Financial Group, Inc.

Apr. 1968 Joined Sumitomo Bank
May 1975 LL.M., University of Michigan Law School, U.S.A.
Jan. 1991 Branch Manager, Chicago Branch, Sumitomo Bank
Jun. 1994 Director, Sumitomo Bank
Nov. 1998 Managing Director, Sumitomo Bank
Jun. 1999 Managing Director and Managing Executive Officer, Sumitomo Bank
Jan. 2001 Senior Managing Director and Senior Managing Executive Officer, Sumitomo Bank
Apr. 2001 Senior Managing Director and Senior Managing Executive Officer, Sumitomo Mitsui Banking Corporation
Dec. 2002 Senior Managing Director, Sumitomo Mitsui Financial Group, Inc.
Jun. 2003 Deputy President and Executive Officer, Sumitomo Mitsui Banking Corporation
Jun. 2005 Chairman of the Board, Sumitomo Mitsui Financial Group, Inc. (current), and President and Chief Executive Officer, Sumitomo Mitsui Banking Corporation
Mar. 2014 Member of the Board, Kao Corporation (current)

Audit & Supervisory Board Members

Shoji Kobayashi

Full-time Audit & Supervisory Board Member

Apr. 1979 Joined the Company
Jun. 2006 Executive Officer
Apr. 2007 Vice President, Chemical Business Unit
Jun. 2010 President, Chemical Business Unit
Mar. 2013 Full-time Audit & Supervisory Board Member (current)

Teruo Suzuki[3]

Independent[5]

Audit & Supervisory Board Member, Certified Public Accountant

Aug. 1978 Registered as Certified Public Accountant
Jan. 2004 Partner, KPMG AZSA LLC
Jun. 2012 Audit & Supervisory Board Member, Kao Corporation (current)

Toshiharu Numata

Full-time Audit & Supervisory Board Member

Apr. 1989 Joined the Company
Jun. 2005 Executive Officer
Jun. 2006 Member of the Board, Executive Officer; and Senior Vice President, Research and Development
Jun. 2008 Member of the Board, Executive Vice President; Senior Vice President, Research and Development; and Responsible for Chemical Business, Product Quality Management; and TCR Promotion
May 2012 Member of the Board, Managing Executive Officer; Senior Vice President, Research and Development; and Responsible for Chemical Business Unit, Product Quality Management; TCR Promotion; and China Business
Jun. 2012 Senior Managing Executive Officer; President, Consumer Products and Chemical Business, China; Chairman of the Board and Chief Executive Officer, Kao (China) Holding Co., Ltd.; Chairman of the Board, Kao Commercial (Shanghai) Co., Ltd.; and Chairman of the Board, Kanebo Cosmetics (China) Co., Ltd.
Mar. 2015 Full-time Audit & Supervisory Board Member (current)

Norio Igarashi[3]

Independent[5]

Audit & Supervisory Board Member, Certified Public Accountant, Professor, Yokohama National University

Apr. 1977 Registered as Certified Public Accountant
Jul. 1988 Partner, Aoyama Audit Corporation and Price Waterhouse
Apr. 2007 Professor, Graduate School of International Social Sciences, Yokohama National University (current)
Mar. 2013 Audit & Supervisory Board Member, Kao Corporation (current)

Yumiko Waseda[3]

Independent[5]

Audit & Supervisory Board Member
Attorney-at-Law

Apr. 1985 Registered as an attorney-at-law Joined Masayuki Matsuda Law & Patent Offices (now Mori Hamada & Matsumoto, a law firm)
Apr. 2013 Joined Tokyo Roppongi Law & Patent Offices
Jan. 2014 Partner, Tokyo Roppongi Law & Patent Offices (current)
Mar. 2014 Audit & Supervisory Board Member, Kao Corporation (current)

Notes: 1. Holds the post of Executive Officer concurrently
2. Outside Director
3. Outside Audit & Supervisory Board Member
4. Reported to Tokyo Stock Exchange, Inc. as Independent Director as set forth in the Regulations of Tokyo Stock Exchange, Inc.
5. Reported to Tokyo Stock Exchange, Inc. as Independent Audit & Supervisory Board Member as set forth in the Regulations of Tokyo Stock Exchange, Inc.

Executive Officers and Executive Fellows

Executive Officers

Michitaka Sawada
President and Chief Executive Officer

Katsuhiko Yoshida
Senior Managing Executive Officer

President, Consumer Products
Responsible for Kao Professional Services Co., Ltd.

Toshiaki Takeuchi
Managing Executive Officer

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

Masumi Natsusaka
Managing Executive Officer

Responsible for Beauty Care Business
President, Beauty Care – Cosmetics Business Unit
Representative Director, President, Kanebo Cosmetics Inc.

Motohiro Morimura
Managing Executive Officer

Senior Vice President, Supply Chain Management
Senior Vice President, Environment and Safety Management
Responsible for TCR Promotion

Yasushi Aoki
Managing Executive Officer

Senior Vice President, Human Capital Development
Representative Director, Chairman of the Board, Kanebo Cosmetics Inc.
Member of the Board and Senior Executive Officer, Senior Vice President, Human Resources and Administration, Kanebo Cosmetics Inc.
President, Kao Group Corporate Pension Fund

Hideko Aoki
Managing Executive Officer

Senior Vice President, Product Quality Management

Yoshimichi Saita
Senior Vice President, Media Planning and Management

Kenji Miyawaki
Senior Vice President, Marketing Research and Development

Kazuyoshi Aoki
Senior Vice President, Accounting and Finance

Tadaaki Sugiyama
Senior Vice President, Legal and Compliance

Masakazu Negoro
President, Chemical Business Unit
Chairman of the Board, Fatty Chemical (Malaysia) Sdn, Bhd.
Chairman of the Board, Pilipinas Kao, Incorporated
Presidente, Kao Chemicals Europe, S.L.

Kozo Saito
President, Consumer Products – International Business Management
Chairman of the Board, Kao USA Inc.

Hideki Tanaka
Senior Vice President, Procurement

Takehiko Shinto
Representative Director, President, Kanebo Cosmetics Sales Inc.

Jun Shida
Vice President, Research and Development – Development Research – Health Care and Household

Yasushi Wada
Vice President, Supply Chain Management – Demand and Supply Planning Center

Tomoharu Matsuda
President, Beauty Care – Skin Care and Hair Care Business Unit

Yoshihiro Hasebe
Senior Vice President, Research and Development

Masayuki Abe
Senior Vice President, Information Systems

Naoki Komoda
President, Fabric and Home Care Business Unit

Hitoshi Hosokawa
Vice President, Research and Development – Development Research – Skin Care, Hair Care and Cosmetics

Hiroyuki Yamashita
Vice President, Supply Chain Management – Technology Development Center
Vice President, Supply Chain Management – Demand and Supply Planning Center – Human Health Care

Minoru Nakanishi
Regional Executive Officer, President, Consumer Products, Greater China
Chairman of the Board and President, Kao (China) Holding Co., Ltd.
Chairman of the Board, Kao Commercial (Shanghai) Co., Ltd.
Chairman of the Board, Kanebo Cosmetics (China) Co., Ltd.

Akemi Ishiwata
Senior Vice President, Corporate Communications

Satoru Tanaka
President, Human Health Care Business Unit

Executive Fellows

Corporate Executive Fellows who are treated as the same as the Company's Executive Officers will engage in activities to deepen the cooperation with outside parties by utilizing their expertise and outside network.

Yoshinori Takema
Corporate Executive Fellow[1]

Takuji Yasukawa
Corporate Executive Fellow[2]

Minoru Utsumi
Corporate Executive Fellow[2]

Notes: 1. Individual treated the same as the Company's Managing Executive Officers
2. Individual treated the same as the Company's Executive Officers

Compliance

Basic Policy

Kao upholds the principle of integrity, passed down from its founder, as one of the "Values" of its corporate philosophy, the Kao Way. "Integrity" means to behave lawfully and ethically and conduct fair and honest business activities. Kao regards integrity as the starting point of compliance and promotes it as a foundation for earning the respect and trust of all stakeholders.

Structure

Kao has established a Compliance Committee, chaired by a Managing Executive Officer and comprised of representatives of relevant divisions and affiliates. Once every six months, the committee (1) discusses the establishment and revision of Kao's code of conduct, the Kao Business Conduct Guidelines (BCG), and other internal compliance-related guidelines; (2) implements educational activities to promote the spread and establishment of corporate ethics both in Japan and overseas; and (3) monitors the operation of and responses to the compliance hotlines. The committee then reports important matters, provides an overview of activities and makes proposals to the Board of Directors as appropriate.

Preventing Bribery

In the BCG, Kao has made clear its strong stance against bribery by specifying that bribes shall not be given to or received from any third party, including government officials, private companies and individuals. Furthermore, the BCG prohibits "facilitation payments," which are small payments to government officials to speed up routine non-discretionary government actions.

To present this stance in a more specific form, the Kao Group has introduced its Anti-Bribery Guidelines, which includes detailed anti-bribery rules applicable Group-wide as well as operating procedures for the giving and receiving of entertainment and gifts, and for other matters geared to the business, country or region.

Verifying the Validity and Appropriateness of Compliance Activities

Based on its medium-to-long-term and annual action plans, Kao conducts compliance promotion activities including regular revision of the BCG, maintenance and operation of compliance hotlines, and Integrity Workshops. To confirm the validity and appropriateness of the activities being conducted so that they lead to more effective compliance activities, Kao has decided to ask the opinions of compliance promoters and general staff in all departments within the Company and obtain verification from a consulting firm outside the Company early in 2015 in order to establish action plans for subsequent years.

PDCA Cycle for Compliance Activities

The Kao Group's Compliance Activities (New activities planned are in red)

Plan

- Plan introduction and/or revision of BCG and compliance-related guidelines
- Plan establishment of Kao Group compliance hotlines (in new entities)
- Plan new educational measures
- Plan new measures based on employee opinions and third-party evaluation

Do

- Introduce and revise BCG and compliance-related guidelines
- Establish and operate Kao Group compliance hotlines
- Implement training based on plans
- Implement new educational measures based on employee opinions
- Implement training based on execution of new measures planned in line with third-party evaluation

Proactive investment

Check

- Self-check of activities (Division self-diagnoses, audit by Global Internal Audit, etc.)
- Ask employee opinions
- Third-party evaluation

Act

- Address issues that require improvement based on division self-diagnoses and third-party evaluation

Basic Policy and Structure

Kao visualizes the various risks pertaining to achieving the Kao Group's targets and its business activities and implements measures to reduce their frequency and influence. In addition, we make preparations and conduct necessary drills to minimize damages and loss in the event that such risk becomes a reality.

With regard to risks involved in business strategies, a responsible division reviews the progress of short-term and medium-to-long-term business plans, including business conditions, which form the basis of such strategies, and further identifies risks and considers and implements necessary countermeasures, in cooperation with related divisions.

With regard to operational risks, the Risk Management Committee, chaired by the Executive Officer in charge of Risk Management, verifies the furtherance of Group-wide risk management and establishes basic policies for the activities to be carried out upon each occurrence of disasters/accidents, product quality problems and other emergency situations, as well as preparation and operating plans of specific countermeasures, in accordance with the "Kao Risk Management Policy." In addition, in each division we appoint a member responsible for promoting risk management, who identifies, evaluates and considers measures to avoid or deal with operational risks on a regular basis.

In addition to the enhancement of operational risk management that it has conducted up to now, Risk Management, Corporate Strategy will enhance overall risk management by visualizing and formulating countermeasures for risks involved in business strategies that must be dealt with by the entire Kao Group.

In the event of an emergency, an emergency response organization will be established to respond to such a situation, centered on the responsible divisions and, depending on the graveness of the impact on the Kao Group as a whole, an emergency response headquarters will further be established in order to direct a prompt response to the situation with the President and Chief Executive Officer or another appropriate person acting as the head thereof.

The management status of the above-described business strategy and operational risks will be reported and discussed at the meeting of the Board of Directors or at the Executive Committee on a regular basis, and also in a timely manner whenever necessary.

Priority Themes

1. Identification of Risks That Could Seriously Affect Achievement of Management Targets and Business Activities and Strengthening of Countermeasures

Kao works to respond appropriately to strategic risks by having top management and responsible persons in each division review the progress of short-term plans and the Kao Group Mid-term Plan 2015 (K15), including the business conditions on which they are based, identifying risks and implementing necessary countermeasures.

With regard to operational risks, Kao will conduct risk surveys at key divisions in Japan as well as at Kao Group companies outside Japan to identify events that could seriously affect Kao Group business activities, factors in their occurrence, current countermeasures and issues. In addition, Kao will establish policies based on the results of these surveys and have the divisions responsible for the relevant risks formulate responses as a priority measure to reduce the impact on business activities.

2. Development and Strengthening of the Emergency Response System

As our business becomes more global, emergency situations that require our response broaden in scope to encompass accidents and disasters, political and social unrest and labor disputes. The impact on the business when such emergency situations occur is increasing in terms of both the scale and speed. We are developing and strengthening our emergency response system to be able to respond to these kinds of situations in Japan and overseas.

3. Strengthening the Business Continuity Plan

We will fulfill our responsibility to ensure the delivery of products that our customers need by formulating and continuously improving a business continuity plan that hypothesizes various events and their main causes that could have a serious negative impact on the continuity of our business activities, such as an operational stoppage due to a large-scale earthquake or an epidemic.

Topics

Changes in "Business Risks and Other Risks"

Kao has changed and revised the presentation of "Business Risks and Other Risks" based on its identification of serious strategic and operational risks that could have a negative impact on achievement of its management targets and its business activities. (For details, see "Business Risks and Other Risks" on page 41.)

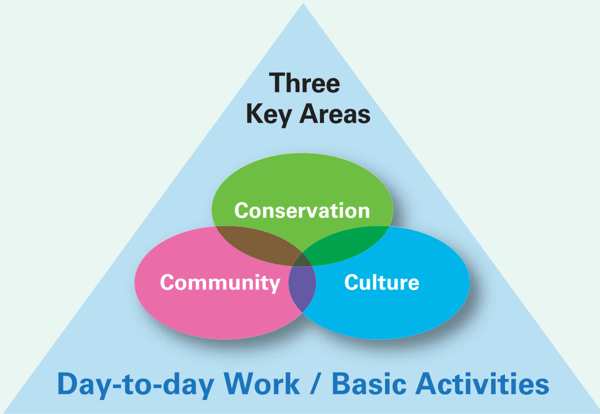
In 2015, Kao will work to evaluate and verify the status of management of these serious risks and further enhance its response.

Basic Policy

Based on its corporate philosophy, the Kao Way, the Kao Group contributes to realizing a sustainable society by working to find solutions to social issues through *Yoki-Monozukuri* tailored to the needs of the times and the community.

On July 1, 2013, we announced the Kao Sustainability Statement to share with stakeholders inside and outside the Kao Group our policy for achieving both corporate growth and a sustainable society as our business expands globally. With this statement as our point of reference, the Kao Group proactively seeks the trust and support of its stakeholders, aiming to enhance its contributions to a sustainable society.

Kao Sustainability Statement



Three Key Areas and Target Fields

To grow its business responsibly and sustainably, the Kao Group will focus its efforts on the three key areas of Conservation, Community and Culture. These were chosen for their compatibility with the mid-term plan and the Kao Group's corporate resources as well as their importance for resolving social issues.

	Conservation	Community	Culture
Fields	Reducing environmental impacts of our business activities	Engaging with communities through business	Integrity
	Environmental activities in partnership with stakeholders	Engaging with local communities through partnerships	Diversity and Inclusion

SRI[1] Indexes and External CSR[2] Evaluations

SRI indexes for which Kao has been selected

CSR-related evaluations from external organizations

Kao Corporation also received Gold Class 2015 and Industry Mover 2015

Notes: 1. SRI: Socially Responsible Investment
2. CSR: Corporate Social Responsibility

Environment

Basic Policy

In a society confronted with a range of global environmental challenges, such as the depletion of natural resources and global warming, Kao has adopted the mission of striving for the enrichment of the lives of people globally. In 2009, we announced the Kao Environmental Statement and medium-term objectives for 2020. The entire Kao Group will focus on manufacturing that reduces environmental impact and on ecology-centered management as it continue meeting its responsibilities as a user of chemicals. We recognize CO_2, water, chemical substances and biodiversity as four priority areas for taking action.

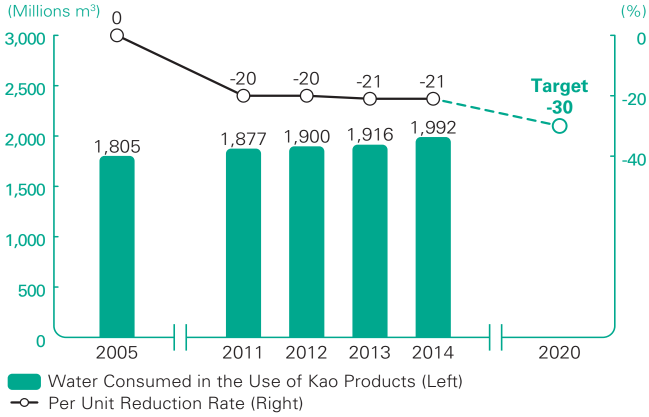
In addition, we conduct "eco together" activities to promote cooperation with our diverse stakeholders, including consumers, business partners and society, throughout the product lifecycle, from raw material procurement to production, logistics, sales, use and disposal. Outside Japan, we promote nationwide cleanliness and water-saving activities in China jointly with the Center for Environmental Education and Communications of the Ministry of Environmental Protection of China. Activities have the theme of "aiming to save 10,000 liters annually per household."

Initiatives for Water

Reducing Water Consumption during Product Use

For household laundering, which consumes a large amount of water, Kao launched the concentrated liquid laundry detergent *Attack Neo* in 2009. The use of ultra-concentration technology that requires only one laundry rinse cycle saves not only water but also electricity and time. In August 2013, we launched *Ultra Attack Neo*, which uses a new cleaning ingredient for high-performance, speedy laundering that powerfully removes dirt and odors with just five minutes of washing time. We have also introduced water-saving laundry detergents in China and Australia.

Changes in Water Consumption during Product Use[1]



Notes: 1. Water consumption during product use is defined as the amount of water used during the lifecycle of an individual consumer product in Japan, multiplied by annual unit sales.
2. Some data for 2005 have been retroactively modified.

For dishwashing, another activity that consumes a large amount of water, in August 2014 we launched an improved version of *CuCute* dishwashing detergent with higher cleaning power and faster rinsing.

Since 2010, our *Merit Shampoo* employs a component allowing swift rinsing of lather. The shampoo cuts rinse water by approximately 20 percent compared with the original version.

Initiatives at Plants and in Offices

Each of Kao's plants uses water as a product ingredient, as well as to clean and cool equipment. To reduce use, Pilipinas Kao, Inc. closely monitors the amount of water it uses. As a measure to reuse water, the Sumida Complex in Japan, Fatty Chemical (Malaysia) Sdn. Bhd. and other sites collect rainwater and use it to water green spaces. Moreover, we promote measures to recycle water by cleaning and reusing water used in certain processes.

