Financial Report 2019

For the year ended December 31, 2019

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Enriching lives,
in harmony with nature.

Kao

Management Discussion and Analysis

Management Policies

Basic 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.

All members of the Kao Group share the Kao Way, which is our corporate philosophy, and have been putting it into practice every day as the foundation of our approaches and actions. Moreover, to continue our profitable growth, in recent years we have created a post-deflation growth model and have been implementing governance reforms aimed at achieving a compact, highly diverse Board of Directors, among other measures, and we have endeavored to contribute to consumers, customers and society by providing products that facilitate clean, beautiful and healthy living, as well as industrial-use products that contribute to the development of industry.

However, social conditions and the natural environment are changing significantly and globally at a rapid pace, and people's values are diversifying accordingly. To deal with this situation, we consider it important not only to respond promptly to change, but also to take initiatives that anticipate change. The key point is ESG. We have announced a major shift to ESG-driven management. By contributing to people, society and the planet while continuing our profitable growth, we aim to enhance our corporate value at a higher level.

Medium-to-long-term Management Strategies of the Kao Group and Management Metric Used as a Target

Long-term Management Strategy

In December 2016, the Kao Group set forth "making Kao a company with a global presence" as its vision to be achieved by 2030 by realizing sustained profitable growth while contributing to the sustainability of the world. To achieve this vision, it will be important to reinforce existing businesses based on *Yoki-Monozukuri** from an ESG perspective and to create new businesses and expand business fields from an ESG perspective.

Through activities under the slogan "Transforming Ourselves to Drive Change," rather than a continuation of what it has been doing, the Kao Group aims to become a company with a global presence.

* 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."

The Kao Group's Vision by 2030

Make the Kao Group a company with a global presence

- A distinctive corporate image
- A high-profit global consumer goods company that exceeds:
  - ¥2.5 trillion yen in net sales (¥1.0 trillion outside Japan)
  - 17% operating margin
  - 20% ROE
- A high level of returns to stakeholders

Mid-term Business Plan

Fiscal 2020 is the final year of the Kao Group Mid-term Plan 2020 (K20), the four-year business plan from fiscal 2017. It is a crucial year that will be a linchpin for realizing the Kao Group's vision for 2030. Among the three goals of K20, the Kao Group will steadily implement "fostering a distinctive corporate image" through innovation while linking the Kirei[1] Lifestyle Plan, the ESG strategy it announced in 2019, with its business strategy. For the goal of "returns to stakeholders," the Kao Group will continue to provide a high level of returns to its many stakeholders, including consumers, customers, employees, business partners and shareholders. In the rapidly changing business environment, the Kao Group aims to achieve the goal of "profitable growth" by raising the level of its *Yoki-Monozukuri* and fully communicating product value. Regarding its commitment to profitable growth, taking into account factors including the current status of the Chemical Business, the progress of businesses with issues, and the possibility of a decrease in inbound demand, the Kao Group has revised its target for net sales CAGR[2] on a like-for-like[3] basis to +3% from +5%. The Kao Group aims for an operating margin of 15%, as planned.

1. *Kirei* is a Japanese word that represents the concept of cleanliness, beauty, health, purity, and fairness.
2. CAGR: Compound annual growth rate
3. Like-for-like: Excluding the effect of currency translation, change of sales system, etc.

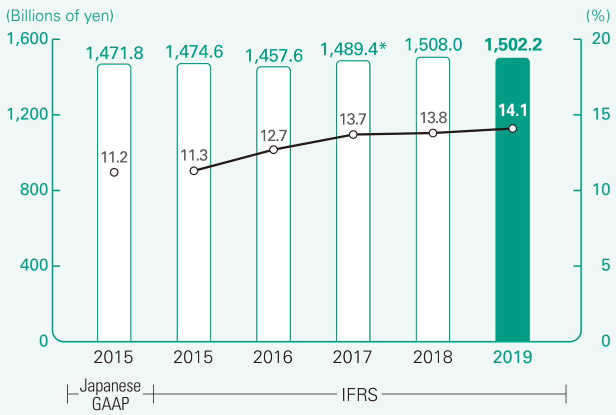
K20 Goals – Three Commitments

- 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 +3%, operating margin of 15%
  - Three ¥100 billion brands (*Merries* baby diapers, *Attack* laundry detergents, *Bioré* skin care products)
- 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

Management Metric Used as a Target

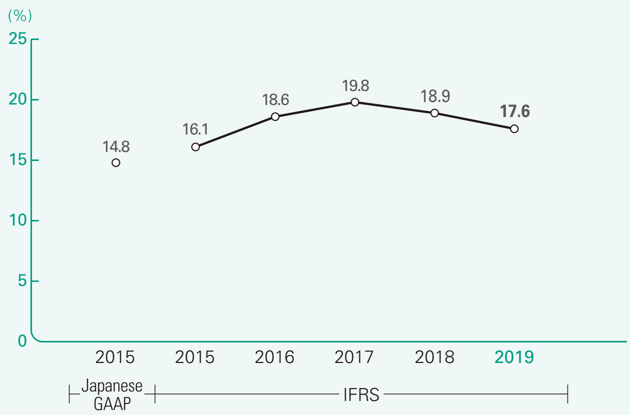
As its principal management metric, the Kao Group uses EVA, which measures true profit by factoring in the cost of invested capital. This essentially takes the perspective of shareholders and other asset owners to deploy capital efficiently and generate profits. The Kao Group believes that continuously 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.

Net Sales / Operating Margin



* In fiscal 2017, 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



Issues for Management

With intensifying market competition, changing market structure and volatility in raw material market conditions and currency 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. The Kao Group will therefore address and deal appropriately with the following issues.

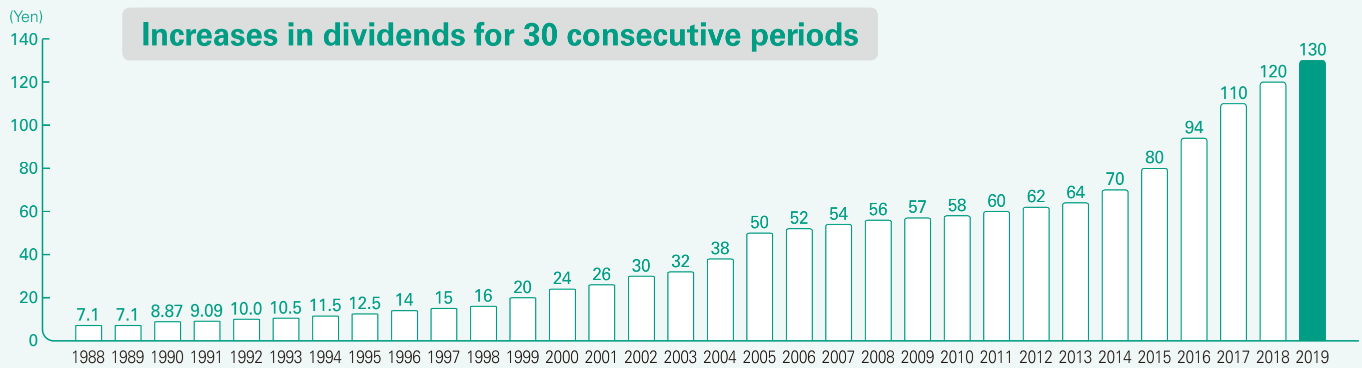
(1) To respond to changes in risks pertaining to its business, the Kao Group defines risks that have a particularly large impact on management and for which it must augment its response as corporate risks, and will work to prevent damage to the corporate value of the Group as a whole by further reinforcing its management system.

(2) Given the current rapid progress of factors such as the diversification of consumer values associated with technology innovation 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 reviewed 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[4] and the use of artificial intelligence, the Internet of Things, robotics and other cutting-edge technologies.

(3) To promote an ESG strategy unique to Kao, the Kirei Lifestyle Plan, all members of the Kao Group must have a proper understanding of its purpose and content, and fulfill their respective roles and responsibilities. To that end, the Kao Group will step up its awareness-raising activities to implement the Kirei Lifestyle Plan at the global level. It will also be necessary to go through the PDCA (plan, do, check, act) cycle under a sound governance system. In addition to creating standards and evaluation mechanisms for the smooth progress of the Kirei Lifestyle Plan, the Kao Group will step up its activities even further by making use of the Board of Directors and third-party checks and opinions from External ESG Advisory Board to make sure it does not become complacent.

4. Research that pursues the essence of things for both humans and materials from a scientific standpoint

Cash Dividends per Share



Note: Impact of share splits is reflected retroactively.

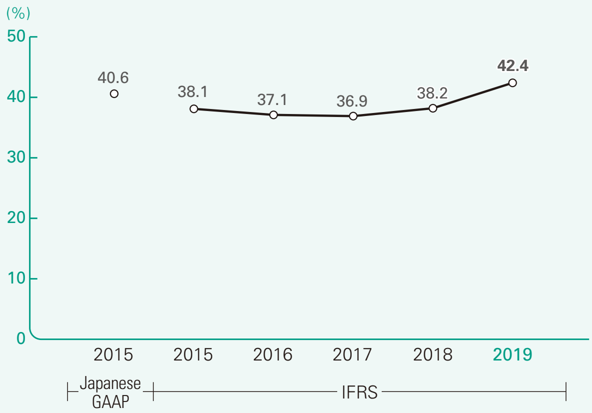
Costs, Expenses and Income as Percentages of Net Sales

	IFRS		
Years ended December 31, 2019, 2018 and 2017	2019	2018	2017
Cost of sales	56.5%	56.6%	56.0%
Gross profit	43.5	43.4	44.0
Selling, general and administrative expenses	29.5	29.5	30.4
Operating income	14.1	13.8	13.7
Income before income taxes	14.0	13.7	13.7
Net income attributable to owners of the parent	9.9	10.2	9.9

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 enhance 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.

Payout Ratio



Overview of Consolidated Results

Amid substantial changes in the social conditions and natural environment in which it operates, the Kao Group has declared a major shift to ESG management to build a foundation that will enable sustainable growth. In April 2019, the Kao Group announced the Kirei Lifestyle Plan, its ESG strategy, and activities kicked into gear.

Conditions in the global economy are unclear due to factors including international trade issues, geopolitical risks in the Middle East and an uncertain economic outlook in Asian countries, and in Japan, economic recovery has been delayed following the increase in the consumption tax rate in October.

In 2019, the markets for household and personal care products and cosmetics in Japan, which are key markets for the Kao Group, were in solid condition throughout the year according to retail sales and consumer purchasing survey data, although there was substantial fluctuation due to factors including last-minute demand ahead of the consumption tax rate increase and the decline thereafter. 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 2 percentage points compared with the previous fiscal year.

Under these circumstances, the Kao Group increased operating income for the tenth consecutive fiscal year and achieved record-high operating income for the seventh consecutive fiscal year.

Analysis of Income Statement

Net sales decreased 0.4% compared with the previous fiscal year to ¥1,502.2 billion. On a like-for-like basis, net sales increased 0.7%. Operating income was ¥211.7 billion, an increase of ¥4.0 billion compared with the previous fiscal year, the operating margin was 14.1% and income before income taxes was ¥210.6 billion, an increase of ¥3.4 billion. Net income was ¥150.3 billion, a decrease of ¥5.0 billion.

Basic earnings per share were ¥306.70, a decrease of ¥7.55, or 2.4%, from ¥314.25 in the previous fiscal year.

Economic value added (EVA*), which the Kao Group uses as a management indicator, decreased ¥6.1 billion compared with the previous fiscal year to ¥87.4 billion due to a decrease in net operating profit after tax (NOPAT).

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

To improve capital efficiency and further increase shareholder returns, Kao Corporation resolved at a meeting of its Board of Directors held on April 24, 2019 to repurchase its own shares, and repurchased shares totaling ¥50.0 billion. Kao Corporation retired 6.7 million treasury shares on July 12, 2019.

Information by Segment

Consumer Products Business

Sales increased 2.0% compared with the previous fiscal year to ¥1,257.0 billion. On a like-for-like basis, sales increased 2.9%.

