Financial Report 2020

For the year ended December 31, 2020

Enriching lives,
in harmony with nature.

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 to respond to changing times during our more than 130 years of doing business, mainly in the domains of cleanliness, beauty and health. 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, while also endeavoring 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.

In 2009, we set forth our Environmental Statement to be a positive force for nature as well as for humankind, then went one step further with the aim of enriching lives in harmony with nature. In 2019, we announced our new ESG strategy, the "Kirei[1] Lifestyle Plan (KLP)," and declared our commitment to shifting to ESG-driven management.

Now, however, crises are impinging on human lives, which are the cornerstone for realizing the "enrichment of the lives of people" set forth in our mission. These threats are expected to continue jeopardizing the foundations of everyday lives.

Under these circumstances, we will tackle this pressing social issue with an approach unique to Kao. With a strong determination to protect not only everyday lives and ecology, but also human lives, the Kao Group will become a company that saves future lives. Under our K25 basic principles toward 2030, "*Kirei*—Making Life Beautiful," we will help to maintain the planet as a sustainable and clean place to live, to achieve a sustainable and prosperous society, and to protect people from hazards so they can enjoy their everyday lives.

These efforts will lead to an ongoing cycle of positive financial results and returns to stakeholders. The Kao Group will continue working to enhance its corporate value at a higher level.

1. The Japanese word "*kirei*" describes something that is clean, well-ordered and beautiful, all at the same time. For Kao, this concept of *kirei* not only describes appearance, but also attitude—to seek to create beauty for oneself, and also for other people and for the natural world around us. At Kao, *kirei* is the value we want to bring to everyday life through our brands, products and services—now and in the future.

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

Long-term Management Strategy

As its commitment to becoming the company it wants to be by 2030, the Kao Group is taking a step forward from its previous aim of "making Kao a company with a global presence" by realizing sustained profitable growth while contributing to the sustainability of the world to aiming to "make Kao a company with a global presence, valuable to society." Through ESG initiatives, we will become a valuable presence for people, society and the planet.

For the environment (E), we aim for zero waste and carbon zero. For society (S), we will promote one and only personalization that is closely attuned to people in the hope of ending wasteful consumption. Then, while ensuring effective governance (G), we will proceed as one team with "*Integrity*[2]", joined by like-minded parties. Following a management guideline of "Maximum with minimum"—generating the maximum value with the minimum resources—we will continue our growth to help create a better tomorrow.

Targets for 2030

Make Kao a company with a global presence, valuable to society

- Become an essential company in a sustainable world
- A highly profitable global company that also significantly contributes to society
- Returns to stakeholders according to levels of growth

Financial targets (as a result)

- ¥2.5 trillion in net sales
- ¥400 billion in operating income
- 41 consecutive years of increases in cash dividends

2. *Integrity* is one of the values of the Kao Way, the corporate philosophy of the Kao Group.

Mid-term Business Plan

The five years from 2021 to 2025 are an important period for the Kao Group to establish the foundation for becoming the company it wants to be by 2030. To that end, the Kao Group Mid-term Plan 2025 "K25" establishes a vision of "Sustainability as the only path" and sets forth three objectives.

To become an essential company in a sustainable world, we must actively promote KLP, the new ESG strategy we announced in 2019, and take leadership in a self-sufficient, sustainable society that curtails the generation of waste to the greatest extent possible. Moreover, we will ensure that our investments for KLP are reflected in future earnings.

By transforming to build robust business through investment, we will create "Another Kao." For people facing compelling problems, we will fully utilize the technologies and expertise we have cultivated as well as our digital transformation (DX) to create new businesses that "save future lives." At the same time, we will further reinforce our current business, which serves as the foundation of this new business, revitalizing it as "Reborn Kao."

Furthermore, to achieve these two objectives, the vitality of our employees is indispensable. Therefore, for our third objective—to maximize the power and potential of employees—we will newly implement an Objectives and Key Results (OKR) employee empowerment system in January 2021 so that all employees can give their utmost to achieving the substantial goals they set for themselves. We will also proactively open positions to talent from outside the Kao Group and promote external collaboration.