2020 Medium-term Objectives

CO_2	Consumer products: 35% reduction (across product lifecycle, per unit sales in Japan, relative to FY2005)
Water	Water consumption during product use: 30% reduction (per unit sales in Japan, relative to FY2005)
Chemical substances	Active implementation of the Strategic Approach to International Chemicals Management (SAICM) to promote sound chemical management
Biodiversity	Implementation of measures to protect biodiversity through responsible raw material procurement and other measures

Notes: 1. With regard to commercial/industrial products, CO_2 reduction and resource conservation measures will be undertaken jointly with customers.
2. These medium-term objectives represent a first step in ongoing environmental activities that will continue to be expanded in the future.

Supply Chain

Basic Policy

Kao is further enhancing its competitiveness in global markets with the aim of becoming a company with a global presence. For that purpose, we conduct procurement with fairness, legal compliance and the highest ethics. In order to achieve a sustainable society, we give full consideration to preservation of natural resources, conservation, safety and human rights, striving to fulfill our corporate social responsibilities.

Initiatives

Sustainable Procurement of Raw Materials

In recognition of the risks to sustainable development from scarcity of resources, degradation of biodiversity, climate change and other environmental problems, as well as human rights issues, Kao strives for sustainable procurement of raw materials. These initiatives require comprehensive engagement of the supply chain. In particular, we work toward climate change mitigation by participating in the CDP Supply Chain Project[1] while requiring major suppliers to disclose and reduce greenhouse gas emissions. In addition, in cooperation with our suppliers, we are streamlining distribution and reducing the environmental impact of procured products.

In particular, recognizing the dependence of its businesses on natural capital, Kao is committed to zero deforestation at the source in its procurement of raw materials including palm oil and paper. Over the medium-to-long term, Kao strives to reduce its use of natural capital by reducing the amount of raw materials used in its business and shifting to alternative raw materials such as algae or other non-edible biomass sources, in addition to working toward sustainable procurement that also takes into account ethical issues that have emerged due to globalization.

Specific activities are as follows.

1. Procurement of Sustainable Raw Materials

Under procurement guidelines that were revised in 2014, Kao declared its goal of switching to procurement of sustainable raw materials for palm oil, paper and pulp by 2020 as an initiative toward zero deforestation. Kao has joined the Roundtable on Sustainable Palm Oil and received supply chain certification at its related plants for procurement of certified palm oil and palm kernel oil. By 2020, Kao aims to purchase only sustainable palm oil and palm kernel oil that is traceable to the plantation.

As for procurement of paper and pulp, by 2020 Kao aims to purchase only recycled paper or sustainably sourced paper and pulp for use in its consumer products, packaging and office paper. In particular, by 2020 Kao aims to purchase only pulp for raw materials that is traceable to the source.

2. Sustainable Sourcing of Plant Resources

In recognition of the problems of the scarcity of plant resources and plunder of resources, Kao purchases plant resources in consideration of access and benefit sharing (ABS),[2] and continues initiatives to diversify sourcing routes and to convert from natural to cultivated plants, considering the natural environment and local communities at their source.

3. Initiatives to Reduce Dependence on Petrochemical Resources in Packaging

Kao continues efforts to reduce total volume of plastics used through minimization of container size and development of refill containers, while promoting use of biomass materials such as plant-based polyethylene in containers and packaging.

Notes: 1. CDP refers to cooperation between institutional investors and major corporations in climate change initiatives and promotion of disclosure of greenhouse gas emissions. The Supply Chain Project refers to cooperation between the CDP and corporations, with corporations requesting their suppliers to disclose information regarding climate change; this project affects the entire supply chain.
2. Access to genetic resources and the fair and equitable sharing of benefits arising from their utilization, as defined by the Convention on Biological Diversity

Diversity & Inclusion

Basic Policy

Based on the recognition that the vitality generated by diversity supports business development, we aim to realize an organization in which each individual's diverse skills, personality and values are included and mobilized to enhance the company's collective strength with the aim of becoming a company with a global presence.

As we work to open up appropriate paths to employees with motivation and ability, we are also continuing our awareness efforts, with the goal of achieving a corporate culture that allows a diverse range of employees to flourish.

Development of Diverse Human Resources

Kao works to fairly evaluate and promote each individual employee, and to develop those with motivation and ability into global leaders, regardless of gender, nationality, or other factors. The Global Leadership Development Program (GLDP) is a global program in which members selected from companies in the Kao Group study Kao management issues from a broader perspective and make proposals to executive management. Half of the participants of the GLDP, which has been held since 2010, are employees of subsidiaries and affiliates outside Japan and engage in vigorous discussions.

Expanding the Number of Female Managers

Evaluating and promoting female employees based on their ambition and abilities and not attributes such as gender leads to expanded roles for female employees. In 2010, a woman was appointed Managing Executive Officer in charge of quality assurance and continues to hold this position today.

Kao's percentage of female employees continues to rise and reached 27.6 percent as of December 2014 for the Kao Group. The percentage of female managers in the Kao Group in Japan is 10.1 percent. The current percentages of female employees and female managers in the Kao Group are shown below.

Policy for the Future

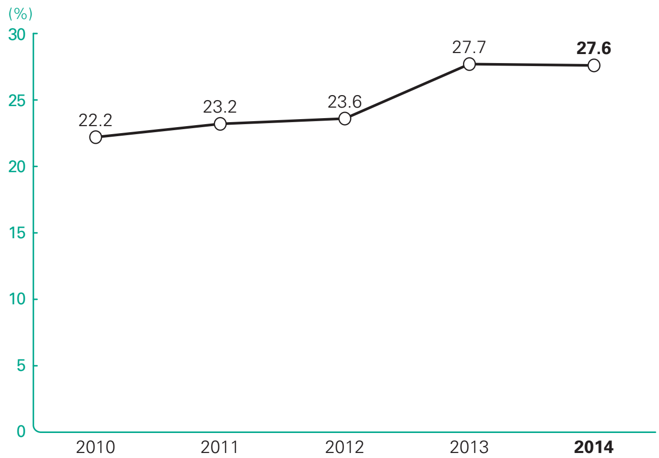
We will further promote the advancement of diverse personnel to leadership positions as we make detailed enhancements to support measures from an on-site perspective, build mechanisms to support women's career formation and increase options for ways of working. In addition, we will steadily work to increase the number of female managers (toward a short-term milestone of 30 percent globally and 15 percent in Japan) by striving to raise awareness of different ways of working and change the workplace environment.

Composition of Kao Group Employees and Managers

(As of December 31, 2014)

	Employees	Female employees (%)	Managers	Female managers (%)
Japan	24,013	13,815 (57.5%)	2,539	257 (10.1%)
Asia (excluding Japan)	8,975	4,532 (50.5%)	954	463 (48.5%)
Americas and Europe	4,242	2,108 (49.7%)	1,168	566 (48.5%)
Total	37,230	20,455 (54.9%)	4,661	1,286 (27.6%)

Change in Percentage of Female Managers



Financial Section

11-Year Summary	32
Management Discussion and Analysis	34
Consolidated Financial Statements	44
Notes to Consolidated Financial Statements	50
Independent Auditor's Report	75

11-Year Summary

Kao Corporation and Consolidated Subsidiaries

Years ended December 31, 2014 to 2012, period ended December 31, 2012, and years ended March 31, 2012 to 2005.	Millions of yen			
	Dec. 2014	Dec. 2013	Dec. 2012 (Restated)	Dec. 2012
For the year:				
Net sales	¥1,401,707	¥1,315,217	¥1,220,359	¥1,012,595
Business Segments				
Beauty Care Business	589,907	570,268	537,814	444,425
Human Health Care Business	240,077	210,628	189,614	151,977
Fabric and Home Care Business	324,505	311,023	291,988	236,748
Consumer Products Business	1,154,489	1,091,919	1,019,416	833,150
Chemical Business	288,022	261,192	236,473	208,071
Eliminations	(40,804)	(37,894)	(35,530)	(28,626)
Former Segments				
Consumer Products	—	—	—	—
Prestige Cosmetics	—	—	—	—
Chemical Products	—	—	—	—
Eliminations	—	—	—	—
Geographic Area				
Japan	997,309	959,405	933,767	720,789
Asia	244,903	199,655	160,005	159,857
Asia and Oceania	—	—	—	—
Americas	124,216	108,599	89,998	89,998
North America	—	—	—	—
Europe	152,056	134,168	110,519	110,519
Eliminations	(116,777)	(86,610)	(73,930)	(68,568)
Operating income	133,270	124,656	111,791	101,567
Net income	79,590	64,764	53,107	52,765
Capital expenditures	68,484	63,687	—	41,929
Depreciation and amortization	79,660	77,297	—	59,788
Cash flows	125,436	109,497	—	80,200
Research and development expenditures	51,739	49,650	—	37,493
(% of sales)	3.7%	3.8%	—	3.7%
Advertising expenditures	92,410	86,406	—	67,045
(% of sales)	6.6%	6.6%	—	6.6%
At year end:				
Total assets	1,198,233	1,133,276	—	1,030,347
Net worth	658,232	628,709	—	582,699
Number of employees	32,707	33,054	—	33,350
	Yen			
Per share:				
Net income	¥ 156.46	¥ 126.03	¥101.77	¥ 101.12
Cash dividends	70.00	64.00	—	62.00
Net worth	1,313.63	1,227.54	—	1,116.61
Weighted average number of shares outstanding during the period (in thousands)	508,687	513,880	—	521,824
	%			
Key financial ratios:				
Return on sales	5.7%	4.9%	4.4%	5.2%
Return on equity	12.4	10.7	9.5	9.4
Net worth ratio	54.9	55.5	—	56.6

Notes: 1. Due to a change in the fiscal year end, the term of consolidation for the fiscal period ended December 31, 2012 consists of the nine months from April to December for Kao Corporation and its subsidiaries whose fiscal year end was previously March 31 and the twelve months from January to December for subsidiaries whose fiscal year end was December 31.

2. December 2012 (Restated) represents figures for the year from January 1 to December 31, 2012, for Kao Group companies whose fiscal year end was previously March 31.
3. As of January 2014, certain changes have been made in inter-company transactions among subsidiaries in the Consumer Products Business in the Americas and Europe.
4. Australia and New Zealand, which had been included in Asia and Oceania until the fiscal year ended March 31, 2012, have been reclassified under Americas from the fiscal period ended December 31, 2012.
5. 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 segments. Figures for March 2007 have been restated to reflect the change.
6. Net sales by segment include intersegment sales. Under the former segments, net sales of Chemical Products include intersegment sales to Consumer Products and Prestige Cosmetics. Under the current 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.

Millions of yen							
Mar. 2012	Mar. 2011	Mar. 2010	Mar. 2009	Mar. 2008	Mar. 2007	Mar. 2006	Mar. 2005
¥1,216,096	¥1,186,831	¥1,184,385	¥1,276,316	¥1,318,514	¥1,231,808	¥ 971,230	¥936,851
537,938	533,514	547,944	588,330	627,914	584,284	—	—
181,758	175,761	183,151	191,319	191,300	183,608	—	—
285,645	279,008	276,918	274,202	274,657	269,519	—	—
1,005,341	988,283	1,008,013	1,053,851	1,093,871	1,037,411	—	—
247,635	231,997	207,834	262,058	258,674	223,609	—	—
(36,880)	(33,449)	(31,462)	(39,593)	(34,031)	(29,212)	—	—
—	—	—	—	—	744,748	704,034	690,007
—	—	—	—	—	292,663	85,247	78,294
—	—	—	—	—	223,609	208,890	196,989
—	—	—	—	—	(29,212)	(26,941)	(28,439)
925,339	912,443	918,499	953,369	968,594	924,196	708,056	703,085
—	—	—	—	—	—	—	—
173,588	152,361	131,699	161,927	158,295	125,989	110,898	100,282
—	—	—	—	—	—	—	—
85,397	80,328	79,200	98,999	111,017	106,731	95,168	83,638
117,005	112,123	111,158	140,623	154,648	135,918	109,486	93,804
(85,233)	(70,424)	(56,171)	(78,602)	(74,040)	(61,026)	(52,378)	(43,958)
108,590	104,591	94,034	96,800	116,253	120,858	120,135	121,379
52,435	46,738	40,507	64,463	66,562	70,528	71,140	72,180
47,178	49,101	44,868	44,624	49,045	70,143	203,595	54,318
79,798	81,380	84,778	87,463	93,444	92,171	60,758	56,794
101,960	97,028	95,269	122,441	131,114	134,906	107,943	109,704
48,171	45,516	44,911	46,126	45,070	44,389	40,262	39,764
4.0%	3.8%	3.8%	3.6%	3.4%	3.6%	4.1%	4.2%
82,209	81,082	86,359	90,258	99,176	96,892	83,770	84,157
6.8%	6.8%	7.3%	7.1%	7.5%	7.9%	8.6%	9.0%
991,272	1,022,799	1,065,751	1,119,676	1,232,601	1,247,797	1,220,564	688,974
538,030	528,895	565,133	545,230	574,038	564,532	509,676	448,249
34,069	34,743	34,913	33,745	32,900	32,175	29,908	19,143
Yen							
¥ 100.46	¥ 87.69	¥ 75.57	¥ 120.25	¥ 122.53	¥ 129.41	¥ 130.58	¥ 131.16
60.00	58.00	57.00	56.00	54.00	52.00	50.00	38.00
1,031.08	1,013.05	1,054.31	1,017.19	1,070.67	1,035.66	935.11	821.47
521,936	532,980	536,009	536,085	543,228	544,996	544,127	549,626
%							
4.3%	3.9%	3.4%	5.1%	5.0%	5.7%	7.3%	7.7%
9.8	8.5	7.3	11.5	11.7	13.1	14.9	16.5
54.3	51.7	53.0	48.7	46.6	45.2	41.8	65.1

7. 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, 2006. The results of Kanebo Cosmetics Inc., which had a fiscal year ended December 31, are included for the eleven months starting in February 2006, after the company was added to the Kao Group.
8. Net sales by geographic area including interregion sales are classified based on the location of Kao Group companies.
9. Cash flows are defined as net income plus depreciation and amortization minus cash dividends.
10. Net income per share is computed based on the weighted average number of shares outstanding during the respective years. The portion of net income unavailable to common shareholders, such as preferred dividends, which should be 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.
11. Cash dividends per share are the amounts applicable to the respective years, including dividends to be paid after the end of the year.
12. Net worth is equity, excluding minority interests and stock acquisition rights.
13. In calculating return on equity, equity excludes minority interests and stock acquisition rights.

Management Discussion and Analysis

Overview of Consolidated Results

During the fiscal year ended December 31, 2014, the global economy showed weakness in some sectors but recovered moderately. In the Japanese economy, although weakness was apparent in personal consumption and elsewhere, a moderate recovery trend continued. The household and personal care products market in Japan, a key market for the Kao Group, grew by 2 percent on a value basis and consumer purchase prices increased, both compared with the previous fiscal year. In addition, the cosmetics market in Japan was flat compared with the previous fiscal year.

Under these circumstances, the Kao Group worked to launch and nurture products with high added value in response to changes in consumer needs based on its concept of *Yoki-Monozukuri*,* which emphasizes research and development geared to customers and consumers. The Kao Group also worked to the utmost to supply products responding to the last-minute surge in demand associated with the consumption tax rate increase in Japan in April 2014, and strove to stimulate the market by launching numerous new and improved products after the consumption tax rate increase.

Regarding Kanebo Cosmetics brightening products containing the ingredient Rhododenol, for which a voluntary recall was announced on July 4, 2013, the Kao Group has been wholeheartedly supporting the recovery and compensation of people who have experienced vitiligo-like symptoms and is working to prevent a recurrence.

Net sales increased 6.6 percent compared with the previous fiscal year to ¥1,401.7 billion (US$11,725.8 million).

Operating income increased ¥8.6 billion compared with the previous fiscal year to ¥133.3 billion (US$1,114.9 million) and net income increased ¥14.8 billion compared with the previous fiscal year to ¥79.6 billion (US$665.8 million).

* The Kao Group defines *Yoki-Monozukuri* as a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction. In Japanese, *Yoki* literally means "good/excellent," and *Monozukuri* means "development/manufacturing of products."

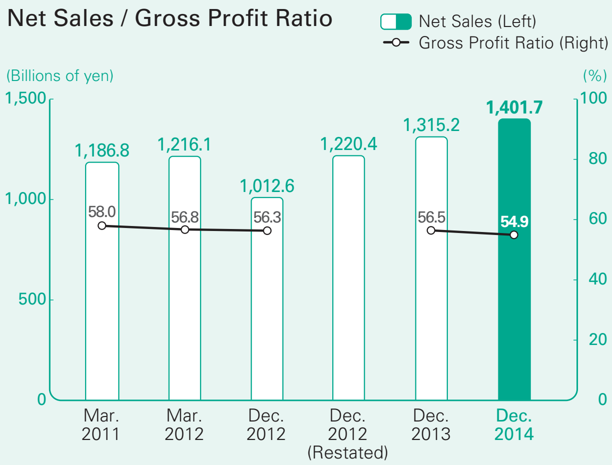
Analysis of Income Statement

Net sales increased 6.6 percent compared with the previous fiscal year to ¥1,401.7 billion (US$11,725.8 million). Excluding the effect of currency translation, net sales would have increased 4.7 percent. In the Consumer Products Business, sales and market share both grew in Japan due to the launch of numerous high-value-added products and proactive sales activities, although there was an impact from adverse weather conditions during the summer. Sales in Asia also continued to grow steadily. Sales in the Chemical Business increased as the Kao Group worked to adjust selling prices in connection with higher prices for natural fats and oils used as raw materials and to increase sales volume.

Despite aggressively increased marketing and other expenses for new and improved products and the impact of higher prices for raw materials, operating income increased ¥8.6 billion compared with the previous fiscal year to ¥133.3 billion (US$1,114.9 million) due to the effect of increased sales of the Consumer Products Business in Japan and Asia and the Chemical Business.

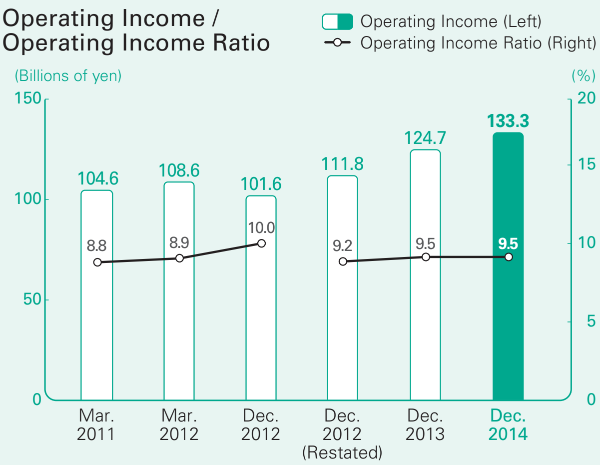
(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

Net Sales / Gross Profit Ratio



Note: The gross profit ratio has not been disclosed for the year ended December 31, 2012.