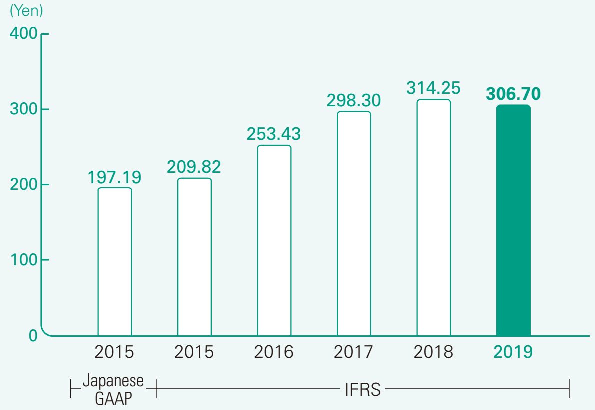
The Kao Group worked for more effective marketing and sales activities, including launching new and improved products that address the diversification of consumer values and strengthening activities in the e-commerce channel in line with changes in purchasing behavior.

Sales in the Cosmetics Business continued to grow steadily, while growth in the Skin Care and Hair Care Business was basically unchanged. The Human Health Care Business was affected by a slowdown in the baby diaper business in the Chinese market. Sales increased in the Fabric and Home Care Business, partly due to launches of new and improved products.

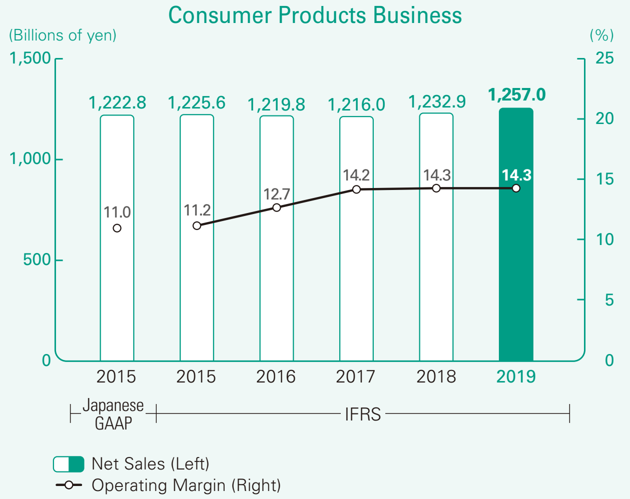
In Japan, sales increased 1.8% to ¥899.6 billion due to launches of new and improved products, the Kao Group's response to the consumption tax rate increase and other factors.

In Asia, sales grew steadily, increasing 3.8% to ¥206.3 billion. On a like-for-like basis, sales increased 6.7%.

Basic Earnings per Share



Net Sales / Operating Margin



Notes: In fiscal 2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan. In fiscal 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.

In the Americas, sales increased 4.5% to ¥88.8 billion. On a like-for-like basis, sales increased 6.6%. In Europe, sales decreased 4.6% to ¥62.2 billion. However, on a like-for-like basis, sales increased 0.9%.

Operating income increased ¥4.2 billion compared with the previous fiscal year to ¥179.9 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 7.8% compared with the previous fiscal year to ¥301.5 billion. On a like-for-like basis, sales increased 9.0%.

The growth strategy for the Cosmetics Business proceeded smoothly. Sales remained strong in Asia, and were on a growth track in Japan. Sales grew strongly for the 11 brands ("G11") the Kao Group selected for its global strategy and the eight regional brands ("R8") it is nurturing, centered on Japan. Amid signs of a slowdown in inbound demand, G11 brands *Curél*, a derma care brand, and *freeplus*, which is hypoallergenic and contains Japanese and Chinese botanical extracts, performed well in Japan and the Chinese market, and sales of *SUQQU* and *SOFINA iP* grew steadily. To strengthen its high-prestige range, the Kao Group made a strong start with the rebranding of the super-prestige brand *SENSAI* in Europe in May. Sales began in Japan in September. The Kao Group offered the *est G.P.* line of skin care cosmetics in November and products that apply Fine Fiber Technology for the formation of layered ultra-thin membranes in December. The Kao Group also reinforced its activities in the growing e-commerce and travel retail channels and promoted a shift to digital marketing.

Operating income was ¥41.4 billion, an increase of ¥13.7 billion from the previous fiscal year, due to the effect of increased sales of strongly performing brands, among other factors.

Skin Care and Hair Care Business

Sales decreased 0.2% compared with the previous fiscal year to ¥340.8 billion. On a like-for-like basis, sales increased 1.1%.

Sales of skin care products increased. In Japan, new body cleanser *Bioré u The Body* steadily increased sales and market share, despite the impact of adverse weather conditions in the first half of the fiscal year. Sales were firm in Asia, but decreased in the Americas due to the impact of stiff competition.

Sales of hair care products were basically unchanged from the previous fiscal year. Sales were strong for hair color products in Japan and for *Oribe*, a brand in the Americas for high-end hair salons, and the Kao Group launched new and improved premium-price shampoos, conditioners and other products in Japan and Europe. However, overall sales of hair care products were affected by the shrinking mass market.

Operating income increased ¥0.7 billion compared with the previous fiscal year to ¥49.5 billion.

Human Health Care Business

Sales decreased 4.7% compared with the previous fiscal year to ¥255.2 billion. On a like-for-like basis, sales decreased 3.5%.

Sales of *Merries* baby diapers decreased. In Japan, demand for the purpose of resale in the Chinese market fell substantially. Sales in the Chinese market, including cross-border e-commerce, were on a recovery track but decreased compared with the previous fiscal year. On the other hand, locally manufactured products targeting the middle-class consumer segment performed strongly in Indonesia. *Merries* also gained broad acceptance among consumers in Russia and neighboring countries.

For *Laurier* sanitary napkins, high-value-added products performed strongly and increased market share in Japan, while sales by Kao China grew as a result of an increase in new retail outlets, enhanced activities in the e-commerce channel and other factors. Sales were also strong in Indonesia.

For personal health products, sales increased with steady performance of oral care products and bath additives.

Operating income decreased ¥10.7 billion compared with the previous fiscal year to ¥17.2 billion due to the decrease in sales of *Merries*, fluctuations in exchange rates and other factors.

Fabric and Home Care Business

Sales increased 4.5% compared with the previous fiscal year to ¥359.5 billion. On a like-for-like basis, sales increased 4.6%. In Japan, sales increased due to the Kao Group's response to last-minute demand ahead of the consumption tax rate increase in October, but fell short of its plan because market growth was lower than expected.

In fabric care products, sales of laundry detergents grew due to the launch in Japan of *Attack ZERO*, an innovative new laundry detergent. Sales of fabric softeners were firm given the severely competitive market environment. In addition, U.S.-based Washing Systems, LLC, which Kao acquired in August 2018, contributed to sales and income.

In home care products, the Kao Group launched the *Quickle Joan* series of antibacterial household cleaning products that are gentle on the skin. Dishwashing detergents were impacted by stiff competition, but sales and market share grew steadily as sales of *CuCute* remained strong, among other factors.

Operating income increased ¥0.5 billion compared with the previous fiscal year to ¥71.8 billion due to the effect of increased sales, despite an increase in marketing expenses for new product launches.

Chemical Business

Sales decreased 8.6% compared with the previous fiscal year to ¥285.9 billion. On a like-for-like basis, sales decreased 6.6%.

Sales of oleo chemicals decreased due to the substantial impact of selling price adjustments associated with a decline in prices for natural fats and oils, in addition to a trend toward declining demand for some products.

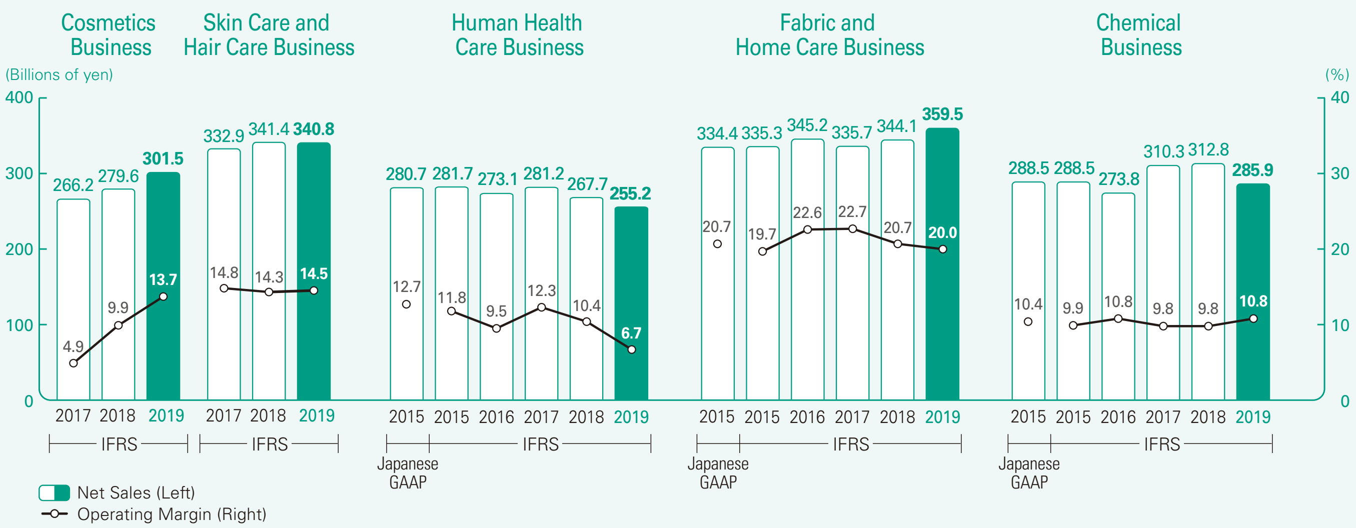
Sales of performance chemicals and specialty chemicals decreased due to the impact of sluggish demand associated with slowing economic growth, especially outside Japan.

Operating income increased ¥0.2 billion compared with the previous fiscal year to ¥30.8 billion due to promotion of high-value-added products, including among oleo chemical products outside Japan.

Financial Position

Total assets increased ¥192.9 billion from December 31, 2018 to ¥1,653.9 billion. The principal increases in assets were a ¥164.8 billion increase in right-of-use assets due to the application of IFRS 16, a ¥23.7 billion increase in cash and cash equivalents, and a ¥17.9 billion increase in property, plant

Net Sales / Operating Margin



Notes: In fiscal 2017, the Kao Group adopted IFRS 15 early in tandem with a revision of its sales system for the Consumer Products Business in Japan.
In fiscal 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. 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. 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.
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.

and equipment. The principal decrease in assets was a ¥14.3 billion decrease in trade and other receivables.

Total liabilities increased ¥157.0 billion from December 31, 2018 to ¥782.5 billion. The principal increase in liabilities was a ¥161.1 billion increase in lease liabilities due to the application of IFRS 16.

Total equity increased ¥35.9 billion from December 31, 2018 to ¥871.4 billion. The principal increase in equity was net income totaling ¥150.3 billion. The principal decreases in equity were dividends totaling ¥61.7 billion and purchase of treasury shares from the market totaling ¥50.0 billion. In addition, the Company retired 6.7 million treasury shares on July 12, 2019.

The ratio of equity attributable to owners of the parent to total assets was 51.9% compared with 56.3% at December 31, 2018. The Kao Group maintained return on equity at the high level of 17.6%.

Cash Flows

The balance of cash and cash equivalents at December 31, 2019 increased ¥23.7 billion compared with December 31, 2018 to ¥289.7 billion, including the effect of exchange rate changes.

Cash Flows from Operating Activities

Net cash flows from operating activities totaled ¥244.5 billion. The principal increases in net cash were income before income taxes of ¥210.6 billion, depreciation and amortization of ¥83.4 billion and decrease in trade and other receivables of ¥12.9 billion. The principal decrease in net cash was income taxes paid of ¥56.7 billion.

Cash Flows from Investing Activities

Net cash flows from investing activities totaled negative ¥94.3 billion. This primarily consisted of purchase of property, plant and equipment of ¥84.0 billion for capacity expansion at production bases in Japan and proactive capital investments in Asia, where growth is notable.

Free cash flow, the sum of net cash flows from operating activities and net cash flows from investing activities adjusted for depreciation of right-of-use assets and other expenses, was ¥128.5 billion.

Cash Flows from Financing Activities

Net cash flows from financing activities totaled negative ¥126.2 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 2019, this primarily consisted of ¥61.8 billion for dividends paid to owners of the parent and non-controlling interests and ¥50.0 billion for purchase of treasury shares.

Basic Policies regarding Distribution of Profits and Dividends for the Fiscal Years Ended December 31, 2019 and Ending December 31, 2020

The Kao Group uses economic value added (EVA) as its principal management metric and clearly sets the uses of its 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 2019 of ¥65 per share, an increase of ¥5 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 ¥130 per share. The consolidated payout ratio will be 42.4%.