Achieving these three objectives will enable us to achieve our targets for record-high sales and profits (¥1.8 trillion in net sales, ¥250 billion in operating income and the 36th consecutive fiscal year of increases in cash dividends in 2025), and to make high-level returns, according to the level of our growth, to our many stakeholders, including employees, consumers, customers, business partners and shareholders.

While continuing to practice the "*Integrity*" set forth in the Kao Way, the Kao Group will achieve these objectives together with like-minded stakeholders, and in so doing create a better tomorrow.

Kao Group Mid-term Plan 2025 "K25"

- Vision
  Sustainability as the only path
- Concept
  Kirei—Making Life Beautiful
- Policy (Objectives)

Objective (1) Become an essential company in a sustainable world

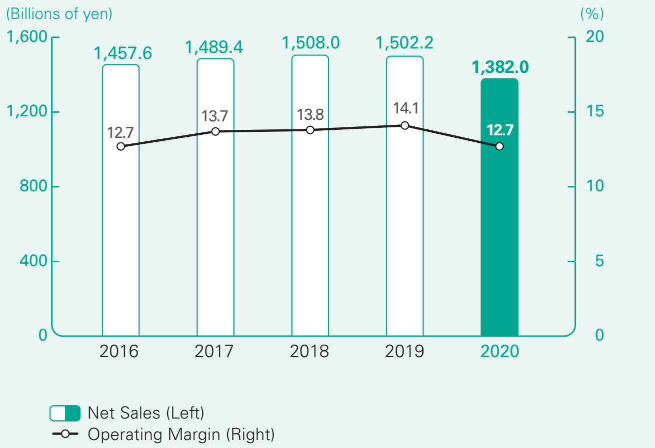
Goal

Take leadership in a self-sufficient, sustainable society (ESG Investment = Reflection of future earnings)

Key Results

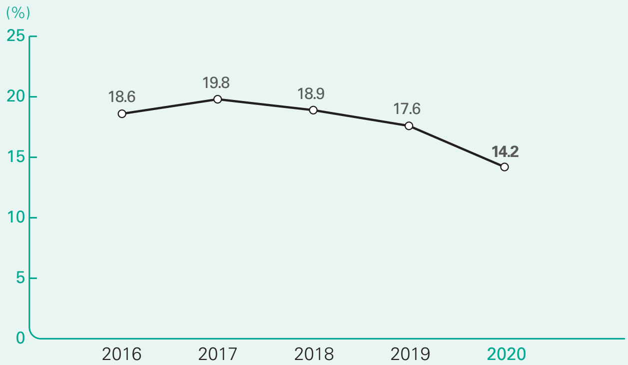
- Carbon recycling (Conversion of carbon dioxide into raw materials)
- Positive recycling (Creation of new business through re-use)
- Stop pandemic (Eradicate the source of infectious diseases)

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. In fiscal 2020, the Kao Group changed its method of recognizing sales for certain transactions from the gross amount to the net amount.

ROE



Objective (2) Transform to build robust business through investment

Goal

Create "Another Kao" and reinforce current Kao (Expand global business by focusing on saving lives)

Key Results

- New business: Launch digital and precision healthcare business (high-precision bioanalysis and homeostasis enhancement solution)
- Current business: Invest in outstanding products and expand business
- Cosmetics business and sanitary business: Pursue next innovation

Objective (3) Maximize the power and potential of employees

Goal

Double the productivity of our business activities (Make challenges visible and pursue open innovation)

Key Results

- Fair compensation according to challenge and contribution (implementation of OKR globally)
- Active promotion of talent from outside Kao and doubling the results of collaboration
- Reform to become "digital Kao" to be completed by 2023

Management Metric Used as a Target

As its principal management metric, the Kao Group uses EVA[3], 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.