Operating Income / Operating Income Ratio



Costs, Expenses and Income as Percentages of Net Sales

Years ended December 31, 2014 and 2013, and period ended December 31, 2012	Dec. 2014	Dec. 2013	Dec. 2012
Cost of sales	45.1%	43.5%	43.7%
Gross profit	54.9	56.5	56.3
Selling, general and administrative expenses	45.4	47.0	46.3
Operating income	9.5	9.5	10.0
Income before income taxes and minority interests	9.0	8.7	10.1
Net income	5.7	4.9	5.2

Net income increased ¥14.8 billion compared with the previous fiscal year to ¥79.6 billion (US$665.8 million). The Kao Group recorded ¥8.9 billion (US$74.4 million) in compensation-related and other expenses in connection with brightening products containing Rhododenol.

Net income per share was ¥156.46 (US$1.31), an increase of ¥30.43, or 24.1 percent, from ¥126.03 in the previous fiscal year.

Information by Segment

Consumer Products Business

Sales increased 5.7 percent compared with the previous fiscal year to ¥1,154.5 billion (US$9,657.8 million). Excluding the effect of currency translation, sales would have increased 4.3 percent.

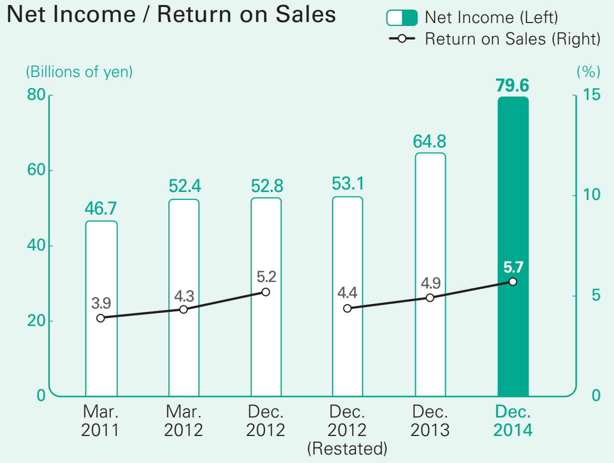
In Japan, sales increased 3.9 percent to ¥900.0 billion (US$7,529.1 million). Sales and market share both grew as the Kao Group responded to changing consumer lifestyles and social issues such as the environment, health, the aging society and hygiene, and enhanced proposal-based sales, among other measures, while working to supply products responding to the last-minute surge in demand associated with the consumption tax rate increase and striving to stimulate the market by launching numerous new and improved products after the consumption tax rate increase.

In Asia, sales increased 20.7 percent to ¥140.5 billion (US$1,175.3 million). Excluding the effect of currency translation, sales would have increased 16.1 percent. Sales continued to grow as the Kao Group worked in areas such as launching and nurturing products targeting the middle-class consumer segment, collaborating with retailers, utilizing wholesale channels and expanding sales regions.

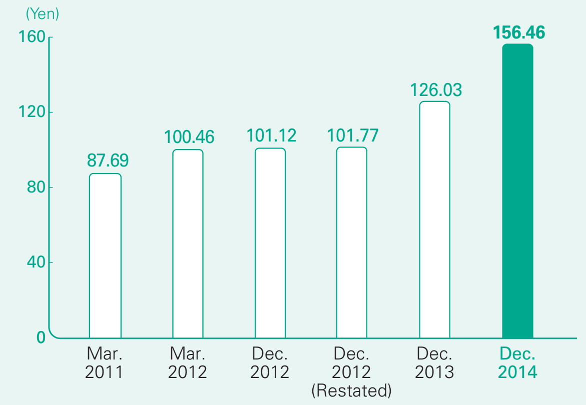
In the Americas, sales increased 15.9 percent to ¥79.9 billion (US$668.0 million). Excluding the effect of currency translation, sales would have increased 7.8 percent. Sales based on the same inter-company transaction method used in the previous fiscal year would have increased 7.5 percent (an increase of 0.1 percent excluding the effect of currency translation).

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

Net Income / Return on Sales



Net Income per Share



Excluding the effect of currency translation, sales of skin care products increased and sales of hair care products decreased compared with the previous fiscal year.

In Europe, sales increased 16.7 percent to ¥84.2 billion (US$704.6 million). Excluding the effect of currency translation, sales would have increased 7.9 percent. Sales based on the same inter-company transaction method used in the previous fiscal year would have increased 9.1 percent (an increase of 0.8 percent excluding the effect of currency translation). Excluding the effect of currency translation, sales of cosmetics increased and sales of hair care products decreased compared with the previous fiscal year.

Operating income increased ¥8.3 billion compared with the previous fiscal year to ¥111.3 billion (US$930.8 million) due to the effect of increased sales in Japan and Asia associated with aggressively increased marketing and other expenses for new and improved products, despite the impact of higher prices for raw materials.

Note: The Kao Group's Consumer Products Business consists of the Beauty Care Business, the Human Health Care Business, and the Fabric and Home Care Business.

Beauty Care Business

Sales increased 3.4 percent compared with the previous fiscal year to ¥589.9 billion (US$4,934.8 million). Excluding the effect of currency translation, sales would have increased 1.3 percent.

Sales of cosmetics increased 1.4 percent compared with the previous fiscal year to ¥260.6 billion (US$2,180.4 million). Excluding the effect of currency translation, sales would have increased 0.3 percent. In Japan, sales were flat compared with the previous fiscal year, due in part to adverse weather conditions during the summer and a delayed recovery from the pullback following the consumption tax rate increase. The Kao Group continued to work to reinforce focal brands and expanded sales of *SOFINA Primavista* base makeup, *ALBLANC* skin care products and the new *DEW beauté* aging care line in counseling cosmetics, as well as renewed *KATE TOKYO* makeup in self-selection cosmetics. Outside Japan, sales increased compared with the previous fiscal year, excluding the effect of currency translation, due in part to growth in sales from the renewal of *Molton Brown*, a prestige brand from the United Kingdom.

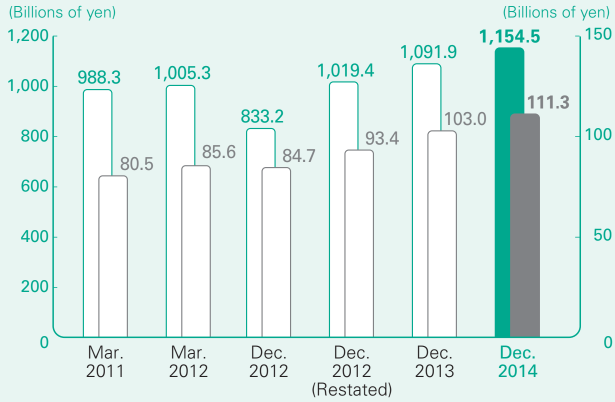
Sales of skin care products increased compared with the previous fiscal year. In Japan, sales increased with strong performance by *Bioré* facial cleanser, *Bioré U* body cleanser and *Curél* derma care products, including new and improved products. In Asia, *Bioré* performed steadily and sales grew. In the Americas, sales excluding the effect of currency translation increased compared with the previous fiscal year, due in part to the launch of improved *Jergens* hand and body lotion products.

Sales of hair care products were flat compared with the previous fiscal year. In Japan, although hair coloring products were impacted by market contraction, sales increased with strong performance by shampoos, conditioners and hair styling products, including the contribution from *Essential* and other new and improved products. In Asia, sales decreased compared with the previous fiscal year due to narrowing down the brands. In the Americas and Europe, the Kao Group launched an improved styling product line from *John Frieda*,

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

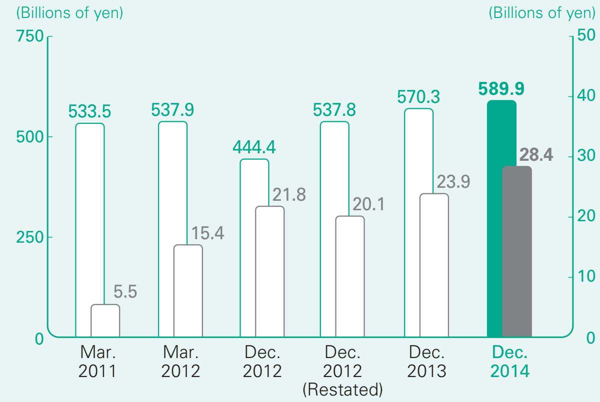
Consumer Products Business

Net Sales / Operating Income



Beauty Care Business

Net Sales / Operating Income



but sales excluding the effect of currency translation decreased compared with the previous fiscal year in the severe competitive environment.

Operating income increased ¥4.5 billion compared with the previous fiscal year to ¥28.4 billion (US$237.9 million) due to the effect of increased sales and other factors. Operating income before amortization of goodwill and other items related to acquisitions (EBITA) increased ¥3.2 billion compared with the previous fiscal year to ¥57.3 billion (US$478.9 million), which is equivalent to 9.7 percent of sales.

Human Health Care Business

Sales increased 14.0 percent compared with the previous fiscal year to ¥240.1 billion (US$2,008.3 million). Excluding the effect of currency translation, sales would have increased 12.8 percent.

Sales of food and beverage products decreased compared with the previous fiscal year in a severe market environment, despite efforts in green tea to strengthen promotion of the function of tea catechins in increasing the body's fat-burning ability and the launch of an improved coffee drink with enhanced flavor, both under the *Healthya* brand of functional drinks that promote body fat utilization.

Sales of sanitary products increased substantially compared with the previous fiscal year. The *Laurier* brand of sanitary napkins increased its market share in Japan due to growth in sales of high-value-added products such as *Laurier F*, which protects skin from dampness and chafing, and *Laurier Slim Guard*, which offers both high absorbency and comfort. *Laurier* sales also increased steadily in Asia.

Merries baby diapers continued to sell strongly in Japan, where the Kao Group increased production capacity, and sales also grew in China and Russia. Regarding locally produced products targeting the middle-class consumer segment, the Kao Group worked to expand sales of products launched in China in 2013 and began sales in Indonesia in September 2014.

Sales of personal health products increased compared with the previous fiscal year. Sales of oral care products were flat, although the Kao Group launched improved products and nurtured high-value-added products. Sales of bath additives were flat, due in part to stiff competition, but sales of *MegRhythm* steam thermo power pads increased substantially.

Operating income increased ¥5.0 billion compared with the previous fiscal year to ¥21.9 billion (US$183.0 million) due to the effect of increased sales and cost reduction activities, although higher raw material prices had an impact.

Fabric and Home Care Business

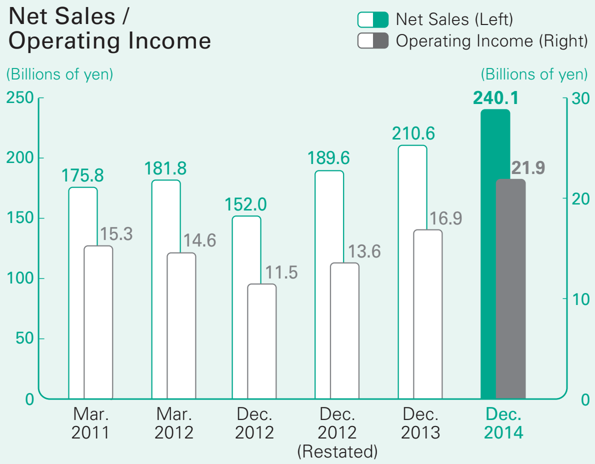
Sales increased 4.3 percent compared with the previous fiscal year to ¥324.5 billion (US$2,714.6 million). Excluding the effect of currency translation, sales would have increased 4.1 percent.

Sales of fabric care products increased compared with the previous fiscal year. In Japan, the Kao Group's efforts to highlight the environmental appeal of conserving water, electricity and resources with the *Neo* series included promotion of the reduced laundry time resulting from the strong cleaning power of *Ultra Attack Neo* ultra-concentrated liquid laundry detergent and an improved version of *Attack Neo Antibacterial EX W Power* ultra-concentrated liquid

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

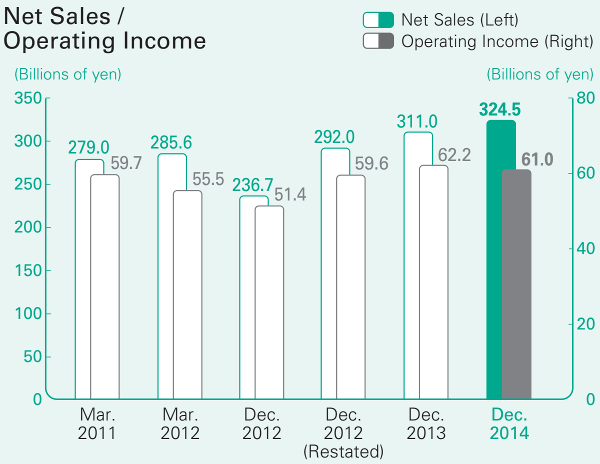
Human Health Care Business

Net Sales / Operating Income



Fabric and Home Care Business

Net Sales / Operating Income



laundry detergent containing more of an anti-mold agent, which was launched in May 2014. For *Attack Reset Power* powder laundry detergent, the Kao Group stimulated the powder laundry detergent market with the launch of a refill product that reduces environmental impact. Due in part to these activities, sales of laundry detergent increased despite the impact of adverse weather conditions during the summer. In fabric softeners, the Kao Group launched *Humming Fine* with a deodorant effect that lasts for 24 hours, and both it and *Flair Fragrance* performed firmly. *Wide Haiter EX Power*, a fabric bleach for color garments with strengthened deodorizing and antibacterial functions, performed well. In Asia, sales increased compared with the previous fiscal year. For *Attack* laundry detergent, sales increased in Indonesia due in part to the launch of *Attack Jaz1*, a powder detergent for hand washing targeting the middle-class consumer segment, and in Taiwan and Hong Kong, where liquid laundry detergent with a strengthened antibacterial function that was launched in 2013 performed well.

Sales of home care products increased compared with the previous fiscal year. In Japan, the Kao Group launched an improved version of *CuCute* dishwashing detergent with an innovative washing formulation for significantly higher cleaning power as well as both long-lasting suds and easy rinsing, and it performed well. Sales of household cleaners increased due in part to contributions from *Bath Magiclean Antibacterial Deodorizer Plus* bathroom cleaner and new *Magiclean Brightening Sheets* home cleaner. In addition, sales of *Quickle Wiper* household mop kits and sheets also grew.

Operating income decreased ¥1.2 billion compared with the previous fiscal year to ¥61.0 billion (US$509.9 million) due in part to aggressively increased marketing and other expenses for new and improved products and the impact of higher raw material prices, despite the effect of increased sales and other factors.

Chemical Business

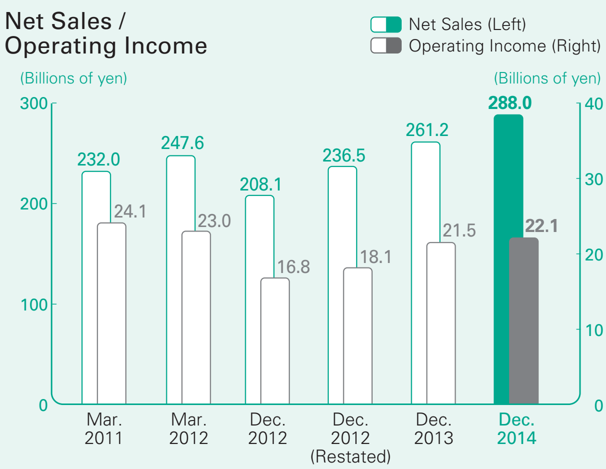
Sales increased 10.3 percent compared with the previous fiscal year to ¥288.0 billion (US$2,409.4 million). Excluding the effect of currency translation, sales would have increased 6.7 percent.

Amid overall weakness in customer industries in Japan, demand increased in certain customer industries, including export-related industries due to the depreciation of the yen and those related to reconstruction following the Great East Japan Earthquake in March 2011. Conditions remained firm in the Americas, and a moderate recovery became apparent in Europe.

In oleo chemicals, the Kao Group worked to increase sales volume of fatty alcohols, for which it expanded its facilities in 2013, and to adjust selling prices in connection with higher prices for natural fats and oils used as raw materials. In performance chemicals, sales were firm as the Kao Group worked to develop and expand sales of high-value-added products with reduced environmental impact. Sales of specialty chemicals were flat compared with the previous fiscal year despite structural changes in the personal computer market, as the Kao Group worked to offer products adapted to customer needs.

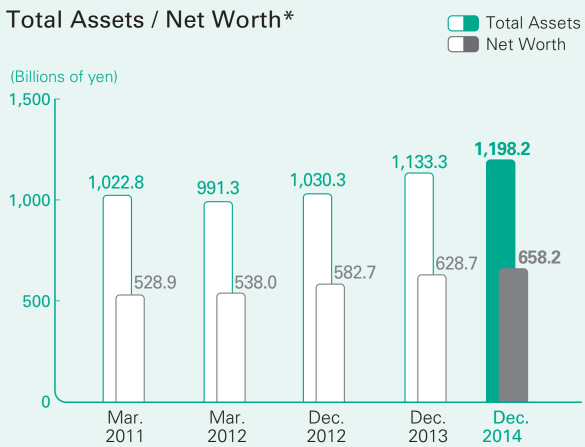
(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2012 to 2014)

Chemical Business



Note: Net sales include intersegment sales.

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2013 and 2014)



* Net worth is equity, excluding minority interests and stock acquisition rights.

Operating income increased ¥0.6 billion compared with the previous fiscal year to ¥22.1 billion (US$184.5 million), despite the impact of higher prices for natural fats and oils used as raw materials, due to the effect of increased sales resulting from selling price adjustments and growth in sales volume, as well as cost reduction activities.

Financial Structure

Total assets increased ¥65.0 billion from the end of the previous fiscal year to ¥1,198.2 billion (US$10,023.7 million). The principal increases in assets were a ¥22.8 billion increase in notes and accounts receivable – trade, a ¥22.0 billion increase in short-term investments, a ¥12.4 billion increase in finished goods, a ¥6.3 billion increase in work in process and raw materials, a ¥30.3 billion increase in property, plant and equipment, and a ¥9.7 billion increase in asset for retirement benefits. The principal decreases in assets were an ¥18.9 billion decrease in cash and time deposits and a ¥24.7 billion decrease in intangible assets due to the progress of amortization of trademarks and other intellectual property rights and goodwill.

Total liabilities increased ¥35.2 billion from the end of the previous fiscal year to ¥525.8 billion (US$4,398.9 million). The principal increases in liabilities were a ¥12.0 billion increase in notes and accounts payable – trade, a ¥10.4 billion increase in notes and accounts payable – other, a ¥3.6 billion increase in accrued expenses and a ¥6.9 billion increase in liability for loss related to cosmetics. The principal decreases in liabilities were a ¥4.2 billion decrease in income taxes payable and a ¥6.4 billion decrease in liability for retirement benefits.