For fiscal 2020, the Company plans to pay total cash dividends of ¥140 per share (41.8% 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 31st consecutive fiscal year of increases in dividends.

The figures have been calculated based on operating income of ¥230.0 billion as stated in the forecast of consolidated operating results for the fiscal year ending December 31, 2020.

EVA and Related Activities

EVA for fiscal 2019 was ¥87.4 billion, a decrease of ¥6.1 billion compared with the previous fiscal year. Although operating income increased, net operating profit after tax (NOPAT) decreased, due in part to an increase in tax expenses, and EVA decreased in tandem with an increase in capital costs from the previous fiscal year.

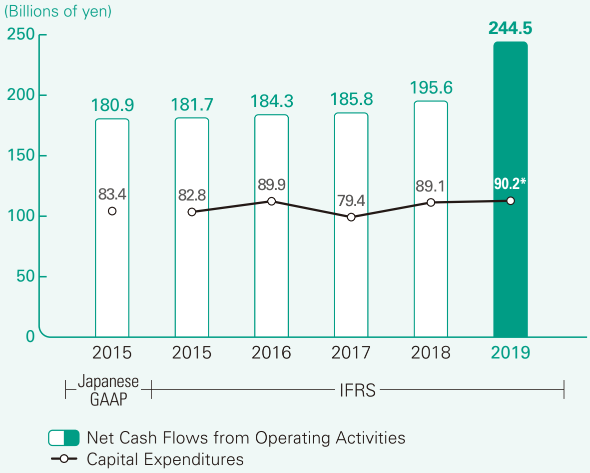
The Kao Group conducted the following EVA-related activities during the fiscal year.

Investing for Growth: During fiscal 2019, the Kao Group invested aggressively for future growth, with capital expenditures* totaling ¥90.2 billion. In the Consumer Products Business, the Kao Group carried out activities including investment in facilities to manufacture new products and streamlining, maintenance and renewal of facilities, in addition to expanding production capacity in Japan and Asia, mainly in the Human Health Care Business. In the Chemical Business, the Kao Group also invested aggressively in production facilities, including expansion of production capacity, inside and outside Japan. Research and development expenditures were ¥59.1 billion, which was the equivalent of 3.9% of net sales, remaining at a high level relative to net sales.

* Excluding right-of-use assets

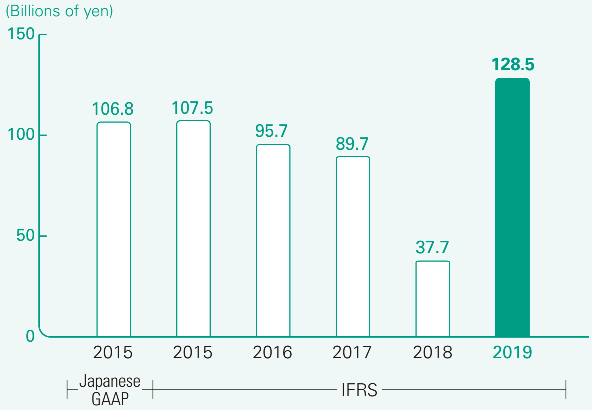
Increasing Profit: In the Consumer Products Business, the Kao Group proactively launched new and improved products inside and outside Japan. The Kao Group increased operating income by stepping up activities in the e-commerce channel and promoting more efficient marketing and sales activities, in addition to the strong performance by the Cosmetics Business. In the Chemical Business, the Kao Group achieved record-high operating income from promotion of high-value-added products such as oleo chemicals outside Japan.

Net Cash Flows from Operating Activities / Capital Expenditures



* Excluding right-of-use assets

Free Cash Flows*



* Free cash flow is the sum of net cash flows from operating activities and net cash flows from investing activities. For fiscal 2019, cash flows from operating activities is adjusted for depreciation of right-of-use assets.

Financial Improvement: For fiscal 2019, the Company paid annual dividends per share of ¥130.00, a year-on-year increase of ¥10.00, or 8%, as announced in its forecast at the beginning of the fiscal year. As a result, the Company has achieved 30 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)

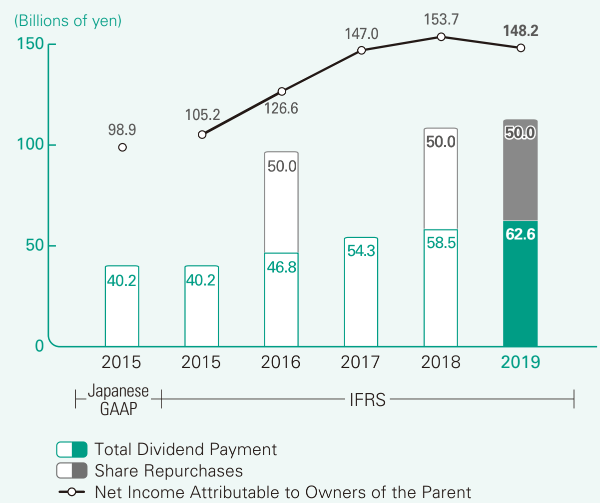
	2019
Cosmetics Business	10.6
Skin Care and Hair Care Business	15.8
Human Health Care Business	12.1
Fabric and Home Care Business	10.2
Chemical Business	10.5

Business Risks and Other Risks

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.

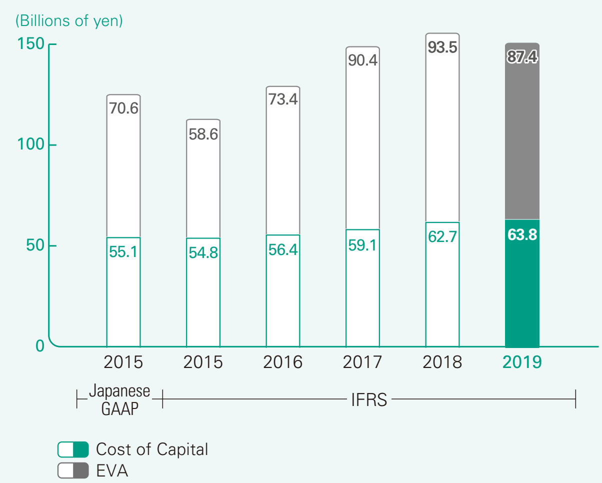
However, with intensifying market competition, a changing market structure and volatility in raw material market conditions and currency exchange rates, the Kao Group's operating environment remains uncertain. Changes in the attitudes of consumers regarding the environment, health and other matters and 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 respond promptly and appropriately to changes in the risks pertaining to their businesses. In this business environment, by placing ESG at the core of its management, further deepening its Essential Research and proactively proposing innovations on a level that impacts society, the Kao Group aims for profitable growth while contributing to people, society and the planet. It also manages the following risks and crises.

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 Kao Group defines a potential negative impact on its management targets and business activities as a "risk" and the manifestation of such risk as a "crisis." The Risk and Crisis Management Committee has established a system and activity guideline for risk and crisis management based on the Kao Risk and Crisis Management Policy. Divisions, subsidiaries and affiliates manage risks by identifying and assessing risks, and formulating and implementing countermeasures based on this activity guideline. In a crisis, the Kao Group works to minimize damage to people and property by establishing an Emergency Response Team Organization that corresponds to the level of emergency and responding promptly and appropriately.

After deliberation by the Risk and Crisis Management Committee and the Management Committee, the Kao Group has selected the following 13 particularly significant risks as the main risks that have a negative impact on its sustained profitable growth and its contribution to the sustainability of the world through its business activities. Among these main risks, the Kao Group designates risks that would have a major impact on management and require an enhanced response as "corporate risks," and once a year, based on internal and external risk surveys and interviews with management, the Management Committee reviews risk themes and the individuals (executive officers) in charge of handling each theme, while the Risk and Crisis Management Committee manages progress. (* Main corporate risk themes and countermeasures are presented in "Main Initiatives.")

These are the main risks that might occur within five years as recognized as of the fiscal year ended December 31, 2019. In addition, there are risks other than the listed risks, which may affect investors' decisions.

Details of Main Risks	Main Initiatives
Risks related to Response to Social Issues	
The Kao Group's Consumer Products Business and Chemical Business are affected by economic cycles and changes in the needs of consumers and customers. The marine plastic waste problem, climate change, depletion of water resources, and environmental and human rights issues in raw material procurement, as well as growing social issues such as the aging society and hygiene have increased consumer awareness about the environment, health and other matters, leading to the trend of ethical consumption and customers' increasing needs for sustainability. Inability to provide appropriate products and services in response to changes in consumer awareness and customer needs relating to these social issues may reduce competitiveness, rendering targets for net sales and market share unattainable. In addition, if efforts to address social issues are deemed inadequate, corporate value could decline.	Under the "Kirei Lifestyle Plan" (KLP), an ESG strategy that integrates an ESG perspective with business strategy, the Kao Group aims to contribute to the sustainability of the world through innovation using technology innovations at every stage from raw material procurement to production, point of use and product disposal, and KLP promotion activities to ensure all Kao Group members correctly understand the purpose and content of KLP so they can fulfill their respective roles and responsibilities. In addition, in order to demonstrate these results early, the Kao Group is conducting steadfast initiatives and simultaneously working proactively to disclose these initiatives to stakeholders. In the Consumer products business, the Kao Group clarifies social issues to be addressed through its brand, which is a point of contact with consumers, and considers social and environmental issues from the product design stage. The Kao Group strives to achieve better lives for consumers and to contribute to the sustainability of society by maximizing the Group's assets. In the Chemical Business, the Kao Group helps to resolve social issues through innovations in chemical technologies to respond to changes in customer needs and advances in technology. By strengthening the development of natural fat and oil derivatives and other sustainable and distinctive products, the information materials and performance materials businesses are developing innovative products that offer greater customization, with the aim of further reducing environmental impact.

Details of Main Risks	Main Initiatives
Risks related to Changes in the Retailing Environment	
The retailing environment in which the Kao Group operates is changing significantly. E-commerce is growing substantially worldwide, the retail industry is becoming more oligopolistic due to mergers and consolidations, and there is a trend toward greater differentiation of store and product strategies. If appropriate sales activities cannot be developed in response to these changes in the retailing environment and their accelerating pace, targets for net sales, market share and profits may be unattainable. In addition, the number of truck deliveries and amount delivered are increasing due to factors such as the increase in retail outlet sizes and the growth of E-commerce. With the aging and growing shortage of drivers, there are increasing risks that the working environment will worsen and that products will not be delivered in a timely and appropriate manner. If a sound supply chain cannot be established in response to these changes in the retailing environment, net sales, market share and profits may be unattainable.	The Kao Group is proactively addressing E-commerce by rolling out products and services favored by E-commerce users and by promoting the evolution of its digital marketing activities. In addition, the Kao Group proposes campaigns and in-store activities customized to the needs of each retailer while working to build a business model capable of harnessing synergy between online and brick-and-mortar commerce. For logistics issues, the Kao Group is working to realize "White Logistics" in cooperation with various stakeholders throughout the supply chain by improving delivery lead times and load factor per vehicle, and other measures. • Main Corporate Risk Themes and Countermeasures Changes in the retailing environment: The Kao Group conducted activities for collaboration with third-party digital platform providers that are being rolled out globally.
Risks related to Business outside Japan	
As one of its growth strategies, the Kao Group is rolling out its businesses outside Japan, with a particular emphasis on strengthening its operations in Asia and other regions where the economic growth rate is high and market expansion is forecast. However, if there is a substantial delay in business plans due to the occurrence of factors in the course of business including a slowdown in economic growth, political or social instability, problems at retail outlets, agents or other business partners, changes in laws, regulations or tax systems, a spate of counterfeit goods, or reputation risk,* targets for net sales and profits may be unattainable. * See "Risks related to Reputation"	The Kao Group routinely collects information on the laws and regulations of each country relating to its business, in addition to the economic, political and social conditions of the countries in which it produces or sells products, and takes necessary measures in response. The Kao Group pays particularly close attention to tightening regulations in each country relating to the environment, product safety and quality, and the impact of changes in import and export regulations on the Group. With regard to intellectual property rights infringements such as counterfeit products, the Kao Group is focusing on countermeasures against counterfeit products, especially in the Asian region in an effort to ensure that consumers and customers can use its products with peace of mind. • Main Corporate Risk Themes and Countermeasures Risks relating to business in Asia: As a core theme, the Kao Group strengthened its system for rapid response to tightening laws and regulations in each country of Asia.
Risks related to Business Investment	
The Kao Group conducts proactive capital investment and M&A for business growth based on investment decisions using EVA, which is highly correlated with corporate value. The Kao Group will continue to make these investments for growth while striving to enhance corporate value through ongoing improvements in EVA. However, if the market and business environments deteriorate at levels not anticipated at the time investment decisions were made and the expected cash flows cannot be generated due to a deviation from business performance plans or other factors, impairment of property, plant and equipment recorded due to capital expenditures or impairment of goodwill and intangible assets recorded due to M&A could have an impact on financial condition and business results.	For major investments, the Kao Group checks performance at the time quarterly results are calculated to ensure that there is no significant deviation from the initial plan, and the results are reported at the Management Committee meeting. As necessary, relevant departments consider future direction and measures to improve business performance.