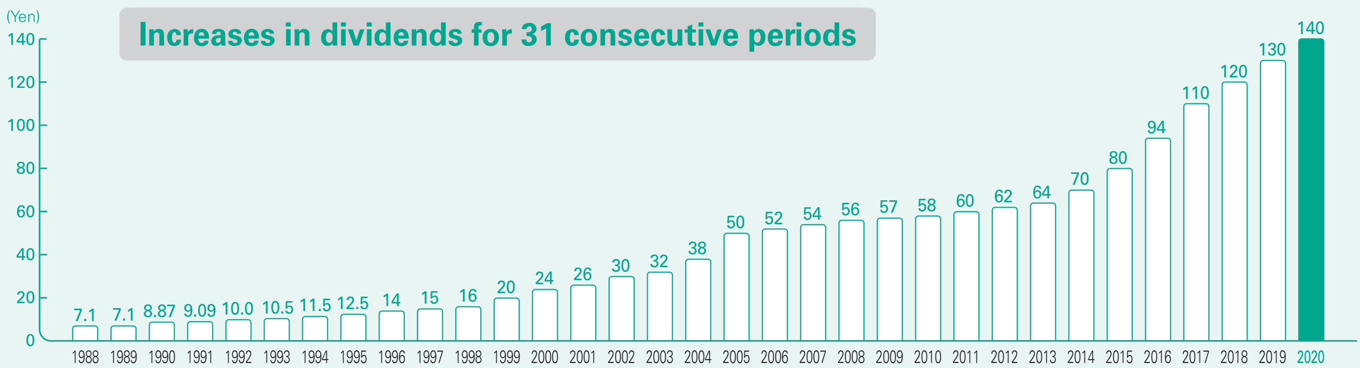
3. EVA is a registered trademark of Stern Stewart & Co.

Issues for Management

Infectious diseases are spreading widely around the world and environmental issues in areas such as climate change, water and forest resources are becoming more serious. Moreover, the importance of efforts for human rights is growing, and market structure and consumer attitudes are changing considerably together with growing social issues such as Japan's aging society. In this significantly changing business environment, with doubts about the continuance of the sustainable society itself, the Kao Group considers sustainable corporate growth to be difficult using only its current business model.

Reducing shortages as much as possible and avoiding lost opportunities during purchasing leads to stable business performance, but on the other hand, it is a cause of over-

Cash Dividends per Share



Note: Impact of share splits is reflected retroactively.

procurement and excess inventory. In addition, an excessive focus on meeting customer needs for consumption makes a company likely to opt for a wide-ranging lineup with short-term product revisions, discontinuances and other measures, causing some products to be discarded without ever being used. This outcome is a negative factor for environmental conservation.

To lead to a resolution of this issue, we must urgently build a consumption cycle model for achieving a sustainable society. Through *Yoki-Monozukuri*[4] of products that can be regularly used as long as possible, we will establish a new business model that neither makes nor delivers useless items.

Furthermore, we believe that we have not yet established the value of our existence for a sustainable society globally. We must take on new challenges to realize the Kao Group's Mission" to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world." We aim to lead the world in offering ESG-oriented products and services as we continue to grow centered on these offerings, while also becoming a leading company that contributes to the businesses of numerous other companies.

Achieving this goal will require a unique co-creation platform in addition to new businesses. To that end, we believe that the extensive fundamental research that has supported our product development research will serve as an engine for the Kao Group. In particular, fundamental research into matters such as the properties, variations, transmission, elimination and prevention of things that are harmful to people and the environment will surely significantly benefit society in the future. Now, as the world faces a crisis, we are determined to focus on helping to resolve compelling social issues.

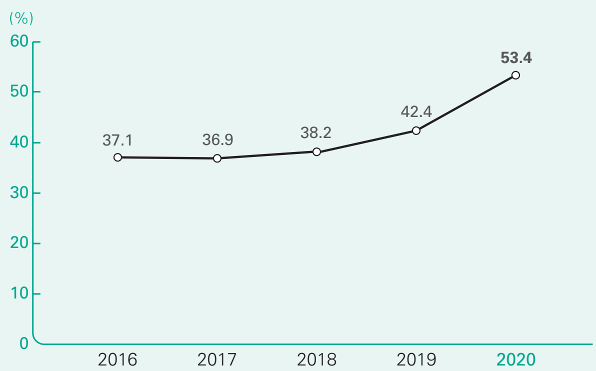
The Kao Group Mid-term Plan 2025 "K25" is crucial for building the business foundation that will be essential for resolving these issues to become the company we want to be by 2030. The Kao Group will continue to take on the challenge of helping to resolve major issues such as these.

4. 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."