Total equity increased ¥29.8 billion from the end of the previous fiscal year to ¥672.4 billion (US$5,624.8 million). The principal increases in equity were net income totaling ¥79.6 billion, foreign currency translation adjustments of ¥23.6 billion and remeasurements of defined benefit plans totaling ¥8.2 billion (post retirement liability adjustments for foreign consolidated subsidiaries at the end of the previous fiscal year). The principal decreases in equity were a ¥50.0 billion decrease due to purchase of treasury stock and payments of dividends from retained earnings totaling ¥33.8 billion. In December 2014, Kao Corporation retired treasury stock.

As a result, the net worth ratio (defined as net worth divided by total assets) was 54.9 percent compared with 55.5 percent at the end of the previous fiscal year.

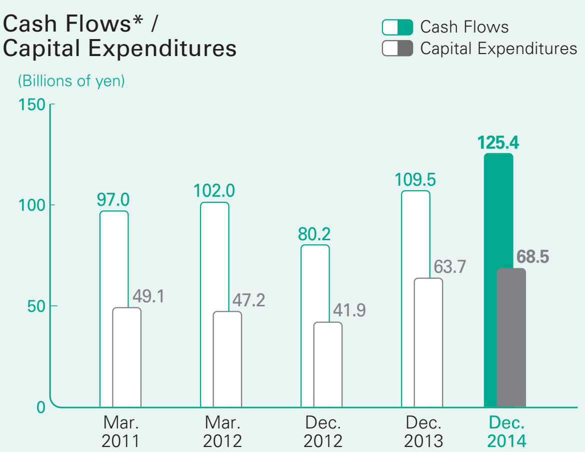
Cash Flows

The balance of cash and cash equivalents at December 31, 2014 increased ¥1.1 billion compared with the end of the previous fiscal year to ¥228.7 billion (US$1,912.8 million).

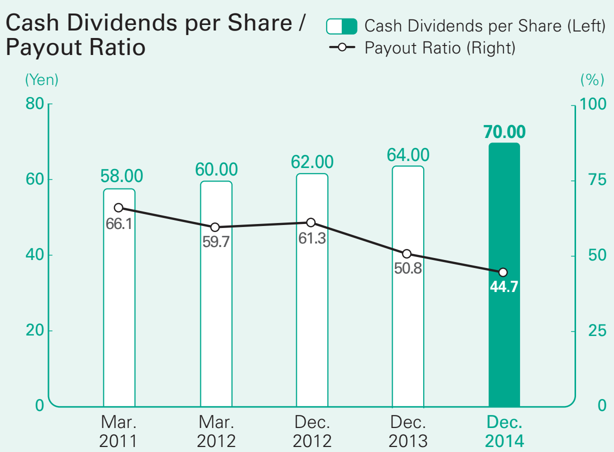
Cash Flows from Operating Activities

Net cash provided by operating activities totaled ¥145.1 billion (US$1,214.0 million). The principal increases in net cash were income before income taxes and minority interests of ¥126.8 billion, depreciation and amortization of ¥79.7 billion and

(Years ended March 31, 2011 and 2012, period ended December 31, 2012 and years ended December 31, 2013 and 2014)



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



change in trade payables of ¥6.7 billion. The principal decreases in net cash were change in trade receivables of ¥11.0 billion, change in inventories of ¥12.4 billion and income taxes paid of ¥49.3 billion.

Cash Flows from Investing Activities

Net cash used in investing activities totaled ¥63.8 billion (US$533.8 million). This primarily consisted of ¥51.2 billion for purchase of property, plant and equipment and ¥4.5 billion for purchase of intangible assets.

Cash Flows from Financing Activities

Net cash used in financing activities totaled ¥85.0 billion (US$711.2 million). This primarily consisted of ¥50.0 billion for purchase of treasury stock and ¥35.0 billion for payments of cash dividends, including to minority shareholders. In September 2014, Kao Corporation repaid ¥20.0 billion in borrowings and borrowed the same amount in the same month to maintain an appropriate capital cost ratio and to enhance its financial base for investment in growth.

Basic Policies Regarding Distribution of Profits and Dividends for the Period

In order to achieve profitable growth, Kao Corporation (the Company) secures an internal reserve for capital investment and acquisitions from a medium-to-long-term management perspective and places priority on providing shareholders with steady and continuous dividends. In addition, the Company flexibly considers share repurchase and retirement of treasury stock from the standpoint of improving capital efficiency.

In accordance with these policies, the Company announced a year-end dividend for the fiscal year ended December 31, 2014 of ¥36.00 (US$0.31) per share, an increase of ¥4.00 per share compared with the previous fiscal year. Consequently, cash dividends for the fiscal year increased ¥6.00 per share compared with the previous fiscal year, resulting in a total of ¥70.00 (US$0.59) per share. The consolidated payout ratio will be 44.7 percent.

For the fiscal year ending December 31, 2015, the Company plans to pay total cash dividends of ¥76.00 per share, an increase of ¥6.00 per share compared with the fiscal year ended December 31, 2014. Although the operating environment is challenging, this plan is in accordance with the Company's basic policies regarding distribution of profits, and free cash flow and other factors have also been taken into consideration. As a result, the projected consolidated payout ratio is 43.8 percent.

EVA

Economic Value Added (EVA®) is the Kao Group's main management metric, defined as net operating profit after tax (NOPAT) less a charge for the cost of capital employed in the business. We believe EVA indicates "true" profit. Continuously increasing EVA raises corporate value, which is consistent with the long-term interest of not only shareholders but other stakeholders as well. The Kao Group aims to conduct business activities that expand the scale of its business while also increasing EVA, and uses EVA for business performance evaluation, performance-based compensation and strategic decision-making. During the fiscal year ended December 31, 2014, EVA increased to 165 from 138 in the previous year due to an increase in net operating profit after tax (NOPAT) and measures to reduce capital charges, including stock repurchases. EVA is expressed as an index with the year ended December 31, 2011 as 100. The Kao Group conducted the following EVA-related activities during the fiscal year.

Investing for Growth: During the fiscal year ended December 31, 2014, the Kao Group invested aggressively for future growth. In Japan, a new plant within the Sakata Plant complex in Sakata, Yamagata Prefecture, started operation in April 2014. Built to reinforce the Kao Group's stable supply structure to address the rapid increase in demand for *Merries* baby diapers inside and outside Japan, the plant contributed to the business by increasing supply. Outside Japan, the Kao Group's second consumer products plant in Indonesia started operation and sales of *Merries* baby diapers targeting the middle-class consumer segment began. In the Fabric and Home Care Business, the Kao Group enhanced facilities to reinforce the business foundation. In the Chemical Business, the Kao Group continued construction of a new plant in China and expanded production facilities for surfactants as well as streamlining, maintaining and renewing facilities in Indonesia. Research and development expenditures were ¥51.7 billion (US$432.8 million), the equivalent of 3.7 percent of net sales.

Increasing Profit: During the fiscal year ended December 31, 2014, the Kao Group launched more new and improved products than usual in the Consumer Products Business to respond to the last-minute surge in demand associated with the consumption tax rate increase in Japan, and to stimulate the market after the increase.

Growth in sales outpaced the market, and contributed to an increase in profit. In addition, continuing growth in sales of *Merries* baby diapers in Japan, China and Russia contributed to improvement of NOPAT. The Chemical Business was impacted by a surge in prices of oils and fats used as raw materials, but NOPAT improved due to growth in sales volume.

Financial Improvement: Free cash flow* totaled ¥813.8 billion (US$680.2 million) for the fiscal year ended December 31, 2014. The Kao Group has set priorities for how it will deploy this free cash flow. Investments for mergers and acquisitions and additional capital expenditures for future growth are the top priorities, followed by stable and continuous dividends. During the fiscal year, Kao Corporation worked to reduce invested capital with the repurchase of ¥50.0 billion of its stock from the market. The repurchased shares have been retired. Kao Corporation increased cash dividends per share for the fiscal year by ¥6.00 to ¥70.00 (US$0.59) for the 25th consecutive year of growth in cash dividends.

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

Business Risks and Other Risks

Various risks arise in the course of a company's business. The Kao Group takes reasonable measures to mitigate risks by preventing the occurrence of, diversifying and hedging them. However, unanticipated situations may occur that exert a significant impact on the Kao Group's business results and financial condition. The risks described below are not a comprehensive list of risks the Kao Group faces. Other risks exist and may have an impact on investment decisions. Any statements below concerning the future are judgments made by Kao Corporation as of the submission of its securities report to the Ministry of Finance on March 25, 2015.

(1) Consumer Products Business

1. Response to Changes in Consumer Needs

The Kao Group's Consumer Products Business is affected by business cycles and changes in consumers' values in the market of each country. The Consumer Products Business maintains and improves brand value by understanding changes in consumer needs and using the comprehensive strength of the Kao Group's product development and manufacturing in working to create high-value-added products and provide services through approaches in areas including the environment, health, the aging society and hygiene. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to provide products and services that respond to changes in consumer needs and brand value could decrease. This could have an impact on the Kao Group's business results and financial condition.

2. Response to Changes in Retailing

The Kao Group's Consumer Products Business is affected by changes in the structure of retailing, including progress in the creation of new corporate groups through retail industry mergers and integration in the market and the emergence of new retail channels. The Consumer Products Business conducts sales activities and makes new offerings that respond to these structural changes. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to conduct sales activities or make new offerings that respond to these structural changes. This could have an impact on the Kao Group's business results and financial condition.

(2) Chemical Business

The Kao Group's Chemical Business is affected by factors including trends in customer demand and fluctuations in raw material prices. The Chemical Business promotes creation of high-value added products that match customer needs, conducts research and development of products in consideration of the environment, and provides such products while working to reduce costs and deal with product prices. However, as a consequence of uncertainties in these business activities due to various factors, the Chemical Business may be unable to provide products that match customer needs or respond to matters such as fluctuations in raw material prices. This could have an impact on the Kao Group's business results and financial condition.

(3) Business Acquisitions, Business Alliances and Mergers

The Kao Group may implement business acquisitions, business alliances, mergers or other such measures. When implementing them, the Kao Group makes decisions after thoroughly assessing economic value and its partner companies. However, due to various unforeseeable uncertainties in its business activities, the Kao Group may be unable to produce the results it initially expected. This could have an impact on the Kao Group's business results and financial condition.

(4) Overseas Business Expansion

As one of its growth strategies, the Kao Group is conducting operations in markets in Asia, the Americas, Europe and elsewhere, with a particular emphasis on strengthening its operations in countries where higher economic growth rates and market expansion are forecast. However, the Kao Group may be unable to strengthen its operations as a consequence of uncertainties due to various factors in the course of business including the occurrence of a slowdown in economic growth or uncertain political or social conditions, intensifying competition, the inability to conduct sufficient cost management or the emergence of problems in relationships with retail outlets, sales agents or other trading partners. This could have an impact on the Kao Group's business results and financial condition.

(5) Procurement of Raw Materials

Market prices for natural fats and oils and petroleum-related materials used as raw materials for products of the Kao Group are affected by factors including geopolitical risks, the balance between supply and demand, abnormal weather and exchange rate fluctuations. The Kao Group has moved to reduce the effect of increases in raw material prices through measures including cost reductions and passing on increases in raw material costs into product prices. In addition, the Kao Group is conducting development of substitute raw materials for natural fats and oils through research into advanced effective utilization of non-edible raw materials. However, unexpectedly radical changes in market conditions and pricing could have an impact on the Kao Group's business results and financial condition.

(6) Product Quality

The Kao Group designs and manufactures products from the viewpoint of consumers, in compliance with related laws and regulations and voluntary standards. 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 centers. However, the unanticipated occurrence of a serious quality problem or concerns about product safety or reliability resulting from new scientific knowledge 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. This could have an impact on the Kao Group's business results and financial condition.

(7) Response to Natural Disasters, Accidents and Other Incidents

To deal with earthquakes and other natural disasters, the Kao Group has formulated disaster countermeasures for its production facilities and primary offices and a business continuity plan (BCP), and will continue to strengthen and reinforce them in the future. However, the occurrence and consequent damage of an earthquake on a scale exceeding assumptions that hinder the supply of products to the market due to problems in areas such as securing raw materials and maintaining production, among other impediments, could have a serious impact on the Kao Group's business results and financial condition. In addition, the emergence of major changes in demand trends due to a worsening economic environment associated with the earthquake could have a serious impact on the Kao Group's business results and financial condition.

Furthermore, the occurrence of an explosion or fire at production facilities, information system malfunction, problems at a supplier of raw materials, dysfunction of social infrastructures such as electric power and water, environmental pollution from harmful substances, the spread of infectious disease, terrorism, political change, riots and other incidents could hinder the supply of products to the market. This could have a serious impact on the Kao Group's reputation, business results and financial condition.

(8) 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, because items on the financial statements of overseas consolidated subsidiaries are translated into Japanese yen, substantial variance in the exchange rate from the expected rate at the time of conversion will have an impact on the Kao Group's business results and financial condition.

(9) Impact of Deferred Tax Assets and Impairment

The Kao Group records various tangible and intangible fixed assets and deferred tax assets including assets used in the course of business and goodwill incurred in corporate acquisitions. The Kao Group may not generate the expected cash flow due to divergence from planned future business results, a decline in market value or other factors. This could have an impact on the Kao Group's business results and financial condition.

(10) Securing Human Resources

The Kao Group strives to secure diverse, superior human resources to achieve its business goals globally. Human resources with advanced expertise in areas such as research and development, production technologies, marketing and sales activities are indispensable in aiming for the *Yoki-Monozukuri* (see note on page 34) that consumers support. However, an inability to secure the necessary human resources due to changes in employment conditions or other factors could have an impact on the Kao Group's business results and financial condition.

(11) Compliance with Laws and Regulations

In the course of its business activities, the Kao Group must comply with a variety of laws and regulations concerning areas such as standards for product quality and safety, the environment and chemical substances, as well as accounting standards, tax law and regulations related to labor and transactions. The Kao Group has constructed a compliance system and strives to comply with all related laws and regulations. However, a serious legal violation by the Kao Group or by a consignee or other party could have an impact on the Kao Group's reputation, business results and financial condition. Moreover, a change in current laws and regulations, or new laws and regulations could restrict the Kao Group's business activities, require investment for compliance, or otherwise affect the Kao Group. This could have an impact on the Kao Group's business results and financial condition.

(12) Information Management

The Kao Group possesses confidential information related to matters including research and development, production, marketing and sales, as well as the personal information of numerous customers used for product development, sales promotion and other purposes. The Kao Group conducts thorough information management using guidelines for handling information and implements appropriate security measures for its information systems, including both hardware and software. However, a leak of confidential or personal information held by the Kao Group resulting from an attack on its server, unlawful access, a computer virus or other factor that exceeds expectations could have an impact on the Kao Group's reputation, business results and financial condition.

(13) Litigation

The Kao Group conducts diverse businesses globally, and various types of litigation may be brought against it. The result of such litigation could have an impact on the Kao Group's business results and financial condition.

Consolidated Balance Sheet

Kao Corporation and Consolidated Subsidiaries
December 31, 2014 and 2013

	Millions of yen		Thousands of U.S. dollars (Note 2)
Assets	Dec. 2014	Dec. 2013	Dec. 2014
Current assets:			
Cash and time deposits (Notes 3 and 16)	¥ 107,412	¥ 126,314	$ 898,544
Short-term investments (Notes 3, 4 and 16)	123,639	101,645	1,034,290
Notes and accounts receivable (Note 16):			
Trade	203,396	180,603	1,701,489
Nonconsolidated subsidiaries and affiliates	1,835	2,372	15,351
Other	7,604	4,011	63,610
Inventories:			
Finished goods	111,831	99,453	935,511
Work in process and raw materials	45,956	39,655	384,440
Deferred tax assets (Note 6)	20,232	22,736	169,249
Other current assets	21,477	18,845	179,663
Allowance for doubtful receivables (Note 16)	(1,648)	(1,669)	(13,786)
Total current assets	641,734	593,965	5,368,361
Property, plant and equipment:			
Land	69,445	64,900	580,935
Buildings and structures	361,223	354,012	3,021,775
Machinery, equipment and other	782,794	747,947	6,548,386
Lease assets (Note 7)	11,261	12,049	94,203
Construction in progress	27,381	22,945	229,053
Total	1,252,104	1,201,853	10,474,352
Accumulated depreciation	(944,489)	(924,569)	(7,901,029)
Net property, plant and equipment	307,615	277,284	2,573,323
Intangible assets:			
Goodwill	139,941	152,286	1,170,663
Trademarks	15,145	28,498	126,694
Other intangible assets	12,844	11,834	107,445
Total intangible assets	167,930	192,618	1,404,802
Investments and other assets:			
Investment securities (Notes 4 and 16)	11,655	10,776	97,499
Investments in and advances to nonconsolidated subsidiaries and affiliates	9,329	7,275	78,041
Deferred tax assets (Note 6)	20,630	23,985	172,578
Asset for retirement benefits (Note 8)	9,692	—	81,077
Other assets (Note 8)	29,648	27,373	248,018
Total investments and other assets	80,954	69,409	677,213
	¥1,198,233	¥1,133,276	$10,023,699

See Notes to Consolidated Financial Statements.

Liabilities and Equity	Millions of yen Dec. 2014	Millions of yen Dec. 2013	Thousands of U.S. dollars (Note 2) Dec. 2014
Current liabilities:			
Short-term debt (Notes 5 and 16)	¥ 1,137	¥ 1,278	$ 9,511
Current portion of long-term debt (Notes 5 and 16)	20,776	21,256	173,800
Notes and accounts payable (Note 16):			
Trade	124,979	112,972	1,045,499
Nonconsolidated subsidiaries and affiliates	8,433	6,596	70,545
Other	61,766	51,322	516,698
Income taxes payable (Note 16)	28,108	32,322	235,135
Accrued expenses	94,584	91,006	791,233
Liability for loss related to cosmetics (Note 15)	8,220	1,350	68,764
Other current liabilities (Notes 5 and 6)	32,533	20,212	272,151
Total current liabilities	380,536	338,314	3,183,336
Long-term liabilities:			
Long-term debt (Notes 5 and 16)	84,152	84,916	703,965
Liability for retirement benefits (Note 8)	42,414	48,847	354,810
Other long-term liabilities (Notes 5 and 6)	18,738	18,559	156,751
Total long-term liabilities	145,304	152,322	1,215,526
Commitments and contingent liabilities (Notes 7, 9 and 17)			
Equity (Notes 10 and 11):			
Common stock:			
Authorized — 1,000,000,000 shares in Dec. 2014 and Dec. 2013			
Issued — 504,000,000 shares in Dec. 2014 and 516,000,000 shares in Dec. 2013	85,424	85,424	714,606
Capital surplus	109,561	109,561	916,522
Stock acquisition rights	944	1,120	7,897
Retained earnings	468,684	471,383	3,920,729
Treasury stock, at cost			
(2,921,992 shares in Dec. 2014 and 3,829,950 shares in Dec. 2013)	(9,719)	(9,397)	(81,303)
Accumulated other comprehensive income			
Unrealized gain on available-for-sale securities	5,507	4,733	46,068
Deferred gain (loss) on derivatives under hedge accounting	8	12	67
Foreign currency translation adjustments	(4,853)	(28,416)	(40,597)
Post retirement liability adjustments for foreign consolidated subsidiaries	—	(4,590)	—
Remeasurements of defined benefit plans	3,619	—	30,274
Total	659,175	629,830	5,514,263
Minority interests	13,218	12,810	110,574
Total equity	672,393	642,640	5,624,837
	¥1,198,233	¥1,133,276	$10,023,699

Consolidated Statement of Income

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2014 and 2013

	Millions of yen		Thousands of U.S. dollars (Note 2)
	Dec. 2014	Dec. 2013	Dec. 2014
Net sales (Note 13)	¥1,401,707	¥1,315,217	$11,725,841
Cost of sales	632,205	572,769	5,288,648
Gross profit	769,502	742,448	6,437,193
Selling, general and administrative expenses (Note 14)	636,232	617,792	5,322,336
Operating income (Note 13)	133,270	124,656	1,114,857
Other income (expenses):			
Interest and dividend income	1,014	1,133	8,483
Interest expense	(1,295)	(1,213)	(10,833)
Foreign currency exchange gain (loss)	1,171	(320)	9,796
Equity in earnings (losses) of nonconsolidated subsidiaries and affiliates	2,225	2,272	18,613
Other, net (Note 15)	(9,624)	(11,589)	(80,509)
Other income (expenses), net	(6,509)	(9,717)	(54,450)
Income before income taxes and minority interests	126,761	114,939	1,060,407
Income taxes (Note 6):			
Current	44,316	50,752	370,722
Deferred	2,023	(1,619)	16,923
Total income taxes	46,339	49,133	387,645
Income before minority interests	80,422	65,806	672,762
Minority interests in earnings of consolidated subsidiaries	832	1,042	6,960
Net income	¥ 79,590	¥ 64,764	$ 665,802
Per share of common stock (Notes 1.v and 18):	Yen		U.S. dollars (Note 2)
Basic net income	¥156.46	¥126.03	$1.31
Diluted net income	156.24	125.89	1.31
Cash dividends applicable to the year	70.00	64.00	0.59

See Notes to Consolidated Financial Statements.