Details of Main Risks	Main Initiatives
Risks related to Product Quality The basis of the Kao Group's product quality management activities is *Yoki-Monozukuri* with a consumer/customer-oriented perspective, as set forth in the Kao Way. At every stage from raw materials to research and development, production, transportation and sales, the Kao Group pursues a high level of product safety and strives to constantly improve quality from a thoroughgoing consumer/customer perspective. However, there are various risks relating to product quality management due to changes in the external environment. Among these risks are changes in laws and regulations in each country; growing requirements to contribute to the resolution of safety and environmental issues; increasing risk of product incidents due to the aging of the population and the growing number of non-Japanese visitors and residents in Japan; increasingly stringent requirements regarding transparency in relation to product ingredients, safety and other matters; and weakening of quality management activities and reduced ability to respond to customers' needs due to the diversification of the supply chain resulting from globalization. The occurrence of serious product incidents or concerns about product safety and environmental issues could lead to a decline in credibility, not only with regard to the problems with the brand concerned, but for the entire Kao Group.	The Kao Group designs and manufactures products in compliance with product-related laws and regulations and in conformance with strict standards it has set voluntarily. At the development stage prior to launch, the Kao Group thoroughly carries out testing, studies and research to confirm safety. After launch, the Kao Group strives to further improve quality by collecting feedback, requests and other information regarding products through the Consumer Communication Center. In addition, to respond to changes in risks relating to product quality management, the Kao Group is ensuring competitiveness by developing alternative technologies that anticipate new requirements in relation to laws and regulations in each country, and to safety and environmental issues; enhancing product satisfaction by promoting universal design and by providing multilingual information for non-Japanese visitors and residents in Japan; strengthening the trust that consumers, customers and society as a whole place in the Kao Group by promoting visualization of product quality management activities and by engaging in communication with all stakeholders; and is intensifying quality management activities on a global scale. • Main Corporate Risk Themes and Countermeasures Response to product quality issues: The Kao Group is enhancing awareness within the Group in order to prevent their occurrence and to respond when serious product quality issues occur.
Risks related to Large-scale Earthquakes, Other Natural Disasters, Accidents and Other Incidents For companies with several large-scale plants, process safety needs have increasingly heightened in the context of accidents at chemical plants and the many natural disasters that have occurred recently. A stoppage of operations and disruption of product supply to the market due to factors including the occurrence of a major accident affecting regions in the vicinities of the Kao Group's plants, a large-scale earthquake, a natural disaster caused by climate change or, the spread of an infectious disease or, other incidents, could have a significant impact on business results, with a resultant loss of social credibility.	The Kao Group prevents fires, explosions and chemical spills while maintaining safe and stable operations, and prepares for emergency situations by conducting measures for facilities and periodic training premised on a natural disaster. The Kao Group has built a framework to keep track of accidents or disasters worldwide when they occur through its emergency reporting network. In addition, the Kao Group is strengthening its response to disasters so that it can execute a plan for countermeasures that place top priority on the safeguarding of human life and a business continuity plan (BCP). To achieve this, the Group has established organizational units for disaster response in both Eastern Japan and Western Japan premised on damage to the Kao Head Office from an earthquake in the greater Tokyo metropolitan area and is establishing an Emergency Response Team Headquarters headed by the President. • Main Corporate Risk Themes and Countermeasures Large-scale earthquakes and other natural disasters: The Kao Group has reinforced physical and administrative countermeasures for large-scale typhoons, floods and other natural disasters brought on by climate change. In addition, the Kao Group has strengthened its disaster response capabilities by implementing emergency response training and BCP training to address the possibility of large-scale earthquakes. Pandemics: To address the possible spread of infections such as a new strain of influenza, the Kao Group has restructured its system to enable a quick and global response and has formulated detailed action plans that place top priority on human life, including dealing appropriately with persons with symptoms, and has proceeded to make preparations for possible pandemics.

Details of Main Risks	Main Initiatives
Risks related to Information Security The Kao Group uses IT to promote efficient business and operations and conducts business using data. The Kao Group possesses confidential information (trade secrets) relating to research and development, production, marketing, sales and other matters, and retains the personal information of many customers and consumers for sales promotion activities, member site management and E-commerce. The Kao Group is working to strengthen information security in order to protect information assets including trade secrets and personal information, as well as IT hardware, software and many kinds of data records, in accordance with Kao's Information Security Policy. However, a leak of confidential information or personal information outside the Kao Group could occur due to an error or to intentional actions including a cyberattack. In addition, the supply chain and other business activities may be temporarily suspended as a result of such actions. If such an incident occurs, credibility could decline and targets for net sales and profits may be unattainable.	As personal and organizational measures for information security, the Kao Group has established rules and systems globally and implemented activities to protect trade secrets, personal information and information security using the PDCA cycle (awareness-raising activities, self-checks, and the setting of improvement targets). The Kao Group is also strengthening its system for responding when an incident occurs. As technical measures, the Information Security Committee has determined a policy on security measures to be implemented, and has implemented measures including the elimination of vulnerabilities by introducing anti-virus software and updating software, the prevention of unauthorized access, and the prevention of e-mail phishing. • Main Corporate Risk Themes and Countermeasures Personal information protection: The Kao Group has created response procedures in the event that an incident occurs, and has conducted relevant training. The Group is also reinforcing its global information security and personal information protection systems.
Risks related to Reputation The rapid penetration of social networking services (SNS) on a global scale has enabled a wide range of interactive communication among consumers or between consumers and companies. The Kao Group conducts marketing activities using SNS and other social media. However, the rapid spread of information enabled by SNS makes it difficult to control. The spread through SNS of inappropriate expressions in the advertisements or other publications of the Kao Group, or the spread of negative evaluations or erroneous information about the Group's business activities or brand image could lower the Kao Group's brand value or credibility. * Reputation risk: Risks that inflict loss on a company from decline in corporate trust and brand value due to the spread of negative evaluation and rumors against the company	From the perspective of ESG, the Kao Group is conducting internal education on topics including the prevention of inappropriate expressions in advertising and SNS messages. The Kao Group also globally monitors external information, including information on SNS, and strives to discover risks at an early stage. If an incident occurs that adversely affects the Kao Group's reputation, the Group responds promptly and strives to maintain its reputation by publicly announcing appropriate information, its corporate stance and other matters, as necessary. • Main Corporate Risk Themes and Countermeasures Reputation risk: The Kao Group has established a system for monitoring external information and is strengthening its emergency response system in the event reputation risk occurs. Risks associated with the use of digital media: The Kao Group is promoting the establishment of guidelines, internal education and other matters for risks that could become reputation risks, such as inappropriate expressions and stealth marketing in advertisements.
Risks related to Raw Material Procurement Market prices for natural fats and oils and petroleum products used as raw materials for the Kao Group's products are affected by factors including global business conditions, geopolitical risks, the balance between supply and demand, abnormal weather, and currency exchange rate fluctuations. A sudden change in market prices could render the Kao Group unable to attain its target for profits. In addition, some of the raw materials used in the Kao Group's products are rare, thus entail risks relating to stable procurement. If the supply of products to the market is disrupted due to a sudden change in demand or difficulties at suppliers, the Kao Group may not only be unable to attain its targets for net sales and profits, but its credibility could also decline. At the same time, the Kao Group is largely dependent on natural capital such as palm oil, paper, and pulp for its raw materials, and it must fulfill its corporate social responsibility by realizing sustainable procurement with extensive environmental considerations including resource conservation, global warming prevention and biodiversity preservation, as well as social considerations including safety, sanitation, labor conditions, and human rights. However, if the Kao Group's efforts for sustainable and responsible procurement are deemed to be insufficient due to reasons in the supply chain, the Group's brand image and credibility could decline.	The Kao Group is working to reduce the impact of increases in raw material prices by reducing costs and conducting measures to pass increases on to selling prices. In addition, for risks relating to stable procurement, the Kao Group is augmenting facilities at its main suppliers and cultivating secondary suppliers to diversify risks. The Kao Group also reviews contracts and proactively cooperates with suppliers to reduce risks. On the other hand, to address risks relating to sustainable and responsible procurement, the Kao Group conducts human rights due diligence based on the Kao Human Rights Policy and risk assessment of suppliers based on the Guidelines for Supplier's Assessment for social issues. For environmental issues, the Kao Group promotes sustainable procurement of palm oil, paper and pulp based on the Guidelines for Sustainable Procurement of Raw Materials. Over the medium to long term, the Kao Group is also working to thoroughly reduce the amount of raw materials it uses and to switch to raw materials from non-food biomass sources. The Kao Group is also strengthening coordination with suppliers through initiatives such as the use of Sedex for supplier monitoring and the CDP Supply Chain Program. The Kao Group strives to disclose these initiatives to its stakeholders proactively and transparently.

Details of Main Risks	Main Initiatives
Risks related to Currency Exchange Rate Fluctuations The Kao Group conducts business activities outside Japan, and currency exchange rate fluctuations affect foreign currency-denominated sales and the cost of procuring raw materials. They also affect the conversion into yen of the amounts on the financial statements of consolidated subsidiaries outside Japan for the consolidated settlement of accounts. Larger-than-expected fluctuations in foreign currency exchange rates against the yen, which is the Kao Group's functional currency, could have an impact on financial condition and business results.	The Kao Group mitigates the impact of foreign-currency denominated transactions on business results by hedging risk of currency exchange rate fluctuations through measures including using foreign currency accounts for transaction settlement and derivative transactions such as forward exchange contracts and currency swaps. The Kao Group does not engage in derivative transactions for the purpose of speculation. In addition, the Kao Group monitors fluctuations in major currencies and the impact of these fluctuations on its business, and reports its findings to the Management Committee in a timely fashion. Under the direction of management, relevant departments consider measures to mitigate the impact on business as required. • Main Corporate Risk Themes and Countermeasures Currency exchange rate fluctuations: The Kao Group studied the makeup of currency exchange rate fluctuation risk and the Group's response to confirm the direction of future countermeasures.
Risks related to Compliance In conducting its business activities, the Kao Group is subject to various laws and regulations on matters including product quality and safety, process safety, environmental protection, chemicals management, accounting standards, taxation, labor, and transaction management. As competition intensifies globally, there is concern of growing temptation to commit improprieties due to factors including difficulties in achieving product differentiation, meeting product launch schedules and delivery timelines, and pressure to achieve performance targets. The risk of harassment may increase due to the generational gap in values and growing employee diversity. A serious violation of compliance by the Kao Group, its subcontractors or other related parties could have an impact on the Group's credibility, financial condition and business results.	The Kao Group regards "Integrity" (behaving lawfully and ethically, and conducting sound and honest business activities) as the starting point of compliance, and promotes it as a foundation for earning the respect and trust of all stakeholders. As such, the Kao Group promotes activities such as ongoing education about the Kao Business Conduct Guidelines, which are its code of conduct, and responding appropriately to communications received via the compliance hotlines. In addition, as activities focused on reducing serious compliance risks, the Kao Group systematically promotes compliance with laws and regulations that apply to its business, and the Compliance Committee monitors the implementation status of particularly important laws and regulations. Furthermore, the Kao Group is conducting activities designed to create an open workplace that allows discovered improprieties to be immediately reported to management and an appropriate response to be taken.
Risks related to Securing Human Capital The Kao Group strives to secure diverse and talented human capital in order to achieve its business targets globally. Meanwhile, with the advent of the digital revolution and low birthrates and aging populations in some countries, employment conditions, expertise requirements, and values with respect to working styles are changing significantly amid the trend to promote ESG management. An inability to systematically implement hiring, development and assignment of human capital with the advanced expertise required in each area, as well as leaders who anticipate major environmental changes, could create a bottleneck in business activities or other factors that have a negative impact on business results.	Based on the recognition that human capital is the Kao Group's most important asset, the Human Capital Development Committee, with top executives as members, discusses and promotes the assignment and development of the human capital and effective organizational management that support sustainable growth. In addition, in order to generate great vitality by drawing out the unlimited potential of individual employees and to maximize that vitality as an organization, the Kao Group employs measures such as using its global human capital information system, improving organizational capabilities through an employee opinion survey, conducting human capital management through job rank, evaluation and training systems and compensation policies that are shared globally, and implementing a health promotion program.
Risks related to Litigation During the fiscal year ended December 31, 2019, no lawsuit or other legal action was filed that had a material effect on the Kao Group. However, the Kao Group conducts diverse businesses globally, and various types of litigation or other action may be brought against it. The result of such litigation or other legal action could have an impact on the Kao Group's financial condition and business results.	The Kao Group complies with various laws and regulations relating to its business, and strives to prevent disputes by providing safe and reliable products, properly acquiring and using intellectual property rights, clarifying contract conditions, negotiating with other parties, and other methods. In addition, the Kao Group has created a global mechanism for prompt and reliable reporting on the filing of important lawsuits and their current status, and has established a system for responding to litigation or other legal actions in cooperation with the individuals in charge at related companies in each country, law firms and other parties.