Costs, Expenses and Income as Percentages of Net Sales

Years ended December 31, 2020, 2019 and 2018	2020	2019	2018
Cost of sales	57.3%	56.5%	56.6%
Gross profit	42.7	43.5	43.4
Selling, general and administrative expenses	30.1	29.5	29.5
Operating income	12.7	14.1	13.8
Income before income taxes	12.6	14.0	13.7
Net income attributable to owners of the parent	9.1	9.9	10.2

Payout Ratio



Basic Approach to Selection of Accounting Standards

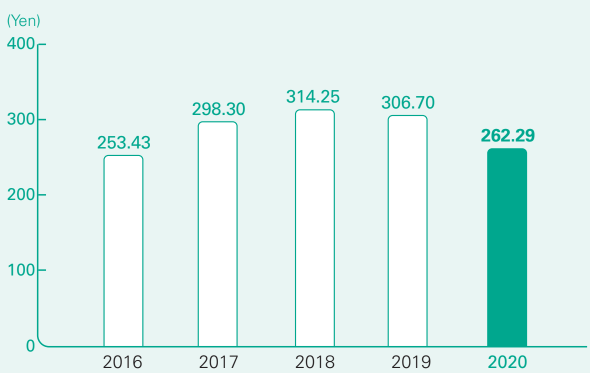
Having decided that unifying accounting standards within the Kao Group will contribute to improving the quality of its business management, the Kao Group has voluntarily adopted International Financial Reporting Standards (IFRS) from fiscal 2016. This enables management based on standardized procedures 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.

Overview of Consolidated Results

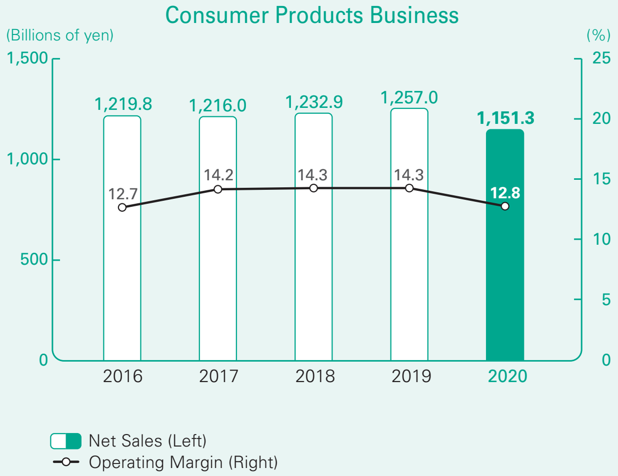
In fiscal 2020, the novel coronavirus (COVID-19) pandemic had a major impact on people's lives and corporate activities worldwide. The Kao Group has been rallying its comprehensive strength in striving to provide products, services and information to contribute to the daily lives and safety of people around the world. Due to heightened awareness of hygiene, demand rose for hand soaps, hand sanitizers and home care products in general, resulting in growth in sales and profits compared with the previous fiscal year, mainly in Japan. On the other hand, sales and profits in the Cosmetics Business decreased substantially in Japan as inbound demand disappeared and the market contracted significantly, due in part to the impact of people voluntarily refraining from going outside. Outside Japan, the Kao Group was affected by mandated temporary store closures and restrictions on going outside all over the world except China, and also incurred extra expenses to respond to the pandemic, resulting in an overall decrease in consolidated financial results compared with the previous fiscal year.

In the Kao Group's key markets, according to retail sales and consumer purchasing survey data, the cosmetics market in Japan shrank significantly from the previous year due to a substantial decline in inbound demand and people's voluntary restraint in going outside. On the other hand, the household and personal care products market grew because of a substantial increase in demand for hygiene-related products, among other factors. 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 5 points compared with the previous fiscal year.

Basic Earnings per Share



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. 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 fiscal 2020, the Kao Group changed its method of recognizing sales for certain transactions from the gross amount to the net amount.

Analysis of Income Statement

Net sales decreased 8.0% compared with the previous fiscal year to ¥1,382.0 billion. On a like-for-like basis, net sales decreased 5.2%. Operating income was ¥175.6 billion, a decrease of ¥36.2 billion compared with the previous fiscal year, the operating margin was 12.7% and income before income taxes was ¥174.0 billion, a decrease of ¥36.7 billion. Net income was ¥128.1 billion, a decrease of ¥22.3 billion.