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2014 and 2013

	Millions of yen		Thousands of U.S. dollars (Note 2)
	Dec. 2014	Dec. 2013	Dec. 2014
Income before minority interests	¥ 80,422	¥ 65,806	$672,762
Other comprehensive income (Note 12)			
Unrealized gain (loss) on available-for-sale securities	639	2,044	5,345
Foreign currency translation adjustments	24,709	44,201	206,701
Share of other comprehensive income in affiliates	222	335	1,857
Post retirement liability adjustments for foreign consolidated subsidiaries	—	(2,759)	—
Remeasurements of defined benefit plans	(3,725)	—	(31,161)
Total other comprehensive income	21,845	43,821	182,742
Comprehensive income	¥102,267	¥109,627	$855,504
Comprehensive income attributable to:			
Shareholders of Kao Corporation	¥100,250	¥107,823	$838,631
Minority interests	2,017	1,804	16,873

See Notes to Consolidated Financial Statements.

Consolidated Statement of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2014 and 2013

	Thousands	Millions of yen												
	Outstanding number of shares of common stock	Common stock	Capital surplus	Stock acquisition rights	Retained earnings	Treasury stock, at cost	Unrealized gain on available-for-sale securities	Deferred gain (loss) on derivatives under hedge accounting	Foreign currency translation adjustments	Post retirement liability adjustments for foreign consolidated subsidiaries	Remeasurements of defined benefit plans	Total	Minority interests	Total equity
Balance at January 1, 2013	521,844	¥85,424	¥109,561	¥1,294	¥468,019	¥ (8,985)	¥2,447	¥ 6	¥(71,872)	¥(1,901)	¥ —	¥583,993	¥12,090	¥596,083
Adjustment of retained earnings for newly consolidated subsidiaries					(19)							(19)		(19)
Net income					64,764							64,764		64,764
Cash dividends, ¥63.00 per share					(32,564)							(32,564)		(32,564)
Purchase of treasury stock	(9,999)					(30,038)						(30,038)		(30,038)
Disposal of treasury stock	325				(79)	888						809		809
Retirement of treasury stock					(28,738)	28,738						—		—
Net change in the year				(174)			2,286	6	43,456	(2,689)		42,885	720	43,605
Balance at December 31, 2013	512,170	85,424	109,561	1,120	471,383	(9,397)	4,733	12	(28,416)	(4,590)		629,830	12,810	642,640
Net income					79,590							79,590		79,590
Cash dividends, ¥66.00 per share					(33,814)							(33,814)		(33,814)
Purchase of treasury stock	(11,527)					(50,041)						(50,041)		(50,041)
Disposal of treasury stock	435				(79)	1,323						1,244		1,244
Retirement of treasury stock					(48,396)	48,396						—		—
Net change in the year				(176)			774	(4)	23,563	4,590	3,619	32,366	408	32,774
Balance at December 31, 2014	501,078	¥85,424	¥109,561	¥ 944	¥468,684	¥ (9,719)	¥5,507	¥ 8	¥ (4,853)	¥ —	¥3,619	¥659,175	¥13,218	¥672,393

	Thousands	Thousands of U.S. dollars (Note 2)												
	Outstanding number of shares of common stock	Common stock	Capital surplus	Stock acquisition rights	Retained earnings	Treasury stock, at cost	Unrealized gain on available-for-sale securities	Deferred gain (loss) on derivatives under hedge accounting	Foreign currency translation adjustments	Post retirement liability adjustments for foreign consolidated subsidiaries	Remeasurements of defined benefit plans	Total	Minority interests	Total equity
Balance at December 31, 2013	512,170	$714,606	$916,522	$ 9,369	$3,943,308	$ (78,610)	$39,593	$100	$(237,711)	$(38,397)	$ —	$5,268,780	$107,161	$5,375,941
Net income					665,802							665,802		665,802
Cash dividends, US$0.55 per share					(282,868)							(282,868)		(282,868)
Purchase of treasury stock	(11,527)					(418,613)						(418,613)		(418,613)
Disposal of treasury stock	435				(661)	11,068						10,407		10,407
Retirement of treasury stock					(404,852)	404,852						—		—
Net change in the year				(1,472)			6,475	(33)	197,114	38,397	30,274	270,755	3,413	274,168
Balance at December 31, 2014	501,078	$714,606	$916,522	$ 7,897	$3,920,729	$ (81,303)	$46,068	$67	$(40,597)	$ —	$30,274	$5,514,263	$110,574	$5,624,837

See Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2014 and 2013

	Millions of yen		Thousands of U.S. dollars (Note 2)
	Dec. 2014	Dec. 2013	Dec. 2014
Operating activities:			
Income before income taxes and minority interests	¥126,761	¥114,939	$1,060,407
Adjustments for:			
Income taxes paid	(49,294)	(29,829)	(412,364)
Depreciation and amortization	79,660	77,297	666,388
(Gain) loss on sales or disposals of property, plant and equipment, and intangible assets, net	2,706	2,644	22,637
(Gain) loss on transfer of business	—	(350)	—
Equity in (earnings) losses of nonconsolidated subsidiaries and affiliates	(2,225)	(2,272)	(18,613)
Unrealized foreign currency exchange (gain) loss	(1,220)	381	(10,206)
Change in trade receivables	(10,953)	(2,415)	(91,626)
Change in inventories	(12,397)	(5,405)	(103,706)
Change in trade payables	6,715	3,505	56,174
Change in notes and accounts payable - other and accrued expenses	2,048	16,819	17,132
Other, net	3,317	3,431	27,747
Net cash provided by operating activities	145,118	178,745	1,213,970
Investing activities:			
Payments into time deposits	(2,125)	(4,802)	(17,776)
Proceeds from withdrawal of time deposits	88	7,190	736
Purchase of short-term investments	—	(7,998)	—
Proceeds from redemption and sales of short-term investments	—	13,000	—
Purchase of property, plant and equipment	(51,151)	(55,672)	(427,899)
Purchase of intangible assets	(4,507)	(4,882)	(37,703)
Increase in investments in and advances to nonconsolidated subsidiaries and affiliates	(1,358)	(1)	(11,360)
Payment for purchase of newly consolidated subsidiaries, net of cash acquired	—	(891)	—
Other, net	(4,755)	(3,722)	(39,777)
Net cash used in investing activities	(63,808)	(57,778)	(533,779)
Financing activities:			
Increase (decrease) in short-term debt	(273)	(2,311)	(2,284)
Proceeds from long-term loans	20,001	19	167,316
Repayments of long-term loans	(20,009)	(9)	(167,383)
Proceeds from issuance of bonds	—	50,000	—
Redemption of bonds	—	(50,000)	—
Purchase of treasury stock	(50,044)	(30,039)	(418,638)
Payments of cash dividends	(34,963)	(34,985)	(292,480)
Other, net	266	(134)	2,226
Net cash used in financing activities	(85,022)	(67,459)	(711,243)
Translation adjustments on cash and cash equivalents	4,776	13,032	39,953
Net increase (decrease) in cash and cash equivalents	1,064	66,540	8,901
Cash and cash equivalents, beginning of year (Note 3)	227,598	160,435	1,903,948
Cash and cash equivalents of newly consolidated subsidiaries, increase	—	623	—
Cash and cash equivalents, end of year (Note 3)	¥228,662	¥227,598	$1,912,849

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2014 and 2013

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 and its related accounting regulations, and in accordance with accounting principles generally accepted in Japan ("Japanese GAAP"), 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 financial statement items of the previous fiscal year were reclassified to conform to the presentation for the current fiscal year.

The preparation of financial statements in accordance 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 these 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 and influence concepts, 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 using 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 and affiliate at the dates of acquisition, consolidation goodwill, is being amortized over an estimated period not exceeding 20 years.

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

The accounting standard for unification of accounting policies applied to foreign subsidiaries for the consolidated financial statements requires: (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 of America 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) Scheduled amortization of actuarial gain or loss of pensions that has been directly recorded in equity
3) Expensing capitalized development costs of R&D
4) Cancellation of the fair value model accounting for property, plant, and equipment and investment properties and incorporation of the cost model of accounting
5) Exclusion of minority interests from net income, if contained in net income

d) Unification of accounting policies applied to foreign affiliated companies for the equity method

The accounting standard requires adjustments to be made to conform the affiliate's accounting policies for similar transactions and events under similar circumstances to those of the parent company when the affiliate's financial statements are used in applying the equity method unless it is impracticable to determine such adjustments. In addition, financial statements prepared by foreign affiliated companies in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States tentatively may be used in applying the equity method if the following items are adjusted so that net income is accounted for in accordance with Japanese GAAP, unless they are not material:

1) Amortization of goodwill
2) Scheduled amortization of actuarial gain or loss on pensions that has been directly recorded in equity
3) Expensing capitalized development costs of R&D
4) Cancellation of the fair value model accounting for property, plant, and equipment and investment properties and incorporation of the cost model of accounting
5) Exclusion of minority interests from net income, if contained in net income

e) Business combinations

The accounting standard for business combinations requires companies to account for business combinations in accordance with the following policies:

1) Business combinations should be accounted for by the purchase method except combinations of entities under common control and joint ventures.
2) In-process research and development (IPR&D) acquired in the business combination should be capitalized as an intangible asset.
3) The acquirer should recognize a bargain purchase gain in profit or loss immediately on the acquisition date after reassessing and confirming that all of the assets acquired and all of the liabilities assumed have been identified after a review of the procedures used in the purchase allocation.

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.

f) Cash equivalents

For purposes of the consolidated statement 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.

g) Allowance for doubtful receivables

To provide for potential loss on trade receivables, loans and other receivables, the Company and its domestic consolidated subsidiaries provide an allowance for the expected amount of unrecoverable receivables.

Allowances for ordinary debt are computed based on the historical rate of default. For specified receivables, such as those where recovery is doubtful, the Company and its domestic consolidated subsidiaries consider the likelihood of recovery on an individual basis and record an allowance for the amount of debt expected to be unrecoverable. Foreign consolidated subsidiaries mainly record an allowance for the amount of specified receivables expected to be unrecoverable.

h) Inventories

The accounting standard for measurement of inventories 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.

Cost of inventories 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.

i) 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.

j) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is computed under the straight-line method over the estimated useful lives, principally ranging from 21 to 35 years for buildings and structures and 7 or 9 years for machinery and equipment.

k) Intangible assets

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

l) 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.

m) Liability for loss related to cosmetics

To provide for payment of compensation-related and other expenses, the estimated substantive amount of actual loss related to cosmetics as of the end of the fiscal year is recorded.

n) Retirement and pension plans

The Company and most domestic consolidated subsidiaries have a cash balance plan and a defined contribution pension plan covering substantially all of their employees. The cash balance plan is linked to market interest rates and treated as a defined benefit plan. The pension plan also covers employees of certain nonconsolidated subsidiaries and affiliates in Japan. In addition, these companies may pay an early retirement allowance to employees who retire early.

Certain domestic consolidated subsidiaries have a defined benefit plan that provides for a lump-sum payment to terminated employees. The subsidiaries may pay an additional lump-sum payment that is not subject to actuarial calculations under the accounting standard for retirement benefits.

Certain foreign subsidiaries have a defined contribution plan and/or a defined benefit plan. Some of these foreign subsidiaries apply the "corridor approach" in calculating actuarial gain or loss.

Certain foreign subsidiaries also have local employees' retirement benefit plans and provide for the amount to recognize 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 recognized in cost of sales and selling, general and administrative expenses in the consolidated statement of income.

In May 2012, the Accounting Standards Board of Japan (the ASBJ) issued ASBJ Statement No. 26, "Accounting Standard for Retirement Benefits" and ASBJ Guidance No. 25, "Guidance on Accounting Standard for Retirement Benefits", which replaced the accounting standard for retirement benefits that had been issued by the Business Accounting Council in 1998 with an effective date of April 1, 2000, and the other related practical guidance, and were followed by partial amendments from time to time through 2009. Major changes are as follows:

(a) Under the revised accounting standard, actuarial gains and losses and past service costs that are yet to be recognized in profit or loss are recognized within equity (accumulated other comprehensive income), after adjusting for tax effects, and any resulting deficit or surplus is recognized as a liability (liability for retirement benefits) or asset (asset for retirement benefits).

(b) The revised accounting standard does not change how to recognize actuarial gains and losses and past service costs in profit or loss. Those amounts are recognized in profit or loss over a certain period no longer than the expected average remaining service period of the employees. However, actuarial gains and losses and past service costs that arose in the current period and have not yet been recognized in profit or loss are included in other comprehensive income and actuarial gains and losses and past service costs that were recognized in other comprehensive income in prior periods and then recognized in profit or loss in the current period shall be treated as reclassification adjustments.

(c) The revised accounting standard also made certain amendments relating to the method of attributing expected benefit to periods and relating to the discount rate and expected future salary increases.

The revised accounting standard and guidance for (a) and (b) above are effective for the end of annual periods beginning on or after April 1, 2013, and for (c) above are effective for the beginning of annual periods beginning on or after April 1, 2014, or for the beginning of annual periods beginning on or after April 1, 2015, subject to certain disclosure in March 2015, both with earlier application being permitted from the beginning of annual periods beginning on or after April 1, 2013. However, no retrospective application of this accounting standard to consolidated financial statements in prior periods is required. The Company applied the revised accounting standard and the guidance for (a) and (b) above from the fiscal year ended December 31, 2014.

As a result, asset for retirement benefits of ¥9,692 million (US$81,077 thousand) and liability for retirement benefits of ¥42,414 million (US$354,810 thousand) were recorded as of December 31, 2014. In addition, accumulated other comprehensive income for the year ended December 31, 2014 increased by ¥11,882 million (US$99,398 thousand). Net worth per share increased by ¥23.71 (US$0.20).

o) Asset retirement obligations

The accounting standard for asset retirement obligations defines an asset retirement obligation as a legal obligation imposed either by law or contract that results from the acquisition, construction, development and the normal operation of a tangible fixed asset and is associated with the retirement of such tangible fixed asset.

The asset retirement obligation is recognized as the sum of the discounted cash flows required for the future asset retirement and is recorded in the period in which the obligation is incurred if a reasonable estimate can be made. If a reasonable estimate of the asset retirement obligation cannot be made in the period the asset retirement obligation is incurred, the liability should be recognized when a reasonable estimate of asset retirement obligation can be made. Upon initial recognition of a liability for an asset retirement obligation, an asset retirement cost is capitalized by increasing the carrying amount of the related fixed asset by the amount of the liability. The asset retirement cost is subsequently allocated to expense through depreciation over the remaining useful life of the asset. Over time, the liability is accreted to its present value each period. Any subsequent revisions to the timing or the amount of the original estimate of undiscounted cash flows are reflected as an increase or a decrease in the carrying amount of the liability and the capitalized amount of the related asset retirement cost.

p) 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.

q) Leases

The accounting standard for lease transactions requires that all finance lease transactions should be capitalized to recognize lease assets and lease obligations in the balance sheet. In addition, the accounting standard permits leases which do not transfer ownership of the leased property to the lessee to be measured at the obligations under finance leases less interest expense and recorded as acquisition cost of lease assets.

All other leases are accounted for as operating leases.

r) Income taxes

The Companies provide for income taxes applicable to all items included in the consolidated statement 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.

The Company and certain subsidiaries file tax returns under the consolidated taxation system, which allows tax payments to be based on the consolidated profits or losses.

s) 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 statement of income to the extent that they are not hedged by foreign exchange derivatives.

t) 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 average exchange rate.

u) 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 and 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 statement 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.

v) 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 statement of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

w) Accounting changes and error corrections

The accounting standard for accounting changes and error corrections requires the following:

1) Changes in Accounting Policies
   When a new accounting policy is applied following revision of an accounting standard, the new policy is applied retrospectively unless the revised accounting standard includes specific transitional provisions in which case the entity shall comply with the specific transitional provisions.
2) Changes in Presentation
   When the presentation of financial statements is changed, prior period financial statements are reclassified in accordance with the new presentation.
3) Changes in Accounting Estimates
   A change in an accounting estimate is accounted for in the period of the change if the change affects that period only, and is accounted for prospectively if the change affects both the period of the change and future periods.
4) Corrections of Prior Period Errors
   When an error in prior period financial statements is discovered, those statements are restated.

x) Changes in presentation

"Liability for loss related to cosmetics", which was included in "Other" under "Current liabilities" in the previous fiscal year, is presented separately from the fiscal year ended December 31, 2014 due to its increased materiality. The consolidated financial statements for the previous fiscal year have been reclassified to reflect the change in presentation. As a result, ¥1,350 million included in "Other" under "Current liabilities" on the consolidated balance sheet for the previous fiscal year has been reclassified as "Liability for loss related to cosmetics".

y) New accounting pronouncements

Accounting Standard for Retirement Benefits

On May 17, 2012, the ASBJ issued ASBJ Statement No. 26, "Accounting Standard for Retirement Benefits" and ASBJ Guidance No. 25, "Guidance on Accounting Standard for Retirement Benefits", which replaced the Accounting Standard for Retirement Benefits that had been issued by the Business Accounting Council in 1998 with an effective date of April 1, 2000, and other related practical guidance, and were followed by partial amendments from time to time through 2009.
Major changes are as follows:

(a) Treatment in the balance sheet
    Under the current requirements, actuarial gains and losses and past service costs that are yet to be recognized in profit or loss are not recognized in the balance sheet, and the difference between retirement benefit obligations and plan assets (hereinafter, "deficit or surplus"), adjusted by such unrecognized amounts, is recognized as a liability or asset.
    Under the revised accounting standard, actuarial gains and losses and past service costs that are yet to be recognized in profit or loss shall be recognized within equity (accumulated other comprehensive income), after adjusting for tax effects, and any resulting deficit or surplus shall be recognized as a liability (liability for retirement benefits) or asset (asset for retirement benefits).
(b) Treatment in the statement of income and the statement of comprehensive income
    The revised accounting standard does not change how to recognize actuarial gains and losses and past service costs in profit or loss. Those amounts would be recognized in profit or loss over a certain period no longer than the expected average remaining service period of the employees. However, actuarial gains and losses and past service costs that arose in the current period and have not yet been recognized in profit or loss shall be included in other comprehensive income and actuarial gains and losses and past service costs that were recognized in other comprehensive income in prior periods and then recognized in profit or loss in the current period shall be treated as reclassification adjustments.

