Financial Report 2018

For the year ended December 31, 2018

Enriching lives,
in harmony with nature.

Management Discussion and Analysis

Management Policies

Management Policies of the Kao Group

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.

The Kao Way, which is the corporate philosophy of the Kao Group, serves as the foundation of all our activities. All members of the Kao Group will share the Kao Way and put it into practice every day as the foundation of our approaches and actions. Moreover, this commitment is embraced by all members of the Kao Group as we further promote efforts to fully utilize our assets and work together with passion to continue to share joy with consumers and customers in our core domains of cleanliness, beauty, health and chemicals.

Social conditions and the natural environment are changing dramatically. For the Kao Group to continue to grow sustainably, we must transform ourselves to drive change. We will deepen our Essential Research[1] to proactively offer innovations on a level that exerts an impact on society.

In addition, the Kao Group considers non-financial as well as financial strategies and initiatives to be a top management priority, and will conduct more substantive ESG activities globally under the name "Kirei[2] Action." To help create the future that people worldwide envision, we will take an approach unique to the Kao Group in squarely confronting the social issues raised by the Sustainable Development Goals (SDGs) and addressing matters such as the strengthening of environmental laws and regulations and the ethical concerns of consumers. As we achieve profitable growth and a high level of returns to stakeholders, we will become a corporate group with a global presence by 2030.

Among the various elements of ESG, the Kao Group views corporate governance as the cornerstone of management for supporting management's intentions and ambitions from both "proactive" and "protective" aspects and for continuously increasing its corporate value. For this purpose, the Kao Group works for ongoing *"Innovation"*[3] and will further enhance its internal controls for the execution of management that is swift, efficient and sound, as well as impartial and transparent.

1. Research that pursues the essence of things for both humans and materials from a scientific standpoint.
2. *Kirei* is a Japanese word that represents the concept of cleanliness, beauty, health, purity, and fairness.
3. *Innovation* is one of the values of the Kao Way, the corporate philosophy of the Kao Group.

Management Metric Used as a Target

As its principal management metric, the Kao Group uses economic value added (EVA®*), which measures true profit by factoring in the cost of invested capital. This essentially takes the perspective of shareholders and other asset owners to deploy capital efficiently and generate profits. The Kao Group believes that continuously increasing EVA will lead to increases in corporate value and thus corresponds with long-term benefits, not only for shareholders, but for all stakeholders. The target of the Kao Group's business activities is to increase EVA while expanding its business scale. The Kao Group uses this metric to assess its businesses, to make evaluations on investment in facilities, acquisitions and other items, and to develop performance targets for each fiscal year and for its compensation system.

* EVA is a registered trademark of Stern Stewart & Co. EVA is defined as net operating profit after tax (NOPAT) less a charge for the cost of capital employed in the business.

Medium-to-long-term Management Strategies of the Kao Group

Long-term Management Strategy

Long-term Targets

As its vision by 2030 based on the above management policies, the Kao Group aims to make Kao a company with a global presence by combining sustained "profitable growth," and "contributions to the sustainability of the world" with proposals to resolve social issues and social contribution activities conducted through its business operations. To achieve this vision, the Kao Group will promote the further reinforcement of the existing businesses that are its strength and the creation of new markets from a global perspective utilizing the R&D capabilities that will create value for the future, in addition to implementing basic measures to further raise the level of safety and reliability.

It is becoming difficult to predict the various changes that will occur throughout the world in all aspects, such as speed, size and direction. To deal with this situation, the Kao Group aims to achieve the above vision by fully embracing the slogan of "Transforming Ourselves to Drive Change."

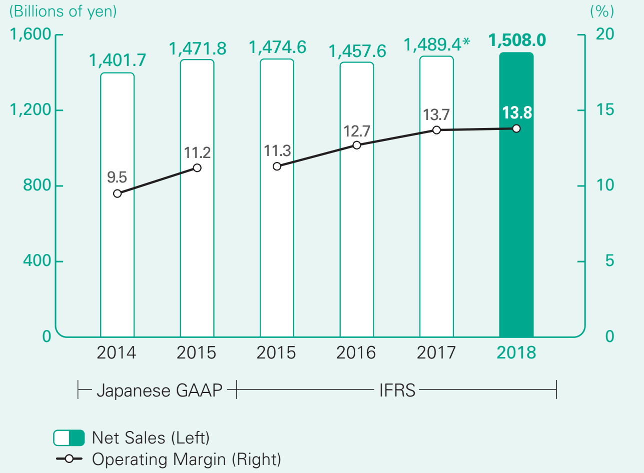
The Kao Group's Vision by 2030

Make Kao a company with a global presence that

- Has a distinctive corporate image

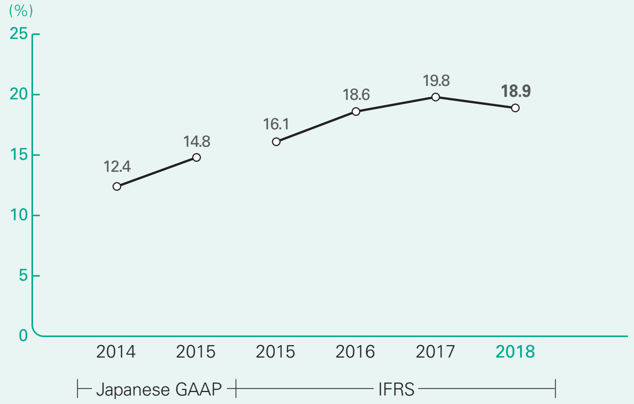
  Become a company that is always by the consumer's side
- Is a high-profit global consumer goods company that exceeds:
  - ¥2.5 trillion in net sales (¥1.0 trillion outside Japan)
  - 17% operating margin
  - 20% ROE
- Provides a high level of returns to stakeholders

Net Sales / Operating Margin



* In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan. As a result, certain items formerly treated as SG&A expenses are accounted for as reductions of net sales or cost of sales.

ROE



Mid-term Business Plan

The Kao Group regards its mid-term business plan for the period to 2020 as an important milestone toward achieving its vision by 2030. To enhance corporate value, it established the Kao Group Mid-term Plan 2020 "K20" targeting the four years from fiscal 2017 to fiscal 2020 and announced it publicly on December 12, 2016.

To further enhance its ESG activities, the Kao Group will thoroughly instill the *Integrity* set forth in the Kao Way, the Kao Group's corporate philosophy, by sharing and practicing it among all employees while deepening Essential Research. In July 2018, we established a new ESG Division to set up a structure for promoting ESG activities globally. In addition, by utilizing artificial intelligence, the Internet of Things, robotics and other cutting-edge technologies to take the full use of its assets to the next dimension, the Kao Group will realize profitable growth at a high level of quality and create new assets to achieve the following goals.

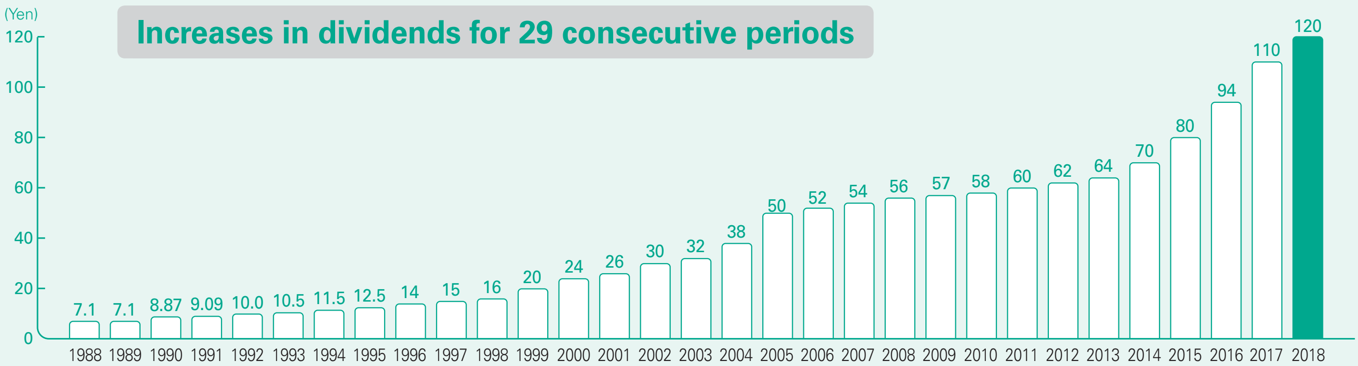
K20 Goals – Three Commitments

- Commitment to fostering a distinctive corporate image
- Commitment to profitable growth
  - Continue to set new record highs for profits
  - Aim for like-for-like* net sales CAGR of +5%, operating margin of 15%
  - Three ¥100 billion brands (*Merries* baby diapers, *Attack* laundry detergents, *Bioré* skin care products)

  * Excluding the effect of currency translation, change of sales system, etc.
- Commitment to returns to stakeholders
  - **Shareholders:** Continuous cash dividend increases (40% payout ratio target)
  - **Employees:** Continuous improvement in compensation, benefits and health support
  - **Customers:** Maximization of win-win relationships
  - **Society:** Advanced measures to address social issues

The Kao Group must securely build this foundation under K20 to achieve its vision by 2030. This entails promoting the evolution of its post-deflation growth model of using proactive investments to generate earning power, thus achieving profitable growth. Doing so will require drastically revising current procedures, approaches and concepts to maximize

Cash Dividends per Share



Note: Impact of share splits is reflected retroactively.

Costs, Expenses and Income as Percentages of Net Sales

	IFRS		
Years ended December 31, 2018, 2017 and 2016	2018	2017	2016
Cost of sales	56.6%	56.0%	43.7%
Gross profit	43.4	44.0	56.3
Selling, general and administrative expenses	29.5	30.4	43.5
Operating income	13.8	13.7	12.7
Income before income taxes	13.7	13.7	12.6
Net income attributable to owners of the parent	10.2	9.9	8.7

and make full use of Kao Group assets. While remaining committed to thoroughly instilling *Integrity,* the Kao Group will put into practice the K20 slogan of "Transforming Ourselves to Drive Change."

Issues for Management

With intensifying market competition, changing market structure and volatility in raw material market conditions and exchange rates, the operating environment remains uncertain. Changes in the attitudes of consumers regarding the environment, health and other matters and associated changes in their purchasing attitudes, as well as the aging society, hygiene and other social issues, are growing in significance. Moreover, amid the global expansion of business and the progress of structural changes in various fields, companies must deal with changes in the risks entailed in their businesses. Under these conditions, the Kao Group will promote both profitable growth and contributions to the sustainability of society through *Yoki-Monozukuri** that is a half-step ahead of these changes. To that end, it will address and deal appropriately with the following issues.

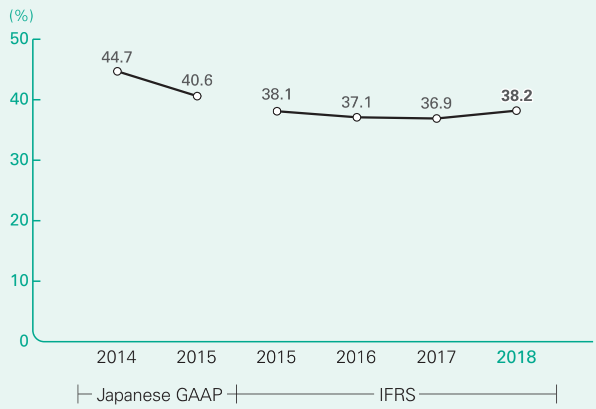
* The Kao Group defines *Yoki-Monozukuri* as a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction. In Japanese, *Yoki* literally means "good/excellent," and *Monozukuri* means "development/manufacturing of products."

(1) To deal with changes in the risks entailed in its businesses, the Kao Group will define risks that have a particularly large impact on management and for which it must enhance its response as corporate risks and work to prevent damage to the corporate value of the Group as a whole by further enhancing its management system.

(2) Given the current rapid progress of factors such as the diversification of values brought on by technology innovations and the accompanying changes in purchasing behavior and the structure of retailing, our business model targeting the mass market, which could formerly be conducted efficiently, must be reconsidered from all aspects, including research and development, production, logistics, sales and marketing. To resolve these issues, the Kao Group will proactively promote the enhancement of Essential Research and the use of artificial intelligence, the Internet of Things, robotics and other cutting-edge technologies.

(3) To sustainably enhance its corporate value, the Kao Group must appropriately address social issues in the areas of environmental preservation and resource conservation such as problems with marine plastic and

Payout Ratio



other kinds of trash, depletion of water resources, sustainable and responsible procurement, as well as safety and human rights, among others. Therefore, the Kao Group will globally roll out and accelerate the ESG-related initiatives it has been conducting, primarily through the ESG Division, and enhance its management system for conducting checks and administering these initiatives. In October 2018, the Kao Group announced "Our Philosophy & Action on Plastic Packaging."

Basic Approach to Selection of Accounting Standards

Having decided that unifying accounting standards within the Kao Group will contribute to improving the quality of its business management, the Kao Group has voluntarily adopted International Financial Reporting Standards (IFRS) from fiscal 2016. This will enable management based on standardized procedures and information for each Group company and business, and the Kao Group intends to reinforce its management foundation in order to increase its corporate value as a global company. The Kao Group also believes that the application of IFRS will facilitate the international comparability of its financial statements in capital markets.

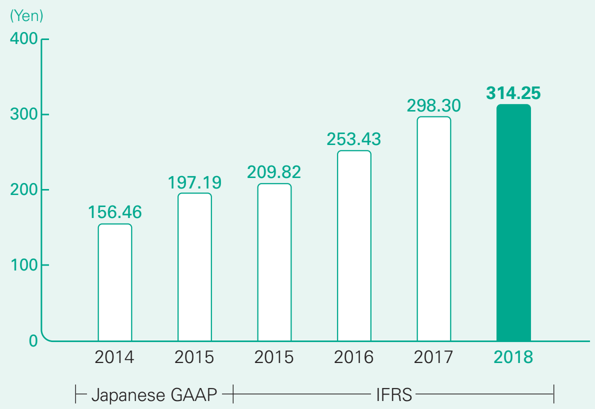
Overview of Consolidated Results

Conditions in the global economy are unclear due to factors including trends in trade issues, the economic outlook for China and other emerging countries in Asia and the impact of uncertainty about the policies of the Americas and Europe.

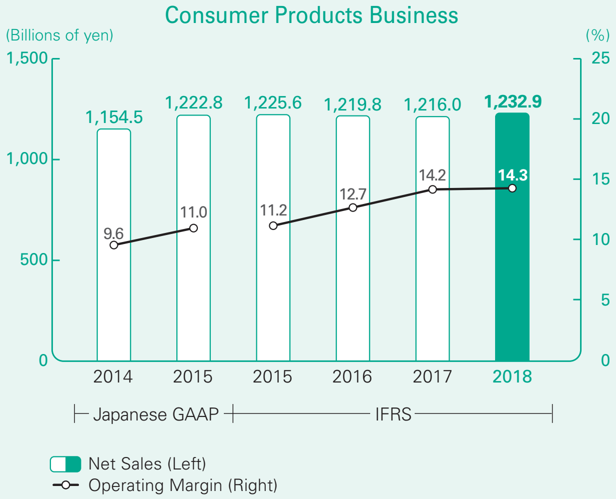
From January to December 2018, the markets for household and personal care products and cosmetics in Japan, which are key markets for the Kao Group, were in solid condition according to retail sales and consumer purchasing survey data. In every product category, the share of the e-commerce channel increased further and average unit prices for household and personal care products increased by 1 percentage point compared with the same period a year earlier.

Under these circumstances, the Kao Group completed the second fiscal year of the Kao Group Mid-term Plan "K20" covering the four years from 2017 to 2020. With technology innovations such as artificial intelligence and the Internet of Things, the structure of retailing and purchasing behavior and other factors are changing rapidly worldwide and consumer values are diversifying. The Kao Group invested proactively for the future and made efforts that included enhancing new and improved product launches, marketing and sales activities that address these changes. As a result, in its consolidated operating results the Kao Group increased operating income and net income

Basic Earnings per Share



Net Sales / Operating Margin



Notes: In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan. In FY 2018, due to the reorganization of the sales organization of the Consumer Products Business in Japan, operating income for the previous fiscal year has been restated.

for the ninth consecutive fiscal year and achieved record-high operating income for the sixth consecutive fiscal year. The Kao Group did not reach its forecast of consolidated operating results, but the entire Group will continue to work to achieve "K20."

Analysis of Income Statement

Net sales increased 1.2% compared with the previous fiscal year to ¥1,508.0 billion. On a like-for-like basis, net sales increased 1.3%. In the Consumer Products Business in Japan, the Kao Group made efforts including launches of new and improved products and further enhancement of its sales promotion activities, but sales decreased slightly. Outside Japan, sales increased. The Chemical Business was impacted by factors including selling price adjustments associated with a drop in prices for natural fats and oils, but sales increased due to promotion of high-value-added products.

As for profits, depreciation expenses and other costs increased, but due to more efficient deployment of marketing expenses and the effect of increased sales in the Consumer Products Business in Asia, among other factors, operating income was ¥207.7 billion, an increase of ¥2.9 billion compared with the previous fiscal year, the operating margin was 13.8% and income before income taxes was ¥207.3 billion, an increase of ¥3.0 billion. Net income was ¥155.3 billion, an increase of ¥6.7 billion.

Basic earnings per share were ¥314.25, an increase of ¥15.95, or 5.3%, from ¥298.30 in the previous fiscal year.

To improve capital efficiency and further increase shareholder returns, Kao Corporation (the Company) resolved at a meeting of its Board of Directors held on April 27, 2018 to repurchase its own shares, and repurchased shares totaling ¥50.0 billion. The Company retired 6.3 million treasury shares on September 14, 2018.

Information by Segment

As of the fiscal year ended December 31, 2018, the following changes have been made.

1. The Beauty Care Business has been divided into the Cosmetics Business and the Skin Care and Hair Care Business, changing the four former reportable segments into five.
2. The *Curél* derma care brand, which formerly had been classified as skin care and hair care products, has been included in the Cosmetics Business, and the *Success* men's products brand, which formerly had been classified in the Human Health Care Business, has been included in the Skin Care and Hair Care Business. Net sales and operating income for the previous fiscal year have been restated accordingly.
3. Due to the reorganization of the sales organization of the Consumer Products Business in Japan, operating income for the previous fiscal year has been restated.

Consumer Products Business

Sales increased 1.4% compared with the previous fiscal year to ¥1,232.9 billion. On a like-for-like basis, sales increased 1.6%.

The Kao Group worked for more effective marketing and sales activities, including launching new and improved products that address the diversification of consumer values and enhancing activities in the e-commerce channel in line with changes in purchasing behavior.

In Japan, sales decreased slightly by 0.3% to ¥883.9 billion.

In Asia, sales were steady, increasing 5.3% to ¥198.7 billion. On a like-for-like basis, sales increased 6.3%.

In the Americas, sales increased 10.0% to ¥85.0 billion. On a like-for-like basis, sales increased 12.1%. In Europe, sales increased 2.3% to ¥65.2 billion. On a like-for-like basis, sales increased 0.1%.

Operating income increased ¥2.7 billion compared with the previous fiscal year to ¥175.7 billion.

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

Cosmetics Business

Sales increased 5.0% compared with the previous fiscal year to ¥279.6 billion. On a like-for-like basis, sales increased 5.0%.

The Kao Group announced a new growth strategy in May 2018, and was able to achieve some success from optimizing the brand portfolio, enhancing marketing and other measures. The Kao Group determined key strategic brands to promote selection and concentration, and enhanced digital marketing in response to changes in consumer purchasing behavior.