Consolidated Statement of Financial Position

Kao Corporation and Consolidated Subsidiaries
As of December 31, 2019

(Millions of yen)

Assets	Notes	2019	2018
Current assets			
Cash and cash equivalents	7, 33	289,681	265,978
Trade and other receivables	8, 33	208,839	223,102
Inventories	9	199,672	197,571
Other financial assets	33	13,788	15,146
Income tax receivables		2,440	2,066
Other current assets	10	22,606	22,449
Total current assets		737,026	726,312
Non-current assets			
Property, plant and equipment	11	436,831	418,935
Right-of-use assets	16	164,822	—
Goodwill	12	179,707	180,286
Intangible assets	12	47,770	46,549
Investments accounted for using the equity method	13	8,287	7,931
Other financial assets	33	26,104	23,540
Deferred tax assets	14	47,876	49,158
Other non-current assets	10, 18	5,496	8,275
Total non-current assets		916,893	734,674
Total assets		1,653,919	1,460,986

Liabilities and equity	Notes	2019	2018
Liabilities			
Current liabilities			
Trade and other payables	17, 33	222,314	225,560
Bonds and borrowings	15, 33	25,505	40,488
Lease liabilities	15, 16, 31, 33	19,653	—
Other financial liabilities	16, 33	6,766	6,880
Income tax payables		36,208	34,198
Provisions	19	2,054	2,873
Contract liabilities	24	20,616	18,387
Other current liabilities	20	99,411	102,452
Total current liabilities		432,527	430,838
Non-current liabilities			
Bonds and borrowings	15, 33	101,636	80,339
Lease liabilities	15, 16, 31, 33	141,438	—
Other financial liabilities	16, 33	7,527	9,506
Retirement benefit liabilities	18	80,579	84,552
Provisions	19	10,122	12,175
Deferred tax liabilities	14	3,747	2,864
Other non-current liabilities		4,922	5,203
Total non-current liabilities		349,971	194,639
Total liabilities		782,498	625,477
Equity			
Share capital	21	85,424	85,424
Capital surplus	21	108,715	108,245
Treasury shares	21	(4,309)	(11,282)
Other components of equity	21	(32,974)	(30,029)
Retained earnings	21	700,839	670,002
Equity attributable to owners of the parent		857,695	822,360
Non-controlling interests		13,726	13,149
Total equity		871,421	835,509
Total liabilities and equity		1,653,919	1,460,986

Consolidated Statement of Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2019

(Millions of yen)

	Notes	2019	2018
Net sales	6, 24	1,502,241	1,508,007
Cost of sales	9, 11, 12, 16, 18	(848,723)	(853,989)
Gross profit		653,518	654,018
Selling, general and administrative expenses	11, 12, 16, 18, 25	(442,912)	(444,845)
Other operating income	24, 26	15,192	14,288
Other operating expenses	11, 12, 16, 18, 27	(14,075)	(15,758)
Operating income	6	211,723	207,703
Financial income	6, 18, 28	2,027	1,717
Financial expenses	6, 16, 18, 28	(5,231)	(4,251)
Share of profit in investments accounted for using the equity method	6, 13	2,126	2,082
Income before income taxes	6	210,645	207,251
Income taxes	14	(60,296)	(51,920)
Net income		150,349	155,331
Attributable to:			
Owners of the parent		148,213	153,698
Non-controlling interests		2,136	1,633
Net income		150,349	155,331
Earnings per share			
Basic (Yen)	29	306.70	314.25
Diluted (Yen)	29	306.63	314.12

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2019

(Millions of yen)

	Notes	2019	2018
Net income		150,349	155,331
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	30, 33	(6)	(2)
Remeasurements of defined benefit plans	30	(1,180)	(15,524)
Share of other comprehensive income of investments accounted for using the equity method	30	(17)	(345)
Total of items that will not be reclassified to profit or loss		(1,203)	(15,871)
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations	30	(2,489)	(16,140)
Share of other comprehensive income of investments accounted for using the equity method	30	(36)	(73)
Total of items that may be reclassified subsequently to profit or loss		(2,525)	(16,213)
Other comprehensive income, net of taxes		(3,728)	(32,084)
Comprehensive income		146,621	123,247
Attributable to:			
Owners of the parent		144,508	122,324
Non-controlling interests		2,113	923
Comprehensive income		146,621	123,247

Consolidated Statement of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2019

(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, 2019 (as previously reported)		85,424	108,245	(11,282)	546	(37,032)	(1)	6,458	—	(30,029)	670,002	822,360	13,149	835,509
Changes in accounting policy[1]		—	—	—	—	—	—	—	—	—	740	740	—	740
January 1, 2019 (after adjustment)		85,424	108,245	(11,282)	546	(37,032)	(1)	6,458	—	(30,029)	670,742	823,100	13,149	836,249
Net income		—	—	—	—	—	—	—	—	—	148,213	148,213	2,136	150,349
Other comprehensive income		—	—	—	—	(2,598)	1	(23)	(1,085)	(3,705)	—	(3,705)	(23)	(3,728)
Comprehensive income		—	—	—	—	(2,598)	1	(23)	(1,085)	(3,705)	148,213	144,508	2,113	146,621
Disposal of treasury shares	21	—	(108)	57,006	(98)	—	—	—	—	(98)	(56,799)	1	—	1
Purchase of treasury shares	21	—	—	(50,033)	—	—	—	—	—	—	—	(50,033)	—	(50,033)
Share-based payment transactions	32	—	337	—	—	—	—	—	—	—	—	337	—	337
Dividends	23	—	—	—	—	—	—	—	—	—	(60,459)	(60,459)	(1,290)	(61,749)
Changes in the ownership interest in subsidiaries		—	241	—	—	—	—	—	—	—	—	241	(246)	(5)
Transfer from other components of equity to retained earnings		—	—	—	—	—	—	(227)	1,085	858	(858)	—	—	—
Total transactions with the owners		—	470	6,973	(98)	—	—	(227)	1,085	760	(118,116)	(109,913)	(1,536)	(111,449)
December 31, 2019		85,424	108,715	(4,309)	448	(39,630)	—	6,208	—	(32,974)	700,839	857,695	13,726	871,421

Note: 1. It represents the financial effect from the adoption of IFRS 16 "Leases."

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	21	—	(99)	48,345	(167)	—	—	—	—	(167)	(47,961)	118	—	118
Purchase of treasury shares	21	—	—	(50,034)	—	—	—	—	—	—	—	(50,034)	—	(50,034)
Share-based payment transactions	32	—	364	—	—	—	—	—	—	—	—	364	—	364
Dividends	23	—	—	—	—	—	—	—	—	—	(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

Consolidated Statement of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2019

(Millions of yen)

	Notes	2019	2018
Cash flows from operating activities			
Income before income taxes		210,645	207,251
Depreciation and amortization		83,369	60,662
Interest and dividend income		(1,885)	(1,578)
Interest expense		2,840	1,256
Share of profit in investments accounted for using the equity method		(2,126)	(2,082)
(Gains) losses on sale and disposal of property, plant and equipment, and intangible assets		3,323	4,531
(Increase) decrease in trade and other receivables		12,862	(12,591)
(Increase) decrease in inventories		(2,848)	(15,677)
Increase (decrease) in trade and other payables		696	3,951
Increase (decrease) in retirement benefit liabilities		(3,788)	20,740
Other		(2,936)	(21,437)
Subtotal		300,152	245,026
Interest received		1,711	1,273
Dividends received		2,146	2,312
Interest paid		(2,806)	(1,293)
Income taxes paid		(56,680)	(51,708)
Net cash flows from operating activities		244,523	195,610
Cash flows from investing activities			
Payments into time deposits		(35,188)	(26,768)
Proceeds from withdrawal of time deposits		36,660	26,987
Purchase of property, plant and equipment		(83,959)	(80,295)
Purchase of intangible assets		(9,819)	(7,703)
Payments for business combinations		(195)	(73,915)
Other		(1,765)	3,799
Net cash flows from investing activities		(94,266)	(157,895)
Cash flows from financing activities			
Increase (decrease) in short-term borrowings		19	230
Proceeds from long-term borrowings		46,220	—
Repayments of long-term borrowings		(40,054)	(67)
Proceeds from issuance of bonds		—	25,060
Redemption of bonds		(12)	(24,939)
Repayments of lease liabilities	31	(20,565)	—
Purchase of treasury shares		(50,033)	(50,035)
Dividends paid to owners of the parent		(60,512)	(56,838)
Dividends paid to non-controlling interests		(1,287)	(745)
Other		58	(1,245)
Net cash flows from financing activities		(126,166)	(108,579)
Net increase (decrease) in cash and cash equivalents		24,091	(70,864)
Cash and cash equivalents at the beginning of the year	7	265,978	343,076
Effect of exchange rate changes on cash and cash equivalents		(388)	(6,234)
Cash and cash equivalents at the end of the year	7	289,681	265,978

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2019

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 located 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.

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

Fiscal year ended December 31, 2019

For leases in which the Group acts as the lessee, the lease liability is initially measured at the present value of the accrued lease payments. Right-of-use assets are measured at the initial amount of the lease liability adjusted for any initial direct costs and any prepaid lease payments, plus any costs including restoration obligations and other factors under the lease contracts.

Right-of-use 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 interest expenses and the reduction of the outstanding liability using the interest method. Interest expenses are presented on the consolidated statement of income separately from depreciation expenses of right-of-use assets.

The Group does not recognize right-of-use assets and lease liabilities for short-term leases with a lease term of 12 months or less and leases for which the underlying asset is of low-value assets. The Group recognizes the lease payments associated with these leases as expenses on either a straight-line basis or another systematic basis over the lease term.

The Group has no significant leases in which it acts as the lessor.

Fiscal year ended December 31, 2018

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 payables 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.

(20) Changes in Significant Accounting Policies

(Leases)

The Group adopted IFRS 16 "Leases" (issued in January 2016; hereafter, "IFRS 16") from the fiscal year ended December 31, 2019. As a transitional measure upon the adoption of IFRS 16, the Group applies this Standard retrospectively with the cumulative effect of initially applying this Standard recognized at the date of initial application.

In transitioning to IFRS 16, the Group has chosen the practical expedient detailed in IFRS 16 paragraph C3 and grandfathered its assessments of whether contracts contain leases based on IAS 17 "Leases" (hereafter, "IAS 17") and IFRIC 4 "Determining whether an Arrangement contains a Lease." From the date of application, this assessment is determined based on the provisions of IFRS 16.

For leases that the Group as lessee previously classified as operating leases applying IAS 17, right-of-use assets and lease liabilities are recognized at the date of initial application. These lease liabilities have been measured at the present value of the remaining lease payments discounted using the lessee's incremental borrowing rate at the date of initial application. The weighted average of the lessee's incremental borrowing rates is 1.0%. Right-of-use assets are initially measured at the initial measurement amount of the lease liability adjusted for the prepaid lease payments and other factors.

For leases that the Group as lessee previously classified as finance leases applying IAS 17, the carrying amounts of right-of-use assets and lease liabilities at the date of initial application are the carrying amounts of lease assets and lease liabilities, respectively, immediately before that date measured applying IAS 17.

The following is a reconciliation of non-cancellable operating lease contracts applying IAS 17 as of December 31, 2018 and lease liabilities recognized in the consolidated statement of financial position at the date of initial application.