(c) Amendments relating to the method of attributing expected benefit to periods and relating to the discount rate and expected future salary increases

The revised accounting standard also made certain amendments relating to the method of attributing expected benefit to periods and relating to the discount rate and expected future salary increases.

The revised accounting standard and guidance for (a) and (b) above are effective for the end of annual periods beginning on or after April 1, 2013, and for (c) above are effective for the beginning of annual periods beginning on or after April 1, 2014, or for the beginning of annual periods beginning on or after April 1, 2015, subject to certain disclosure in March 2015, both with earlier application being permitted from the beginning of annual periods beginning on or after April 1, 2013. However, no retrospective application of this accounting standard to consolidated financial statements in prior periods is required.

The Company applied the revised accounting standard and guidance for (a) and (b) above from the end of the fiscal year ended December 31, 2014, and will apply (c) above from the beginning of the fiscal year beginning January 1, 2015, and is in the process of measuring the effects of applying the revised accounting standard for (c) above in future applicable periods.

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 December 31, 2014 of ¥119.54=US$1, solely for convenience. The translations should not be construed as representations that Japanese yen amounts 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 December 31, 2014 and 2013 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Cash and time deposits	¥107,412	¥126,314	$ 898,544
Short-term investments	123,639	101,645	1,034,290
Less: time deposits and short-term investments which mature or become due over three months after the date of acquisition	(2,389)	(361)	(19,985)
Cash and cash equivalents	¥228,662	¥227,598	$1,912,849

4 Short-Term Investments and Investment Securities

Short-term investments and investment securities as of December 31, 2014 and 2013 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Short-term investments:			
Investment trust funds and other	¥123,639	¥101,645	$1,034,290
Total	¥123,639	¥101,645	$1,034,290
Investment securities:			
Marketable equity securities	¥ 10,473	¥ 9,595	$ 87,611
Investment trust funds and other	1,182	1,181	9,888
Total	¥ 11,655	¥ 10,776	$ 97,499

The carrying amount and aggregate fair value of the securities classified as available-for-sale and held-to-maturity at December 31, 2014 and 2013 were as follows:

	Millions of yen			
	Dec. 2014			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 2,641	¥7,853	¥(21)	¥10,473
Debt securities and other	47,644	—	—	47,644
Held-to-maturity:				
Debt securities and other	75,995	—	—	75,995

	Millions of yen			
	Dec. 2013			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 2,666	¥6,966	¥37	¥ 9,595
Debt securities and other	41,651	—	—	41,651
Held-to-maturity:				
Debt securities and other	59,994	—	—	59,994

	Thousands of U.S. dollars			
	Dec. 2014			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	$ 22,093	$65,693	$(176)	$ 87,611
Debt securities and other	398,561	—	—	398,561
Held-to-maturity:				
Debt securities and other	635,729	—	—	635,729

Available-for-sale securities whose fair values are not readily determinable as of December 31, 2014 and 2013 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Available-for-sale:			
Equity securities	¥1,182	¥1,181	$9,888
Total	¥1,182	¥1,181	$9,888

Proceeds from sales of available-for-sale securities for the years ended December 31, 2014 and 2013 were ¥47 million (US$393 thousand) and ¥9 million, respectively. Gross realized gains and losses on these sales, computed on the moving-average cost basis, for the year ended December 31, 2014 were ¥18 million (US$151 thousand) and ¥1 million (US$8 thousand), respectively. And gross realized gains for the year ended 2013 were ¥3 million.

The carrying values of debt securities by contractual maturities for securities classified as held-to-maturity at December 31, 2014 are included in Note 16.

5 Short-Term and Long-Term Debt

Short-term debt at December 31, 2014 and 2013 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Unsecured loans principally from financial institutions	¥1,137	¥1,278	$9,511
Total	¥1,137	¥1,278	$9,511

The weighted average interest rates applicable to the above loans were 1.49% and 1.37% at December 31, 2014 and 2013, respectively. In addition to the above short-term debt, deposits payable to affiliates, included in other current liabilities, were ¥9,074 million (US$75,908 thousand) and ¥4,273 million at December 31, 2014 and 2013, respectively, and the applicable interest rates were 0.48% and 0.56% at December 31, 2014 and 2013, respectively.

Long-term debt at December 31, 2014 and 2013 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Unsecured bonds due 2018, 0.39%	¥ 25,000	¥ 25,000	$ 209,135
Unsecured bonds due 2020, 0.62%	25,000	25,000	209,135
Unsecured loans principally from financial institutions, weighted average rate of 0.31% in Dec. 2014, 0.56% in Dec. 2013	50,096	50,103	419,073
Lease obligations	4,832	6,069	40,422
	¥104,928	¥106,172	$ 877,765
Less current portion	(20,776)	(21,256)	(173,800)
Total	¥ 84,152	¥ 84,916	$ 703,965

In addition to the above long-term debt, deposits payable to customers, included in other long-term liabilities, were ¥6,066 million (US$50,745 thousand) and ¥6,008 million at December 31, 2014 and 2013, respectively, and the applicable interest rate was 0.11% at December 31, 2014 and 2013.

The aggregate annual maturities of long-term debt as of December 31, 2014 were as follows:

Years ending December 31	Millions of yen	Thousands of U.S. dollars
2015	¥ 20,776	$173,800
2016	724	6,057
2017	30,670	256,567
2018	25,581	213,995
2019	490	4,099
2020 and thereafter	26,687	223,247
Total	¥104,928	$877,765

6 Income Taxes

The Company and its domestic subsidiaries are subject to Japanese national and local taxes based on income, which in the aggregate resulted in a normal statutory tax rate of approximately 36% and 38% for the years ended December 31, 2014 and 2013, respectively.

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 December 31, 2014 and 2013 were as follows:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Deferred tax assets:			
Depreciation and amortization	¥ 22,644	¥ 20,634	$ 189,426
Pension and severance costs	—	16,272	—
Liability for retirement benefits	13,920	—	116,446
Accrued expenses	13,290	10,649	111,176
Enterprise taxes	1,780	1,928	14,890
Tax loss carryforwards	20,826	33,021	174,218
Other	19,100	17,650	159,780
Less valuation allowance	(21,096)	(28,127)	(176,476)
Deferred tax assets	¥ 70,464	¥ 72,027	$ 589,460
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities	¥ (2,765)	¥ (2,482)	$ (23,130)
Undistributed foreign earnings	(12,747)	(11,524)	(106,634)
Deferred gains on sales of property	(3,495)	(3,800)	(29,237)
Prepaid pension cost	—	(1,461)	—
Asset for retirement benefits	(5,133)	—	(42,940)
Other	(8,883)	(8,707)	(74,310)
Deferred tax liabilities	¥(33,023)	¥(27,974)	$(276,251)
Net deferred tax assets	¥ 37,441	¥ 44,053	$ 313,209

Reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statement of income was as follows:

	Dec. 2014	Dec. 2013
Normal effective statutory tax rate	—	38.0%
Tax credit for research and development costs and other	—	(2.2)
Valuation allowance	—	(3.7)
Expiration of tax loss carryforwards	—	8.9
Amortization expenses not deductible for income tax purposes	—	3.7
Other – net	—	(1.9)
Actual effective tax rate	—	42.8%

For the year ended December 31, 2014, the reconciliation is not disclosed because the difference is less than 5% of the normal effective statutory tax rate.

Following the promulgation on March 31, 2014 of the “Act for Partial Amendment of the Income Tax Act, etc.” (Act No. 10 of 2014), the special reconstruction corporation tax is not imposed from fiscal years beginning on or after April 1, 2014. As a result, the effective statutory tax rate used for the calculation of deferred tax assets and deferred tax liabilities was changed from the former 36.23% to 35.64% for temporary differences expected to be eliminated during the fiscal year beginning on January 1, 2015. The effect of the change in the tax rate was immaterial.

7 Leases

(a) Finance leases:

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

(b) Operating leases:

The minimum rental commitments under noncancellable operating leases as of December 31, 2014 and 2013 were as follows:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Due within one year	¥ 9,868	¥ 9,090	$ 82,550
Due after one year	23,110	22,128	193,324
Total	¥32,978	¥31,218	$275,874

8 Retirement Benefits

The Company and most domestic consolidated subsidiaries have a cash balance plan and a defined contribution pension plan. The cash balance plan is linked to market interest rates and treated as a defined benefit pension plan. These companies may pay an early retirement allowance to early retired employees.

Certain domestic consolidated subsidiaries have a defined benefit plan that provides for a lump-sum payment to terminated employees. The subsidiaries may make an additional lump-sum payment that is not subject to actuarial calculations under the accounting standard for retirement benefits.

Certain foreign consolidated subsidiaries have a defined contribution plan and/or a defined benefit plan.

For the year ended December 31, 2014

(1) Changes in defined benefit obligation

The aggregate annual maturities of long-term debt as of December 31, 2014 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Balance at January 1	¥272,497	$2,279,547
Current service cost	9,641	80,651
Interest cost	5,112	42,764
Actuarial gain and loss	3,546	29,664
Benefits paid	(10,421)	(87,176)
Past service cost	(483)	(4,040)
Other	3,780	31,620
Balance at December 31	¥283,672	$2,373,030

(2) Changes in plan assets

The changes in plan assets for the year ended December 31, 2014 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Balance at January 1	¥230,352	$1,926,987
Expected return on plan assets	5,329	44,579
Actuarial gain and loss	12,681	106,082
Contribution by the employer	10,551	88,263
Benefits paid	(9,630)	(80,559)
Other	1,667	13,945
Balance at December 31	¥250,950	$2,099,297

(3) Reconciliation between the balances of defined benefit obligation and plan assets and liability and asset recorded on the consolidated balance sheet at December 31, 2014

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Funded defined benefit obligation	¥ 281,199	$ 2,352,342
Plan assets	(250,950)	(2,099,297)
	30,249	253,045
Unfunded defined benefit obligation	2,473	20,688
Net liability for defined benefit obligation	¥ 32,722	$ 273,733

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Liability for retirement benefits	¥42,414	$354,810
Asset for retirement benefits	(9,692)	(81,077)
Net liability for defined benefit obligation	¥32,722	$273,733

(4) Benefit costs

Components of net periodic benefit costs for the year ended December 31, 2014 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Current service cost	¥ 9,641	$ 80,651
Interest cost	5,112	42,764
Expected return on plan assets	(5,329)	(44,579)
Amortization of actuarial gain and loss	(892)	(7,462)
Amortization of past service cost	(4,077)	(34,106)
Other	1,651	13,811
Net periodic benefit costs	¥ 6,106	$ 51,079

In addition to the above net periodic benefit costs, the costs for the defined contribution plan were ¥3,382 million (US$28,292 thousand) for the year ended December 31, 2014.

(5) Accumulated other comprehensive income on the defined benefit plan

Components of accumulated other comprehensive income on the defined benefit plan before deduction of tax effects at December 31, 2014 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Dec. 2014	Dec. 2014
Unrecognized past service costs	¥3,789	$31,697
Unrecognized actuarial gain and loss	2,547	21,307
Other	(454)	(3,799)
Total	¥5,882	$49,205

(6) Plan assets

Components of plan assets at December 31, 2014 were as follows:

	Dec. 2014
Debt securities	77%
Equity securities	17
Cash and deposits	1
Other	5
Total	100%

The expected rate of return on plan assets is determined considering components of plan assets, actual return on plan assets, policy on plan assets management, market trends and other factors.

(7) Actuarial assumption

Assumptions used for the year ended December 31, 2014 were as follows:

	Dec. 2014
Discount rate	Primarily 1.6%
Expected rate of return on plan assets	Primarily 2.0%

For the year ended December 31, 2013

The liability for retirement benefits at December 31, 2013 consisted of the following:

	Millions of yen
	Dec. 2013
Projected benefit obligation	¥ 272,497
Fair value of plan assets	(230,352)
Unrecognized prior service cost	5,004
Unrecognized actuarial gain (loss)	3,892
Unrecognized transitional obligation	(2,240)
Prepaid pension cost	46
Net liability for retirement benefits	¥ 48,847

The components of net periodic benefit costs for the year ended December 31, 2013 were as follows:

	Millions of yen
	Dec. 2013
Service cost	¥ 9,699
Interest cost	4,916
Expected return on plan assets	(4,734)
Amortization of prior service cost (credit)	(1,967)
Recognized actuarial (gain) loss	(19)
Amortization of transitional obligation	1,802
Net periodic benefit costs	¥ 9,697

Assumptions used for the year ended December 31, 2013 were as follows:

	Dec. 2013
Discount rate	Primarily 1.6%
Expected rate of return on plan assets	Primarily 2.0%
Amortization period of prior service cost	Primarily 15 years
Recognition period of actuarial gain / loss	Primarily 10 years
Amortization period of transitional obligation	15 years

In addition to the above net periodic benefit costs, the costs for other retirement and pension plans such as the defined contribution plan and for other supplemental retirement benefits were ¥3,343 million for the year ended December 31, 2013.

Certain foreign subsidiaries apply the "corridor approach" in calculating actuarial gain or loss.

9 Contingent Liabilities

At December 31, 2014, the Companies had the following contingent liabilities:

	Millions of yen	Thousands of U.S. dollars
Trade notes discounted	¥ 21	$ 176
Guarantees of borrowings, principally of affiliates and employees	181	1,514

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.

10 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) an audit & supervisory board, 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 meets all four criteria, but has not made the said prescription in its articles of incorporation. The Company pays the dividends 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 own 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 at the shareholders' meeting.

The Company's legal reserve amount, which is included in retained earnings, totaled ¥14,117 million (US$118,094 thousand) at both December 31, 2014 and 2013. The Company's additional paid-in capital amount, which is included in capital surplus, totaled ¥108,889 million (US$910,900 thousand) at both December 31, 2014 and 2013.

The accompanying consolidated financial statements do not include any provision for the year-end dividend of ¥36.0 (US$0.30) per share, aggregating ¥18,059 million (US$151,071 thousand) which the Company will subsequently propose at the 109th Annual General Meeting of Shareholders to be held on March 25, 2015 as an appropriation of retained earnings in respect of the year ended December 31, 2014.

(c) Treasury stock and treasury stock acquisition rights

The Corporation Law also provides for companies to purchase their own stock and retire treasury stock by resolution of the board of directors. The amount of own stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by a 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 their own stock and stock acquisition rights in their own companies. Such treasury stock is presented as a separate component of equity. Such stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

The Company purchased 11.5 million shares of its common stock from the market during the year ended December 31, 2014, at an aggregate cost of ¥50,000 million (US$418,270 thousand). On December 10, 2014, the Company retired 12.0 million shares of treasury stock by the resolution of the Board of Directors at the meeting held on November 20, 2014.

11 Stock-Based Compensation Plans

The stock options for the year ended December 31, 2014 were as follows:

Name	Persons originally granted	Number of options originally granted	Date of grant	Exercise price (Yen)	Exercise price (U.S. dollars)	Exercise period
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	$28.83	September 1, 2009 through August 29, 2014
Stock option 2008 I	14 Directors of the Company	24,000 shares*	August 29, 2008	¥1	$0.01	July 1, 2010 through June 30, 2015
Stock option 2008 II	12 Executive Officers of the Company***	12,000 shares*	August 29, 2008	¥1	$0.01	July 1, 2010 through June 30, 2015
Stock option 2008 III	81 Employees of the Company 4 Directors of subsidiaries of the Company	447,000 shares*	August 29, 2008	¥3,100	$25.93	September 1, 2010 through August 31, 2015
Stock option 2009 I	13 Directors of the Company	36,000 shares*	August 28, 2009	¥1	$0.01	July 1, 2011 through June 30, 2016
Stock option 2009 II	12 Executive Officers of the Company****	24,000 shares*	August 28, 2009	¥1	$0.01	July 1, 2011 through June 30, 2016
Stock option 2009 III	74 Employees of the Company 8 Directors of subsidiaries of the Company	430,000 shares*	August 28, 2009	¥2,355	$19.70	September 1, 2011 through August 31, 2016
Stock option 2010 I	14 Directors of the Company	38,000 shares*	August 25, 2010	¥1	$0.01	July 1, 2012 through June 30, 2017
Stock option 2010 II	12 Executive Officers of the Company*****	24,000 shares*	August 25, 2010	¥1	$0.01	July 1, 2012 through June 30, 2017
Stock option 2010 III	81 Employees of the Company 2 Directors of subsidiaries of the Company	435,000 shares*	August 25, 2010	¥2,190	$18.32	September 1, 2012 through August 31, 2017
Stock option 2011 I	13 Directors of the Company	36,000 shares*	August 25, 2011	¥1	$0.01	July 1, 2013 through June 29, 2018
Stock option 2011 II	13 Executive Officers of the Company******	26,000 shares*	August 25, 2011	¥1	$0.01	July 1, 2013 through June 29, 2018
Stock option 2011 III	81 Employees of the Company 1 Director of subsidiary of the Company 1 Employee of subsidiary of the Company	435,000 shares*	August 25, 2011	¥2,254	$18.86	September 1, 2013 through August 31, 2018
Stock option 2012 I	9 Directors of the Company	30,000 shares*	August 23, 2012	¥1	$0.01	July 1, 2014 through June 28, 2019
Stock option 2012 II	22 Executive Officers of the Company*******	49,000 shares*	August 23, 2012	¥1	$0.01	July 1, 2014 through June 28, 2019
Stock option 2013 I	10 Directors of the Company	22,000 shares	May 23, 2013	¥1	$0.01	July 1, 2015 through June 30, 2020
Stock option 2013 II	22 Executive Officers of the Company********	27,000 shares	May 23, 2013	¥1	$0.01	July 1, 2015 through June 30, 2020
Stock option 2014 I	6 Directors of the Company	12,000 shares	May 22, 2014	¥1	$0.01	July 1, 2016 through June 30, 2021
Stock option 2014 II	23 Executive Officers of the Company*********	28,000 shares	May 22, 2014	¥1	$0.01	July 1, 2016 through June 30, 2021

* The number of options originally granted converts into number of shares of common stock.
** The 14 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
*** The 12 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
**** The 12 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
***** The 12 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
****** The 13 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
******* The 22 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
******** The 22 Executive Officers were not members of the Board of Directors of the Company at the date of grant.
********* The 23 Executive Officers were not members of the Board of Directors of the Company at the date of grant.