Counseling cosmetics *SUQQU* and *RMK*, which are available in the department store channel, and in self-selection cosmetics, freeplus, which is hypoallergenic and contains Japanese and Chinese botanical extracts, and the *Curél* derma care brand sold strongly. *SOFINA iP* base essence was improved in September 2018, and sales grew steadily as it gained acceptance among an increasing number of consumers. Sales increased substantially in the strongly growing Asian region, led by China. The Kao Group will further develop the Cosmetics Business by executing its new growth strategy as it steadily implements structural reforms.

Operating income was ¥27.7 billion, a substantial improvement of ¥14.7 billion from the previous fiscal year, due to the effects of increased sales of strongly performing brands and the Asia business, among other factors.

Skin Care and Hair Care Business

Sales increased 2.6% compared with the previous fiscal year to ¥341.4 billion. On a like-for-like basis, sales increased 2.7%.

In skin care products, sales of the *Bioré* brand grew steadily in Japan and Asia, but were impacted by stiff competition in the Americas. *Jergens* hand and body lotions performed steadily in the Americas.

In hair care products in Japan, the Kao Group launched *Rerise*, an innovative next-generation brand for gray hair care, and its performance was strong but sales of shampoos and conditioners decreased due to a delayed response to the growing premium market and the impact of the shrinking mass market. In Europe, the *John Frieda* hair care brand was affected by intense market competition.

In January 2018, U.S.-based Oribe Hair Care, LLC, which owns *Oribe*, a super-premium-price brand for hair salons, became a consolidated subsidiary and its sales were strong.

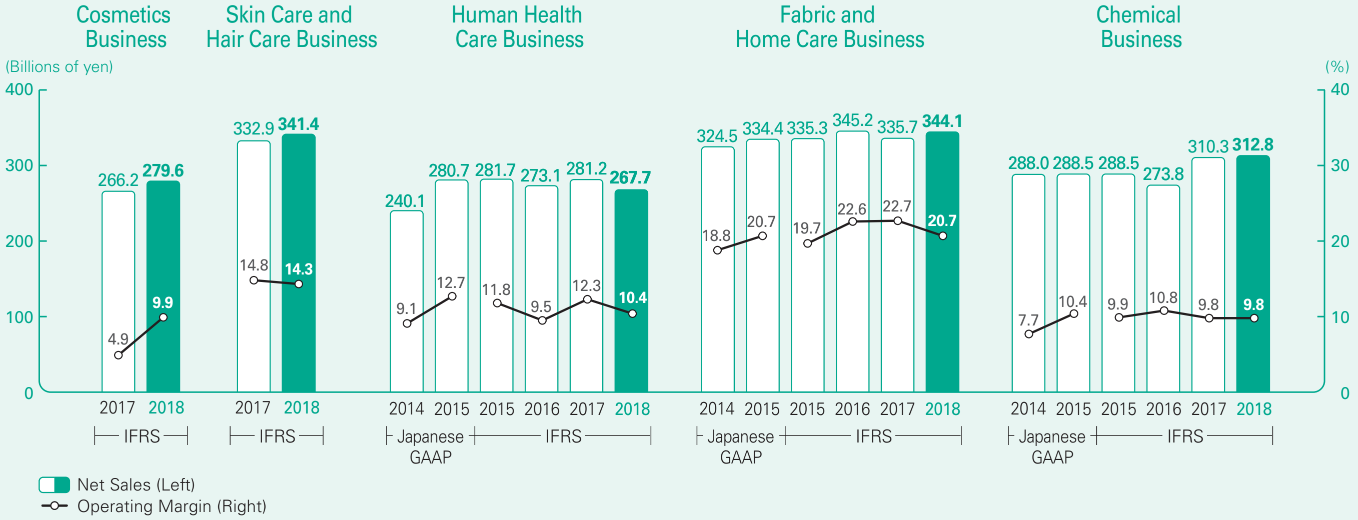
Operating income decreased ¥0.5 billion compared with the previous fiscal year to ¥48.8 billion due to factors including expenses incurred for structural reforms in the Americas and Europe, despite the effect of increased sales of skin care products in Japan and in Asia.

Human Health Care Business

Sales decreased 4.8% compared with the previous fiscal year to ¥267.7 billion. On a like-for-like basis, sales decreased 4.4%.

For *Merries* baby diapers, sales in Japan decreased. The Kao Group gained greater consumer support in Japan by conducting product improvements and enhancing sampling and other sales promotion activities, but due to factors including the impact of the new e-commerce law in China, which came into effect as of January 2019, there was a substantial downturn in demand for the purpose of resale in China. Sales in China also decreased due to factors including

Net Sales / Operating Margin



Notes: In FY2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan.
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Figures for the Consumer Products Business present sales to external customers and figures for the Chemical Business include sales to the Consumer Products Business in addition to external customers.

intensifying price competition and aggressive activities by local manufacturers. On the other hand, locally produced products targeting the middle-class consumer segment performed well in Indonesia and market share grew in Russia and neighboring countries as the products gained broad acceptance among consumers.

For *Laurier* sanitary napkins, high-value-added products performed strongly in Japan, China and elsewhere, and among adult incontinence products, sales grew steadily in Japan for a line of *Relief* ultra-thin pants-type diapers designed to be like regular underwear.

Sales of personal health products were steady. In oral care and bath additives, high-performance products sold steadily. Sales of *MegRhythm* thermo products grew as the Kao Group increased the number of loyal users through measures such as launching improved items and enhancing digital marketing.

In food and beverage products, the Kao Group conducted business reforms and the profit structure improved.

Operating income decreased ¥6.5 billion compared with the previous fiscal year to ¥27.9 billion, due to the decrease in sales of baby diapers, higher raw material costs, increased depreciation expenses and other factors.

Fabric and Home Care Business

Sales increased 2.5% compared with the previous fiscal year to ¥344.1 billion. On a like-for-like basis, sales increased 2.6%.

Sales of fabric care products were firm amid an environment of severe competition in Japan. The Kao Group worked to enhance communication of the value of *Attack* laundry detergent in "changing tap water for washing to antibacterial water" and increased the market share of fabric softeners by improving *Flair Fragrance* amid the ongoing expansion of the market for high-value-added products.

Sales of home care products were firm. In Japan, the Kao Group cultivated new users by improving foam spray-type *CuCute* dishwashing detergent, and sales grew steadily.

Sales were firm in Asia as the Kao Group launched high-value-added products and enhanced in-store merchandising in Thailand and other countries. In addition, to strengthen its commercial-use products business outside Japan, the Kao Group completed the acquisition of U.S.-based Washing Systems, LLC and made it a consolidated subsidiary in August 2018.

Operating income decreased ¥5.0 billion compared with the previous fiscal year to ¥71.2 billion due to factors including the impact of increased costs for petrochemicals and other raw materials in a severe competitive environment.

Chemical Business

Sales increased 0.8% compared with the previous fiscal year to ¥312.8 billion. On a like-for-like basis, sales increased 0.5%.

Sales of oleo chemicals decreased due to the impact of selling price adjustments associated with a drop in prices for natural fats and oils, although demand outside Japan was firm. Sales of performance chemicals increased, due in part to the contribution from growth in sales volume in infrastructure-related fields. In specialty chemicals, sales of hard disk-related products were steady, despite the impact of a decrease in customer demand for toner and toner binder.

Operating income increased ¥0.3 billion compared with the previous fiscal year to a record high of ¥30.6 billion due to growth in sales of oleo chemicals outside Japan and promotion of high-value-added products.

Financial Position

Total assets increased ¥33.6 billion from December 31, 2017 to ¥1,461.0 billion. The principal increases in assets were a ¥13.7 billion increase in inventories, a ¥23.1 billion increase in property, plant and equipment, a ¥41.6 billion increase in goodwill and a ¥29.7 billion increase in intangible assets. The principal decrease in assets was a ¥77.1 billion decrease in cash and cash equivalents.

Total liabilities increased ¥17.5 billion from December 31, 2017 to ¥625.5 billion. The principal increase in liabilities was a ¥19.9 billion increase in retirement benefit liabilities.

Total equity increased ¥16.1 billion from December 31, 2017 to ¥835.5 billion. The principal increase in equity was net income totaling ¥155.3 billion. The principal decreases in equity were purchase of treasury shares from the market totaling ¥50.0 billion, dividends totaling ¥57.5 billion and other comprehensive income totaling ¥32.1 billion.

As a result of the above factors, the ratio of equity attributable to owners of the parent to total assets was 56.3% compared with 56.5% at December 31, 2017. The Kao Group maintained return on equity at the high level of 18.9%.

In addition, the Company retired 6.3 million treasury shares on September 14, 2018.

Cash Flows

The balance of cash and cash equivalents at December 31, 2018 decreased ¥77.1 billion compared with December 31, 2017 to ¥266.0 billion, including the effect of exchange rate changes.

Cash Flows from Operating Activities

Net cash flows from operating activities totaled ¥195.6 billion. The principal increases in net cash were income before income taxes of ¥207.3 billion, depreciation and amortization of ¥60.7 billion and increase in retirement benefit liabilities of ¥20.7 billion. The principal decreases in net cash were increase in trade and other receivables of ¥12.6 billion, increase in inventories of ¥15.7 billion and income taxes paid of ¥51.7 billion.

Cash Flows from Investing Activities

Net cash flows from investing activities totaled negative ¥157.9 billion. This primarily consisted of purchase of property, plant and equipment of ¥80.3 billion for capacity expansion at production bases in Japan and proactive capital investments in Asia, where growth is notable, and payments for business combinations of ¥73.9 billion for businesses for hair salons, commercial-use products and other purposes where synergies with existing business are expected.

Free cash flow, the sum of net cash flows from operating activities and net cash flows from investing activities, was ¥37.7 billion.

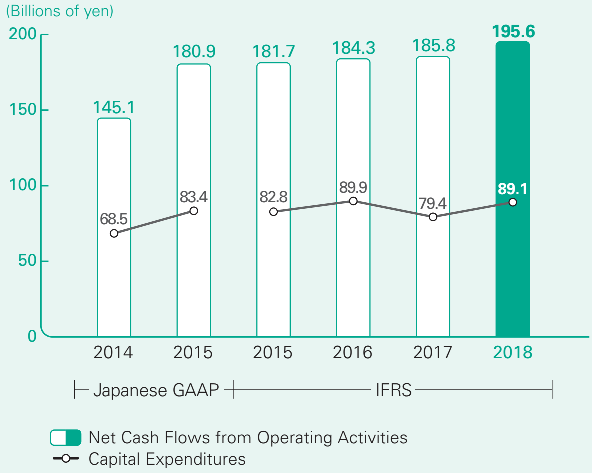
Cash Flows from Financing Activities

Net cash flows from financing activities totaled negative ¥108.6 billion. The Company emphasizes steady and continuous dividends and flexibly repurchases and retires treasury shares to improve capital efficiency from the perspective of EVA. During fiscal 2018, this primarily consisted of ¥57.6 billion for dividends paid to owners of the parent and non-controlling interests and ¥50.0 billion for purchase of treasury shares. In addition, to reinforce its financial base in order to maintain an appropriate capital cost rate and to invest for growth, the Kao Group issued and redeemed corporate bonds, which resulted in ¥25.1 billion in proceeds from issuance of bonds and payments totaling ¥24.9 billion for redemption of bonds.

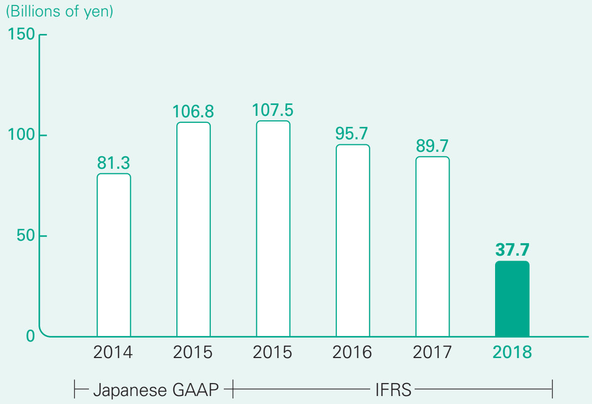
Basic Policies regarding Distribution of Profits and Dividends for the Fiscal Years Ended December 31, 2018 and Ending December 31, 2019

The Kao Group uses economic value added (EVA) as its principal management metric and clearly sets the uses of its

Net Cash Flows from Operating Activities / Capital Expenditures



Free Cash Flows*



* Free cash flow is the sum of net cash flows from operating activities and net cash flows from investing activities.

steadily generated cash flow as shown below from that viewpoint. Shareholder returns are one such use, and they are implemented after considering future demand for funds and the situation in financial markets.

Use of cash flow:

- Investment for future growth (capital expenditures, M&A, etc.)
- Steady and continuous dividends (40% payout ratio target)
- Share repurchases and early repayment of interest-bearing debt including borrowings

In accordance with these policies, the Company plans to pay a year-end dividend for fiscal 2018 of ¥60 per share, an increase of ¥4 per share compared with the previous fiscal year. Consequently, annual cash dividends will increase ¥10 per share compared with the previous fiscal year, resulting in a total of ¥120 per share. The consolidated payout ratio will be 38.2%.

For fiscal 2019, the Company plans to pay total cash dividends of ¥130 per share (39.1% payout ratio), an increase of ¥10 per share compared with the previous fiscal year. 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 Company is aiming for its 30th consecutive fiscal year of increases in dividends.

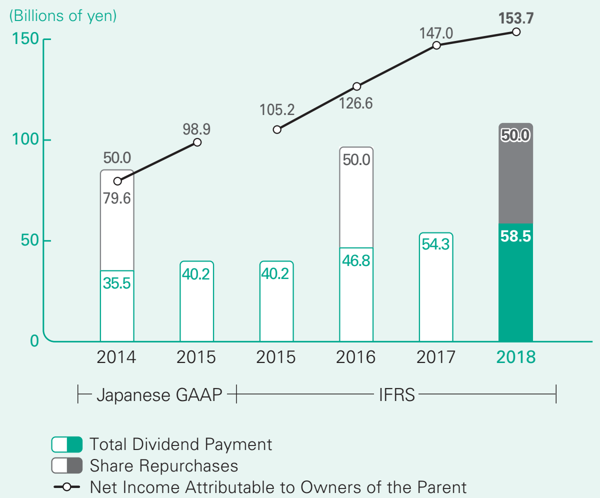
EVA and Related Activities

EVA for fiscal 2018 was ¥93.5 billion, an increase of ¥3.1 billion compared with the previous fiscal year due to growth in net operating profit after tax (NOPAT) that exceeded the increase in capital costs from the previous fiscal year.

The Kao Group conducted the following EVA-related activities during the fiscal year.

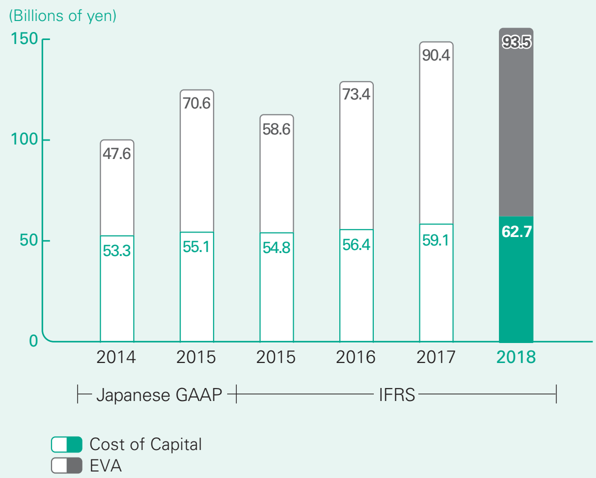
Investing for Growth: During fiscal 2018, the Kao Group invested aggressively for future growth. Capital expenditures were ¥89.1 billion. In the Consumer Products Business, the Kao Group carried out activities including facility expansion, streamlining, maintenance and renewal in each of its businesses. The Kao Group reinforced its supply system in the Skin Care and Hair Care Business by constructing a new building on the grounds of the Toyohashi Plant for efficient production of premium products, and in the Human Health Care Business by expanding production capacity at its factories for sanitary products inside and outside Japan. In the Chemical Business, the Kao Group expanded production capacity inside and outside Japan and conducted activities including streamlining, maintaining and renewing facilities. Expenditures for business combinations with a hair salon business, a commercial-use products business and other businesses with

Total Dividend Payment / Share Repurchases* / Net Income Attributable to Owners of the Parent



* Excludes repurchase of shares of less than one trading unit

Cost of Capital / EVA



the expectation of synergy with existing businesses totaled ¥73.9 billion. Research and development expenditures were ¥57.7 billion, which was the equivalent of 3.8% of net sales, remaining at a high level relative to net sales.

Increasing Profit: The Kao Group increased operating income in the Consumer Products Business by launching new and improved products, further enhancing sales promotion activities and promoting a shift to digital marketing in Japan. In the Chemical Business, the Kao Group achieved record-high operating income from growth in sales of oleo chemicals outside Japan and promotion of high-value-added products.

Financial Improvement: For fiscal 2018, the Company paid annual dividends per share of ¥120.00, a year-on-year increase of ¥10.00, or 9%, as announced in its forecast at the beginning of the fiscal year. As a result, the Company has achieved 29 consecutive fiscal periods of dividend growth. In addition, the Kao Group repurchased ¥50.0 billion of its own shares to improve capital efficiency.

R&D Expenses

(Billions of yen)

	2018
Cosmetics Business	10.5
Skin Care and Hair Care Business	16.0
Human Health Care Business	11.3
Fabric and Home Care Business	9.8
Chemical Business	10.2

Business Risks and Other Risks

Various risks arise in the course of a company's business. The Kao Group manages risks appropriately by identifying and evaluating risks to formulate and implement necessary countermeasures, among other activities. In addition, in the event a risk manifests itself, the Kao Group sets up an emergency response organization and strives to keep the extent of injury and damage as small as possible by responding promptly. However, in the event a major risk such as those described below manifests itself, it may exert a significant impact on the Kao Group's business results and financial condition. The major 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 the Company as of the submission of its securities report to the Ministry of Finance.

(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 and expansion 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, unexpected radical changes in market prices 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 Associated with Events Such as Large-scale Earthquakes or Climate Change, 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, natural disasters associated with events such as a large-scale earthquake or climate change 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 or control system malfunction, problems at a supplier of raw materials, dysfunction of social infrastructure 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 fixed assets and intangible 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 Capital

The Kao Group strives to secure diverse, superior human capital to achieve its business goals globally. Human capital with advanced expertise in areas such as research and development, production, marketing and sales is indispensable in aiming for the *Yoki-Monozukuri* (see note on page 4) that consumers support. However, an inability to secure the necessary human capital 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 and Response to Laws and Regulations, Etc.