Basic earnings per share were ¥262.29, a decrease of ¥44.41, or 14.5%, from ¥306.70 in the previous fiscal year.

In addition, 2020 was the final year of the Kao Group Mid-term Plan "K20", under which the Kao Group set and aimed to achieve the following three goals. The Kao Group was able to achieve all of its targets other than "continue to set new record highs for profits" and "like-for-like net sales CAGR* of +5% and operating margin of 15%" under "commitment to profitable growth."

- Commitment to fostering a distinctive corporate image
- Commitment to profitable growth
- Commitment to returns to stakeholders

* CAGR: Compound annual growth rate

Information by Segment

Consumer Products Business

Sales decreased 8.4% compared with the previous fiscal year to ¥1,151.3 billion. On a like-for-like basis, sales decreased 5.3%.

During fiscal 2020, business activities worldwide were substantially impacted by the COVID-19 pandemic.

In Japan, sales increased as demand for hygiene-related products grew, but Cosmetics Business sales decreased substantially. With additional factors including a change in the method of recognizing certain transactions from the gross amount to the net amount, sales decreased 9.9% to ¥811.0 billion. On a like-for-like basis, sales decreased 6.3%.

In Asia, sales decreased 2.9% to ¥200.3 billion. On a like-for-like basis, sales decreased 0.7%. In the Americas, sales decreased 5.9% to ¥83.6 billion. On a like-for-like basis, sales decreased 3.7%. In Europe, sales decreased 9.3% to ¥56.4 billion. On a like-for-like basis, sales decreased 8.8%.

Operating income decreased ¥32.7 billion compared with the previous fiscal year to ¥147.2 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 decreased 22.4% compared with the previous fiscal year to ¥234.1 billion. On a like-for-like basis, sales decreased 22.1%.

Cosmetics Business sales decreased substantially due to a significant decline in inbound demand, as well as the impact of mandated temporary store closures and regulations and other restrictions on going outside enacted around the world. In particular, sales of makeup products decreased, as wearing masks became common practice.

In Japan, in addition to the decrease in inbound demand, there was an impact from people voluntarily refraining from going outside and voluntary temporary retail store closures. Furthermore, the number of newly infected people began to rise again even after the declaration of a state of emergency in April, delaying market recovery. In Europe, mandated temporary store closures had a negative impact. In Asia, on the other hand, the Kao Group enhanced its e-commerce and other initiatives in China, where sales were steady for *freeplus*, which is hypoallergenic and contains Japanese and Chinese botanical extracts, and *Curél*, a derma care brand.

Operating income was ¥2.6 billion, a decrease of ¥38.8 billion from the previous fiscal year.

Skin Care and Hair Care Business

Sales decreased 9.3% compared with the previous fiscal year to ¥308.9 billion due to the change in the method of recognizing sales for certain transactions from the gross amount to the net amount, among other factors. On a like-for-like basis, sales increased 1.4%.

In skin care products, sales of *Bioré u* hand soap, hand sanitizer and other hygiene-related products increased due to the Kao Group's efforts to concentrate all its capabilities on meeting increased demand in Japan resulting from the pandemic.

Sales of hair care products decreased as sales of hair coloring products grew in Japan with increased opportunities for hair care at home as people voluntarily refrained from going outside, but sales of the business for hair salons in the Americas and Europe decreased due to mandated temporary salon closures by customers of the Kao Group, among other factors.

Operating income increased ¥1.3 billion compared with the previous fiscal year to ¥50.8 billion.

Human Health Care Business

Sales decreased 8.3% compared with the previous fiscal year to ¥234.0 billion. On a like-for-like basis, sales decreased 7.3%.

Sales of *Laurier* sanitary napkins in Japan remained basically unchanged from the previous fiscal year in a fluctuating market, with special demand but also fewer occasions for use because people voluntarily refrained from going outside. In Asia, sales grew substantially due to smooth progress of e-commerce initiatives in China.

Sales of *Merries* baby diapers grew steadily in Indonesia but decreased in both Japan and China.