The activity of stock options was as follows:

(Number of shares)

	Stock option 2007 I	Stock option 2007 II	Stock option 2007 III	Stock option 2008 I	Stock option 2008 II	Stock option 2008 III	Stock option 2009 I	Stock option 2009 II	Stock option 2009 III	Stock option 2010 I	Stock option 2010 II
For the year ended December 31, 2014											
Non-vested											
Outstanding at December 31, 2013	—	—	—	—	—	—	—	—	—	—	—
Granted	—	—	—	—	—	—	—	—	—	—	—
Expired	—	—	—	—	—	—	—	—	—	—	—
Vested	—	—	—	—	—	—	—	—	—	—	—
Outstanding at December 31, 2014	—	—	—	—	—	—	—	—	—	—	—
Vested											
Outstanding at December 31, 2013	4,000	4,000	288,000	5,000	4,000	430,000	11,000	9,000	367,000	16,000	10,000
Vested	—	—	—	—	—	—	—	—	—	—	—
Exercised	4,000	4,000	46,000	1,000	3,000	85,000	3,000	4,000	93,000	—	2,000
Expired	—	—	242,000	—	—	—	—	—	—	—	—
Outstanding at December 31, 2014	—	—	—	4,000	1,000	345,000	8,000	5,000	274,000	16,000	8,000
Exercise price											
Yen	¥1	¥1	¥3,446	¥1	¥1	¥3,100	¥1	¥1	¥2,355	¥1	¥1
U.S. dollars	$0.01	$0.01	$28.83	$0.01	$0.01	$25.93	$0.01	$0.01	$19.70	$0.01	$0.01
Average stock price at exercise											
Yen	¥3,445	¥3,872	¥4,033	¥4,000	¥3,752	¥3,933	¥4,402	¥3,995	¥3,768	—	¥4,313
U.S. dollars	$28.82	$32.39	$33.74	$33.46	$31.39	$32.90	$36.82	$33.42	$31.52	—	$36.08
Fair value price at grant date											
Yen	¥3,063	¥3,063	¥420	¥2,865	¥2,865	¥426	¥2,115	¥2,115	¥394	¥1,749	¥1,749
U.S. dollars	$25.62	$25.62	$3.51	$23.97	$23.97	$3.56	$17.69	$17.69	$3.30	$14.63	$14.63

(Number of shares)

	Stock option 2010 III	Stock option 2011 I	Stock option 2011 II	Stock option 2011 III	Stock option 2012 I	Stock option 2012 II	Stock option 2013 I	Stock option 2013 II	Stock option 2014 I	Stock option 2014 II
For the year ended December 31, 2014										
Non-vested										
Outstanding at December 31, 2013	—	—	—	—	—	—	—	—	—	—
Granted	—	—	—	—	—	—	—	—	12,000	28,000
Expired	—	—	—	—	—	—	—	—	—	—
Vested	—	—	—	—	—	—	—	—	12,000	28,000
Outstanding at December 31, 2014	—	—	—	—	—	—	—	—	—	—
Vested										
Outstanding at December 31, 2013	244,000	23,000	18,000	421,000	28,000	49,000	22,000	27,000	—	—
Vested	—	—	—	—	—	—	—	—	12,000	28,000
Exercised	80,000	4,000	4,000	90,000	5,000	7,000	—	—	—	—
Expired	—	—	—	—	—	—	—	—	—	—
Outstanding at December 31, 2014	164,000	19,000	14,000	331,000	23,000	42,000	22,000	27,000	12,000	28,000
Exercise price										
Yen	¥2,190	¥1	¥1	¥2,254	¥1	¥1	¥1	¥1	¥1	¥1
U.S. dollars	$18.32	$0.01	$0.01	$18.86	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01
Average stock price at exercise										
Yen	¥3,910	¥3,280	¥3,447	¥3,575	¥4,231	¥4,335	—	—	—	—
U.S. dollars	$32.71	$27.44	$28.84	$29.91	$35.39	$36.26	—	—	—	—
Fair value price at grant date										
Yen	¥245	¥1,718	¥1,718	¥211	¥2,119	¥2,119	¥3,027	¥3,027	¥3,808	¥3,808
U.S. dollars	$2.05	$14.37	$14.37	$1.77	$17.73	$17.73	$25.32	$25.32	$31.86	$31.86

The fair value prices for 2014 stock options were estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	Stock option 2014 I	Stock option 2014 II
Volatility of stock price	20.560%	20.560%
Estimated remaining outstanding period	3.5 years	3.5 years
Estimated dividend per share		
Yen	¥64	¥64
U.S. dollars	$0.54	$0.54
Risk-free interest rate	0.120%	0.120%

12 Comprehensive Income

Each component of other comprehensive income for the years ended December 31, 2014 and 2013 was as follows:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Unrealized gain (loss) on available-for-sale securities			
Gains (losses) arising during the year	¥ 1,005	¥ 3,122	$ 8,407
Reclassification adjustments to profit or loss	(11)	55	(92)
Amount before income tax effect	994	3,177	8,315
Income tax effect	(355)	(1,133)	(2,970)
Total	¥ 639	¥ 2,044	$ 5,345
Foreign currency translation adjustments			
Adjustments arising during the year	¥24,709	¥44,201	$206,701
Reclassification adjustments to profit or loss	—	—	—
Amount before income tax effect	24,709	44,201	206,701
Income tax effect	—	—	—
Total	¥24,709	¥44,201	$206,701
Share of other comprehensive income in affiliates			
Gains (losses) arising during the year	¥ 222	¥ 335	$ 1,857
Total	¥ 222	¥ 335	$ 1,857
Post retirement liability adjustments for foreign consolidated subsidiaries			
Adjustments arising during the year	—	¥ (4,401)	—
Reclassification adjustments to profit or loss	—	748	—
Amount before income tax effect	—	(3,653)	—
Income tax effect	—	894	—
Total	—	¥ (2,759)	—
Remeasurements of defined benefit plans			
Adjustments arising during the year	¥ (5,127)	—	$ (42,889)
Reclassification adjustments to profit or loss	(460)	—	(3,848)
Amount before income tax effect	(5,587)	—	(46,737)
Income tax effect	1,862	—	15,576
Total	¥ (3,725)	—	$ (31,161)
Total other comprehensive income	¥21,845	¥43,821	$182,742

13 Segment Information

(1) Description of reportable segments

The Companies' reportable segments are components for which separate financial information is available, and whose operating results are reviewed regularly by the chief operating decision maker in order to determine allocation of resources and assess segment performance.

The Companies are organized into four business operating units, the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business (collectively, the Consumer Products Business) and the Chemical Business. Each business operating unit plans comprehensive strategies for business in Japan and other countries, and conducts its own business activities.

Therefore, the Companies have four reportable segments: the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business.

The Beauty Care Business segment manufactures and sells cosmetics, skin care and 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.

(2) Methods of measurement for sales, profit (loss), assets, and other items for reportable segments

The amount of segment profit corresponds to that of operating income. Intersegment sales and transfer prices are calculated mainly based on market value or manufacturing cost.

(a) Information related to sales, profit (loss), assets, and other items

Information by reportable segment of the Companies for the years ended December 31, 2014 and 2013 was as follows:

	Millions of yen						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations*	Consolidated
Sales to customers	¥589,907	¥240,077	¥324,505	¥1,154,489	¥247,218	¥ —	¥1,401,707
Intersegment sales	—	—	—	—	40,804	(40,804)	—
Total sales	589,907	240,077	324,505	1,154,489	288,022	(40,804)	1,401,707
Segment profit (Operating income)	¥ 28,437	¥ 21,880	¥ 60,952	¥ 111,269	¥ 22,060	¥ (59)	¥ 133,270
Segment assets**	¥466,128	¥161,280	¥158,552	¥ 785,960	¥273,397	¥138,876	¥1,198,233
Other							
Depreciation and amortization***	¥ 30,302	¥ 10,618	¥ 9,541	¥ 50,461	¥ 14,101	¥ —	¥ 64,562
Investments in equity method affiliates**	3,782	1,122	1,328	6,232	3,032	—	9,264
Increase in property, plant and equipment and intangible assets	17,042	22,956	13,781	53,779	14,705	—	68,484

* Reconciliation of segment profit includes elimination of intersegment transactions of inventory.
Reconciliation of assets includes ¥163,750 million of the Company's financial assets and negative ¥24,874 million elimination of receivables among reportable segments.
** Balances as of December 31, 2014
*** Depreciation and amortization excludes amortization of goodwill.

	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations*	Consolidated
	Millions of yen						
	Dec. 2013						
	Reportable segment						
	Consumer Products Business						
Sales to customers	¥570,268	¥210,628	¥311,023	¥1,091,919	¥223,298	¥ —	¥1,315,217
Intersegment sales	—	—	—	—	37,894	(37,894)	—
Total sales	570,268	210,628	311,023	1,091,919	261,192	(37,894)	1,315,217
Segment profit (Operating income)	¥ 23,933	¥ 16,850	¥ 62,183	¥ 102,966	¥ 21,509	¥ 181	¥ 124,656
Segment assets**	¥482,704	¥130,610	¥148,936	¥ 762,250	¥245,720	¥125,306	¥1,133,276
Other							
Depreciation and amortization***	¥ 32,094	¥ 8,993	¥ 9,008	¥ 50,095	¥ 13,373	¥ —	¥ 63,468
Investments in equity method affiliates**	3,074	994	1,116	5,184	2,026	—	7,210
Increase in property, plant and equipment and intangible assets	19,219	13,628	14,699	47,546	16,141	—	63,687

* Reconciliation of segment profit includes elimination of intersegment transactions of inventory.
Reconciliation of assets includes ¥152,828 million of the Company's financial assets and negative ¥27,522 million elimination of receivables among reportable segments.
** Balances as of December 31, 2013
*** Depreciation and amortization excludes amortization of goodwill.

	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations*	Consolidated
	Thousands of U.S. dollars						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
Sales to customers	$4,934,809	$2,008,340	$2,714,614	$9,657,763	$2,068,078	$ —	$11,725,841
Intersegment sales	—	—	—	—	341,342	(341,342)	—
Total sales	4,934,809	2,008,340	2,714,614	9,657,763	2,409,420	(341,342)	11,725,841
Segment profit (Operating income)	$ 237,887	$ 183,035	$ 509,888	$ 930,810	$ 184,541	$ (494)	$ 1,114,857
Segment assets**	$3,899,347	$1,349,172	$1,326,351	$6,574,870	$2,287,075	$1,161,754	$10,023,699
Other							
Depreciation and amortization***	$ 253,488	$ 88,824	$ 79,814	$ 422,126	$ 117,961	$ —	$ 540,087
Investments in equity method affiliates**	31,638	9,386	11,109	52,133	25,364	—	77,497
Increase in property, plant and equipment and intangible assets	142,563	192,036	115,284	449,883	123,013	—	572,896

* Reconciliation of segment profit includes elimination of intersegment transactions of inventory.
Reconciliation of assets includes $1,369,834 thousand of the Company's financial assets and negative $208,081 thousand elimination of receivables among reportable segments.
** Balances as of December 31, 2014
*** Depreciation and amortization excludes amortization of goodwill.

(b) Information related to reportable segments

Sales by geographic area for the years ended December 31, 2014 and 2013 were as follows:

	Millions of yen				
	Dec. 2014				
	Japan	Asia	Americas*	Europe**	Consolidated
Sales to customers	¥937,696	¥203,174	¥125,324	¥135,513	¥1,401,707

	Millions of yen				
	Dec. 2013				
	Japan	Asia	Americas*	Europe**	Consolidated
Sales to customers	¥908,801	¥171,202	¥112,569	¥122,645	¥1,315,217

	Thousands of U.S. dollars				
	Dec. 2014				
	Japan	Asia	Americas*	Europe**	Consolidated
Sales to customers	$7,844,203	$1,699,632	$1,048,385	$1,133,621	$11,725,841

Note: Sales are classified by country or region based on the location of customers.

Property, plant and equipment by geographic area at December 31, 2014 and 2013 was as follows:

	Millions of yen				
	Dec. 2014				
	Japan	Asia	Americas*	Europe**	Consolidated
Property, plant and equipment	¥199,484	¥75,294	¥13,721	¥19,116	¥307,615

	Millions of yen				
	Dec. 2013				
	Japan	Asia	Americas*	Europe**	Consolidated
Property, plant and equipment	¥188,533	¥56,636	¥12,642	¥19,473	¥277,284

	Thousands of U.S. dollars				
	Dec. 2014				
	Japan	Asia	Americas*	Europe**	Consolidated
Property, plant and equipment	$1,668,764	$629,864	$114,782	$159,913	$2,573,323

*Americas: North America, South America, and Oceania **Europe: Europe and South Africa

(c) Impairment losses by reportable segment

Impairment losses by reportable segment for the years ended December 31, 2014 and 2013 were as follows:

	Millions of yen						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Impairment losses of assets	¥62	¥28	¥42	¥132	¥—	¥—	¥132

	Millions of yen						
	Dec. 2013						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Impairment losses of assets	¥96	¥35	¥54	¥185	¥785	¥—	¥970

	Thousands of U.S. dollars						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Impairment losses of assets	$519	$234	$351	$1,104	$—	$—	$1,104

(d) Amortization and balance of goodwill by reportable segment

Amortization and balance of goodwill by reportable segment for the years ended December 31, 2014 and 2013 were as follows:

	Millions of yen						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Amortization of goodwill	¥ 15,098	¥—	¥—	¥ 15,098	¥—	¥—	¥ 15,098
Goodwill at December 31, 2014	139,941	—	—	139,941	—	—	139,941

	Millions of yen						
	Dec. 2013						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Amortization of goodwill	¥ 13,829	¥—	¥—	¥ 13,829	¥—	¥—	¥ 13,829
Goodwill at December 31, 2013	152,286	—	—	152,286	—	—	152,286

	Thousands of U.S. dollars						
	Dec. 2014						
	Reportable segment						
	Consumer Products Business						
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Total	Chemical Business	Reconciliations	Consolidated
Amortization of goodwill	$ 126,301	$—	$—	$ 126,301	$—	$—	$ 126,301
Goodwill at December 31, 2014	1,170,663	—	—	1,170,663	—	—	1,170,663

14 Selling, General and Administrative Expenses

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

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Advertising	¥ 92,410	¥ 86,406	$ 773,047
Promotion	73,072	69,554	611,277
Research and development	51,739	49,650	432,817
Salaries and bonuses	130,974	130,265	1,095,650
Packing and delivery expenses	81,391	77,253	680,868

15 Other Income (Expenses)

"Other, net" consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Loss related to cosmetics	¥(8,896)*	¥ (9,652)**	$(74,419)*
Loss on sales or disposals of property, plant and equipment, and intangible assets, net	(2,706)	(2,645)	(22,637)
Other, net	1,978	708	16,547
Total	¥(9,624)	¥(11,589)	$(80,509)

* Compensation-related and other expenses of ¥8,896 million (US$74,419 thousand) have been recognized as "Loss related to cosmetics" as the substantive amount of loss on Kanebo Cosmetics brightening products containing Rhododenol, for which a voluntary recall was announced on July 4, 2013. Of this amount, ¥8,220 million (US$68,764 thousand) for estimated future expenditures has been recorded in "Liability for loss related to cosmetics" under current liabilities on the consolidated balance sheet.

** In connection with the voluntary recall by Kanebo Cosmetics Inc., Lissage Ltd. and e'quipe, Ltd., gross profit decreased by ¥2,400 million due to various factors including the deduction from net sales of goods returned from retailers, and ¥9,652 million in expenditures, including an estimated portion recognized as other expenses, was recognized as "Loss related to cosmetics" under other expenses in the consolidated statement of income. The relevant amount of impact was included in the operating income of the "Beauty Care Business" segment in segment information (Note 13). Please note that items in compensation expenses for which actual losses cannot be estimated have not been recognized in "Loss related to cosmetics".

16 Financial Instruments

(1) Group policy for financial instruments

The Companies position excess cash as standby funds until investing them in business activities, and manage them by investment only in short-term, low-risk financial instruments. The Companies have a policy to finance by debt from financial institutions and issuance of corporate bonds and other instruments in capital markets. The Companies use derivatives to hedge risk and do not use derivatives for the purposes of speculation.

(2) Nature and extent of risks arising from financial instruments and risk management

Receivables such as trade notes and trade accounts are exposed to customer credit risk. The Companies manage this risk by ensuring their internal deliberations and approval processes of reviewing customers' credit standing before entering into transactions with new customers. In addition, the Companies secure guarantee deposits or collateral as necessary. Furthermore, the Companies monitor due dates and manage balances of receivables by customer and periodically check the credit risk of key customers.

Marketable securities, which consist of commercial paper of highly-rated companies, bond investment trusts and others, are highly safe and liquid financial instruments.

Investment securities, which consist mainly of stock of business partners, are exposed to stock price volatility risk. The Companies periodically check the validity of their stockholdings.

Payment terms of payables, such as trade notes and trade accounts, are mostly less than one year.

Loans, principally from financial institutions, in short-term debt are mainly for financing related to operating activities. Bonds and loans, principally from financial institutions, in long-term debt are for financing related to maintenance of appropriate capital cost ratio and investment in property, plant and equipment. Certain loans with floating interest rates are exposed to interest rate volatility risk. The Companies use interest rate swaps for the purpose of hedging the interest rate volatility risk by converting the floating rates into fixed rates.

Derivative transactions entered into and managed by the Companies are made in accordance with internal policies that regulate objectives, credit limit amount, scope, organization and others. The Companies do not use derivatives for the purpose of speculation. All derivative transactions are entered into to meet requirements for hedging risk incorporated in the Companies' business. The Companies limit the counterparties to these derivative transactions to major international financial institutions to reduce their credit risk.

With regard to payables, such as trade notes, trade accounts and loans, the Companies monitor and manage liquidity risk by preparing monthly forecast statements of cash flows of each company.

(3) Fair values of financial instruments

Fair values of financial instruments are based on the quoted price in active markets. If a quoted price is not available, other rational valuation techniques are used. Also, see Note 17 for details of the fair values of derivatives. The contract amounts of derivatives which are shown in Note 17 do not represent the amounts exchanged by the parties and do not measure the Companies' exposure to credit or market risk.