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. It will also be required to respond to policies and tightening of legal and regulatory systems in various countries for mitigating climate change. The Kao Group has constructed a compliance system, among other measures, and strives to comply with and respond to all related laws, regulations, policies and systems. 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 Statement of Financial Position

Kao Corporation and Consolidated Subsidiaries
As of December 31, 2018

(Millions of yen)

Assets	Notes	2018	2017
Current assets			
Cash and cash equivalents	8, 35	265,978	343,076
Trade and other receivables	9, 35	223,102	216,507
Inventories	10	197,571	183,921
Other financial assets	35	15,146	14,914
Income tax receivables		2,066	2,653
Other current assets	11	22,449	28,162
Subtotal		726,312	789,233
Non-current assets held for sale	12	—	147
Total current assets		726,312	789,380
Non-current assets			
Property, plant and equipment	13	418,935	395,800
Goodwill	14	180,286	138,735
Intangible assets	14	46,549	16,829
Investments accounted for using the equity method	15	7,931	7,682
Other financial assets	35	23,540	27,345
Deferred tax assets	16	49,158	40,918
Other non-current assets	11, 20	8,275	10,686
Total non-current assets		734,674	637,995
Total assets		1,460,986	1,427,375

Liabilities and equity	Notes	2018	2017
Liabilities			
Current liabilities			
Trade and other payables	19, 35	225,560	224,893
Bonds and borrowings	17, 35	40,488	25,262
Other financial liabilities	18, 35	6,880	7,739
Income tax payables		34,198	34,255
Provisions	21	2,873	4,822
Contract liabilities	26	18,387	17,296
Other current liabilities	22	102,452	107,404
Total current liabilities		430,838	421,671
Non-current liabilities			
Bonds and borrowings	17, 35	80,339	95,322
Other financial liabilities	18, 35	9,506	10,091
Retirement benefit liabilities	20	84,552	64,694
Provisions	21	12,175	10,617
Deferred tax liabilities	16	2,864	435
Other non-current liabilities		5,203	5,181
Total non-current liabilities		194,639	186,340
Total liabilities		625,477	608,011
Equity			
Share capital	23	85,424	85,424
Capital surplus	23	108,245	107,980
Treasury shares	23	(11,282)	(9,593)
Other components of equity	23	(30,029)	(12,315)
Retained earnings	23	670,002	634,885
Equity attributable to owners of the parent		822,360	806,381
Non-controlling interests		13,149	12,983
Total equity		835,509	819,364
Total liabilities and equity		1,460,986	1,427,375

Consolidated Statement of Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2018

(Millions of yen)

	Notes	2018	2017
Net sales	6, 26	1,508,007	1,489,421
Cost of sales	10, 13, 14, 20	(853,989)	(834,107)
Gross profit		654,018	655,314
Selling, general and administrative expenses	13, 14, 20, 27	(444,845)	(452,666)
Other operating income	13, 26, 28	14,288	14,909
Other operating expenses	13, 14, 20, 29	(15,758)	(12,766)
Operating income	6	207,703	204,791
Financial income	6, 20, 30	1,717	1,452
Financial expenses	6, 20, 30	(4,251)	(3,960)
Share of profit in investments accounted for using the equity method	6, 15	2,082	2,007
Income before income taxes	6	207,251	204,290
Income taxes	16	(51,920)	(55,683)
Net income		155,331	148,607
Attributable to:			
Owners of the parent		153,698	147,010
Non-controlling interests		1,633	1,597
Net income		155,331	148,607
Earnings per share			
Basic (Yen)	31	314.25	298.30
Diluted (Yen)	31	314.12	298.09

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2018

(Millions of yen)

	Notes	2018	2017
Net income		155,331	148,607
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	32, 35	(2)	1,166
Remeasurements of defined benefit plans	32	(15,524)	21,260
Share of other comprehensive income of investments accounted for using the equity method	32	(345)	317
Total of items that will not be reclassified to profit or loss		(15,871)	22,743
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations	32	(16,140)	8,541
Share of other comprehensive income of investments accounted for using the equity method	32	(73)	(1)
Total of items that may be reclassified subsequently to profit or loss		(16,213)	8,540
Other comprehensive income, net of taxes		(32,084)	31,283
Comprehensive income		123,247	179,890
Attributable to:			
Owners of the parent		122,324	178,020
Non-controlling interests		923	1,870
Comprehensive income		123,247	179,890

Consolidated Statement of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2018

(Millions of yen)

		Equity attributable to owners of the parent												
					Other components of equity									
	Notes	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
January 1, 2018		85,424	107,980	(9,593)	731	(21,540)	4	8,490	—	(12,315)	634,885	806,381	12,983	819,364
Net income....................		—	—	—	—	—	—	—	—	—	153,698	153,698	1,633	155,331
Other comprehensive income.......................		—	—	—	—	(15,492)	(5)	(338)	(15,539)	(31,374)	—	(31,374)	(710)	(32,084)
Comprehensive income....		—	—	—	—	(15,492)	(5)	(338)	(15,539)	(31,374)	153,698	122,324	923	123,247
Disposal of treasury shares........................	23	—	(99)	48,345	(167)	—	—	—	—	(167)	(47,961)	118	—	118
Purchase of treasury shares........................	23	—	—	(50,034)	—	—	—	—	—	—	—	(50,034)	—	(50,034)
Share-based payment transactions.............	34	—	364	—	—	—	—	—	—	—	—	364	—	364
Dividends	25	—	—	—	—	—	—	—	—	—	(56,793)	(56,793)	(746)	(57,539)
Transfer from other components of equity to retained earnings...		—	—	—	(18)	—	—	(1,694)	15,539	13,827	(13,827)	—	—	—
Other increase (decrease)		—	—	—	—	—	—	—	—	—	—	—	(11)	(11)
Total transactions with the owners.................		—	265	(1,689)	(185)	—	—	(1,694)	15,539	13,660	(118,581)	(106,345)	(757)	(107,102)
December 31, 2018		85,424	108,245	(11,282)	546	(37,032)	(1)	6,458	—	(30,029)	670,002	822,360	13,149	835,509
January 1, 2017		85,424	107,648	(57,124)	911	(29,761)	4	7,025	—	(21,821)	565,715	679,842	11,621	691,463
Net income....................		—	—	—	—	—	—	—	—	—	147,010	147,010	1,597	148,607
Other comprehensive income.......................		—	—	—	—	8,221	(0)	1,472	21,317	31,010	—	31,010	273	31,283
Comprehensive income....		—	—	—	—	8,221	(0)	1,472	21,317	31,010	147,010	178,020	1,870	179,890
Disposal of treasury shares........................	23	—	—	49,373	(165)	—	—	—	—	(165)	(48,914)	294	—	294
Purchase of treasury shares........................	23	—	—	(1,842)	—	—	—	—	—	—	—	(1,842)	—	(1,842)
Share-based payment transactions	34	—	332	—	—	—	—	—	—	—	—	332	—	332
Dividends	25	—	—	—	—	—	—	—	—	—	(50,265)	(50,265)	(369)	(50,634)
Changes in the ownership interest in a subsidiary...........		—	(0)	—	—	—	—	—	—	—	—	(0)	—	(0)
Transfer from other components of equity to retained earnings...		—	—	—	(15)	—	—	(7)	(21,317)	(21,339)	21,339	—	—	—
Other increase (decrease)		—	—	—	—	—	—	—	—	—	—	—	(139)	(139)
Total transactions with the owners.................		—	332	47,531	(180)	—	—	(7)	(21,317)	(21,504)	(77,840)	(51,481)	(508)	(51,989)
December 31, 2017		85,424	107,980	(9,593)	731	(21,540)	4	8,490	—	(12,315)	634,885	806,381	12,983	819,364

Consolidated Statement of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2018

(Millions of yen)

	Notes	2018	2017
Cash flows from operating activities			
Income before income taxes		207,251	204,290
Depreciation and amortization		60,662	54,508
Interest and dividend income		(1,578)	(1,295)
Interest expense		1,256	1,339
Share of profit in investments accounted for using the equity method		(2,082)	(2,007)
(Gains) losses on sale and disposal of property, plant and equipment, and intangible assets		4,531	3,111
(Increase) decrease in trade and other receivables		(12,591)	(3,464)
(Increase) decrease in inventories		(15,677)	(15,349)
Increase (decrease) in trade and other payables		3,951	14,637
Increase (decrease) in retirement benefit liabilities		20,740	(30,886)
Other		(21,437)	14,476
Subtotal		245,026	239,360
Interest received		1,273	1,069
Dividends received		2,312	2,047
Interest paid		(1,293)	(1,329)
Income taxes paid		(51,708)	(55,302)
Net cash flows from operating activities		195,610	185,845
Cash flows from investing activities			
Payments into time deposits		(26,768)	(26,673)
Proceeds from withdrawal of time deposits		26,987	25,349
Purchase of property, plant and equipment		(80,295)	(83,663)
Purchase of intangible assets		(7,703)	(6,273)
Payments for business combinations	33	(73,915)	(2,906)
Other		3,799	(1,980)
Net cash flows from investing activities		(157,895)	(96,146)
Cash flows from financing activities			
Increase (decrease) in short-term borrowings		230	(59)
Proceeds from long-term borrowings		—	30,000
Repayments of long-term borrowings		(67)	(30,090)
Proceeds from issuance of bonds		25,060	—
Redemption of bonds		(24,939)	—
Purchase of treasury shares		(50,035)	(1,842)
Dividends paid to owners of the parent		(56,838)	(50,299)
Dividends paid to non-controlling interests		(745)	(369)
Other		(1,245)	(585)
Net cash flows from financing activities		(108,579)	(53,244)
Net increase (decrease) in cash and cash equivalents		(70,864)	36,455
Cash and cash equivalents at the beginning of the year	8	343,076	303,026
Effect of exchange rate changes on cash and cash equivalents		(6,234)	3,595
Cash and cash equivalents at the end of the year	8	265,978	343,076

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2018

1 Reporting Entity

Kao Corporation (hereinafter the "Company") is a corporation established pursuant to the Companies Act of Japan (hereinafter the "Companies Act") with its headquarters in Chuo-ku, Tokyo.

The consolidated financial statements of the Company and its subsidiaries (hereinafter the "Group") have a closing date of December 31 and comprise the financial statements of the Group and the interests in associates of the Company.

The Group manufactures consumer products including cosmetics, skin care products, hair care products, sanitary products, fabric care products, and chemical products including fatty alcohols and surfactants. The Group delivers its products to customers through its sales companies and distributors in Japan and other countries. Details of these principal business activities of the Group are presented in Note 6 "Segment Information."

2 Basis of Preparation

(1) Compliance with International Financial Reporting Standards (hereinafter "IFRS")

The Group's consolidated financial statements have been prepared in accordance with IFRS issued by the International Accounting Standards Board, as permitted by the provision of Article 93 of the Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance of Japan No. 28 of 1976), as they satisfy the requirements for an "IFRS Specified Company" in Article 1-2 of the same ordinance.

(2) Basis of Measurement

The Group's consolidated financial statements have been prepared on the historical cost basis, except for certain assets and liabilities including financial instruments measured at fair value as presented in Note 3 "Significant Accounting Policies."

(3) Functional Currency and Presentation Currency

The Group's consolidated financial statements are presented in Japanese yen, which is the Company's functional currency. All financial information presented in Japanese yen is rounded to the nearest million yen.

(4) Changes in Presentation (Consolidated Statement of Cash Flows)

"Acquisition of subsidiaries and businesses," which was presented in cash flows from investing activities for the fiscal year ended December 31, 2017, has been presented as "Payments for business combinations" to appropriately reflect the substance of the transactions for the fiscal year ended December 31, 2018.

3 Significant Accounting Policies

(1) Basis of Consolidation

1) Subsidiaries

Subsidiaries refer to all business entities controlled by the Company. The Company controls an entity when it has exposure, or rights, to variable returns from involvement with an investee and has the ability to affect those returns through its power over the investee.

The financial statements of subsidiaries are included in the consolidated financial statements of the Group from the date the Company gains control until the date it loses control of the subsidiary.

All intergroup balances, transactions, income and expenses and unrealized gains and losses arising from intergroup transactions are eliminated in preparing the consolidated financial statements.

A change in the Company's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the Group.

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. Comprehensive income of subsidiaries is attributed to owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All subsidiaries have the same closing date as the Company.

2) Associates

An associate is defined as an entity over which the Company has significant influence on financial and operating policy decisions but does not have control over the entity. The Company is presumed to have significant influence over another entity when it directly or indirectly holds at least 20%, but no more than 50% of the voting rights of that entity. Entities over which the Company is able to exercise significant influence on financial and operating policy decisions are also included in associates, even if it holds less than 20% of the voting rights.

Investments in associates are initially recognized at cost, and are accounted for by the equity method from the date the Company gains significant influence until the date it loses that influence.

Goodwill recognized on acquisition of associates (less any accumulated impairment losses) is included in investments in associates.

The closing dates of some associates differ from that of the Company. Associates with different closing dates prepare additional financial closings as of the closing date of the Company.

(2) Business Combinations

Business combinations are accounted for using the acquisition method. The consideration of an acquisition is measured as the aggregate of the acquisition-date fair value of the assets transferred, liabilities assumed and equity securities issued by the Company to the former owners of the acquiree in exchange for control of the acquiree.

Identifiable assets and liabilities of the acquiree in business combinations are measured at their acquisition-date fair value, with the following exceptions:

- Deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognized and measured in accordance with IAS 12 "Income Taxes" and IAS 19 "Employee Benefits," respectively.
- Non-current assets and disposal groups that are classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are measured in accordance with that Standard.
- Liabilities or equity instruments related to share-based payment transactions of the acquiree or share-based payment transactions of the Company entered into to replace such transactions of the acquiree are measured in accordance with IFRS 2 "Share-based Payment."

Any excess of the consideration over the net fair value of identifiable assets acquired and liabilities assumed at the acquisition date is recognized as goodwill in the consolidated statement of financial position. Conversely, any deficit is immediately recognized as income in the consolidated statement of income.

Costs associated with business combinations, such as advisory fees, attorney fees and due diligence costs, are expensed as incurred.

The additional acquisition of non-controlling interests is accounted for as an equity transaction, and therefore no goodwill is recognized with respect to such a transaction.

Business combinations under common control are business combinations in which all of the combining entities or combining businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. These business combinations are accounted for based on the carrying amounts.

(3) Foreign Currency Translation

1) Functional currency and presentation currency

The presentation currency used in the Group's consolidated financial statements is Japanese yen, which is the Company's functional currency. Subsidiaries and associates in the Group determine their own functional currencies and each entity's transactions are measured in its functional currency.

2) Foreign currency transactions

Foreign currency transactions are translated into the functional currency at the spot exchange rate at the date of the transaction, or an exchange rate that approximates the spot rate.

At the end of each reporting period, foreign currency monetary items are translated into the functional currency using the rates at the end of each reporting period.

Non-monetary items that are measured in terms of historical cost in foreign currencies are translated using the exchange rates at the date of acquisition. Non-monetary items that are measured at fair value in foreign currencies are translated into the functional currency using the exchange rates at the date when the fair value was measured. Exchange differences arising from such translations and settlements are recognized in profit or loss. However, exchange differences arising from equity instruments measured at fair value through other comprehensive income and cash flow hedges are recognized in other comprehensive income.

3) Financial statements of foreign operations

Assets and liabilities of foreign operations are translated at the rates at the end of each reporting period. Income and expenses are translated at the average exchange rates for the period, provided that there were no significant fluctuations in the exchange rates during the period. Exchange differences arising from translation of the financial statements of foreign operations are recognized in other comprehensive income. On the disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation is reclassified from equity to profit or loss when the gain or loss on disposal is recognized.

(4) Financial Instruments

1) Financial assets

(i) Initial recognition and measurement

The Group initially recognizes trade and other receivables at the date they are originated. Other financial assets are initially recognized at the transaction date when the Group becomes a party to the contractual provisions of the financial instrument.

At initial recognition, all financial assets are measured at fair value, but those that are not classified as financial assets measured at fair value through profit or loss are measured at fair value plus transaction costs directly attributable to the acquisition of the financial asset. Transaction costs of financial assets measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies the financial assets it holds as (a) financial assets measured at amortized cost; (b) debt instruments measured at fair value through other comprehensive income; (c) equity instruments measured at fair value through other comprehensive income; or (d) financial assets measured at fair value through profit or loss. This classification is determined at initial recognition, and measurement of financial assets after initial recognition is performed according to the classification of the financial asset as follows:

(a) Financial assets measured at amortized cost
Financial assets held by the Group are measured at amortized cost if both of the following conditions are met:

- The financial asset is held in a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

After initial recognition, the carrying amounts of financial assets measured at amortized cost are recognized using the effective interest method less impairment loss, if any. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(b) Debt instruments measured at fair value through other comprehensive income
Financial assets held by the Group are classified as debt instruments measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial asset; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

(c) Equity instruments measured at fair value through other comprehensive income
The Group has made an irrevocable election to present subsequent changes in the fair value of certain equity instruments in other comprehensive income, and classifies them in equity instruments measured at fair value through other comprehensive income.

These financial assets are measured at fair value after initial recognition, and changes in the fair value are included in other comprehensive income. If the Group disposes of an investment, or if the fair value of the investment declines significantly, the cumulative gain or loss recognized in other comprehensive income is reclassified from other components of equity to retained earnings.

Dividends from equity instruments measured at fair value through other comprehensive income are recognized as financial income in profit or loss.

(d) Financial assets measured at fair value through profit or loss
Financial assets that are not classified as financial assets measured at amortized cost, debt instruments measured at fair value through other comprehensive income, or equity instruments measured at fair value through other comprehensive income are classified as financial assets measured at fair value through profit or loss. The Group's financial assets that are measured at fair value through profit or loss include certain short-term investments and derivative assets. The Group has not irrevocably designated any financial assets as measured at fair value through profit or loss.

These financial assets are measured at fair value after initial recognition, and changes in their fair value are recognized in profit or loss. Gains and losses on financial assets measured at fair value through profit or loss are recognized in profit or loss.

(iii) Impairment of financial assets
With respect to impairment of financial assets measured at amortized cost, the Group recognizes a loss allowance for expected credit losses on such financial assets.

At each reporting date, the Group assesses whether the credit risks on the financial assets have increased significantly since initial recognition.

If credit risk on a financial instrument has not increased significantly since initial recognition, the loss allowance for that financial instrument is measured at an amount equal to the 12-month expected credit losses. If credit risk on a financial instrument has increased significantly since initial recognition, the loss allowance is measured in an amount equal to the lifetime expected credit losses.

However, the loss allowance on trade receivables and others is always measured in an amount equal to the lifetime expected credit losses.

The expected credit losses of financial assets are estimated in a way that reflects the following:

- An unbiased and probability-weighted amount determined by evaluating a range of possible outcomes
- The time value of money
- Reasonable and supportable information about past events, current conditions and forecasts of economic conditions that is available without undue cost or effort at the reporting date

The amounts of these measurements are recognized in profit or loss.

If an event that reduces an impairment loss occurs after the impairment loss has been recognized, the impairment loss will be reversed to the extent of the decrease and credited to profit or loss.

(iv) Derecognition of financial assets

The Group derecognizes financial assets only when the contractual rights to the cash flows from the financial assets expire, or when the Group transfers financial assets and substantially all the risks and rewards of ownership of the financial assets.

2) Financial liabilities

(i) Initial recognition and measurement

The Group initially recognizes bonds and borrowings at the date they are issued, and other financial liabilities at the transaction date.

Upon initial recognition, all financial liabilities are measured at fair value. However, financial liabilities measured at amortized cost are measured in the full amount after deducting directly attributable transaction costs from the fair value.

Transaction costs of financial liabilities measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies financial liabilities as either financial liabilities measured at fair value through profit or loss, or financial liabilities measured at amortized cost. This classification is determined at initial recognition. Measurement of financial liabilities after initial recognition is performed as follows, according to the classification of the financial liability.

The Group's financial liabilities measured at fair value through profit or loss are derivative liabilities. The Group has not irrevocably designated any financial liabilities as measured at fair value through profit or loss at initial recognition. Financial liabilities measured at fair value through profit or loss are measured at fair value after initial recognition, and any changes in their fair value are recognized in profit or loss for the period.

Financial liabilities measured at amortized cost are subsequently measured at amortized cost using the effective interest method. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(iii) Derecognition of financial liabilities

The Group derecognizes financial liabilities when they are extinguished (i.e., when the obligation specified in the contract is discharged or cancelled or expires).

3) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the consolidated statement of financial position only when the Group currently has a legally enforceable right to set off the recognized amount and intends either to settle on a net basis or realize the assets and settle the liabilities simultaneously.

4) Fair value of financial instruments

The Group recognizes the fair value of financial instruments using various valuation methodologies and inputs. The fair values recognized based on the observability of inputs into the valuation methodologies are grouped into the following three levels:

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities

Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Fair value measured with unobservable inputs for the asset or liability

5) Hedge accounting

The Group uses interest rate swaps and other derivatives to hedge interest rate risk. At the inception of a hedging relationship, the Group formally designates and documents the hedging relationship and the interest rate risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and the methods of assessing whether the hedging relationship meets the hedge effectiveness requirements. In addition, the Group assesses whether the hedging relationship meets the hedge effectiveness requirements, both at the inception and on an ongoing basis. Ongoing assessments are conducted either at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first.