Sales of personal health products decreased. Bath additives performed strongly due to demand from people spending more time at home, among other factors, but sales of oral care products declined due to intense competition.

Operating income decreased ¥4.3 billion compared with the previous fiscal year to ¥12.9 billion.

Fabric and Home Care Business

Sales increased 4.1% compared with the previous fiscal year to ¥374.4 billion. On a like-for-like basis, sales increased 4.5%.

In fabric care products in Japan, competition remained fierce in the markets for both laundry detergents and fabric softeners. Under these conditions, sales and market share of fabric care products held firm as the Kao Group launched new and improved laundry detergent products. Sales of home care products increased substantially as a result of enhanced promotion of antibacterial and anti-virus measures amid growing demand for hygiene-related products due to the pandemic. Sales of hygiene-related products also grew in Asia. In addition, sales of commercial-use products grew as the Kao Group substantially ramped up its production capacity for hand sanitizers to supply the food service industry including restaurants, as well as lodging facilities, medical institutions, nursing facilities and other locations where hygiene management is particularly necessary.

Operating income increased ¥9.1 billion compared with the previous fiscal year to ¥80.9 billion.

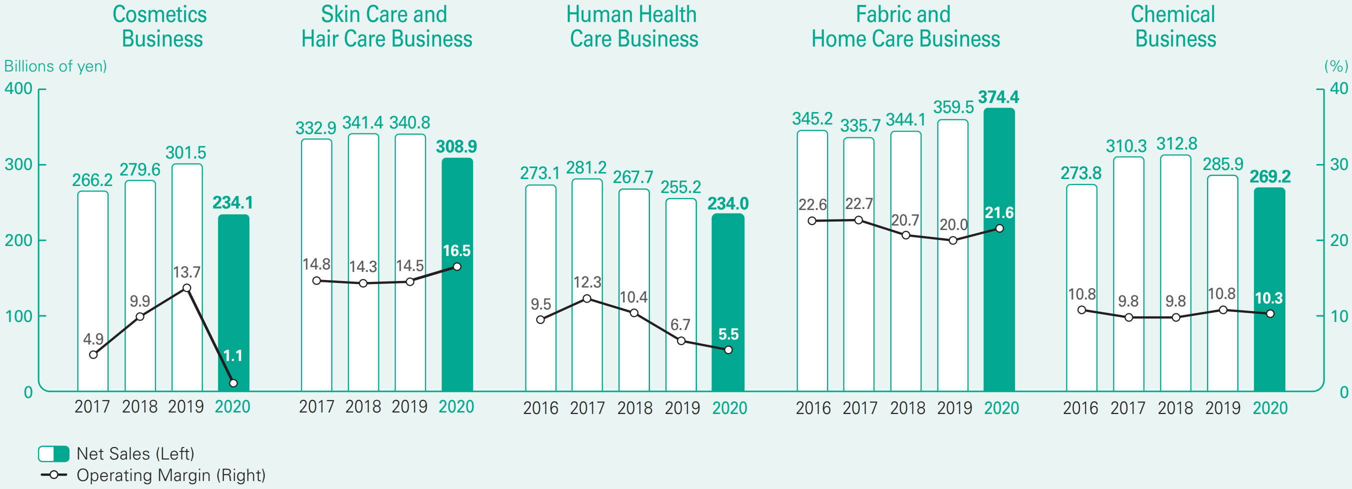
Chemical Business

Sales decreased 5.8% compared with the previous fiscal year to ¥269.2 billion. On a like-for-like basis, sales decreased 4.7%.

Amid a decline in demand for oleo chemicals due to the economic slowdown, sales of fat and oil derivative products for disinfection and cleaning were firm. Sales of performance chemicals decreased due to the ongoing impact of a decline in demand in automobile-related and other fields. Specialty chemicals were impacted by a slump in the market for toner and toner binder.

Operating income decreased ¥3.1 billion compared with the previous fiscal year to ¥27.7 billion.

Net Sales* / Operating Margin



* 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.
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. In fiscal 2020, the Kao Group changed its method of recognizing sales for certain transactions from the gross amount to the net amount.