(Millions of yen)

Non-cancellable operating lease contracts as of December 31, 2018	25,018
Finance lease liabilities as of December 31, 2018	2,419
Cancellable operating lease contracts, etc.	139,998
Lease liabilities as of January 1, 2019	167,435

Right-of-use assets recognized at the date of initial application in the consolidated statement of financial position were 171,890 million yen.

The following practical expedients are used in the application of IFRS 16.

- A single discount rate is applied to portfolios of leases with reasonably similar characteristics.
- As an alternative to performing an impairment review, the Group relies on its assessment of whether leases are onerous applying IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" immediately before the date of initial application.
- Initial direct costs are excluded from the measurement of right-of-use assets at the date of initial application.

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, Right-of-use assets, Goodwill and Intangible Assets

The Group conducts impairment tests for property, plant and equipment, right-of-use assets, 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 12 "Goodwill and Intangible Assets" presents the method for measuring the recoverable amount and sensitivity associated with goodwill.

(2) Lease Term of Right-of-use Assets

The Group determines the lease term as the non-cancellable period of the lease, together with any periods when it is reasonably certain such lease will be extended or will not be terminated. Specifically, the lease term is estimated in consideration of factors including variation in rent due to extension or termination of the lease, whether there is a penalty for termination, and the period for recovery of investment in improvements of important leaseholds.

Note 3 "Significant Accounting Policies (9) Leases" presents details related to lease terms. Note 33 "Financial Instruments" presents amounts.

(3) 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 18 "Employee Benefits" presents actuarial assumptions and related sensitivity.

(4) 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 19 "Provisions" presents the nature and amounts of these provisions.

(5) 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 14 "Income Taxes" presents income taxes and amounts.

(6) 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 33 "Financial Instruments" presents fair value measurement methods and amounts for major financial assets and liabilities measured at fair value.

(7) 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 38 "Approval of the Consolidated Financial Statements," but were not yet early adopted by the Group as of December 31, 2019 are not presented because the impacts are 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.

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	Sanitary products	Sanitary napkins, baby diapers
		Personal health products	Bath additives, oral care products, thermo products
		Beverage products	Beverages
	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, 2019 (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	301,547	340,757	255,224	359,507	1,257,035	245,206	1,502,241	—	1,502,241
Intersegment sales and transfers[2]	—	—	—	—	—	40,729	40,729	(40,729)	—
Total net sales	301,547	340,757	255,224	359,507	1,257,035	285,935	1,542,970	(40,729)	1,502,241
Operating income	41,398	49,524	17,166	71,774	179,862	30,839	210,701	1,022	211,723
Financial income									2,027
Financial expenses									(5,231)
Share of profit in investments accounted for using the equity method									2,126
Income before income taxes									210,645
Other items									
Depreciation and amortization[3]	14,865	13,814	21,627	17,899	68,205	14,205	82,410	959	83,369
Capital expenditures[4]	17,962	18,389	27,314	22,139	85,804	24,189	109,993	3,394	113,387

Notes: 1. The operating income reconciliation of 1,022 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 11 "Property, Plant and Equipment," Note 12 "Goodwill and Intangible Assets" and Note 16 "Leases" present the details of depreciation and amortization.
4. Capital expenditures include investments in property, plant and equipment, right-of-use assets and intangible assets.

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 11 "Property, Plant and Equipment" and Note 12 "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)

	2019	2018
Japan	947,096	939,463
Asia	293,388	295,714
Americas	137,819	140,637
Europe	123,938	132,193
Total	1,502,241	1,508,007

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)

	2019	2018
Japan	597,950	448,357
Asia	104,643	88,843
Americas	98,730	96,426
Europe	39,444	27,184
Total	840,767	660,810

7 Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

(Millions of yen)

	2019	2018
Cash and deposits	239,781	206,078
Short-term investments	49,900	59,900
Total	289,681	265,978

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.

8 Trade and Other Receivables

Trade and other receivables consist of the following:

(Millions of yen)

	2019	2018
Trade receivables	204,322	217,594
Other receivables	6,179	7,073
Allowance for doubtful receivables	(1,662)	(1,565)
Total	208,839	223,102

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.

9 Inventories

Inventories consist of the following:

(Millions of yen)

	2019	2018
Merchandise and finished goods	155,611	146,684
Work in progress	12,893	14,875
Materials and supplies	31,168	36,012
Total	199,672	197,571

The amount of inventories recognized as expenses and included in cost of sales for the fiscal years ended December 31, 2019 and 2018 were 729,425 million yen and 733,108 million yen, respectively.

Write-downs of inventories recognized as expenses for the fiscal years ended December 31, 2019 and 2018 were 6,065 million yen and 5,044 million yen, respectively.

10 Other Assets

Other assets consist of the following:

(Millions of yen)

	2019	2018
Other current assets		
Insurance receivable	521	2,886
Prepaid expenses	8,587	9,538
Other	13,498	10,025
Total	22,606	22,449
Other non-current assets		
Insurance receivable	2,263	2,109
Long-term prepaid lease payments	—	4,060
Long-term prepaid expenses	472	435
Retirement benefit assets	2,146	1,166
Other	615	505
Total	5,496	8,275

11 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, 2018	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
Changes in accounting policy[1]	(11,853)	(47)	(10)	(24)	—	(11,934)
January 1, 2019 (after adjustment)	423,918	738,370	121,541	75,659	34,543	1,394,031
Additions	162	493	1,084	—	78,671	80,410
Acquisitions through business combinations	15	—	1	—	—	16
Sales and disposals	(3,878)	(18,094)	(8,952)	(373)	—	(31,297)
Reclassification	14,151	40,741	12,285	4,116	(71,293)	—
Exchange differences on translation of foreign operations	(751)	(509)	(37)	109	(159)	(1,347)
Other	169	310	(513)	—	(7)	(41)
December 31, 2019	433,786	761,311	125,409	79,511	41,755	1,441,772

Note: 1. It represents the financial effect from the adoption of IFRS 16 "Leases."

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, 2018	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
Changes in accounting policy[2]	(9,434)	(27)	(9)	—	—	(9,470)
January 1, 2019 (after adjustment)	290,999	582,411	93,830	10,320	—	977,560
Depreciation[1]	13,453	32,031	12,012	—	—	57,496
Sales and disposals	(3,324)	(17,265)	(8,684)	—	—	(29,273)
Exchange differences on translation of foreign operations	(510)	(444)	0	—	—	(954)
Other	135	316	(339)	—	—	112
December 31, 2019	300,753	597,049	96,819	10,320	—	1,004,941

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. It represents the financial effect from the adoption of IFRS 16 "Leases."

Carrying Amount (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2018	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
December 31, 2019	133,033	164,262	28,590	69,191	41,755	436,831

(2) Leased Assets

The carrying amount of leased assets from finance leases included in property, plant and equipment for the fiscal year ended December 31, 2018 is as follows:

(Millions of yen)

	Buildings and structures	Other	Total
January 1, 2018	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 36 "Commitments" presents information on commitments to acquire property, plant and equipment.

12 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, 2018	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
Additions	—	76	—	—	9,702	9,778
Acquisitions through business combinations	—	1	—	—	—	1
Sales and disposals	—	(5,048)	—	(294)	(1,789)	(7,131)
Reclassification	—	6,990	—	—	(6,990)	—
Exchange differences on translation of foreign operations	(579)	(50)	(210)	(211)	(34)	(505)
Other	—	(3)	—	—	(75)	(78)
December 31, 2019	179,707	31,286	14,500	13,234	7,549	66,569

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, 2018	—	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
Amortization[1]	—	5,938	765	898	430	8,031
Sales and disposals	—	(5,027)	—	(294)	(1,787)	(7,108)
Exchange differences on translation of foreign operations	—	(46)	(12)	(14)	(13)	(85)
Other	—	6	—	—	—	6
December 31, 2019	—	15,266	1,489	1,256	788	18,799

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, 2018	138,735	12,821	—	719	3,289	16,829
December 31, 2018	180,286	14,925	13,974	13,073	4,577	46,549
December 31, 2019	179,707	16,020	13,011	11,978	6,761	47,770

(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)

	2019	2018
Cosmetics Business	130,605	130,455
Kanebo Cosmetics Group	119,400	119,400
Molton Brown Group	11,205	11,055
Skin Care and Hair Care Business	28,412	28,831
Oribe Hair Care and other	24,545	24,908
Other	3,867	3,923
Fabric and Home Care Business	18,160	18,423
Chemical Business	2,530	2,577
Total	179,707	180,286

(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 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 medium-term plans 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 6.8 % for the fiscal year ended December 31, 2019 and 8.2% for the fiscal year ended December 31, 2018. For the fiscal year ended December 31, 2019 and 2018, management determined that there was a low probability that the recoverable amounts of relevant cash-generating units would be less than their carrying amounts even in cases where key assumptions used in the impairment test changed within a reasonably possible range.

(4) Intangible Assets with Indefinite Useful Lives

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

(5) Commitments

Note 36 "Commitments" presents information on commitments associated with the acquisition of intangible assets.

13 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)

	2019	2018
Investments accounted for using the equity method	8,287	7,931

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)

	2019	2018
The Group's share of net income	2,126	2,082
The Group's share of other comprehensive income	(53)	(418)
The Group's share of comprehensive income	2,073	1,664

14 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, 2019 (Millions of yen)

	January 1, 2019 (as previously reported)	Changes in accounting policy[1]	January 1, 2019 (after adjustment)	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2019
Deferred tax assets							
Property, plant and equipment and intangible assets	19,217	—	19,217	1,519	—	(21)	20,715
Lease liabilities	—	46,887	46,887	(1,137)	—	276	46,026
Retirement benefit liabilities	24,093	—	24,093	(2,177)	(480)	(17)	21,419
Accrued expenses	10,446	—	10,446	(184)	—	(22)	10,240
Unused tax losses	1,400	—	1,400	(551)	—	(462)	387
Other	15,866	—	15,866	521	—	(382)	16,005
Total deferred tax assets	71,022	46,887	117,909	(2,009)	(480)	(628)	114,792
Deferred tax liabilities							
Property, plant and equipment and intangible assets	10,188	—	10,188	424	—	(664)	9,948
Right-of-use assets	—	46,887	46,887	(1,202)	—	241	45,926
Financial assets	2,635	—	2,635	—	(18)	(101)	2,516
Undistributed foreign earnings	11,161	—	11,161	372	—	—	11,533
Other	744	—	744	153	—	(157)	740
Total deferred tax liabilities	24,728	46,887	71,615	(253)	(18)	(681)	70,663
Deferred tax assets, net	46,294	—	46,294	(1,756)	(462)	53	44,129

Note: 1. It represents the financial effect from the adoption of IFRS 16 "Leases."

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

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

(Millions of yen)

	2019	2018
Deferred tax assets	47,876	49,158
Deferred tax liabilities	3,747	2,864
Deferred tax assets, net	44,129	46,294

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

(Millions of yen)

	2019	2018
Unused tax losses	2,687	2,664
Deductible temporary differences	11,879	11,981
Total	14,566	14,645

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

(Millions of yen)

	2019	2018
Not later than 1 year	343	210
Later than 1 year and not later than 2 years	458	353
Later than 2 years and not later than 3 years	288	472
Later than 3 years and not later than 4 years	493	297
Later than 4 years	1,105	1,332
Total	2,687	2,664

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, 2019 and 2018 were 13,648 million yen and 11,512 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)

	2019	2018
Current taxes	58,540	52,344
Deferred taxes[1]	1,756	(424)
Total	60,296	51,920

Note: 1. Deferred taxes include 79 million yen and 385 million yen for the fiscal years ended December 31, 2019 and 2018, 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:

(%)

	2019	2018
Effective statutory tax rate	30.62	30.86
Tax credit for experimental research costs and other	(1.90)	(3.80)
Different tax rates applied to subsidiaries	(1.42)	(1.64)
Reassessment of recoverability of unused tax losses and deferred tax assets	0.69	(0.30)
Change in tax rates	0.04	0.19
Other	0.59	(0.26)
Average actual tax rate	28.62	25.05

Note: The "Act for Partial Revision of the Income Tax Act, etc." (Act No. 15 of 2016) and the "Act for Partial Revision of the Local Tax Act, etc." (Act No. 13 of 2016) enacted in Japan on March 29, 2016 reduced the income tax rate for fiscal years beginning on or after April 1, 2016, in stages. Accordingly, the effective statutory tax rate has changed from 30.86% to 30.62%.