The Group does not use cash flow hedges, fair value hedges or net investment hedges in foreign operations.

(5) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments that are highly liquid and readily convertible to known amounts of cash subject to an insignificant risk of changes in value, and that mature or become due within three months from the date of acquisition.

Cash equivalents include certificates of deposit, time deposits, commercial paper, public and corporate bonds in investment trusts, and money in trust.

(6) Inventories

Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition, and are determined principally by the weighted average method.

(7) Property, Plant and Equipment

Property, plant and equipment are measured using the cost model and carried at cost less any accumulated depreciation and any accumulated impairment losses.

The cost of an item of property, plant and equipment comprises any costs directly attributable to acquisition of the asset and the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Depreciation of assets other than land and construction in progress is calculated on a straight-line basis over the estimated useful lives of the assets.

The estimated useful lives of major asset items are as follows:

- Buildings and structures: 10 to 35 years
- Machinery and vehicles: 7 to 14 years
- Tools, furniture and fixtures: 3 to 10 years

The estimated useful lives, residual values and depreciation method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

(8) Goodwill and Intangible Assets

1) Goodwill

Goodwill arising from a business combination is not amortized, and is carried at cost, determined at the acquisition date, less any accumulated impairment losses.

In addition, goodwill is allocated to the cash generating unit or group of cash-generating units that is expected to benefit from the synergies of the business combination, and is tested for impairment at least once a year by each fiscal year end or if there are indications of impairment. Impairment loss on goodwill is recognized in profit or loss and is not reversed in subsequent periods.

Goodwill measurements at initial recognition are presented in Note 3 "Significant Accounting Policies (2) Business Combinations."

2) Intangible assets

Intangible assets are measured using the cost model and carried at cost less any accumulated amortization and any accumulated impairment losses.

The costs of separately acquired intangible assets comprise any costs directly attributable to acquisition of the assets.

The costs of intangible assets acquired in business combinations are measured at fair value at the acquisition date.

Expenditures related to internally generated intangible assets are recognized as expenses when incurred, with the exception of development expenses that meet the criteria for capitalization. Software development expense only meets the criteria for capitalization.

After initial recognition, with the exception of intangible assets with indefinite useful lives, intangible assets are amortized on a straight-line basis over their estimated useful lives.

The Group has no material intangible assets with indefinite useful lives. The estimated useful lives of major intangible assets are as follows:

- Trademarks: 20 years
- Customer relationships: 15 or 20 years
- Software: 5 years

The estimated useful lives, residual values and amortization method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

3) Research and development expenses

Research expenditures are expensed as incurred. Development expenditures are capitalized only if they can be measured reliably, future economic benefits are probable, and the Group intends to, and has sufficient resources to, complete development and to use or sell the asset. If research expenditures and development expenditures cannot be clearly distinguished, they are expensed as incurred as research expenditures.

(9) Leases

The Group classifies a lease that transfers substantially all the risks and rewards incidental to ownership of an asset as a finance lease and a lease other than a finance lease as an operating lease.

In finance lease transactions, leased assets and lease obligations are initially recognized at the lower of the fair value of leased property and the present value of the minimum lease payments, each determined at the inception of the lease.

Leased assets are depreciated on a straight-line basis over the shorter of their estimated useful lives and lease terms. Lease payments are apportioned between the finance charges and the reduction of the outstanding liability using the interest method.

Lease payments under operating leases are recognized as an expense on a straight-line basis over the lease term.

Determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement, in accordance with IFRIC Interpretation 4 "Determining Whether an Arrangement Contains a Lease."

(10) Impairment of Non-financial Assets

Non-financial assets, excluding inventories, deferred tax assets, non-current assets classified as held for sale and assets arising from employee benefits, are assessed at the end of each reporting period to determine whether there is any indication of impairment. If there is an indication of impairment, the recoverable amount of the asset is estimated. For goodwill, the recoverable amount is estimated at least once a year by each fiscal year end, irrespective of whether there is any indication of impairment.

The recoverable amount of an asset or a cash-generating unit is the higher of its value in use and fair value less cost of disposal. The discount rate used in calculating the asset's value in use is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset, for which the future cash flow estimates have not been adjusted.

If it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the cash-generating unit to which the asset belongs is measured. Goodwill acquired in business combinations is allocated to each of the cash-generating units or groups of cash-generating units of the Group that is expected to benefit from synergies of the business combinations after the acquisition date, and is tested for impairment.

Because corporate assets do not generate separate cash inflows, the recoverable amount of individual corporate assets cannot be measured unless management has decided to dispose of the asset. If there is an indication that a corporate asset may be impaired, the recoverable amount of the cash-generating unit or group of cash-generating units to which the asset belongs is measured and compared with the carrying amount.

Impairment losses are recognized in profit or loss whenever the recoverable amount is less than the carrying amount. Such impairment losses of the cash-generating unit or group of cash-generating units are recognized by first reducing the carrying amount of any goodwill allocated to the cash-generating unit or group of cash-generating units, and then allocating the rest of the losses to other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

The Group reviews assets other than goodwill at each fiscal year end to determine whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If there are any such indications, the Group estimates the recoverable amount of the asset.

Impairment losses on assets other than goodwill that were recognized in prior fiscal years are reversed only when there have been changes in the estimates used to determine the recoverable amount of the asset since the last impairment loss was recognized. In this case, the carrying amount of the asset is increased as a reversal of impairment loss to the recoverable amount.

Impairment losses are reversed up to the carrying amount, net of amortization or depreciation, that would have been determined had no impairment loss for the asset been recognized in prior fiscal years.

(11) Employee Benefits

1) Post-employment benefits

The Group sponsors a defined benefit plan and a defined contribution plan as post-employment benefit plans for employees.

(i) Defined benefit plan

For the defined benefit plan, the projected unit credit method is used to individually determine the present value of defined benefit obligations, related current service costs and past service costs of each plan.

The discount rate is determined by referring to market yields at the end of the fiscal year on high quality corporate bonds corresponding to the period until the expected date of future benefit payment.

The net amount of the present value of defined benefit obligations and the fair value of plan assets is accounted for as a liability or asset. However, if the defined benefit plan has surplus, the net defined benefit asset is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. Net interest on the net defined benefit liability (asset) is recognized in profit or loss as financial expenses (income).

Remeasurements of the net defined benefit liability (asset) are recognized in other comprehensive income and immediately reclassified to retained earnings in the period in which they occur.

Past service costs are recognized in profit or loss for the period in which they are incurred.

(ii) Defined contribution plan

Payments to the defined contribution plan are recognized as expenses when employees have rendered services entitling them to the contributions.

2) Other employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis, and are recognized as an expense when the related services are rendered.

For bonuses, when there is a present legal or constructive obligation to make payments of bonuses, and a reliable estimate of the obligation can be made, the estimated amount to be paid is accounted for as a liability.

For the paid absence expenses, when there is a legal or constructive obligation with respect to accumulating paid absence systems and a reliable estimate of the obligation can be made, the estimated amount to be paid based on those systems is accounted for as a liability.

(12) Share-based Payments

1) Stock option plan

The Company has a stock option plan accounted for as an equity-settled share-based payment plan. Due to the introduction of a performance share plan, the stock option plan has been abolished except for the options already granted.

2) Performance share plan

The Company introduced a performance share plan accounted for as an equity-settled share-based payment plan.

The performance share plan measures services received at the fair value of the Company's shares on the date of grant, recognizing them as an expense from the date of grant through the vesting period and recognizing the same amount as an increase in capital surplus. The fair value of the Company's shares on the date of grant is determined by adjusting the market price of the shares taking expected dividends into account.

(13) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amounts recognized as provisions are the best estimates of necessary expenditures to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties associated with the obligation. When the effect of the time value of money is material, the amount of provision is measured at the present value of the expenditures expected to be required to settle the obligation.

(14) Revenue

The Group recognizes revenue based on the following five-step model:

Step 1: Identify the contract with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognize revenue when the entity satisfies a performance obligation

The Group sells consumer products including cosmetics, skin care products, hair care products, sanitary products and fabric care products, as well as chemical products including fatty alcohols and surfactants. For sales of such products, because the customer obtains control over the products upon delivery, the performance obligation is judged to have been satisfied and revenue is therefore recognized upon delivery of the products. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates, returned products and other items.

(15) Income Taxes

Income taxes consist of current income taxes and deferred income taxes. Income taxes are recognized as income or expenses and included in profit or loss, except for taxes related to business combinations and taxes related to items that are recognized directly in equity or in other comprehensive income.

1) Current income taxes

Current income taxes are recognized in the amount of the expected taxes payable to or receivable from the taxation authorities. Calculation of the amount of tax is based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period in countries where the Group conducts business and earns taxable income.

2) Deferred income taxes

Deferred tax assets and liabilities are recognized for temporary differences between the carrying amounts of assets or liabilities at the end of the reporting period and its tax base, and for tax loss carryforwards and tax credits.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available against such deferred tax assets. Deferred tax liabilities are recognized, in principle, for all taxable temporary differences.

The carrying amount of deferred tax assets is reviewed each period and reduced to the extent that it is no longer probable that sufficient future taxable income will be available to realize benefits from all or part of the assets.

Unrecognized deferred tax assets are reassessed each period and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax assets to be recovered.

Deferred tax assets and liabilities are not recognized for the following temporary differences:

- Taxable temporary differences arising from initial recognition of goodwill
- Temporary differences arising from initial recognition of assets and liabilities from transactions that are not business combinations and affect neither accounting income nor taxable income
- Taxable temporary differences on investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future
- Deductible temporary differences on investments in subsidiaries and associates, when it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the assets are realized or the liabilities are settled, based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are offset if the Group has a legally enforceable right to set off current tax assets against current tax liabilities and income taxes are levied by the same taxation authority on the same taxable entity.

The Company and some of its subsidiaries have adopted the consolidated tax system.

(16) Earnings per Share

Basic earnings per share are calculated by dividing net income attributable to owners of the parent by the weighted average number of ordinary shares outstanding during the period, adjusted for treasury shares held. Diluted earnings per share are calculated by adjusting the effects of all dilutive potential ordinary shares.

(17) Non-current Assets Held for Sale

A non-current asset or disposal group whose carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use is classified as a non-current asset or disposal group held for sale if it is highly probable that the asset or disposal group will be sold within one year and is available for immediate sale in its present condition, and the Group's management is committed to a plan to sell. Non-current assets are not depreciated or amortized while they are classified as held for sale or are part of a disposal group classified as held for sale. Non-current assets or disposal groups classified as held for sale are measured at the lower of the carrying amount and fair value less costs to sell.

(18) Equity and Other Capital

1) Ordinary shares

Ordinary shares are recognized in share capital and capital surplus at their issue price. Share issuance costs are deducted from the issue price.

2) Treasury shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or retirement of the Company's treasury shares. Any difference between the carrying amount and consideration received on the sale of treasury shares is recognized directly in equity.

(19) Dividends

Dividend distributions to shareholders of the Company are recognized as liabilities in the period in which year-end dividends are resolved upon by the General Meeting of Shareholders and interim dividends are resolved upon by the Board of Directors.

4 Significant Accounting Estimates and Judgments

The Group's consolidated financial statements include estimates and assumptions made by management regarding income and expenses, measurement of the carrying amounts of assets and liabilities, and disclosure of contingencies and others at the end of the reporting period. These estimates and assumptions are based on management's best judgment at the end of the reporting period, and take into account historical experience and various other factors that can be considered as reasonable. However, due to their nature, actual results may differ from these estimates and assumptions.

The estimates and their underlying assumptions are reviewed by management on an ongoing basis. The effects of revisions to accounting estimates and assumptions are recognized in the period when the estimates are revised and in future periods.

Estimates and assumptions that significantly affect the amounts recognized in the Group's consolidated financial statements are as follows:

(1) Impairment of Property, Plant and Equipment, Goodwill and Intangible Assets

The Group conducts impairment tests for property, plant and equipment, goodwill and intangible assets when there is an indication that the recoverable amount of the asset or cash-generating unit is less than the carrying amount.

Triggering events for impairment testing include, for example, significant changes with adverse effects on past or projected business performance, significant changes in the use of acquired assets, or changes in overall business strategy.

Furthermore, goodwill is tested for impairment at least once a year by each fiscal year end, irrespective of indication of impairment, to verify that the recoverable amount of the cash-generating unit to which goodwill is allocated exceeds the carrying amount.

Impairment tests are performed by comparing the carrying amount and the recoverable amount of the asset or cash-generating unit. If the recoverable amount is less than the carrying amount, the carrying amount is reduced to the recoverable amount and the reduction is recognized as an impairment loss. The recoverable amount is the higher of the value in use and the fair value less cost of disposal of the asset or cash-generating unit.

In calculating the value in use, the Group makes certain assumptions about the remaining useful life and future cash flows of the asset, discount rate, growth rate and other factors. These assumptions are based on management's best estimates and judgments, but may be affected by changes in future business plans, economic conditions or other factors. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 14 "Goodwill and Intangible Assets" presents the method for measuring the recoverable amount and sensitivity associated with goodwill.

(2) Post-employment Benefits

The Group provides a variety of post-retirement benefit plans that include a defined benefit plan. The present value of defined benefit obligations and related service costs are determined based on actuarial assumptions.

Actuarial assumptions are based on management's best estimates and judgments, but may be affected by the revision of inputs including the discount rate and mortality rate due to changes in economic conditions. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 20 "Employee Benefits" presents actuarial assumptions and related sensitivity.

(3) Provisions

The Group has recognized a provision for loss related to cosmetics, a provision for asset retirement obligations and other provisions in the consolidated statement of financial position.

The amounts recognized are the best estimates of the expenditures required to settle the present obligations, taking into account historical experience and other factors at the end of the reporting period.

The provision for loss related to cosmetics may be affected by changes in compensation-related and other expenses.

The provision for asset retirement obligations and other provisions may be affected by factors such as changes in future business plans.

If the actual amounts paid differ from the estimates, such differences could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 21 "Provisions" presents the nature and amounts of these provisions.

(4) Income Taxes

The Group recognizes and measures income tax payables and income taxes based on reasonable estimates of the amounts to be paid to the taxation authorities in each country. Such estimates are made using the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Calculating income tax payables and income taxes requires estimates and judgments of various factors, including interpretations of tax regulations by the Group and the taxation authorities and the experience of past tax audits.

Therefore, if the final tax outcome is different from the amount initially recognized, the difference is recognized in the period when the tax outcome is finalized.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available. The realizability of deferred tax assets is assessed using the tax rates that are expected to apply to the period when the asset is realized, based on tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Recognition and measurement of deferred tax assets are based on management's best estimates and judgments, but may be affected by future changes in business plans or other conditions, or by the amendment or promulgation of related laws. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 16 "Income Taxes" presents income taxes and amounts.

(5) Fair Value

The Group uses various inputs, including unobservable inputs, and valuation methodologies to estimate the fair value of specific assets and liabilities. When measuring fair value, the Group maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs, and management's best estimates and judgments are required in that process.

The fair value of these assets and liabilities is based on management's best estimates and judgments, but could be affected by factors including changes in inputs due to changes in economic conditions. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 35 "Financial Instruments" presents fair value measurement methods and amounts for major financial assets and liabilities measured at fair value.

(6) Contingencies

Contingencies are disclosed when there are items that could have a material effect on future business after considering the probability of occurrence and the amount of financial impact, taking into account all available evidence at the end of the reporting period.

5 New Standards and Interpretations Not Yet Adopted

New or revised major Standards and Interpretations that were issued by the date of approval presented in Note 40 "Approval of the Consolidated Financial Statements," but were not yet early adopted by the Group as of December 31, 2018 are as follows:

IFRS	Title	Mandatory adoption (From the fiscal year beginning)	Adoption by the Group	Overview of new or revised Standards and Interpretations
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 31, 2019	Revised lease definition, accounting treatment and disclosure

IFRS 16 "Leases" replaces IAS 17 "Leases" and others. As a result of this adoption, due to its single lessee accounting model, right-of-use assets representing the right to use an underlying asset and lease liabilities representing the obligation to make lease payments are required to be recognized for all leases, in principle, on the consolidated statement of financial position. After recognition of right-of-use assets and lease liabilities, depreciation of the right-of-use assets and interest on the lease liabilities are recognized on the consolidated statement of income. The main impact of this adoption on the Group's consolidated financial statements is expected to be increases of approximately 160 billion yen in right-of-use assets and lease liabilities on the consolidated statement of financial position at the beginning of the fiscal year ending December 31, 2019. Cash flows from operating activities on the consolidated statement of cash flows are expected to increase by approximately 20 billion yen and cash flows from financing activities are expected to decrease by the same amount. The impact on the consolidated statement of income will be immaterial.

6 Segment Information

(1) Summary of Reportable Segments

The Group's reportable segments are the components of the Group for which discrete financial information is available and which are regularly reviewed by the Board of Directors in deciding how to allocate resources and in assessing their performance. Net sales and operating income are the key measures used by the Board of Directors to evaluate the performance of each segment.

The Group is organized on the basis of five businesses: the four business areas that constitute the Consumer Products Business (the Cosmetics Business, the Skin Care and Hair Care Business, the Human Health Care Business, and the Fabric and Home Care Business) and the Chemical Business. In each business, the Group plans comprehensive business strategies and carries out business activities on a global basis.

Accordingly, the Group has five reportable segments: the Cosmetics Business, the Skin Care and Hair Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business.

Due to a change in organization as of January 1, 2018, in the fiscal year ended December 31, 2018 the Group reclassified its four former reportable segments (the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business) into five (the Cosmetics Business, the Skin Care and Hair Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business). Segment information for the fiscal year ended December 31, 2017 has been restated to reflect the reclassification.

Information about major customers has been omitted as the revenue from each customer is less than 10% of the Group's net sales.

Reportable segments		Major products	
Consumer Products Business	Cosmetics Business	Cosmetics	Counseling cosmetics, self-selection cosmetics
	Skin Care and Hair Care Business	Skin care products	Soaps, facial cleansers, body cleansers
		Hair care products	Shampoos, conditioners, hair styling agents, hair coloring agents, men's products
	Human Health Care Business	Food and beverage products	Beverages
		Sanitary products	Sanitary napkins, baby diapers
		Personal health products	Bath additives, oral care products, thermo products
	Fabric and Home Care Business	Fabric care products	Laundry detergents, fabric treatments
		Home care products	Kitchen cleaning products, house cleaning products, paper cleaning products, commercial-use products
Chemical Business		Oleo chemicals	Fatty alcohols, fatty amines, fatty acids, glycerin, commercial-use edible fats and oils
		Performance chemicals	Surfactants, plastics additives, superplasticizers for concrete admixtures
		Specialty chemicals	Toner and toner binder for copiers and printers, ink and colorants for inkjet printers, fragrances and aroma chemicals

(2) Sales and Results of Reportable Segments

Fiscal year ended December 31, 2018 (Millions of yen)

	Reportable segments								
	Consumer Products Business								
	Cosmetics Business	Skin Care and Hair Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliation[1]	Consolidated
Net sales									
Sales to customers	279,635	341,419	267,702	344,105	1,232,861	275,146	1,508,007	—	1,508,007
Intersegment sales and transfers[2]	—	—	—	—	—	37,661	37,661	(37,661)	—
Total net sales	279,635	341,419	267,702	344,105	1,232,861	312,807	1,545,668	(37,661)	1,508,007
Operating income	27,710	48,827	27,907	71,249	175,693	30,631	206,324	1,379	207,703
Financial income									1,717
Financial expenses									(4,251)
Share of profit in investments accounted for using the equity method									2,082
Income before income taxes									207,251
Other items									
Depreciation and amortization[3]	10,908	9,593	17,602	10,299	48,402	12,000	60,402	260	60,662
Capital expenditures[4]	11,597	17,021	19,259	18,107	65,984	23,032	89,016	81	89,097

Notes: 1. The operating income reconciliation of 1,379 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the details of depreciation and amortization.
4. Capital expenditures include investments in property, plant and equipment and intangible assets.