Financial Position

Total assets increased ¥11.7 billion from December 31, 2019 to ¥1,665.6 billion. The principal increase in assets was a ¥63.5 billion increase in cash and cash equivalents. The principal decreases in assets were a ¥15.3 billion decrease in right-of-use assets and an ¥8.8 billion decrease in trade and other receivables.

Total liabilities decreased ¥55.1 billion from December 31, 2019 to ¥727.4 billion. The principal decreases in liabilities were a ¥28.7 billion decrease in retirement benefit liabilities, a ¥14.6 billion increase in lease liabilities and an ¥8.1 billion decrease in income tax payables.

Total equity increased ¥66.8 billion from December 31, 2019 to ¥938.2 billion. The principal increases in equity were net income totaling ¥128.1 billion and remeasurements of defined benefit plans totaling ¥16.4 billion. The principal decreases in equity were dividends totaling ¥66.2 billion and exchange differences on translation of foreign operations totaling ¥9.9 billion.

The ratio of equity attributable to owners of the parent to total assets was 55.5% compared with 51.9% at December 31, 2019. The Kao Group maintained return on equity at the high level of 14.2%.

Cash Flows

The balance of cash and cash equivalents at December 31, 2020 increased ¥63.5 billion compared with December 31, 2019 to ¥353.2 billion, including the effect of exchange rate changes.

Cash Flows from Operating Activities

Net cash flows from operating activities totaled ¥214.7 billion. The principal increases in net cash were income before income taxes of ¥174.0 billion and depreciation and amortization of ¥86.1 billion. The principal decreases in net cash were income taxes paid of ¥53.9 billion and a decrease in retirement benefit liabilities of ¥28.8 billion.

Cash Flows from Investing Activities

Net cash flows from investing activities totaled negative ¥61.9 billion. This primarily consisted of purchase of property, plant and equipment of ¥59.4 billion for capacity expansion at production bases in Japan and proactive capital investments in Asia, where growth is notable, and purchase of intangible assets totaling ¥10.5 billion.

Adjusted free cash flow, the sum of net cash flows from operating activities and net cash flows from investing activities less depreciation of right-of-use assets and other expenses, was ¥131.2 billion.

Cash Flows from Financing Activities

Net cash flows from financing activities totaled negative ¥87.1 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 2020, this primarily consisted of ¥66.2 billion for dividends paid to owners of the parent and non-controlling interests and ¥20.9 billion in repayments of lease liabilities. To maintain an appropriate cost of capital ratio and to reinforce its financial base for growth investments, the Company issues and redeems corporate bonds, which consisted of ¥24.9 billion in proceeds from issuance of bonds and ¥24.9 billion in redemption of bonds.

Basic Policies regarding Distribution of Profits and Dividends for the Fiscal Years Ended December 31, 2020 and Ending December 31, 2021

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 2020 of ¥70.00 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 ¥140 per share. The consolidated payout ratio will be 53.4%.

For fiscal 2021, the Company plans to pay total cash dividends of ¥144 per share (53.9% payout ratio), an increase of ¥4 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 32nd consecutive fiscal year of increases in dividends.

EVA and Related Activities

EVA for fiscal 2020 was ¥62.3 billion, a decrease of ¥25.1 billion compared with the previous fiscal year, due to decreases in operating income and net operating profit after tax (NOPAT) in addition to an increase in capital costs from the previous fiscal year.

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

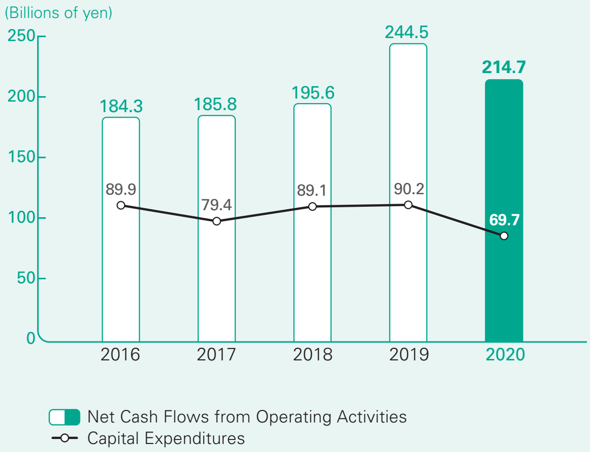
Investing for Growth: During fiscal 2020, the Kao Group's capital expenditures* totaled ¥69.7 billion, centered on investments for future growth. In the Consumer Products Business, the Kao Group carried out activities including investment in facilities to manufacture new products, streamlining, maintenance and renewal of facilities, and upgrading of distribution bases, in addition to expanding production capacity, mainly in Japan and Asia. In the Chemical Business, the Kao Group also invested aggressively in facilities to expand production capacity for fat and oil derivatives and other products, inside and outside Japan. Research and development expenditures were ¥58.5 billion, equivalent to 4.2% of net sales, remaining at a high level relative to net sales.