15 Bonds and Borrowings and Other

Bonds and borrowings and lease liabilities consist of the following:

(Millions of yen)

	2019	2018	Average interest rate[1] (%)	Maturity
Short-term borrowings	450	430	1.26	—
Current portion of long-term borrowings	48	40,046	1.12	—
Long-term borrowings	76,582	30,299	0.64	2021-2029
Current portion of bonds[2]	25,007	12	—	—
Bonds[2]	25,054	50,040	—	—
Lease liabilities (Current)	19,653	—	0.55	
Lease liabilities (Non-current)	141,438	—	1.02	2021-2066
Total	288,232	120,827		
Current liabilities				
Bonds and borrowings	25,505	40,488		
Lease liabilities	19,653	—		
Subtotal	45,158	40,488		
Non-current liabilities				
Bonds and borrowings	101,636	80,339		
Lease liabilities	141,438	—		
Subtotal	243,074	80,339		
Total	288,232	120,827		

Notes: 1. The average interest rate is the weighted average interest rate on the balance as of December 31, 2019.
2. Details of bonds issued are as follows:

(Millions of yen)

Issuer	Bond name	Issue date	2019	2018	Interest rate (%)	Collateral	Maturity date
The Company	4th unsecured bonds	June 14, 2013	24,995	24,985	0.62	None	June 19, 2020
The Company	5th unsecured bonds	June 19, 2018	24,958	24,947	0.08	None	June 20, 2023
Subsidiaries	Other bonds	—	108	120	—	—	—
Total			50,061	50,052			

16 Leases

Fiscal year ended December 31, 2019

As a lessee, the Group leases assets including buildings etc. Some lease contracts include extension options and termination options. The Group has no restrictions or covenants imposed by leases.

Income and expenses relating to leases consist of the following:

(Millions of yen)

	2019
Depreciation charge for right-of-use assets[1]	
Buildings and structures	16,171
Other	1,671
Total	17,842
Interest expense on lease liabilities[2]	1,676
Expenses relating to short-term leases[3]	1,562
Other	907
Total	4,145

Notes: 1. Depreciation of right-of-use assets is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
2. Interest expense on lease liabilities is included in financial expenses in the consolidated statement of income.
3. Expenses relating to short-term leases are included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

The total cash outflow for leases for the fiscal year ended December 31, 2019 was 24,722 million yen.

Carrying amount of right-of-use assets consists of the following:

(Millions of yen)

	January 1, 2019	December 31, 2019
Right-of-use assets		
Buildings and structures	162,222	156,965
Other	9,668	7,857
Total	171,890	164,822

Note 31 “Cash Flow Information” presents additions to right-of-use assets.

Note 33 “Financial Instruments” presents lease liabilities by maturity date.

Fiscal year ended December 31, 2018

(1) Finance Lease Payables

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	2018
Not later than 1 year	689	663
Later than 1 year and not later than 5 years	1,769	1,731
Later than 5 years	25	25
Total	2,483	2,419
Financial charges	(64)	—
Present value of minimum lease payments	2,419	2,419

(2) Non-cancellable Operating Leases

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

(Millions of yen)

	2018
Not later than 1 year	8,622
Later than 1 year and not later than 5 years	15,539
Later than 5 years	6,381
Total	30,542

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

(Millions of yen)

	2018
Total of minimum lease payments	9,829

17 Trade and Other Payables

Trade and other payables consist of the following:

(Millions of yen)

	2019	2018
Trade payables	144,864	145,603
Non-trade payables	77,450	79,957
Total	222,314	225,560

18 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 performance of 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)

	2019	2018
Present value of defined benefit obligations	362,080	342,130
Fair value of plan assets	(283,647)	(258,744)
Net defined benefit liabilities	78,433	83,386
Amounts recognized in consolidated statement of financial position		
Retirement benefit liabilities	80,579	84,552
Retirement benefit assets	(2,146)	(1,166)
Net defined benefit liabilities	78,433	83,386

2) Defined benefit obligations

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

(Millions of yen)

	2019	2018
The present value of the defined benefit obligations at beginning of year	342,130	333,614
Current service cost[1]	9,804	9,376
Interest expense[2]	2,710	2,569
Remeasurements		
Actuarial (gains) losses arising from changes in demographic assumptions	2,389	6,755
Actuarial (gains) losses arising from changes in financial assumptions	17,402	1,376
Actuarial (gains) losses arising from experience adjustments	365	1,748
Past service cost and (gains) losses arising from settlements[3]	35	107
Benefits paid[4]	(12,381)	(11,865)
Exchange differences on translation of foreign operations and other	(374)	(1,550)
The present value of the defined benefit obligations at end of year	362,080	342,130

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 18.0 years at December 31, 2019 and 17.4 years at December 31, 2018.

3) Plan assets

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

(Millions of yen)

	2019	2018
The fair value of plan assets at beginning of year	258,744	270,144
Interest income	1,911	1,927
Remeasurements		
Return on plan assets (excluding amounts included in interest income)	19,456	(12,656)
Contributions to the plan by the employer[1]	14,870	10,292
Payments from the plan	(11,242)	(10,249)
Exchange differences on translation of foreign operations and other	(92)	(714)
The fair value of plan assets at end of year	283,647	258,744

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 15,760 million yen to the defined benefit plan for the fiscal year ending December 31, 2020.

Plan assets consist of the following:

(Millions of yen)

	2019			2018		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Equity securities	11,623	57,118	68,741	8,830	43,962	52,792
Japan	—	28,412	28,412	—	21,502	21,502
Overseas	11,623	28,706	40,329	8,830	22,460	31,290
Debt securities	7,863	195,263	203,126	6,640	188,425	195,065
Japan	—	130,418	130,418	—	126,940	126,940
Overseas	7,863	64,845	72,708	6,640	61,485	68,125
Other	334	11,446	11,780	352	10,535	10,887
Total	19,820	263,827	283,647	15,822	242,922	258,744

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:

	2019	2018
Discount rate	Mainly 0.6%	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)

	2019	2018
The impact on defined benefit obligations		
0.5% increase in discount rate	(27,430)	(25,292)
0.5% decrease in discount rate	28,821	26,314

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 3,820 million yen and 4,176 million yen for the fiscal years ended December 31, 2019 and 2018, 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, 2019 and 2018 were 274,937 million yen and 272,234 million yen, respectively.

19 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, 2019	8,168	4,414	2,466	15,048
Increase	—	53	755	808
Interest expense on discounted provision	8	57	—	65
Decrease (provision used)	(2,217)	(7)	(1,470)	(3,694)
Decrease (provision reversed)	—	—	(4)	(4)
Exchange differences on translation of foreign operations	—	(11)	(36)	(47)
December 31, 2019	5,959	4,506	1,711	12,176

(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 1,468 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 right-of-use 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.

20 Other Current Liabilities

Other current liabilities consist of the following:

(Millions of yen)

	2019	2018
Accrued expenses	72,551	77,530
Consumption tax payables	10,663	8,808
Obligation for unused paid absences	7,948	7,865
Other	8,249	8,249
Total	99,411	102,452

21 Equity and Other Equity Items

(1) Share Capital

The numbers of shares authorized and issued are as follows:

(Shares)

	2019	2018
Authorized	1,000,000,000	1,000,000,000
Issued[1]		
Beginning balance	488,700,000	495,000,000
Change during the year[2]	(6,700,000)	(6,300,000)
Ending balance	482,000,000	488,700,000

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, 2019 and 2018 decreased by 6,700,000 shares and 6,300,000 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)

	2019	2018
Beginning balance[1]	2,043,272	2,225,561
Increase[2]	5,786,409	6,237,461
Decrease[3]	(6,746,215)	(6,419,750)
Ending balance[4]	1,083,466	2,043,272

Notes: 1. 556,492 shares of treasury shares held by associates were included at December 31, 2019 and 2018.
In addition, 242,675 shares and 257,300 shares held by the Board Incentive Plan Trust (hereinafter "BIP Trust") were included at December 31, 2019 and 2018, respectively.
2. The increase of 5,786,409 shares of treasury shares during the fiscal year ended December 31, 2019 resulted from the acquisition of 5,782,400 shares by resolution of the Board of Directors and the purchase of 4,009 fractional shares.
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.
3. The decrease of 6,746,215 shares of treasury shares during the fiscal year ended December 31, 2019 resulted from the retirement of 6,700,000 shares by resolution of the Board of Directors, a decrease of 30,000 shares due to the exercise of stock options, a decrease of 16,125 shares due to the grant to the Board of Directors by the BIP trust and the sale of 90 fractional shares.
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.
4. 556,492 shares of treasury shares held by associates were included at December 31, 2019 and 2018.
In addition, 226,550 shares and 242,675 shares held by the BIP Trust were included at December 31, 2019 and 2018, 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 32 "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.

22 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, 2019, EVA decreased 6.1 billion yen compared with the previous fiscal year to 87.4 billion yen due to a decrease 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.

23 Dividends

Dividends paid are as follows:

Fiscal year ended December 31, 2019

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
113th Annual General Meeting of Shareholders held on March 26, 2019	29,199	60	December 31, 2018	March 27, 2019
Board of Directors meeting held on July 31, 2019	31,259	65	June 30, 2019	September 2, 2019

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 113th Annual General Meeting of Shareholders held on March 26, 2019 was 29,247 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 31, 2019 was 31,310 million yen before the deduction.

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.

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

Fiscal year ended December 31, 2019

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
114th Annual General Meeting of Shareholders held on March 25, 2020	31,310	65	December 31, 2019	March 26, 2020

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

24 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:

Fiscal year ended December 31, 2019 (Millions of yen)

	Japan	Asia	Americas	Europe	Total
Cosmetics Business	232,132	42,725	6,047	20,643	301,547
Skin Care and Hair Care Business	199,541	28,485	71,430	41,301	340,757
Human Health Care Business	160,312	94,793	113	6	255,224
Fabric and Home Care Business	307,658	40,347	11,245	257	359,507
Consumer Products Business	899,643	206,350	88,835	62,207	1,257,035
Chemical Business	123,422	57,349	46,076	59,088	285,935
Elimination of intersegment transactions	(35,911)	(2,851)	(60)	(1,907)	(40,729)
Consolidated	987,154	260,848	134,851	119,388	1,502,241
Revenue of logistics services to third parties included in other operating income	8,973	—	—	—	8,973
Total revenue from contracts with customers	996,127	260,848	134,851	119,388	1,511,214

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, 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.

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, 2019 (Millions of yen)

	January 1, 2019	December 31, 2019
Contract liabilities		
Advances	181	384
Refund liabilities	18,206	20,232
Total	18,387	20,616

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

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, 2019 and 2018 were recognized as revenue during the fiscal years ended December 31, 2019 and 2018, respectively. The amount of revenue recognized during the fiscal year ended December 31, 2019 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, 2019 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.

25 Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of the following:

(Millions of yen)

	2019	2018
Advertising	77,545	80,274
Sales promotion	56,943	55,308
Employee benefits	148,431	148,220
Depreciation	18,775	9,186
Amortization	7,950	6,860
Research and development	59,143	57,673
Other	74,125	87,324
Total	442,912	444,845

As a transitional measure upon the adoption of IFRS 16, the Group applies this Standard retrospectively with the cumulative effect of initially applying this Standard recognized at the date of initial application and thus has not restated the amounts for the comparative period. As a result, the expenses of 9,581 million yen previously included in other are accounted for as depreciation.

26 Other Operating Income

Other operating income consists of the following:

(Millions of yen)

	2019	2018
Revenue of logistics services to third parties	8,973	8,548
Royalty income	1,244	1,039
Other	4,975	4,701
Total	15,192	14,288

27 Other Operating Expenses

Other operating expenses consist of the following:

(Millions of yen)

	2019	2018
Expenses of logistics services to third parties	8,293	7,667
Losses on sale and disposal of property, plant and equipment	3,600	4,769
Expenses for business transformation at subsidiaries in Europe and the Americas	752	1,516
Other	1,430	1,806
Total	14,075	15,758

28 Financial Income and Financial Expenses

Financial income consists of the following:

(Millions of yen)

	2019	2018
Interest income		
Financial assets measured at amortized cost	1,707	1,320
Retirement benefit assets	28	30
Dividend income		
Financial assets measured at fair value through other comprehensive income		
Financial assets derecognized during the year	8	78
Financial assets held at year end	162	171
Financial assets measured at fair value through profit or loss	7	8
Other	115	110
Total	2,027	1,717

Financial expenses consist of the following:

(Millions of yen)

	2019	2018
Foreign exchange loss[1]	1,521	2,304
Interest expenses[2]		
Financial liabilities measured at amortized cost	1,164	1,256
Lease liabilities	1,676	—
Retirement benefit liabilities	827	672
Other	43	19
Total	5,231	4,251

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.