Fiscal year ended December 31, 2017 (Millions of yen)

	Reportable segments								
	Consumer Products Business								
	Cosmetics Business	Skin Care and Hair Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliation[1]	Consolidated
Net sales									
Sales to customers	266,214	332,872	281,201	335,709	1,215,996	273,425	1,489,421	—	1,489,421
Intersegment sales and transfers[2]	—	—	—	—	—	36,860	36,860	(36,860)	—
Total net sales	266,214	332,872	281,201	335,709	1,215,996	310,285	1,526,281	(36,860)	1,489,421
Operating income	12,989	49,329	34,453	76,247	173,018	30,299	203,317	1,474	204,791
Financial income									1,452
Financial expenses									(3,960)
Share of profit in investments accounted for using the equity method									2,007
Income before income taxes									204,290
Other items									
Depreciation and amortization[3]	10,333	7,730	15,822	8,884	42,769	11,479	54,248	260	54,508
Capital expenditures[4]	11,267	16,450	23,596	12,676	63,989	15,245	79,234	121	79,355

Notes: 1. The operating income reconciliation of 1,474 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the details of depreciation and amortization.
4. Capital expenditures include investments in property, plant and equipment and intangible assets.

(3) Geographical Information

Sales to customers and non-current assets (excluding financial assets, deferred tax assets and retirement benefit assets) by region consist of the following:

Sales to Customers (Millions of yen)

	2018	2017
Japan	939,463	938,074
Asia	295,714	288,087
China	135,629	134,751
Americas	140,637	134,219
United States	110,783	102,763
Europe	132,193	129,041
Total	1,508,007	1,489,421

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

Non-current Assets (excluding Financial Assets, Deferred Tax Assets and Retirement Benefit Assets) (Millions of yen)

	2018	2017
Japan	448,357	431,673
Asia	88,843	85,290
Americas	96,426	22,610
Europe	27,184	28,935
Total	660,810	568,508

7 Business Combinations

(1) Acquisition of Oribe Hair Care, LLC in the U.S.

1) Outline of Business Combination

Name of the acquired business and the acquiree:	Oribe Hair Care, LLC
Business outline:	Development, manufacturing and sales of hair care products for hair salons
Acquisition date:	January 17, 2018
Acquisition method:	Cash consideration to acquire equity interests
Percentage of voting rights acquired:	100%

2) Primary Reason for Business Combination

The "Oribe," a super-premium price brand for hair salons, which is owned by Oribe Hair Care, LLC, has a substantial presence in the top-class hair salon industry and among major specialty retailers in the United States. By utilizing the brand and products obtained through this acquisition, the Group aims to expand its brand portfolio for hair salons and to expand its customer base.

3) Acquisition Cost of Acquired Business and Acquiree and Its Components

Acquisition cost of acquired business and acquiree:	45,633 million yen
Components of acquisition cost:	
Cash	45,633 million yen

4) Fair Value of Assets Acquired and Liabilities Assumed at the Acquisition Date

Current assets	4,074 million yen
Trademarks	14,232 million yen
Other non-current assets	4,151 million yen
Total assets	22,457 million yen
Current liabilities	1,090 million yen
Total liabilities	1,090 million yen

5) Goodwill

Goodwill recognized:	24,266 million yen
Components of goodwill:	Goodwill recognized for this business combination reflects excess earning powers in future from using newly acquired brands, products and sales networks from Oribe Hair Care, LLC. Goodwill recognized is expected to be deductible for tax purposes.

6) Net Sales and Income of Acquired Business

Information on income associated with this business combination after the acquisition date and information on income assuming that the business combination took place on the date of January 1, 2018 are not presented because the impacts on the consolidated statement of income are immaterial.

(2) Acquisition of Washing Systems Intermediate Holdings, Inc. in the U.S.

1) Outline of Business Combination

Name of the acquiree:	Washing Systems Intermediate Holdings, Inc. (hereinafter "Washing Systems")
Business outline:	Development and sales of detergents and other products and provision of consulting and other services to the commercial laundry market
Acquisition date:	August 9, 2018
Acquisition method:	Cash consideration to acquire shares
Percentage of voting rights acquired:	100%

2) Primary Reason for Business Combination

Washing Systems has earned substantial market support by developing and selling industry-leading cleaning agents and by providing integrated supply systems for cleaning agents and best-in-class customer service to commercial laundry companies, mainly in North America. The Group develops professional-use products, primarily in Japan, through Kao Professional Services Company, Ltd. (hereinafter "KPS") The mission of KPS is to maintain people's safety, security, and comfort through support for cleaning applications, hygiene management and other measures in a variety of fields including food service, food processing, hospitals and cleaning. With this acquisition, the Company will promote global development of its professional-use products.

3) Acquisition Cost of Acquired Business and Acquiree and Its Components

Acquisition cost of acquired business and acquiree:	30,706 million yen
Components of acquisition cost:	
Cash	30,706 million yen

4) Fair Value of Assets Acquired and Liabilities Assumed at the Acquisition Date

Current assets	2,609 million yen
Customer relationships	9,291 million yen
Other non-current assets	4,630 million yen
Total assets	16,530 million yen
Current liabilities	1,672 million yen
Non-current liabilities	2,752 million yen
Total liabilities	4,424 million yen

5) Goodwill

Goodwill recognized:	18,600 million yen
Components of goodwill:	Goodwill recognized for this business combination reflects excess earning powers in future from using newly acquired products and sales networks from Washing Systems. A portion of goodwill recognized is expected to be deductible for tax purposes.

6) Net Sales and Income of Acquired Business

Information on income associated with this business combination after the acquisition date and information on income assuming that the business combination took place on the date of January 1, 2018 are not presented because the impacts on the consolidated statement of income are immaterial.

8 Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

(Millions of yen)

	2018	2017
Cash and deposits	206,078	260,176
Short-term investments	59,900	82,900
Total	265,978	343,076

The balance of cash and cash equivalents presented in the consolidated statement of financial position is equal to the balance of cash and cash equivalents presented in the consolidated statement of cash flows.

9 Trade and Other Receivables

Trade and other receivables consist of the following:

(Millions of yen)

	2018	2017
Trade receivables	217,594	211,990
Other receivables	7,073	5,915
Allowance for doubtful receivables	(1,565)	(1,398)
Total	223,102	216,507

Trade receivables are recognized when the Group's products are delivered because the Group's right to consideration is unconditional except for the passage of time from that point. Moreover, the Group receives payment within a short period of time after satisfying its performance obligation under separately determined payment terms. Because the period from satisfaction of the performance obligation to receipt of consideration is usually within one year or less, as a practical expedient, the Group does not adjust the promised amount of consideration for the effects of a significant financing component for such receivables.

10 Inventories

Inventories consist of the following:

(Millions of yen)

	2018	2017
Merchandise and finished goods	146,684	136,795
Work in progress	14,875	12,723
Materials and supplies	36,012	34,403
Total	197,571	183,921

The amount of inventories recognized as expenses and included in cost of sales for the fiscal years ended December 31, 2018 and 2017 were 733,108 million yen and 714,981 million yen, respectively.

Write-downs of inventories recognized as expenses for the fiscal years ended December 31, 2018 and 2017 were 5,044 million yen and 5,093 million yen, respectively.

11 Other Assets

Other assets consist of the following:

(Millions of yen)

	2018	2017
Other current assets		
Insurance receivable	2,886	8,120
Prepaid expenses	9,538	9,566
Other	10,025	10,476
Total	22,449	28,162
Other non-current assets		
Insurance receivable	2,109	2,654
Long-term prepaid lease payments	4,060	4,508
Long-term prepaid expenses	435	1,624
Retirement benefit assets	1,166	1,224
Other	505	676
Total	8,275	10,686

12 Non-current Assets Held for Sale

Certain assets including the buildings and land for sales offices were classified as non-current assets held for sale in the fiscal year ended December 31, 2017 pursuant to the decision to sell these assets. These assets were sold in the fiscal year ended December 31, 2018.

13 Property, Plant and Equipment

(1) Changes in Property, Plant and Equipment

The following tables present changes in acquisition costs, accumulated depreciation and accumulated impairment losses, and carrying amounts of property, plant and equipment.

Acquisition Cost (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2017	408,899	716,797	119,612	73,018	24,488	1,342,814
Additions	566	230	4,762	13	67,471	73,042
Acquisitions through business combinations	697	100	48	83	—	928
Sales and disposals	(5,468)	(27,952)	(13,424)	(443)	(3)	(47,290)
Reclassification	18,605	36,152	7,464	370	(62,591)	—
Exchange differences on translation of foreign operations	2,766	4,327	1,197	274	359	8,923
Other	60	281	(315)	(0)	172	198
December 31, 2017	426,125	729,935	119,344	73,315	29,896	1,378,615
Additions	327	331	1,433	2,749	76,545	81,385
Acquisitions through business combinations	46	1,649	181	—	129	2,005
Sales and disposals	(6,808)	(26,497)	(8,457)	(226)	—	(41,988)
Reclassification	20,519	41,311	10,773	34	(72,637)	—
Exchange differences on translation of foreign operations	(4,207)	(8,474)	(1,389)	(189)	(538)	(14,797)
Other	(231)	162	(334)	0	1,148	745
December 31, 2018	435,771	738,417	121,551	75,683	34,543	1,405,965

Accumulated Depreciation and Accumulated Impairment Losses (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2017	285,460	583,202	92,901	10,416	—	971,979
Depreciation[1]	13,036	25,133	11,323	—	—	49,492
Impairment losses[2]	—	18	1	—	—	19
Impairment losses reversed[2]	(0)	—	(1)	—	—	(1)
Sales and disposals	(5,132)	(27,219)	(13,185)	(96)	—	(45,632)
Exchange differences on translation of foreign operations	1,888	4,091	929	—	—	6,908
Other	69	272	(291)	—	—	50
December 31, 2017	295,321	585,497	91,677	10,320	—	982,815
Depreciation[1]	13,739	28,209	11,683	—	—	53,631
Sales and disposals	(6,315)	(25,663)	(8,270)	—	—	(40,248)
Exchange differences on translation of foreign operations	(2,199)	(5,737)	(1,042)	—	—	(8,978)
Other	(113)	132	(209)	—	—	(190)
December 31, 2018	300,433	582,438	93,839	10,320	—	987,030

Notes: 1. Depreciation of property, plant and equipment is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
2. Impairment losses on property, plant and equipment are included in other operating expenses and impairment losses reversed are recognized in other operating income in the consolidated statement of income.

Carrying Amount (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2017	123,439	133,595	26,711	62,602	24,488	370,835
December 31, 2017	130,804	144,438	27,667	62,995	29,896	395,800
December 31, 2018	135,338	155,979	27,712	65,363	34,543	418,935

(2) Leased Assets

The carrying amount of leased assets from finance leases included in property, plant and equipment is as follows:

(Millions of yen)

	Buildings and structures	Other	Total
January 1, 2017	4,060	54	4,114
December 31, 2017	3,195	58	3,253
December 31, 2018	2,419	45	2,464

(3) Impairment Losses

The Group allocates property, plant and equipment into cash-generating units based on the smallest identifiable group of assets that generates cash inflows that are largely independent. For idle assets, the Group evaluates whether to recognize impairment losses for individual properties based on impairment tests performed.

(4) Commitments

Note 38 "Commitments" presents information on commitments to acquire property, plant and equipment.

14 Goodwill and Intangible Assets

(1) Changes in Goodwill and Intangible Assets

The following tables present changes in acquisition costs, accumulated amortization and accumulated impairment losses, and carrying amounts of goodwill and intangible assets.

Acquisition Cost (Millions of yen)

		Intangible assets				
	Goodwill	Software	Trademarks	Customer relationships	Other[1]	Total
January 1, 2017	137,783	27,284	—	—	5,163	32,447
Additions	—	84	—	—	6,229	6,313
Acquisitions through business combinations	495	11	2	768	12	793
Sales and disposals	—	(5,502)	(2)	(63)	(807)	(6,374)
Reclassification	—	5,194	—	—	(5,188)	6
Exchange differences on translation of foreign operations	457	134	—	72	(55)	151
Other	—	(9)	—	—	(11)	(20)
December 31, 2017	138,735	27,196	—	777	5,343	33,316
Additions	—	110	—	—	7,602	7,712
Acquisitions through business combinations	42,866	5	14,778	13,115	1,525	29,423
Sales and disposals	—	(5,640)	—	—	(143)	(5,783)
Reclassification	—	7,495	—	—	(7,495)	—
Exchange differences on translation of foreign operations	(1,315)	(127)	(68)	(153)	(72)	(420)
Other	—	281	—	—	(25)	256
December 31, 2018	180,286	29,320	14,710	13,739	6,735	64,504

Note: 1. Software in progress is included in other in intangible assets.

Accumulated Amortization and Accumulated Impairment Losses (Millions of yen)

	Goodwill	Intangible assets: Software	Trademarks	Customer relationships	Other	Total
January 1, 2017	—	14,915	—	—	2,843	17,758
Amortization[1]	—	4,839	—	120	57	5,016
Sales and disposals	—	(5,486)	—	(63)	(794)	(6,343)
Exchange differences on translation of foreign operations	—	117	—	1	(52)	66
Other	—	(10)	—	—	—	(10)
December 31, 2017	—	14,375	—	58	2,054	16,487
Amortization[1]	—	5,397	737	619	278	7,031
Sales and disposals	—	(5,500)	—	—	(135)	(5,635)
Exchange differences on translation of foreign operations	—	(105)	(1)	(11)	(52)	(169)
Other	—	228	—	—	13	241
December 31, 2018	—	14,395	736	666	2,158	17,955

Note: 1. Amortization of intangible assets is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

Carrying Amount (Millions of yen)

	Goodwill	Intangible assets: Software	Trademarks	Customer relationships	Other	Total
January 1, 2017	137,783	12,369	—	—	2,320	14,689
December 31, 2017	138,735	12,821	—	719	3,289	16,829
December 31, 2018	180,286	14,925	13,974	13,073	4,577	46,549

(2) Goodwill

The following table presents the carrying amount of goodwill recognized in the Group's consolidated statement of financial position. Goodwill arising from business combinations is allocated at the acquisition date to cash-generating units benefiting from the business combination, and the goodwill belongs to the Cosmetics Business, the Skin Care and Hair Care Business, the Fabric and Home Care Business and the Chemical Business. The goodwill primarily relates to the acquisition of the Kanebo Cosmetics Group.

(Millions of yen)

	2018	2017
Cosmetics Business	130,455	131,283
Kanebo Cosmetics Group	119,400	119,400
Molton Brown Group	11,055	11,883
Skin Care and Hair Care Business	28,831	4,792
Oribe Hair Care and other	24,908	779
Other	3,923	4,013
Fabric and Home Care Business	18,423	—
Chemical Business	2,577	2,660
Total	180,286	138,735

(3) Impairment Test for Goodwill

The Group tests goodwill for impairment at least once a year by each fiscal year end or if there are indications of impairment.

The recoverable amount on the impairment test is measured based on value in use. The majority of goodwill recognized at the Group relates to the Kanebo Cosmetics Group.

For the goodwill associated with the Kanebo Cosmetics Group, cash flow projections that are the basis for the value in use are estimated using two-year medium-term plans that reflect past year's performance. The key assumptions used in formulating these estimates include sales growth rates and discount rates and the sales growth rates are consistent with the growth rate projections of the markets in which the cash-generating units operate. Estimated cash flows in years beyond the two-year forecasts approved by management were calculated using an annual growth rate of 0% and were discounted to present value using a weighted average cost of capital (WACC) of 8.2% for the fiscal year ended December 31, 2018 and 7.1% for the fiscal year ended December 31, 2017. For the fiscal year ended December 31, 2018, management assumed the probability that material impairment would occur in this cash-generating unit was low even in cases where the key assumptions used for the impairment test changed within the reasonably possible ranges. While the value in use exceeded carrying amount at December 31, 2017, increasing the discount rate by 2.9% would result in impairment.

(4) Intangible Assets with Indefinite Useful Lives

The intangible assets above include no material intangible assets with indefinite useful lives.

(5) Commitments

Note 38 "Commitments" presents information on commitments associated with the acquisition of intangible assets.

15 Investments Accounted for Using the Equity Method

Investments in associates are accounted for using the equity method in the Group's consolidated financial statements. The carrying amount of investments in associates that are not individually material is as follows:

(Millions of yen)

	2018	2017
Investments accounted for using the equity method	7,931	7,682

Changes in the Group's share of net income and other comprehensive income of associates that are not individually material are as follows:

(Millions of yen)

	2018	2017
The Group's share of net income	2,082	2,007
The Group's share of other comprehensive income	(418)	316
The Group's share of comprehensive income	1,664	2,323

16 Income Taxes

(1) Deferred Tax Assets and Liabilities

Details of major causes of occurrence and changes in deferred tax assets and liabilities consist of the following:

Fiscal year ended December 31, 2018 (Millions of yen)

	January 1, 2018	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2018
Deferred tax assets					
Property, plant and equipment and intangible assets	18,735	559	—	(77)	19,217
Retirement benefit liabilities	16,737	589	7,011	(244)	24,093
Accrued expenses	11,431	(998)	—	13	10,446
Unused tax losses	2,099	(1,065)	—	366	1,400
Other	13,318	2,593	—	(45)	15,866
Total deferred tax assets	62,320	1,678	7,011	13	71,022
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,103	776	—	2,309	10,188
Financial assets	3,270	—	121	(756)	2,635
Undistributed foreign earnings	10,735	426	—	—	11,161
Other	729	52	—	(37)	744
Total deferred tax liabilities	21,837	1,254	121	1,516	24,728
Deferred tax assets, net	40,483	424	6,890	(1,503)	46,294

Fiscal year ended December 31, 2017 (Millions of yen)

	January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2017
Deferred tax assets					
Property, plant and equipment and intangible assets	18,316	384	—	35	18,735
Retirement benefit liabilities	27,847	(1,536)	(9,624)	50	16,737
Accrued expenses	11,927	(561)	—	65	11,431
Unused tax losses	1,240	866	—	(7)	2,099
Other	15,841	(2,439)	—	(84)	13,318
Total deferred tax assets	75,171	(3,286)	(9,624)	59	62,320
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,945	(766)	—	(76)	7,103
Financial assets	2,764	—	509	(3)	3,270
Undistributed foreign earnings	12,730	(1,995)	—	—	10,735
Other	1,321	(611)	—	19	729
Total deferred tax liabilities	24,760	(3,372)	509	(60)	21,837
Deferred tax assets, net	50,411	86	(10,133)	119	40,483

Deferred tax assets and liabilities recognized in the consolidated statement of financial position are as follows:

(Millions of yen)

	2018	2017
Deferred tax assets	49,158	40,918
Deferred tax liabilities	2,864	435
Deferred tax assets, net	46,294	40,483

Deductible temporary differences and unused tax losses for which no deferred tax asset is recognized are as follows:

(Millions of yen)

	2018	2017
Unused tax losses	2,664	17,656
Deductible temporary differences	11,981	19,967
Total	14,645	37,623

Unused tax losses for which no deferred tax asset is recognized will expire as follows:

(Millions of yen)

	2018	2017
Not later than 1 year	210	507
Later than 1 year and not later than 2 years	353	3,426
Later than 2 years and not later than 3 years	472	7,007
Later than 3 years and not later than 4 years	297	5,336
Later than 4 years	1,332	1,380
Total	2,664	17,656

The aggregate amounts of taxable temporary differences associated with investments in subsidiaries and associates for which deferred tax liabilities were not recognized at December 31, 2018 and 2017 were 11,512 million yen and 15,835 million yen, respectively. The Group did not recognize deferred tax liabilities for these temporary differences because it was able to control the timing of the reversal of these temporary differences, and it was probable that the temporary difference will not reverse in the foreseeable future.