The carrying amount, fair value and unrealized gain or loss of financial instruments as of December 31, 2014 and 2013 consisted of the following:

	Millions of yen		
	Dec. 2014		
	Carrying amount	Fair value	Unrealized gain/(loss)
Cash and time deposits	¥107,412	¥107,412	¥ —
Short-term investments	123,639	123,639	—
Notes and accounts receivable	212,835		
Allowance for doubtful receivables	(1,371)		
Notes and accounts receivable, net	211,464	211,464	—
Investment securities	10,473	10,473	—
Total	¥452,988	¥452,988	¥ —
Short-term debt	¥ 1,137	¥ 1,137	¥ —
Current portion of long-term debt	20,776	20,810	34
Notes and accounts payable	195,178	195,178	—
Income taxes payable	28,108	28,108	—
Long-term debt	84,152	85,258	1,106
Total	¥329,351	¥330,491	¥1,140
Derivatives	¥ (412)	¥ (412)	¥ —

	Millions of yen		
	Dec. 2013		
	Carrying amount	Fair value	Unrealized gain/(loss)
Cash and time deposits	¥126,314	¥126,314	¥ —
Short-term investments	101,645	101,645	—
Notes and accounts receivable	186,986		
Allowance for doubtful receivables	(1,503)		
Notes and accounts receivable, net	185,483	184,483	—
Investment securities	9,595	9,595	—
Total	¥423,037	¥423,037	¥ —
Short-term debt	¥ 1,278	¥ 1,278	¥ —
Current portion of long-term debt	21,256	21,299	(43)
Notes and accounts payable	170,890	170,890	—
Income taxes payable	32,322	32,322	—
Long-term debt	84,916	85,313	(397)
Total	¥310,662	¥311,102	¥(440)
Derivatives	¥ (189)	¥ (189)	¥ —

	Thousands of U.S. dollars		
	Dec. 2014		
	Carrying amount	Fair value	Unrealized gain/(loss)
Cash and time deposits	$ 898,544	$ 898,544	$ —
Short-term investments	1,034,290	1,034,290	—
Notes and accounts receivable	1,780,450		
Allowance for doubtful receivables	(11,469)		
Notes and accounts receivable, net	1,768,981	1,768,981	—
Investment securities	87,611	87,611	—
Total	$3,789,426	$3,789,426	$ —
Short-term debt	$ 9,511	$ 9,511	$ —
Current portion of long-term debt	173,800	174,084	284
Notes and accounts payable	1,632,742	1,632,742	—
Income taxes payable	235,135	235,135	—
Long-term debt	703,965	713,218	9,253
Total	$2,755,153	$2,764,690	$9,537
Derivatives	$ (3,447)	$ (3,447)	$ —

Cash and time deposits
The carrying values of cash and time deposits approximate fair value because of their short maturities.

Short-term investments and investment securities
The fair value of marketable equity securities is measured at the quoted market price of the stock exchange. The fair value of marketable debt securities is measured at the quoted market price of the stock exchange or at the quoted price obtained from the financial institutions if there is no quoted market price. The carrying values of other marketable securities, such as commercial paper, investment trust funds and others, approximate fair value because of their short maturities. See Note 4 for information on the fair value of short-term investments and investment securities by classification.

Notes and accounts receivable
The carrying values of notes and accounts receivable approximate fair value because of their short maturities.

Short-term debt
The carrying values of short-term debt approximate fair value because of their short maturities.

Current portion of long-term debt
The fair value of fixed interest loans is measured at the present value by discounting expected repayments of principal and interest in the remaining period using an assumed interest rate on an equivalent new loan.

Notes and accounts payable, and income taxes payable

The carrying values of notes and accounts payable, and income taxes payable approximate fair value because of their short maturities.

Long-term debt

The fair value of bonds issued by the Company is measured at the quoted market price.

The fair value of fixed interest loans is measured at the present value by discounting expected repayments of principal and interest in the remaining period using an assumed interest rate on an equivalent new loan.

The fair value of long-term loans subject to a special accounting method for interest rate swaps which qualify for hedge accounting and meet specific matching criteria is measured at the present value by discounting expected repayments of principal and interest together with the interest rate swaps in the remaining period using an assumed interest rate on an equivalent new loan.

The fair value of lease obligations is measured at the present value by discounting expected repayments of lease obligations including interest in the remaining period using an assumed interest rate on equivalent new lease obligations.

Derivatives

Information on fair value of derivatives is included in Note 17.

The carrying amount of financial instruments whose fair value cannot be reliably determined as of December 31, 2014 and 2013 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	Dec. 2014	Dec. 2013	Dec. 2014
Investment securities that do not have a quoted market price in an active market	¥1,182	¥1,181	$9,888

(4) Maturity analysis for financial assets and securities with contractual maturities

The maturity analysis for financial assets and securities with contractual maturities as of December 31, 2014 was as follows:

	Millions of yen			
	Due within one year	Due after one year through five years	Due after five years through ten years	Due after ten years
Cash and time deposits	¥107,412	¥—	¥—	¥—
Short-term investments and investment securities:				
Held-to-maturity debt securities	76,000	—	—	—
Available-for-sale other securities with contractual maturities		—	—	—
Notes and accounts receivable	212,835	—	—	—
Total	¥396,247	¥—	¥—	¥—

	Thousands of U.S. dollars			
	Due within one year	Due after one year through five years	Due after five years through ten years	Due after ten years
Cash and time deposits	$ 898,544	$—	$—	$—
Short-term investments and investment securities:				
Held-to-maturity debt securities	635,771	—	—	—
Available-for-sale other securities with contractual maturities		—	—	—
Notes and accounts receivable	1,780,450	—	—	—
Total	$3,314,765	$—	$—	$—

Please see Note 5 for annual maturities of long-term debt.

17 Derivatives

(a) Derivative transactions to which hedge accounting is not applied

The Company had the following derivative contracts outstanding to which hedge accounting was not applied at December 31, 2014 and 2013:

	Millions of yen			
	Dec. 2014			
	Contract amount	Contract amount due after one year	Fair value	Unrealized gain / (loss)
Foreign exchange forward contracts:				
Buying U.S. Dollar	¥3,652	¥2,980	¥ 154	¥ 154
Buying Japanese Yen	863	808	(115)	(115)
Buying other currencies	27	—	(0)	(0)
Selling U.S. Dollar	6,285	—	(162)	(162)
Selling Chinese Yuan	3,053	3,053	(67)	(67)
Selling other currencies	1,368	—	36	36
Foreign currency swaps:				
Receiving Japanese Yen, paying Chinese Yuan	2,279	2,279	(602)	(602)
Receiving U.S. Dollar, paying Indonesian Rupiah	7,750	7,750	405	405
Interest rate swaps:				
Receiving floating rate, paying fixed rate	2,637	2,637	(61)	(61)

	Millions of yen			
	Dec. 2013			
	Contract amount	Contract amount due after one year	Fair value	Unrealized gain / (loss)
Foreign exchange forward contracts:				
Buying U.S. Dollar	¥3,974	¥2,739	¥ (12)	¥ (12)
Buying Japanese Yen	33	—	(3)	(3)
Buying other currencies	8	—	0	0
Selling U.S. Dollar	6,996	—	(36)	(36)
Selling other currencies	1,120	—	2	2
Foreign currency swaps:				
Receiving Japanese Yen, paying Chinese Yuan	2,279	2,279	(380)	(380)
Receiving U.S. Dollar, paying Indonesian Rupiah	2,832	2,832	295	295
Interest rate swaps:				
Receiving floating rate, paying fixed rate	281	281	(55)	(55)

	Thousands of U.S. dollars			
	Dec. 2014			
	Contract amount	Contract amount due after one year	Fair value	Unrealized gain / (loss)
Foreign exchange forward contracts:				
Buying U.S. Dollar	$30,550	$24,929	$ 1,288	$ 1,288
Buying Japanese Yen	7,219	6,759	(962)	(962)
Buying other currencies	226	—	(0)	(0)
Selling U.S. Dollar	52,577	—	(1,355)	(1,355)
Selling Chinese Yuan	25,540	25,540	(560)	(560)
Selling other currencies	11,444	—	301	301
Foreign currency swaps:				
Receiving Japanese Yen, paying Chinese Yuan	19,065	19,065	(5,036)	(5,036)
Receiving U.S. Dollar, paying Indonesian Rupiah	64,832	64,832	3,388	3,388
Interest rate swaps:				
Receiving floating rate, paying fixed rate	22,060	22,060	(510)	(510)

(b) Derivative transactions to which hedge accounting is applied

The Companies had the following derivative contracts outstanding to which hedge accounting was applied at December 31, 2014 and 2013:

		Millions of yen						Thousands of U.S. dollars		
		Dec. 2014			Dec. 2013			Dec. 2014		
	Hedged item	Contract amount	Contract amount due after one year	Fair value	Contract amount	Contract amount due after one year	Fair value	Contract amount	Contract amount due after one year	Fair value
Interest rate swaps:										
(Fixed rate payment, Floating rate receipt)	Long-term debt	¥20,000	—	—	¥40,000	¥20,000	—	$167,308	—	—

The interest rate swaps which qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differentials paid or received under the swap agreements are recognized and included in interest expense or income. In addition, the fair value of the interest rate swaps is included in that of the hedged item, long-term debt, in Note 16.

18 Net Income per Share

A reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended December 31, 2014 and 2013 was as follows:

	Millions of yen	Thousands of shares	Yen	U.S. dollars
	Net income	Weighted average shares	EPS	
For the year ended December 31, 2014:				
Basic EPS				
Net income available to common shareholders	¥79,590	508,687	¥156.46	$1.31
Effect of dilutive securities				
Warrants	—	710		
Diluted EPS				
Net income for computation	¥79,590	509,397	¥156.24	$1.31

	Millions of yen	Thousands of shares	Yen
	Net income	Weighted average shares	EPS
For the year ended December 31, 2013:			
Basic EPS			
Net income available to common shareholders	¥64,764	513,880	¥126.03
Effect of dilutive securities			
Warrants	—	550	
Diluted EPS			
Net income for computation	¥64,764	514,430	¥125.89

Independent Auditor's Report

Deloitte.

Deloitte Touche Tohmatsu LLC
Shinagawa Intercity
2-15-3, Konan
Minato-ku, Tokyo 108-6221
Japan

Tel:+81 (3) 6720 8200
Fax:+81 (3) 6720 8205
www.deloitte.com/jp

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Kao Corporation:

We have audited the accompanying consolidated balance sheet of Kao Corporation and its consolidated subsidiaries as of December 31, 2014, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 its consolidated subsidiaries as of December 31, 2014, and the consolidated results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in Japan.

Convenience Translation

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

Deloitte Touche Tohmatsu LLC

March 17, 2015

Member of
Deloitte Touche Tohmatsu Limited

Principal Subsidiaries and Affiliates (As of March 25, 2015)

Country/Area	Business				Company
Japan	●	●	●		Kao Customer Marketing Co., Ltd.
	●				Kanebo Cosmetics Inc.
	●				Kanebo Cosmetics Sales Inc.
	●				E'quipe, Ltd.
	●				Kanebo Cosmillion Ltd.
	●				Nivea-Kao Co., Ltd.
		●	●		Kao Sanitary Products Ehime Co., Ltd.
			●		Kao Professional Services Co., Ltd.
				●	Kao-Quaker Co., Ltd.
China	●	●	●	●	Kao (China) Holding Co., Ltd.
	●	●	●		Kao Corporation Shanghai
	●	●	●		Kao Commercial (Shanghai) Co., Ltd.
	●				Kanebo Cosmetics (China) Co., Ltd.
	●				Shanghai Kanebo Cosmetics Co., Ltd.
				●	Kao Chemical Corporation Shanghai
				●	Kao Trading Corporation Shanghai
				●	Kao (Shanghai) Chemical Industries Co., Ltd.
	●	●	●		Kao (Hong Kong) Ltd.
Taiwan	●	●	●	●	Kao (Taiwan) Corporation
Vietnam	●	●	●		Kao Vietnam Co., Ltd.
Philippines				●	Pilipinas Kao, Inc.
Thailand	●	●	●	●	Kao Industrial (Thailand) Co., Ltd.
	●	●	●		Kao Commercial (Thailand) Co., Ltd.
Malaysia	●				Kao Soap (Malaysia) Sdn. Bhd.
	●	●	●		Kao (Malaysia) Sdn. Bhd.
				●	Fatty Chemical (Malaysia) Sdn. Bhd.
				●	Kao Plasticizer (Malaysia) Sdn. Bhd.
				●	Kao Oleochemical (Malaysia) Sdn. Bhd.
Singapore	●	●	●	●	Kao Singapore Private Limited
Indonesia	●	●	●		P.T. Kao Indonesia
				●	P.T. Kao Indonesia Chemicals

Country/Area	Business				Company
Australia	●		●		Kao Australia Pty. Limited
Canada	●				Kao Canada Inc.
United States	●				Kao USA Inc.
				●	Kao America Inc.
				●	Kao Specialties Americas LLC
Mexico				●	Quimi-Kao, S.A. de C.V.
Germany	●				Kao Germany GmbH
	●				Guhl Ikebana GmbH
	●				Kao Manufacturing Germany GmbH
				●	Kao Chemicals GmbH
Netherlands	●				Kao Netherlands B.V.
United Kingdom	●				Kao (UK) Limited
	●				KPSS (UK) Limited
	●				Molton Brown Limited
Switzerland	●				Kao Switzerland AG
	●				Kanebo Cosmetics (Europe) Ltd.
Spain				●	Kao Chemicals Europe, S.L.
				●	Kao Corporation S.A.

Consumer Products Business

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

Chemical Business

- ● Chemical Business

Investor Information (As of December 31, 2014)

Kao Corporation

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

Founded
June 19, 1887

Common Stock
Authorized: 1,000,000,000 shares
Issued: 504,000,000 shares
Outstanding (excluding treasury stock):
512,726,542 shares
Number of Shareholders: 46,744

Stock Listing
Tokyo Stock Exchange

Ticker Symbol Number
4452

Administrator of Shareholder Register
Sumitomo Mitsui Trust Bank, Limited
8-4, Izumi 2-chome, Suginami-ku, Tokyo 168-0063, Japan

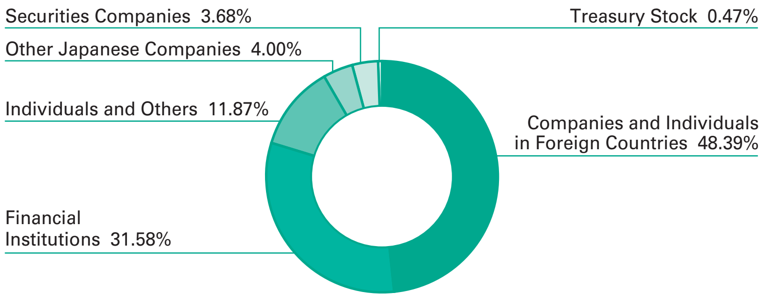
Depositary and Registration for American Depositary Receipts (ADR Ticker Symbol: KCRPY)
JPMorgan Chase Bank, N.A.
1 Chase Manhattan Plaza, Floor 58,
New York, NY 10005, U.S.A.

Top Ten Shareholders

Name of Shareholder	Number of Shares (thousand shares)	Ratio of Shareholding* (percentage)
Japan Trustee Services Bank, Ltd. (Trust Account)	30,106	5.97
The Master Trust Bank of Japan, Ltd. (Trust Account)	26,480	5.25
State Street Bank and Trust Company 505223	20,050	3.98
State Street Bank and Trust Company	9,790	1.94
Tokio Marine & Nichido Fire Insurance Co., Ltd.	8,664	1.72
JPMorgan Chase Bank 380055	8,380	1.66
State Street Bank and Trust Company 505225	8,275	1.64
Northern Trust Co. (AVFC) Re U.S. Tax Exempted Pension Funds	7,313	1.45
Mellon Bank, N.A. as Agent for its Client Mellon Omnibus US Pension	7,228	1.43
Northern Trust Co. (AVFC) Re Silchester International Investors International Value Equity Trust	7,053	1.40

* Ratio of shareholding is calculated based on the outstanding shares.

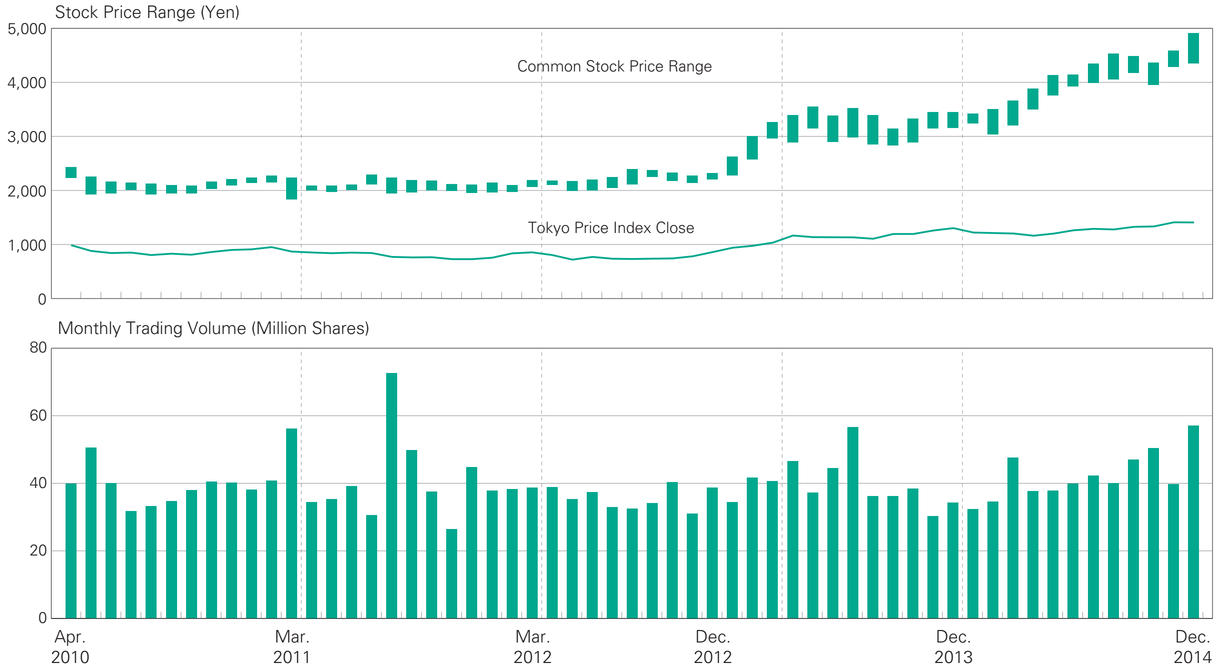
Composition of Shareholders



For the Kao Sustainability Report and Kao Group Profile, please refer to the Kao Group website at http://www.kao.com/group/en/group/reports.html

Investor Relations
Telephone: 81-3-3660-7101 Facsimile: 81-3-3660-8978
E-mail: ir@kao.co.jp
Website: http://www.kao.com/jp/en/corp_ir/investors.html

Stock Price Range and Trading Volume (Tokyo Stock Exchange)



Enriching lives, in harmony with nature.

Kao Corporation

14-10, Nihonbashi Kayabacho 1-chome
Chuo-ku, Tokyo 103-8210, Japan
http://www.kao.com

Waterless Printing. Naturally.

VEGETABLE OIL INK

GPN Green Purchasing Network
We promote green purchasing for printing services.

MIX
Paper from responsible sources
FSC™ C014687
www.fsc.org