29 Earnings per Share

(1) The Basis for Calculating Basic Earnings per Share

(Millions of yen, unless otherwise noted)

	2019	2018
Net income attributable to owners of the parent	148,213	153,698
Amounts not attributable to ordinary shareholders of the parent	—	—
Net income used to calculate basic earnings per share	148,213	153,698
Weighted average number of ordinary shares (Thousands of shares)	483,252	489,089
Basic earnings per share (Yen)	306.70	314.25

(2) The Basis for Calculating Diluted Earnings per Share

(Millions of yen, unless otherwise noted)

	2019	2018
Net income used to calculate basic earnings per share	148,213	153,698
Adjustments to net income	—	—
Net income used to calculate diluted earnings per share	148,213	153,698
Weighted average number of ordinary shares (Thousands of shares)	483,252	489,089
Increase in ordinary shares		
Subscription rights to shares (Thousands of shares)	104	199
Weighted average number of ordinary shares after dilution (Thousands of shares)	483,356	489,289
Diluted earnings per share (Yen)	306.63	314.12
Summary of potential ordinary shares not included in the calculation of diluted earnings per share because they have no dilutive effect	—	—

30 Other Comprehensive Income

Amount arising during the fiscal year, reclassification adjustments to profit or loss and tax effects for each component of other comprehensive income are as follows:

Fiscal year ended December 31, 2019

(Millions of yen)

	Gains (losses) arising for the year	Reclassification adjustments	Before tax effect	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	(24)	—	(24)	18	(6)
Remeasurements of defined benefit plans	(700)	—	(700)	(480)	(1,180)
Share of other comprehensive income of investments accounted for using the equity method	(24)	—	(24)	7	(17)
Total of items that will not be reclassified to profit or loss	(748)	—	(748)	(455)	(1,203)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(2,723)	234	(2,489)	—	(2,489)
Share of other comprehensive income of investments accounted for using the equity method	(36)	—	(36)	(0)	(36)
Total of items that may be reclassified subsequently to profit or loss	(2,759)	234	(2,525)	(0)	(2,525)
Total	(3,507)	234	(3,273)	(455)	(3,728)

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

	Gains (losses) arising for the year	Reclassification adjustments	Before tax effect	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	—	119	(121)	(2)
Remeasurements of defined benefit plans	(22,535)	—	(22,535)	7,011	(15,524)
Share of other comprehensive income of investments accounted for using the equity method	(497)	—	(497)	152	(345)
Total of items that will not be reclassified to profit or loss	(22,913)	—	(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)	—	(16,140)
Share of other comprehensive income of investments accounted for using the equity method	(75)	—	(75)	2	(73)
Total of items that may be reclassified subsequently to profit or loss	(16,215)	—	(16,215)	2	(16,213)
Total	(39,128)	—	(39,128)	7,044	(32,084)

31 Cash Flow Information

(1) Changes in Liabilities Arising from Financing Activities

The following table presents the major changes in liabilities arising from financing activities for lease liabilities.

Fiscal year ended December 31, 2019 (Millions of yen)

	January 1, 2019 (as previously reported)	Changes in accounting policy[1]	January 1, 2019 (after adjustment)	Changes from financing cash flows	Non-cash changes		December 31, 2019
					New leases	Other	
Lease liabilities	—	167,435	167,435	(20,565)	22,804	(8,583)	161,091

Note: 1. It represents the financial effect from the adoption of IFRS 16 "Leases."

Except for lease liabilities, the major changes in liabilities arising from financing activities were changes from financing cash flows and there were no significant non-cash changes for the fiscal year ended December 31, 2019.

The major changes in liabilities arising from financing activities were changes from financing cash flows and there are no significant non-cash changes for the fiscal year ended December 31, 2018.

(2) Non-cash Transactions

The major non-cash transactions comprised the acquisition of right-of-use assets resulted from leases of 23,199 million yen for the fiscal year ended December 31, 2019.

32 Share-based Payments

(1) Stock Options

1) Outline of stock options

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

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

2) Number of stock options and weighted average exercise price

	2019		2018	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
	(Shares)	(Yen)	(Shares)	(Yen)
Beginning balance of outstanding	125,000	1	313,000	973
Granted	—	—	—	—
Exercised	(30,000)	1	(105,000)	1,117
Expired at maturity	—	—	(83,000)	2,254
Ending balance of outstanding	95,000	1	125,000	1
Ending balance of exercisable	95,000	1	125,000	1

Notes: 1. The weighted average share price on the date of exercise for the fiscal years ended December 31, 2019 and 2018 was 8,118 yen and 7,877 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:

2019			2018		
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	95,000	2.2	1	125,000	2.8

(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:

	2019		2018	
	Achievement-linked points	Fixed points	Achievement-linked points	Fixed points
Number of points granted during the period	35,000	15,000	37,625	16,125
Weighted average fair value (Yen)	6,821	6,551	6,821	6,659

(3) Share-based Payment Expenses

Share-based payment expenses recognized in the consolidated statement of income for the fiscal years ended December 31, 2019 and 2018 were 337 million yen and 364 million yen, respectively.

33 Financial Instruments

(1) Classification of Financial Instruments

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

(Millions of yen)

Financial assets	2019	2018
Financial assets measured at amortized cost		
Cash and cash equivalents (Note 7)	269,781	236,078
Trade and other receivables (Note 8)	208,839	223,102
Other	25,893	23,495
Financial assets measured at fair value through profit or loss		
Cash and cash equivalents (Note 7)	19,900	29,900
Derivatives	214	1,068
Other	3,063	2,983
Financial assets measured at fair value through other comprehensive income		
Equity securities	10,722	11,140
Total	538,412	527,766
Current assets		
Cash and cash equivalents	289,681	265,978
Trade and other receivables	208,839	223,102
Other financial assets	13,788	15,146
Subtotal	512,308	504,226
Non-current assets		
Other financial assets	26,104	23,540
Total	538,412	527,766

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, 2019 (Millions of yen)

Company name	Fair value
Seven & i Holdings Co., Ltd.	2,360
Saiwai Trading Co., Ltd.	1,308
Livedo Corporation	1,201
Aeon Co., Ltd.	952
Tokio Marine Holdings, Inc.	910
Japan Alcohol Trading Co., Ltd.	700
Keytrading Co., Ltd.	414
Izumi Co., Ltd.	394
Kawaken Fine Chemicals Co., Ltd.	245
Kyoto Seisakusho Co., Ltd.	205

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

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)

	2019	2018
Fair value	400	3,077
Cumulative gains (losses)	328	2,451

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, 2019 and 2018, were 227 million yen and 1,694 million yen, respectively.

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

(Millions of yen)

Financial liabilities	2019	2018
Financial liabilities measured at amortized cost		
Trade and other payables (Note 17)	222,314	225,560
Bonds and borrowings (Note 15)	127,141	120,827
Lease liabilities (Note 16)	161,091	—
Other	13,898	16,178
Financial liabilities measured at fair value through profit or loss		
Derivatives	395	208
Total	524,839	362,773
Current liabilities		
Trade and other payables	222,314	225,560
Bonds and borrowings	25,505	40,488
Lease liabilities	19,653	—
Other financial liabilities	6,766	6,880
Subtotal	274,238	272,928
Non-current liabilities		
Bonds and borrowings	101,636	80,339
Lease liabilities	141,438	—
Other financial liabilities	7,527	9,506
Subtotal	250,601	89,845
Total	524,839	362,773

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, 2019 and 2018 totaling 12,790 million yen and 12,380 million yen, respectively. The average interest rate on deposits received as of December 31, 2019 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	2019 Contract amount	2019 Contract amount over 1 year	2019 Carrying amount (fair value)[1]	2018 Contract amount	2018 Contract amount over 1 year	2018 Carrying amount (fair value)[1]
Foreign exchange forward contracts:						
Selling						
U.S. dollar	21,052	—	4	14,583	—	116
Euro	19	—	0	—	—	—
Buying						
Euro	105	—	(1)	—	—	—
Chinese yuan	458	—	(9)	212	—	(1)
Currency swaps:						
Receiving Japanese yen, paying U.S. dollar	—	—	—	7,343	7,343	(15)

Note: 1. Note 33 "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, 2019 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	23,641	1,725	11,630

As of December 31, 2018 (Millions of yen)

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

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)

	2019	2018
U.S. dollar	(2,364)	(280)
Euro	(173)	(193)
Chinese yuan	(1,163)	(1,077)

(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 5,830 million yen and 6,640 million yen at December 31, 2019 and 2018, 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 guaranties 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 guaranties 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 6,829 million yen and 6,782 million yen at December 31, 2019 and 2018, respectively.

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

Fiscal year ended December 31, 2019

(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, 2019	217,018	576	217,594
Change during the year (Recognition and derecognition)	(12,408)	(31)	(12,439)
Transfer to credit-impaired financial assets	(100)	100	—
Other changes	(820)	(13)	(833)
December 31, 2019	203,690	632	204,322

(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, 2019	957	491	1,448
Increase during the year	323	100	423
Decrease during the year (charge-offs)	(104)	(12)	(116)
Decrease during the year (other)	(73)	(34)	(107)
Transfer to credit-impaired financial assets	11	(11)	—
Other changes	(0)	(14)	(14)
December 31, 2019	1,114	520	1,634

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

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, 2019 (Millions of yen, unless otherwise noted)

	Not due	Days past due: Less than 30 days	Over 30 days	Over 60 days	Over 90 days	Total
Trade receivables	188,864	6,461	3,087	1,728	4,182	204,322
Allowance for doubtful receivables	187	107	117	69	1,154	1,634
Expected credit loss (%)	0.1	1.7	3.8	4.0	27.6	0.8

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

	Not due	Days past 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

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, 2019 (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	222,314	222,314	222,314	—	—	—	—	—
Bonds and borrowings	127,141	127,187	25,510	30,253	6,279	65,031	25	89
Lease liabilities	161,091	174,820	21,245	17,382	14,388	11,411	10,598	99,796
Long-term deposits payable	6,829	6,829	—	—	—	—	—	6,829
Derivative financial liabilities								
Currency related	320	320	248	—	72	—	—	—
Interest rate related	75	75	—	—	19	—	56	—
Total	517,770	531,545	269,317	47,635	20,758	76,442	10,679	106,714

Lease liabilities by maturity date consist of the following:

As of December 31, 2019 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 5 years	Later than 5 years but not later than 10 years	Later than 10 years but not later than 15 years	Later than 15 years but not later than 20 years	Later than 20 years
Lease liabilities	161,091	174,820	21,245	53,779	40,588	24,192	19,691	15,325

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

(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, 2019 or 2018.

As of December 31, 2019 (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	—	19,900	—	19,900
Derivative assets	—	214	—	214
Other	—	3,063	—	3,063
Financial assets measured at fair value through other comprehensive income				
Equity securities	5,830	—	4,892	10,722
Total	5,830	23,177	4,892	33,899
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	395	—	395
Total	—	395	—	395

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

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

(Millions of yen)

	2019	2018
Beginning balance	4,500	3,927
Gains (losses)[1]	391	574
Sales	(0)	(0)
Other changes	1	(1)
Ending balance	4,892	4,500

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, 2019 (Millions of yen)

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	50,061	—	50,129	—	50,129
Borrowings	77,080	—	77,571	—	77,571

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

34 Principal Subsidiaries

Principal subsidiaries consist of the following. Voting rights at December 31, 2019 did not significantly change from a year earlier.

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

35 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)

	2019	2018
Short-term benefits	1,069	1,161
Post-retirement benefits	33	28
Share-based payments	337	364
Total	1,439	1,553

36 Commitments

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

(Millions of yen)

	2019	2018
Acquisition of property, plant and equipment	25,041	30,751
Acquisition of intangible assets	3,735	1,188
Total	28,776	31,939

37 Significant Subsequent Events

There were no significant subsequent events to present.

38 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 23, 2020.

Independent Auditor's Report

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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, 2019, 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, 2019, 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 23, 2020

Member of
Deloitte Touche Tohmatsu Limited

Enriching lives, in harmony with nature.

Kao Corporation

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