(2) Income Taxes

Income taxes consist of the following:

(Millions of yen)

	2018	2017
Current taxes	52,344	55,769
Deferred taxes[1]	(424)	(86)
Total	51,920	55,683

Note: 1. Deferred taxes include 385 million yen and 160 million yen for the fiscal years ended December 31, 2018 and 2017, respectively, due to tax rate changes.

(3) Reconciliation of Effective Tax Rate

The details of difference between the effective statutory tax rate and the Group's average actual tax rate consist of the following:

(%)

	2018	2017
Effective statutory tax rate	30.86	30.86
Tax credit for experimental research costs and other	(3.80)	(2.68)
Different tax rates applied to subsidiaries	(1.64)	(0.92)
Reassessment of recoverability of unused tax losses and deferred tax assets	(0.30)	0.48
Change in tax rates	0.19	0.08
Other	(0.26)	(0.56)
Average actual tax rate	25.05	27.26

17 Bonds and Borrowings

Bonds and borrowings consist of the following:

(Millions of yen)

	2018	2017	Average interest rate[1] (%)	Maturity
Short-term borrowings	430	201	1.18	—
Current portion of long-term borrowings	40,046	67	0.13	—
Long-term borrowings	30,299	70,347	0.11	2021-2023
Current portion of bonds[2]	12	24,994	—	—
Bonds[2]	50,040	24,975	—	—
Total	120,827	120,584		
Current liabilities				
Bonds and borrowings	40,488	25,262		
Non-current liabilities				
Bonds and borrowings	80,339	95,322		
Total	120,827	120,584		

Notes: 1. The average interest rate is the weighted average interest rate on the balance of borrowings as of December 31, 2018.
2. Details of bonds issued are as follows:

(Millions of yen)

Issuer	Bond name	Issue date	2018	2017	Interest rate (%)	Collateral	Maturity date
The Company	3rd unsecured bonds	June 14, 2013	—	24,994	0.39	None	June 20, 2018
The Company	4th unsecured bonds	June 14, 2013	24,985	24,975	0.62	None	June 19, 2020
The Company	5th unsecured bonds	June 19, 2018	24,947	—	0.08	None	June 20, 2023
Subsidiaries	Other bonds	—	120	—	—	—	—
Total			50,052	49,969			

18 Leases

(1) Finance Lease Payables

As a lessee, the Group leases assets including buildings. Some lease contracts include renewal options. The Group has no lease contracts with covenants such as restrictions on additional borrowings or additional leases.

The total of future minimum lease payments and the present value under finance lease contracts consist of the following:

(Millions of yen)

	Minimum lease payments		Present value of minimum lease payments	
	2018	2017	2018	2017
Not later than 1 year	689	789	663	755
Later than 1 year and not later than 5 years	1,769	2,337	1,731	2,276
Later than 5 years	25	149	25	147
Total	2,483	3,275	2,419	3,178
Financial charges	(64)	(97)	—	—
Present value of minimum lease payments	2,419	3,178	2,419	3,178

(2) Non-cancellable Operating Leases

As a lessee, the Group leases assets including land.

The total of future minimum lease payments under non-cancellable operating lease contracts consists of the following:

(Millions of yen)

	2018	2017
Not later than 1 year	8,622	8,414
Later than 1 year and not later than 5 years	15,539	16,347
Later than 5 years	6,381	6,917
Total	30,542	31,678

The total of minimum lease payments under operating lease contracts recognized as expenses is as follows:

(Millions of yen)

	2018	2017
Total of minimum lease payments	9,829	10,080

19 Trade and Other Payables

Trade and other payables consist of the following:

(Millions of yen)

	2018	2017
Trade payables	145,603	143,944
Non-trade payables	79,957	80,949
Total	225,560	224,893

20 Employee Benefits

(1) Post-employment Benefits

The Company and most of its domestic subsidiaries have a cash balance plan as a defined benefit plan and a defined contribution plan as post-employment benefits (The cash balance plan is linked to market interest rates). The defined benefit obligations held in Japan account for a large proportion of the Group's defined benefit obligations.

Cash balance plan benefits are determined using points acquired during the enrollment period and a multiplier based on the enrollment period. The Group may also pay an early retirement bonus allowance to employees who retire earlier than the retirement age.

In accordance with laws and regulations, the defined benefit plan is operated as a pension fund that is legally separated from the Group. The pension fund is managed by a Board of Representatives composed of representatives elected by the participating companies and the representatives of participating employees. Pension fund management institutions manage the pension fund's assets in accordance with management policies specified by the Board of Representatives. The Board of Representatives and the pension fund management institutions are legally required to act in the best interests of plan participants in executing their responsibilities for managing the plan assets.

Certain foreign subsidiaries have defined benefit plans and/or defined contribution plans as post-employment benefits.

The defined benefit plan is exposed to actuarial risk and to the risk of fluctuation in the fair value of plan assets. Actuarial risk primarily involves interest rate risk. Interest rate risk involves the potential for an increase in defined benefit plan obligations if the discount rate used to determine their present value decreases, because this discount rate is based on market yields on instruments including high-quality corporate bonds. The risk of fluctuation in the fair value of plan assets involves underfunding if actual interest rates are lower than the interest rate criteria for managing the plan assets.

1) Defined benefit liabilities recognized in the consolidated statement of financial position

Net defined benefit liabilities and assets recognized in the consolidated statement of financial position, defined benefit obligations and plan assets are as follows:

(Millions of yen)

	2018	2017
Present value of defined benefit obligations	342,130	333,614
Fair value of plan assets	(258,744)	(270,144)
Net defined benefit liabilities	83,386	63,470
Amounts recognized in consolidated statement of financial position		
Retirement benefit liabilities	84,552	64,694
Retirement benefit assets	(1,166)	(1,224)
Net defined benefit liabilities	83,386	63,470

2) Defined benefit obligations

Changes in the present value of defined benefit obligations are as follows:

(Millions of yen)

	2018	2017
The present value of the defined benefit obligations at beginning of year	333,614	355,579
Current service cost[1]	9,376	9,839
Interest expense[2]	2,569	2,672
Remeasurements		
Actuarial (gains) losses arising from changes in demographic assumptions	6,755	(31)
Actuarial (gains) losses arising from changes in financial assumptions	1,376	(20,245)
Actuarial (gains) losses arising from experience adjustments	1,748	2,242
Past service cost and (gains) losses arising from settlements[3]	107	(407)
Benefits paid[4]	(11,865)	(12,015)
Changes due to termination (curtailment and settlement) of defined benefit plans	—	(4,738)
Exchange differences on translation of foreign operations and other	(1,550)	718
The present value of the defined benefit obligations at end of year	342,130	333,614

Notes: 1. Current service cost is recognized in profit or loss and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
2. Interest expense or interest income associated with the net of the present value of the defined benefit obligations and the fair value of plan assets is recognized in profit or loss and included in financial expenses or financial income in the consolidated statement of income.
3. Past service cost and (gains) losses arising from settlements are recognized in profit or loss and included in cost of sales and general and administrative expenses in the consolidated statement of income.
4. The weighted average duration of the defined benefit obligations in Japan was mainly 17.4 years at December 31, 2018 and 16.6 years at December 31, 2017.

3) Plan assets

Changes in the fair value of plan assets are as follows:

(Millions of yen)

	2018	2017
The fair value of plan assets at beginning of year	270,144	261,857
Interest income	1,927	1,882
Remeasurements		
Return on plan assets (excluding amounts included in interest income)	(12,656)	12,850
Contributions to the plan by the employer[1]	10,292	8,941
Payments from the plan	(10,249)	(10,624)
Changes due to termination (curtailment and settlement) of defined benefit plans	—	(4,738)
Exchange differences on translation of foreign operations and other	(714)	(24)
The fair value of plan assets at end of year	258,744	270,144

Note: 1. Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefits and maintaining the balance of pension financing when the plan is underfunded. The Group plans to contribute 13,661 million yen to the defined benefit plan for the fiscal year ending December 31, 2019.

Plan assets consist of the following:

(Millions of yen)

	2018			2017		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Equity securities	8,830	43,962	52,792	9,207	50,055	59,262
Japan	—	21,502	21,502	—	25,010	25,010
Overseas	8,830	22,460	31,290	9,207	25,045	34,252
Debt securities	6,640	188,425	195,065	7,518	192,628	200,146
Japan	—	126,940	126,940	—	128,279	128,279
Overseas	6,640	61,485	68,125	7,518	64,349	71,867
Other	352	10,535	10,887	257	10,479	10,736
Total	15,822	242,922	258,744	16,982	253,162	270,144

Note: Plan assets invested in pooled funds of trust banks are classified without quoted market prices in active markets.

Pension assets in Japan account for a large proportion of the Group's plan assets. The objective in managing the plan assets is to raise total returns to the greatest extent possible in order to ensure stable benefits and lump-sum payments for plan participants in the future and beneficiaries with a long-term view under acceptable risks. Specifically, the Group considers factors including expected rate of return on investments in appropriate assets, risks of each asset, and asset combinations to set an asset mix policy for an appropriate basic portfolio in future years as the basis for maintaining asset allocation. The Group reviews the basic portfolio annually and realigns it as necessary if the asset allocation conditions have changed since the asset mix was set.

4) Significant actuarial assumptions and related sensitivity analysis

Significant actuarial assumptions are as follows:

	2018	2017
Discount rate	Mainly 0.8%	Mainly 0.8%

Note: The above table presents the discount rate used by the Company and major domestic subsidiaries.

Sensitivity analysis of the effect of changes in the present value of the defined benefit obligations of the Company and major domestic subsidiaries given changes in the discount rate used as a significant actuarial assumption is as follows:

(Millions of yen)

	2018	2017
The impact on defined benefit obligations		
0.5% increase in discount rate	(25,292)	(23,414)
0.5% decrease in discount rate	26,314	24,311

Note: This sensitivity analysis estimates the effect on the defined benefit obligations at the end of each reporting period from changes in the discount rate while all of the other assumptions remain constant.

5) Defined contribution plans
Expenses related to the defined contribution plan recognized in profit or loss were 4,176 million yen and 3,873 million yen for the fiscal years ended December 31, 2018 and 2017, respectively and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

(2) Other Employee Benefit Expenses
Other employee benefit expenses recognized in cost of sales, selling, general and administrative expenses, and other operating expenses in the consolidated statement of income for the fiscal years ended December 31, 2018 and 2017 were 272,234 million yen and 268,034 million yen, respectively.

21 Provisions

Components of and changes in provisions consist of the following:

(Millions of yen)

	Provision for loss related to cosmetics	Provision for asset retirement obligations	Other provisions	Total
January 1, 2018	8,763	4,339	2,337	15,439
Increase	2,732	174	1,383	4,289
Interest expense on discounted provision	7	62	—	69
Decrease (provision used)	(3,334)	(139)	(1,002)	(4,475)
Decrease (provision reversed)	—	—	(181)	(181)
Exchange differences on translation of foreign operations	—	(22)	(71)	(93)
December 31, 2018	8,168	4,414	2,466	15,048

(1) Provision for Loss Related to Cosmetics
The Group has recognized estimated compensation and other expenses related to cosmetics for brightening products of Kanebo Cosmetics containing the ingredient Rhododenol, for which a voluntary recall was announced on July 4, 2013. The Group expects its insurance policy to cover 2,521 million yen of the estimated expenses.

(2) Provision for Asset Retirement Obligations
The Group recognizes asset retirement obligations principally based on or pursuant to reasonably estimated future expenditures using historical experience and other factors when the Group has a legal or contractual obligation associated with the retirement of property, plant and equipment and leased assets held for use.

These expenditures are generally expected to take place after a year or more, but are affected by factors including future business plans.

(3) Other Provisions
Other provisions consist of estimated expenses for business transformation at subsidiaries in Europe and the Americas and other expenses.

22 Other Current Liabilities

Other current liabilities consist of the following:

(Millions of yen)

	2018	2017
Accrued expenses	77,530	81,515
Consumption tax payables	8,808	9,741
Obligation for unused paid absences	7,865	7,558
Other	8,249	8,590
Total	102,452	107,404

23 Equity and Other Equity Items

(1) Share Capital

The numbers of shares authorized and issued are as follows:

(Shares)

	2018	2017
Authorized	1,000,000,000	1,000,000,000
Issued[1]		
Beginning balance	495,000,000	504,000,000
Change during the year[2]	(6,300,000)	(9,000,000)
Ending balance	488,700,000	495,000,000

Notes: 1. All of the issued shares of the Company are ordinary shares that have no par value and no limitations on rights. Issued shares are fully paid.
2. The number of issued shares during the fiscal year ended December 31, 2018 and 2017 decreased by 6,300,000 shares and 9,000,000 shares respectively due to the retirement of treasury shares pursuant to the resolution of the Board of Directors.

(2) Capital Surplus

Capital surplus consists of capital reserve and other capital surplus.

The Companies Act stipulates that over half of the capital contributed from the issue of shares must be included in share capital and that the remainder must be included in capital reserve. Moreover, capital reserve may be included in share capital by resolution of the General Meeting of Shareholders.

(3) Treasury Shares

The changes in treasury shares are as follows:

(Shares)

	2018	2017
Beginning balance[1]	2,225,561	11,137,654
Increase[2]	6,237,461	263,176
Decrease[3]	(6,419,750)	(9,175,269)
Ending balance[4]	2,043,272	2,225,561

Notes: 1. 556,492 shares of treasury shares held by associates were included at December 31, 2018 and 2017.
257,300 shares held by the Board Incentive Plan Trust (hereinafter "BIP Trust") were included at December 31, 2018.
2. The increase of 6,237,461 shares of treasury shares during the fiscal year ended December 31, 2018 resulted from the acquisition of 6,233,200 shares by resolution of the Board of Directors and the purchase of 4,261 fractional shares.
The increase of 263,176 shares of treasury shares during the fiscal year ended December 31, 2017 resulted from the acquisition of 257,300 shares by BIP Trust and the purchase of 5,876 fractional shares.
3. The decrease of 6,419,750 shares of treasury shares during the fiscal year ended December 31, 2018 resulted from the retirement of 6,300,000 shares by resolution of the Board of Directors, a decrease of 105,000 shares due to the exercise of stock options, a decrease of 14,625 shares due to the grant to the Board of Directors by the BIP trust and the sale of 125 fractional shares.
The decrease of 9,175,269 shares of treasury shares during the fiscal year ended December 31, 2017 resulted from the retirement of 9,000,000 shares by resolution of the Board of Directors, a decrease of 175,000 shares due to the exercise of stock options, and the sale of 269 fractional shares.
4. 556,492 shares of treasury shares held by associates were included at December 31, 2018 and 2017.
In addition, 242,675 shares and 257,300 shares held by the BIP Trust were included at December 31, 2018 and 2017, respectively.

(4) Other Components of Equity

1) Subscription rights to shares

The Company employs a stock option system and issues subscription rights to shares in accordance with the Companies Act; however, due to the introduction of a performance share plan, the stock option plan has been abolished except for the options already granted.

Note 34 "Share-based Payments" presents information including terms and conditions and amounts.

2) Exchange differences on translation of foreign operations

Foreign currency translation differences arise from the translation of financial statements of foreign operations prepared in foreign currencies.

3) Net gain (loss) on derivatives designated as cash flow hedges

Associates hedge their exposure to the risk of variability in future cash flows. Net gain (loss) on derivatives designated as cash flow hedges is the portion of the change in the fair value of the hedging instrument that meets the hedge effectiveness requirements under hedge accounting.

4) Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income

This is the accumulated amount of changes in the fair value of financial assets measured at fair value through other comprehensive income. The Group reclassifies net gain (loss) on revaluation of financial assets from other components of equity to retained earnings when it disposes of an investment or when fair value declines significantly.

5) Remeasurements of defined benefit plans

Remeasurements of defined benefit plans include the effect of any variances between actuarial assumptions at the beginning of the year and actual results, the effects of changes in actuarial assumptions, actual return on plan assets and interest income on plan assets (excluding amounts included in net interest on the net defined benefit liability (asset)), and any change in the effect of the asset ceiling (excluding amounts included in net interest on the net defined benefit liability (asset)). Remeasurements of defined benefit plans are recognized in other comprehensive income and immediately reclassified from other components of equity to retained earnings in the period when they occur.

(5) Retained Earnings

Retained earnings consist of legal reserve and other retained earnings.

The Companies Act requires that an amount equal to one-tenth of dividends must be appropriated as capital reserve or as legal reserve until the total of the aggregate amount of capital reserve and legal reserve equals a quarter of share capital. Legal reserve may be appropriated to reduce a deficit, and also may be reversed by resolution of the General Meeting of Shareholders.

24 Basic Strategy for Capital Policy

The Group's capital policy follows a basic strategy of securing a sound financial structure to make investments for sustainable growth and tolerate the related risks, and to make stable, continuous returns to shareholders. To realize this policy, the Group uses Economic Value Added (hereinafter "EVA®[1]"), a management indicator that takes capital cost into account, as its main indicator and works to enhance its corporate value by improving EVA. Guided by EVA management, which places importance on both continuous enhancements in corporate value and long-term profits for all stakeholders, the Group develops its business strategy and business plan.

The Group manages all equity and interest-bearing liabilities as capital cost and intends to optimize capital cost from the viewpoint of safety and capital efficiency. For equity, the Group aims for a streamlined and sound structure from a medium- to long-term perspective with efficiency in mind and, while maintaining interest-bearing liabilities at a moderate level, aims to maintain high credit ratings which will allow it to procure capital for large-scale investments. The Group is not subject to significant capital regulations except for general requirements under the Companies Act and others.

Although the Group emphasizes shareholder returns, it realizes that investments for growth will meet the expectations of its stakeholders, and therefore prioritizes such investments. In addition to providing stable dividends, the Group aims to continuously increase dividends to reflect improvements in business results. The Group also uses surplus funds to flexibly conduct share repurchases.

In addition to making returns to shareholders, the Group retains the capital necessary to conduct investments for growth in a timely fashion and to ensure the appropriate resources to deal with situations that exceed assumptions while improving EVA.

For the fiscal year ended December 31, 2018, EVA increased 3.1 billion yen compared with the previous fiscal year to 93.5 billion yen due to an increase in net operating profit after tax (hereinafter "NOPAT").

Note: 1. EVA is a monetary metric defined as NOPAT less capital cost. EVA is a registered trademark of Stern Stewart & Co.

25 Dividends

Dividends paid are as follows:

Fiscal year ended December 31, 2018

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
112th Annual General Meeting of Shareholders held on March 23, 2018	27,595	56	December 31, 2017	March 26, 2018
Board of Directors meeting held on July 26, 2018	29,197	60	June 30, 2018	September 3, 2018

Note: 1. Total dividends are reduced by dividends on treasury shares held by associates accounted for using the equity method and dividends on shares of the Company held by the BIP Trust.
The dividend resolved at the 112th Annual General Meeting of Shareholders held on March 23, 2018 was 27,641 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 26, 2018 was 29,245 million yen before the deduction.

Fiscal year ended December 31, 2017

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
111th Annual General Meeting of Shareholders held on March 21, 2017	23,657	48	December 31, 2016	March 22, 2017
Board of Directors meeting held on July 27, 2017	26,608	54	June 30, 2017	September 1, 2017

Note: 1. Dividends on treasury shares held by associates accounted for using the equity method are deducted by an amount corresponding to the Group's equity in these associates. In addition, total dividends pursuant to the resolution of the Board of Directors held on July 27, 2017 are deducted by the amount of dividends on shares of the Company held by the BIP Trust.
The dividend resolved at the 111th Annual General Meeting of Shareholders held on March 21, 2017 was 23,684 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 27, 2017 was 26,652 million yen before the deduction.

Dividends with an effective date after the fiscal year end are as follows:

Fiscal year ended December 31, 2018

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
113th Annual General Meeting of Shareholders held on March 26, 2019	29,247	60	December 31, 2018	March 27, 2019

Fiscal year ended December 31, 2017

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
112th Annual General Meeting of Shareholders held on March 23, 2018	27,641	56	December 31, 2017	March 26, 2018

26 Revenue

(1) Disaggregation of Revenue

The Group is organized on the basis of five businesses: the four business areas that constitute the Consumer Products Business (the Cosmetics Business, the Skin Care and Hair Care Business, the Human Health Care Business, and the Fabric and Home Care Business), and the Chemical Business.

Revenues of these five businesses are presented as net sales. The Board of Directors of the Company reviews them regularly to determine allocation of resources and to assess their performance. Revenue of logistics services to third parties is included in other operating income because it is not a part of the abovementioned five main businesses.

The Group disaggregates revenue from contracts with customers by separating the Consumer Products Business into the Cosmetics Business and non-Cosmetics Businesses based on contracts with customers, with the Chemical Business as a separate division. Revenue by geographic region is disaggregated based on the location of revenue recognized. The relationship between disaggregated revenue and net sales by segment is as follows:

Due to a change in organization as of January 1, 2018, in the fiscal year ended December 31, 2018 the Group reclassified its reportable segments and disaggregation of revenue for the fiscal year ended December 31, 2017 has been restated to reflect the reclassification. Changes in segment classification are presented in Note 6 "Segment Information (1) Summary of Reportable Segments."

Fiscal year ended December 31, 2018 (Millions of yen)

	Japan	Asia	Americas	Europe	Total
Cosmetics Business	217,726	34,667	6,397	20,845	279,635
Skin Care and Hair Care Business	195,821	28,513	72,804	44,281	341,419
Human Health Care Business	171,633	95,971	98	—	267,702
Fabric and Home Care Business	298,712	39,558	5,723	112	344,105
Consumer Products Business	883,892	198,709	85,022	65,238	1,232,861
Chemical Business	126,550	67,480	51,846	66,931	312,807
Elimination of intersegment transactions	(32,864)	(3,088)	(87)	(1,622)	(37,661)
Consolidated	977,578	263,101	136,781	130,547	1,508,007
Revenue of logistics services to third parties included in other operating income	8,548	—	—	—	8,548
Total revenue from contracts with customers	986,126	263,101	136,781	130,547	1,516,555

Note: Figures for the Consumer Products Business present sales to external customers and figures for the Chemical Business include sales to the Consumer Products Business in addition to external customers.

Fiscal year ended December 31, 2017 (Millions of yen)

	Japan	Asia	Americas	Europe	Total
Cosmetics Business	215,035	25,356	6,276	19,547	266,214
Skin Care and Hair Care Business	191,853	27,942	68,866	44,211	332,872
Human Health Care Business	184,453	96,701	47	—	281,201
Fabric and Home Care Business	294,838	38,786	2,085	—	335,709
Consumer Products Business	886,179	188,785	77,274	63,758	1,215,996
Chemical Business	123,886	69,572	52,625	64,202	310,285
Elimination of intersegment transactions	(31,833)	(3,352)	(99)	(1,576)	(36,860)
Consolidated	978,232	255,005	129,800	126,384	1,489,421
Revenue of logistics services to third parties included in other operating income	8,619	—	—	—	8,619
Total revenue from contracts with customers	986,851	255,005	129,800	126,384	1,498,040

Note: Figures for the Consumer Products Business present sales to external customers and figures for the Chemical Business include sales to the Consumer Products Business in addition to external customers.

1) Consumer Products Business

The Consumer Products Business sells consumer products including cosmetics, skin care products, hair care products, sanitary products and fabric care products. Its customers are mainly retailers in Japan and retailers and wholesalers outside Japan. Revenue from such sales is recognized when control of a product is transferred to a customer, i.e., at the point in time a product is delivered and handed over at the place designated by a customer because legal title to the product, physical possession and the significant risks and rewards of ownership of the product are transferred to the customer and the customer has the right to decide the method of sale and selling price of the product.

In the Consumer Products Business, products may be sold with a rebate conditional upon achievement of certain targets such as the quantity or amount of sales (hereinafter "Achievement Rebate") or other payments. In such cases, the transaction price is determined in an amount deducting the estimated amount of the Achievement Rebate or other payments from the consideration promised in the contract with the customer. Estimates of Achievement Rebate or other payment amounts use the most likely outcome method based on historical experience and other factors, and revenue is recognized only to the extent that it is highly probable that a significant reversal will not occur.

In addition, in the event that the Group makes payments to customers such as funding for sales promotions, if the consideration paid to customers is payment for separate goods or services from the customer and fair value cannot be reasonably estimated, revenue is measured by deducting the consideration from the transaction price.

Among the products in the Consumer Products Business, cosmetics are composed of counseling cosmetics and self-selection cosmetics. The Group may provide support to customers when they sell counseling cosmetics through counseling to final consumers.

In addition, when selling cosmetics, a certain level of product returns from customers associated with the termination of products is expected to occur. Because the Group has an obligation to refund the consideration for a product if a customer returns it, the Group recognizes a liability for sales returns as a deduction from revenue for projected refunds to customers. To estimate liabilities related to such sales returns, the Group uses the most likely outcome method based on historical experience and other factors, and revenue is recognized only to the extent that it is highly probable that a significant reversal will not occur. When customers return products, the Group has the right to collect the products from the customers, but because returned goods are primarily the result of a product termination, the products returned have no asset value and therefore such assets are not recognized.

2) Chemical Business
The Chemical Business sells chemical products such as fatty alcohols and surfactants. Its customers are mainly the users and distributors of the products. Revenue from such sales is recognized when control of a product is transferred to a customer, i.e., at the point in time a product is delivered and handed over at the place designated by a customer because legal title to the product, physical possession and the significant risks and rewards of ownership of the product are transferred to the customer and the customer has the right to decide the method of sale and selling price of the product. Revenue from sales of products in the Chemical Business is measured at transaction prices for contracts with customers.

(2) Liabilities from Contracts with Customers
Liabilities from contracts with customers are as follows:

Fiscal year ended December 31, 2018 (Millions of yen)

	January 1, 2018	December 31, 2018
Contract liabilities		
Advances	392	181
Refund liabilities	16,904	18,206
Total	17,296	18,387

Fiscal year ended December 31, 2017 (Millions of yen)

	January 1, 2017	December 31, 2017
Contract liabilities		
Advances	2,501	392
Refund liabilities	14,046	16,904
Total	16,547	17,296

Among liabilities from contracts with customers, estimates of Achievement Rebates or other payment amounts expected to be paid to customers related to sales by the end of the reporting period and liabilities for returned products are recognized as refund liabilities.

The balances of advances as of January 1, 2018 and 2017 were recognized as revenue during the fiscal years ended December 31, 2018 and 2017, respectively. The amount of revenue recognized during the fiscal year ended December 31, 2018 from performance obligations satisfied in previous periods was not material.

(3) Transaction Price Allocated to the Remaining Performance Obligations
The Group uses the practical expedient of omitting the disclosure of information on the remaining performance obligations because it has no significant transactions with individual expected contractual terms exceeding one year. In addition, there are no significant amounts in consideration from contracts with customers that are not included in transaction prices.

(4) Assets Recognized from the Costs of Obtaining or Fulfilling Contracts with Customers
The amount of assets recognized from the costs of obtaining or fulfilling contracts with customers during the fiscal year ended December 31, 2018 was not material. In addition, if the amortization period of the assets that the Group otherwise would have recognized is one year or less, the Group uses the practical expedient of recognizing the incremental costs of obtaining the contract as an expense when incurred.

27 Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of the following:

(Millions of yen)

	2018	2017
Advertising	80,274	89,935
Sales promotion	55,308	58,940
Employee benefits	148,220	147,007
Depreciation	9,186	8,870
Amortization	6,860	4,784
Research and development	57,673	56,703
Other	87,324	86,427
Total	444,845	452,666

28 Other Operating Income

Other operating income consists of the following:

(Millions of yen)

	2018	2017
Revenue of logistics services to third parties	8,548	8,619
Royalty income	1,039	1,112
Other	4,701	5,178
Total	14,288	14,909

29 Other Operating Expenses

Other operating expenses consist of the following:

(Millions of yen)

	2018	2017
Expenses of logistics services to third parties	7,667	7,688
Losses on sale and disposal of property, plant and equipment	4,769	3,729
Expenses for business transformation at subsidiaries in Europe and the Americas	1,516	27
Other[1]	1,806	1,322
Total	15,758	12,766

Note: 1. Note 13 "Property, Plant and Equipment" presents impairment losses included in other.

30 Financial Income and Financial Expenses

Financial income consists of the following:

(Millions of yen)

	2018	2017
Interest income		
Financial assets measured at amortized cost	1,320	1,059
Retirement benefit assets	30	38
Dividend income		
Financial assets measured at fair value through other comprehensive income		
Financial assets derecognized during the year	78	0
Financial assets held at year end	171	224
Financial assets measured at fair value through profit or loss	8	12
Other	110	119
Total	1,717	1,452

Financial expenses consist of the following:

(Millions of yen)

	2018	2017
Foreign exchange loss[1]	2,304	1,765
Interest expenses[2]		
Financial liabilities measured at amortized cost	1,256	1,339
Retirement benefit liabilities	672	828
Other	19	28
Total	4,251	3,960

Notes: 1. Valuation gains or losses on currency derivatives that are not designated as hedges are included in foreign exchange loss.
2. Valuation gains or losses on interest rate derivatives that are not designated as hedges are included in interest expenses.

31 Earnings per Share

(1) The Basis for Calculating Basic Earnings per Share

(Millions of yen, unless otherwise noted)

	2018	2017
Net income attributable to owners of the parent	153,698	147,010
Amounts not attributable to ordinary shareholders of the parent	—	—
Net income used to calculate basic earnings per share	153,698	147,010
Weighted average number of ordinary shares (Thousands of shares)	489,089	492,832
Basic earnings per share (Yen)	314.25	298.30

(2) The Basis for Calculating Diluted Earnings per Share

(Millions of yen, unless otherwise noted)

	2018	2017
Net income used to calculate basic earnings per share	153,698	147,010
Adjustments to net income	—	—
Net income used to calculate diluted earnings per share	153,698	147,010
Weighted average number of ordinary shares (Thousands of shares)	489,089	492,832
Increase in ordinary shares		
Subscription rights to shares (Thousands of shares)	199	337
Weighted average number of ordinary shares after dilution (Thousands of shares)	489,289	493,170
Diluted earnings per share (Yen)	314.12	298.09
Summary of potential ordinary shares not included in the calculation of diluted earnings per share because they have no dilutive effect	—	—

32 Other Comprehensive Income

Amount arising during the fiscal year and tax effects for each component of other comprehensive income are as follows:

Fiscal year ended December 31, 2018 (Millions of yen)

	Gains (losses) arising for the year	Tax effect	After tax effect
Items that will not be reclassified to profit or loss			
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	119	(121)	(2)
Remeasurements of defined benefit plans	(22,535)	7,011	(15,524)
Share of other comprehensive income of investments accounted for using the equity method	(497)	152	(345)
Total of items that will not be reclassified to profit or loss	(22,913)	7,042	(15,871)
Items that may be reclassified subsequently to profit or loss			
Exchange differences on translation of foreign operations	(16,140)	—	(16,140)
Share of other comprehensive income of investments accounted for using the equity method	(75)	2	(73)
Total of items that may be reclassified subsequently to profit or loss	(16,215)	2	(16,213)
Total	(39,128)	7,044	(32,084)

Fiscal year ended December 31, 2017 (Millions of yen)

	Gains (losses) arising for the year	Tax effect	After tax effect
Items that will not be reclassified to profit or loss			
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	1,675	(509)	1,166
Remeasurements of defined benefit plans	30,884	(9,624)	21,260
Share of other comprehensive income of investments accounted for using the equity method	457	(140)	317
Total of items that will not be reclassified to profit or loss	33,016	(10,273)	22,743
Items that may be reclassified subsequently to profit or loss			
Exchange differences on translation of foreign operations	8,541	—	8,541
Share of other comprehensive income of investments accounted for using the equity method	(1)	0	(1)
Total of items that may be reclassified subsequently to profit or loss	8,540	0	8,540
Total	41,556	(10,273)	31,283

33 Cash Flow Information

(1) Payments for Business Combinations

Payments for business combinations consist of the following:

(Millions of yen)

	2018
Cash and cash equivalents paid for acquisition	76,387
Cash and cash equivalents held by the acquiree at the time of acquisition	(2,472)
Payments for business combinations	73,915

(2) Changes in Liabilities Arising from Financing Activities

The major changes in liabilities arising from financing activities are changes from financing cash flows and there are no significant non-cash changes.

34 Share-based Payments

(1) Stock Options

1) Outline of stock options

The Company issued the following two types of stock options to directors, executive officers and employees of the Group. Due to the introduction of a performance share plan, the stock option plan has been abolished except for the options already granted.

(i) Stock options for share-based payment

Stock options for share-based payment were granted as compensation for directors and executive officers who do not concurrently serve as directors. These stock options were intended to motivate and inspire recipients to enhance the Company's results and value of shares and to further enhance corporate value by aligning the interests of recipients with those of shareholders by further increasing the linkage among the compensation of recipients, the Company's results and value of shares.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled
- Exercise period: Five years from July 1 of two years after the date the stock options were granted

(ii) Conventional stock options

Conventional stock options were granted to the employees of the Company and the directors and employees of its subsidiaries and associates as incentives. These stock options were intended to further enhance corporate value by aligning the interests of recipients with those of shareholders.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled
- Exercise period: Five years from September 1 of two years after the date the stock options were granted

2) Number of stock options and weighted average exercise price

	2018		2017	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
	(Shares)	(Yen)	(Shares)	(Yen)
Beginning balance of outstanding	313,000	973	549,000	1,331
Granted	—	—	—	—
Exercised	(105,000)	1,117	(175,000)	1,672
Expired at maturity	(83,000)	2,254	(61,000)	2,190
Ending balance of outstanding	125,000	1	313,000	973
Ending balance of exercisable	125,000	1	273,000	1,115

Notes: 1. The weighted average share price on the date of exercise for the fiscal years ended December 31, 2018 and 2017 was 7,877 yen and 6,254 yen, respectively.
2. The exercise price and the weighted average remaining contractual life for stock options outstanding at the end of the period are as follows:

2018			2017		
Exercise price	Number of shares	Weighted average remaining contractual life	Exercise price	Number of shares	Weighted average remaining contractual life
(Yen)	(Shares)	(Years)	(Yen)	(Shares)	(Years)
1	125,000	2.8	1	178,000	3.3
—	—	—	2,254	135,000	0.7
Total	125,000	2.8	Total	313,000	2.2

(2) Performance Share Plan

1) Outline of performance share plan

The Company introduced a performance share plan (hereinafter the "Plan") for the members of the Board of Directors (excluding Outside Directors) and Executive Officers (collectively, "Directors, etc.") as a highly transparent and objective compensation system that is closely linked to company performance. The purpose of the Plan is to improve the Company's mid- and long-term performance as well as increase the awareness of contributions to increasing corporate value.

The Company has introduced the Plan using a structure called a BIP Trust. A BIP Trust is designed as an executive incentive plan based on the performance share plans and restricted stock plans in the U.S. wherein the Company's shares that are acquired through the BIP Trust and the amount equivalent to the converted value of such shares will be vested or paid to Directors, etc. depending on their executive positions and level of achievement of performance targets in the mid-term plan and other factors. The shares held by the BIP Trust are accounted for as treasury shares.

The Plan grants specified points (1 point = 1 share) to Directors, etc. each year depending on their executive positions and other factors on the condition that the requirements of a designated beneficiary, such as holding the office of Director, etc. on the last day of each fiscal year during the eligibility period, have been satisfied. The Company's shares and cash in the amount of the converted value of such Company's shares equivalent to the number of such points may be granted or paid following completion of settlement procedures by the designated beneficiary, after the end of the eligibility period in the case of performance-linked points, or for a specified period each year during the eligibility period in the case of fixed points.

The Plan is accounted for as an equity-settled share-based payment transaction.

2) Number of points granted during the period and weighted average fair value of points

The fair value of the points on the date of grant is determined by adjusting the market price of the Company's shares taking expected dividends into account.

The number of points granted during the period and the weighted average fair value of the points are as follows:

	2018		2017	
	Achievement-linked points	Fixed points	Achievement-linked points	Fixed points
Number of points granted during the period	37,625	16,125	34,125	14,625
Weighted average fair value (Yen)	6,821	6,659	6,821	6,767

(3) Share-based Payment Expenses

Share-based payment expenses recognized in the consolidated statement of income for the fiscal years ended December 31, 2018 and 2017 were 364 million yen and 332 million yen, respectively.

35 Financial Instruments

(1) Classification of Financial Instruments

The amounts of each classification of financial assets are as follows:

(Millions of yen)

Financial assets	2018	2017
Financial assets measured at amortized cost		
Cash and cash equivalents (Note 8)	236,078	313,176
Trade and other receivables (Note 9)	223,102	216,507
Other	23,495	24,639
Financial assets measured at fair value through profit or loss		
Cash and cash equivalents (Note 8)	29,900	29,900
Derivatives	1,068	602
Other	2,983	2,926
Financial assets measured at fair value through other comprehensive income		
Equity securities	11,140	14,092
Total	527,766	601,842
Current assets		
Cash and cash equivalents	265,978	343,076
Trade and other receivables	223,102	216,507
Other financial assets	15,146	14,914
Subtotal	504,226	574,497
Non-current assets		
Other financial assets	23,540	27,345
Total	527,766	601,842

Equity securities held by the Group are mainly issued by the entities that maintain business relationships with the Group and held for the long-term without speculative purposes. The Group has designated such equity securities as financial assets measured at fair value through other comprehensive income. Names of major equity securities and their fair values are as follows:

As of December 31, 2018

(Millions of yen)

Company name	Fair value
Seven & i Holdings Co., Ltd.	3,076
Saiwai Trading Co., Ltd.	1,191
Livedo Corporation	1,122
Aeon Co., Ltd.	905
Tokio Marine Holdings, Inc.	889
Japan Alcohol Trading Co., Ltd.	622
Izumi Co., Ltd.	511
Keytrading Co., Ltd.	389
The Yamagata Bank, Ltd.	237
Inageya Co., Ltd.	225

As of December 31, 2017

(Millions of yen)

Company name	Fair value
Seven & i Holdings Co., Ltd.	3,011
Seven Bank, Ltd.	1,930
Livedo Corporation	981
Tokio Marine Holdings, Inc.	978
The Nisshin OilliO Group, Ltd.	962
Saiwai Trading Co., Ltd.	956
Aeon Co., Ltd.	799
Izumi Co., Ltd.	700
Japan Alcohol Trading Co., Ltd.	552
Keytrading Co., Ltd.	373

The Group derecognizes some financial assets measured at fair value through other comprehensive income by sale for reasons including asset efficiency and changes in business relationships. The total amounts of the fair values of such financial assets at the time of sale and the cumulative gains or losses on sales are as follows:

(Millions of yen)

	2018	2017
Fair value	3,077	24
Cumulative gains (losses)	2,451	10

The Group transfers to retained earnings the cumulative gains or losses arising from changes in the fair value of financial assets measured at fair value through other comprehensive income recognized as other components of equity when it disposes of an investment or when fair value declines significantly. Cumulative gains or losses of other comprehensive income, net of taxes, that were transferred to retained earnings for the fiscal years ended December 31, 2018 and 2017, were 1,694 million yen and 7 million yen, respectively.

The amounts of each classification of financial liabilities are as follows:

(Millions of yen)

Financial liabilities	2018	2017
Financial liabilities measured at amortized cost		
Trade and other payables (Note 19)	225,560	224,893
Bonds and borrowings (Note 17)	120,827	120,584
Other	16,178	16,804
Financial liabilities measured at fair value through profit or loss		
Derivatives	208	1,026
Total	362,773	363,307
Current liabilities		
Trade and other payables	225,560	224,893
Bonds and borrowings	40,488	25,262
Other financial liabilities	6,880	7,739
Subtotal	272,928	257,894
Non-current liabilities		
Bonds and borrowings	80,339	95,322
Other financial liabilities	9,506	10,091
Subtotal	89,845	105,413
Total	362,773	363,307

There are no significant assets pledged for the above financial liabilities. The Group held deposits received, which are interest-bearing liabilities in other financial liabilities, at December 31, 2018 and 2017 totaling 12,380 million yen and 12,599 million yen, respectively. The average interest rate on deposits received as of December 31, 2018 was 0.13%.

(2) Risk Management on Financial Instruments

The Group manages financial instrument risk based on the following policies to avoid and mitigate market risk, credit risk and liquidity risk.

1) Market risk management

The Group is exposed to the risk of market variability such as fluctuations in exchange rates, interest rates and share prices. The Group appropriately manages market risk to mitigate risk. In addition, the Group uses derivatives mainly consisting of foreign exchange forward contracts, currency swaps and interest rate swaps with the objective of appropriately managing market risk. The Group executes and manages derivatives in accordance with the internal policies that define the objectives, position limit, scope, organizational structure and others. The Group limits the use of derivatives to actual risk mitigation needs, and does not use derivatives for trading or speculative purposes. Therefore, as a rule, changes in the fair value of derivative instruments that the Group holds effectively offset changes in the fair value or cash flows.

(i) Exchange rate risk

The Group also operates outside Japan, and therefore is exposed to the risks of exchange rate fluctuations associated with transactions conducted in foreign currencies and with net investments in foreign operations. The Group minimizes the effect of exchange rate fluctuations on operating results by settling transactions denominated in foreign currencies through foreign currency accounts, and by hedging the risk of exchange rate fluctuations using derivative instruments such as foreign exchange forward and currency swaps.

Details of foreign exchange forward contracts and currency swaps between the Japanese yen, which is the Group's functional currency, and its main foreign currencies including the U.S. dollar, the euro and the Chinese yuan are as follows:

The Group did not apply hedge accounting for these derivative transactions, but determined that these transactions effectively offset the impact of fluctuations in exchange rates.

(Millions of yen)

Derivatives transactions	2018 Contract amount	2018 Contract amount over 1 year	2018 Carrying amount (fair value)[1]	2017 Contract amount	2017 Contract amount over 1 year	2017 Carrying amount (fair value)[1]
Foreign exchange forward contracts:						
Selling						
U.S. dollar	14,583	—	116	13,800	7,280	135
Euro	—	—	—	70	—	1
Buying						
Euro	—	—	—	120	—	(2)
Chinese yuan	212	—	(1)	725	—	(98)
Currency swaps:						
Receiving Japanese yen, paying U.S. dollar	7,343	7,343	(15)	8,004	2,339	(53)
Receiving Japanese yen, paying Chinese yuan	—	—	—	1,987	—	(325)

Note: 1. Note 35 "Financial Instruments (3) Fair Value of Financial Instruments" presents the method of measuring the fair value of the above derivatives.

The above assets or liabilities related to derivative transactions are included in other financial assets or other financial liabilities in the consolidated statement of financial position.

Net exposure to exchange rate risk consists of the following. Amounts hedged against exchange rate fluctuation risk with derivatives are excluded.

As of December 31, 2018 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	2,801	1,930	10,766

As of December 31, 2017 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	8,713	161	8,458

The following table illustrates the impact on income before income taxes in the consolidated statement of income from foreign currency-denominated financial instruments held by the Group at the end of each fiscal year if the Japanese yen appreciated by 10% against the U.S. dollar, the euro and the Chinese yuan.

The effects of translating financial instruments denominated in the Group's functional currency, and the assets, liabilities, income and expenses of foreign operations are not included in the analysis. The analysis also assumes that currencies other than those used in the calculation remain constant.

(Millions of yen)

	2018	2017
U.S. dollar	(280)	(871)
Euro	(193)	(16)
Chinese yuan	(1,077)	(846)

(ii) Interest rate fluctuation risk
The Group obtains finances through long-term borrowings and bonds for maintaining an appropriate cost of capital and strengthening its financial base for investment for growth. The Group considers interest rate market movements and the balance between floating and fixed interest rates in making decisions about long-term funding. The Group's short-term borrowings generally have floating interest rates. The Group hedges interest rate risk as necessary using derivative instruments such as interest rate swaps, and therefore estimates that its exposure to interest rate fluctuation risk is limited.

(iii) Share price fluctuation risk
The Group held marketable equity securities, primarily those of companies with which the Group has business relationships, totaling 6,640 million yen and 10,165 million yen at December 31, 2018 and 2017, respectively. These equity securities are exposed to share price fluctuation risk. However, the Group annually evaluates the rationale and reviews ongoing advisability and position size of these holdings. Fluctuations in their prices do not affect net profit or loss because all of these equity securities are designated as financial assets measured at fair value through other comprehensive income.

2) Credit risk management
The Group is exposed to credit risk such as a counterparty's default on contractual obligations resulting in financial losses to the Group.

(i) Trade and other receivables
Notes and accounts receivable are trade receivables that expose the Group to customer credit risk. The Group manages that risk with an internal process for investigating and approving customer credit on initial transactions, and by obtaining deposits, collateral or other guarantees as necessary. The Group also manages due dates and outstanding balances by customer, and periodically reconfirms the creditworthiness of major customers. Non-trade receivables expose the Group to business partner credit risk, but these receivables are almost entirely settled in the short term.

(ii) Short-term investments
Short-term investments are recognized in cash and cash equivalents and other financial assets. They are highly safe and liquid financial instruments that include commercial paper issued by entities with high bond ratings, bond investment trusts, and money held in trust.

(iii) Loan receivables
Loan receivables expose the Group to borrower credit risk. The Group manages this risk with an internal process for investigating and approving borrower credit on initial lending transactions, and by obtaining deposits, collateral or other guarantees as necessary. The Group also periodically reconfirms the creditworthiness of borrowers.

(iv) Derivatives
The Group executes and manages derivatives in accordance with the internal policies that define the objectives, position limit, scope and organizational structure. The Group limits the use of derivatives to actual risk mitigation needs, and does not use derivatives for trading or speculative purposes, and reduces credit risk by limiting transactions to highly creditworthy financial institutions.

The carrying amount after impairment of financial assets in the consolidated statement of financial position represents the Group's maximum exposure to the credit risk of financial assets. The Group is not exposed to excessive credit risk associated with a particular customer that requires exceptional management.

The Group recognizes an allowance for doubtful receivables for trade receivables and other financial assets measured at amortized cost by estimating future credit losses in consideration of recoverability and significant increases in credit risk. The Group determines if credit risk has increased significantly by evaluating changes in default risk with reference to factors including downgrading of internal credit ratings, the decline of counterparty results, and delinquency information.

Trade receivables are particularly important financial assets for the Group. The Group collectively measures expected credit losses of the financial assets for the entire period to recognize the allowance for doubtful receivables. In the following situations that would adversely affect future cash flows, however, the Group measures expected credit losses individually by treating each receivable as a credit-impaired financial asset:

- Where the customer has serious financial difficulties
- Where the customer defaults or becomes delinquent in accounts receivable payments despite repeated demands for payment
- Where it is more likely that the customer will go into bankruptcy or face a situation that forces it to reconstruct its business

The Group directly writes down the carrying amount if it does not reasonably expect to recover all or part of the trade receivables, following an internal process of investigation and approval.

The Group held security deposits for credit enhancement totaling 6,782 million yen and 6,463 million yen at December 31, 2018 and 2017, respectively.

The carrying amount of trade receivables and changes in the related allowance for doubtful receivables are as follows:

Fiscal year ended December 31, 2018 (Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2018	211,441	549	211,990
Change during the year (Recognition and derecognition)	10,605	(16)	10,589
Transfer to credit-impaired financial assets	(84)	84	—
Other changes	(4,944)	(41)	(4,985)
December 31, 2018	217,018	576	217,594

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2018	915	459	1,374
Increase during the year	238	98	336
Decrease during the year (charge-offs)	(78)	(19)	(97)
Decrease during the year (other)	(86)	(0)	(86)
Transfer to credit-impaired financial assets	(4)	4	—
Other changes	(28)	(51)	(79)
December 31, 2018	957	491	1,448

Fiscal year ended December 31, 2017 (Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2017	204,736	363	205,099
Change during the year (Recognition and derecognition)	3,914	45	3,959
Transfer to credit-impaired financial assets	(99)	99	—
Other changes	2,890	42	2,932
December 31, 2017	211,441	549	211,990

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2017	781	382	1,163
Increase during the year	237	84	321
Decrease during the year (charge-offs)	(69)	(34)	(103)
Decrease during the year (other)	(77)	(10)	(87)
Transfer to credit-impaired financial assets	—	—	—
Other changes	43	37	80
December 31, 2017	915	459	1,374

The following tables present an analysis of the carrying amount of trade receivables and the allowance for doubtful receivables by days past due.

As of December 31, 2018 (Millions of yen unless otherwise noted)

		Days past due				
	Not due	Less than 30 days	Over 30 days	Over 60 days	Over 90 days	Total
Trade receivables	204,308	7,453	2,021	1,197	2,615	217,594
Allowance for doubtful receivables	164	129	37	53	1,065	1,448
Expected credit loss (%)	0.1	1.7	1.8	4.4	40.7	0.7

As of December 31, 2017 (Millions of yen unless otherwise noted)

		Days past due				
	Not due	Less than 30 days	Over 30 days	Over 60 days	Over 90 days	Total
Trade receivables	200,841	7,033	1,441	680	1,995	211,990
Allowance for doubtful receivables	195	135	55	44	945	1,374
Expected credit loss (%)	0.1	1.9	3.8	6.5	47.4	0.6

3) Liquidity risk management

Liquidity risk is the risk that the Group may not be able to fulfill its obligation to pay financial liabilities that come due.

The Group uses methods such as scheduled medium- and long-term financing plans to understand its liquidity and consistently ensure the availability of sufficient funding.

The Group has also implemented the Global Cash Management System to reduce liquidity risk through the focused and efficient management of the Group's capital in Japan and overseas.

Financial liabilities including derivative instruments by maturity date consist of the following:

As of December 31, 2018 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other payables	225,560	225,560	225,560	—	—	—	—	—
Bonds and borrowings	120,827	120,895	40,488	25,050	30,247	32	25,018	60
Lease obligations	2,419	2,483	689	666	494	485	124	25
Long-term deposits payable	6,782	6,782	—	—	—	—	—	6,782
Derivative financial liabilities								
Currency related	208	208	50	54	—	104	—	—
Total	355,796	355,928	266,787	25,770	30,741	621	25,142	6,867

As of December 31, 2017 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other payables	224,893	224,893	224,892	1	—	—	—	—
Bonds and borrowings	120,584	120,614	25,268	40,046	25,038	30,235	21	6
Lease obligations	3,178	3,275	789	690	666	495	486	149
Long-term deposits payable	6,463	6,463	—	—	—	—	—	6,463
Derivative financial liabilities								
Currency related	1,022	1,022	635	—	296	—	91	—
Interest rate related	4	4	3	—	—	—	1	—
Total	356,144	356,271	251,587	40,737	26,000	30,730	599	6,618

(3) Fair Value of Financial Instruments

1) Fair value hierarchy levels

For financial instruments measured at fair value, the fair values developed based on the observability of inputs into the valuation techniques used in measurement are categorized within the following three levels:

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities
Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3: Fair value measured with inputs not based on observable market data for the asset or liability

2) Financial instruments measured at fair value

The measurement methods for the main financial instruments measured at fair value are as follows:

(i) Short-term investments (excluding short-term investments measured at amortized cost)
Short-term investments are included in cash and cash equivalents, and are designated as financial assets measured at fair value through profit or loss. Short-term investments primarily consist of bond investment trusts and money held in trust, and are measured with a financial model using observable inputs such as interest rates.

(ii) Derivative assets and derivative liabilities
Derivative assets and derivative liabilities are included in other financial assets and other financial liabilities, and are designated as financial assets and financial liabilities measured at fair value through profit or loss. Consisting of instruments including foreign exchange forward contracts, currency swaps and interest rate swaps, derivative assets and derivative liabilities are primarily measured with a financial model using observable inputs such as exchange rates and interest rates.

(iii) Equity securities
Equity securities are included in other financial assets, and are designated as financial assets measured at fair value through other comprehensive income. Equity securities that are categorized within Level 1 are publicly listed and traded in active markets, and are measured using market prices on exchanges. Equity securities that are categorized within Level 3 are unlisted, and are primarily measured using a net asset valuation model, which measures corporate value based on the net asset of the issuing company with adjustments based on fair value.

The fair value hierarchy of financial instruments measured at fair value is shown below.

The Group recognizes transfers of financial instruments between levels of the fair value hierarchy at the end of each fiscal year. No financial instruments were transferred between levels of the fair value hierarchy for the fiscal years ended December 31, 2018 or 2017.

As of December 31, 2018 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	29,900	—	29,900
Derivative assets	—	1,068	—	1,068
Other	—	2,983	—	2,983
Financial assets measured at fair value through other comprehensive income				
Equity securities	6,640	—	4,500	11,140
Total	6,640	33,951	4,500	45,091
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	208	—	208
Total	—	208	—	208

As of December 31, 2017 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	29,900	—	29,900
Derivative assets	—	602	—	602
Other	—	2,926	—	2,926
Financial assets measured at fair value through other comprehensive income				
Equity securities	10,165	—	3,927	14,092
Total	10,165	33,428	3,927	47,520
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	1,026	—	1,026
Total	—	1,026	—	1,026

Changes in financial instruments categorized within Level 3 are as follows:

(Millions of yen)

	2018	2017
Beginning balance	3,927	3,472
Gains (losses)[1]	574	454
Sales	(0)	—
Other changes	(1)	1
Ending balance	4,500	3,927

Note: 1. All gains and losses are associated with financial assets measured at fair value through other comprehensive income at the end of each reporting period. These gains and losses are recognized in net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income in the consolidated statement of comprehensive income.

Financial instruments categorized within Level 3 are primarily unlisted equity securities. Each responsible department of the Group refers to the Group accounting policies in measuring the fair value of unlisted equity securities each quarter using recently available data, and reports any changes in fair value and the reasons to the department manager, and to senior management as necessary.

3) Financial instruments measured at amortized cost

The following tables present the measurement techniques for measuring the fair value of major financial instruments measured at amortized cost. Financial instruments for which carrying amounts are a reasonable approximation of fair value or financial instruments that are not material are not included in the tables.

(i) Cash and cash equivalents (excluding short-term investments measured at fair value), trade and other receivables, and trade and other payables

Carrying amounts approximate fair value because these are settled in the short term.

(ii) Bonds and borrowings

The fair value of bonds is based on market prices. The fair value of borrowings is the present value of remaining principal and interest discounted using a deemed interest rate on equivalent new borrowings.

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost are as follows:

As of December 31, 2018 (Millions of yen)

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	50,052	—	50,338	—	50,338
Borrowings	70,775	—	70,985	—	70,985

As of December 31, 2017 (Millions of yen)

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,969	—	50,345	—	50,345
Borrowings	70,615	—	70,946	—	70,946

36 Principal Subsidiaries

Principal subsidiaries consist of the following. Voting rights at December 31, 2018 did not significantly change from a year earlier.

Company name	Country	Principal businesses	Voting rights (%)
Kao Group Customer Marketing Co., Ltd.	Japan	Control of sales companies and other subsidiaries in Japan Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics Inc.	Japan	Cosmetics	100.0
Kao Transport & Logistics Co., Ltd.	Japan	Logistics and related services in Japan	100.0
Kao (China) Holding Co., Ltd.	China	Control of subsidiaries in China Cosmetics	100.0
Kao Corporation Shanghai	China	Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care	100.0
Kao (Hefei) Co., Ltd.	China	Human Health Care	100.0
Kao Commercial (Shanghai) Co., Ltd.	China	Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics (China) Co., Ltd.	China	Cosmetics	100.0
Kao (Shanghai) Chemical Industries Co., Ltd.	China	Chemical	100.0
Kao (Taiwan) Corporation	Taiwan	Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care Chemical	92.2
Pilipinas Kao, Inc.	Philippines	Chemical	100.0
Kao Industrial (Thailand) Co., Ltd.	Thailand	Skin Care and Hair Care Human Health Care Fabric and Home Care Chemical	100.0
Kao Commercial (Thailand) Co., Ltd.	Thailand	Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care	100.0
Fatty Chemical (Malaysia) Sdn. Bhd.	Malaysia	Chemical	70.0
PT Kao Indonesia	Indonesia	Skin Care and Hair Care Human Health Care Fabric and Home Care	72.2
Kao USA Inc.	U.S.A.	Cosmetics Skin Care and Hair Care	100.0
Oribe Hair Care, LLC	U.S.A.	Skin Care and Hair Care	100.0
Washing Systems, LLC	U.S.A.	Fabric and Home Care	100.0
Kao America Inc.	U.S.A.	Corporate service to subsidiaries in the U.S. Holding company for Chemical Business in the U.S.	100.0
Kao Specialties Americas LLC	U.S.A.	Chemical	100.0
Kao Germany GmbH	Germany	Cosmetics Skin Care and Hair Care	100.0
Kao Manufacturing Germany GmbH	Germany	Skin Care and Hair Care	100.0
Kao Chemicals GmbH	Germany	Chemical	100.0
Molton Brown Limited	U.K.	Cosmetics	100.0
Kao Chemicals Europe, S.L.	Spain	Control of subsidiaries in Chemical Business in Europe, etc.	100.0
Kao Corporation S.A.	Spain	Chemical	100.0

37 Related Parties

(1) Transactions with Related Parties
Disclosure is omitted because there are no material related party transactions.

(2) Primary Executive Management Compensation
Primary executive management compensation consists of the following. The Group's primary executive management includes members of the Board of Directors and executive officers of the Company for each fiscal year.

(Millions of yen)

	2018	2017
Short-term benefits	1,161	1,315
Post-retirement benefits	28	30
Share-based payments	364	332
Total	1,553	1,677

38 Commitments

Commitments to acquire property, plant and equipment and intangible assets after the end of each reporting period are as follows:

(Millions of yen)

	2018	2017
Acquisition of property, plant and equipment	30,751	37,906
Acquisition of intangible assets	1,188	1,237
Total	31,939	39,143

39 Significant Subsequent Events

There were no significant subsequent events to present.

40 Approval of the Consolidated Financial Statements

The Consolidated Financial Statements were approved by Michitaka Sawada, President and Chief Executive Officer, and by Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting and Finance, on March 25, 2019.

Independent Auditor's Report

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Kao Corporation:

We have audited the accompanying consolidated statement of financial position of Kao Corporation and its subsidiaries as of December 31, 2018, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, and notes to consolidated financial statements.

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 International Financial Reporting Standards, 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 subsidiaries as of December 31, 2018, and the consolidated results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu LLC

March 25, 2019

Member of
Deloitte Touche Tohmatsu Limited

Enriching lives, in harmony with nature.

Kao Corporation

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