* Excluding right-of-use assets

Increasing Profit: In the Consumer Products Business, demand for hygiene-related products increased due to the COVID-19 pandemic, but operating income decreased due to factors including a slump in the Cosmetics Business in Japan. In the Chemical Business, sales were firm for fat and oil derivative products for disinfection and cleaning, but operating income decreased due to a slump in imaging materials and other products.

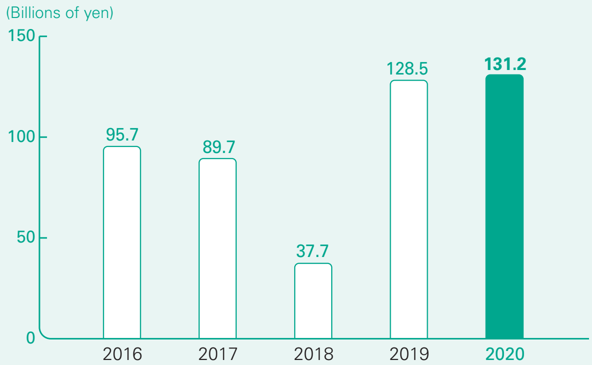
Financial Improvement: For fiscal 2020, the Company paid annual dividends per share of ¥140.00, a year-on-year increase of ¥10.00, or 8%, as announced in its forecast at the beginning of the fiscal year. As a result, the Company has achieved 31 consecutive fiscal periods of dividend growth.

Net Cash Flows from Operating Activities / Capital Expenditures*



* Excluding right-of-use assets from fiscal 2019

Free Cash Flows



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

R&D Expenses

(Billions of yen)

	2020
Cosmetics Business	10.5
Skin Care and Hair Care Business	15.7
Human Health Care Business	11.9
Fabric and Home Care Business	10.2
Chemical Business	10.4

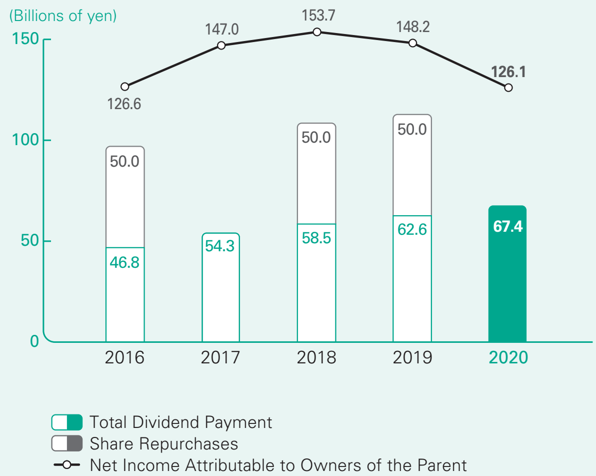
Business Risks and Other Risks

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. In addition, the Group is conducting initiatives under the Kao Group Mid-term Plan 2025 "K25," which establishes a Vision of "Sustainability as the only path" and sets forth three objectives: (1) Become an essential company in a sustainable world; (2) Transform to build robust business through investment; and (3) Maximize the power and potential of employees.

However, with the global spread of COVID-19, intensifying market competition, a changing market structure and volatility in raw material market conditions and exchange rates, the Kao Group's business environment remains uncertain. The COVID-19 pandemic has brought about changes in the attitudes of consumers regarding the environment, health, hygiene and other matters and associated changes in their purchasing attitudes. 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 Earth. To do so, it manages the following risks and crises.

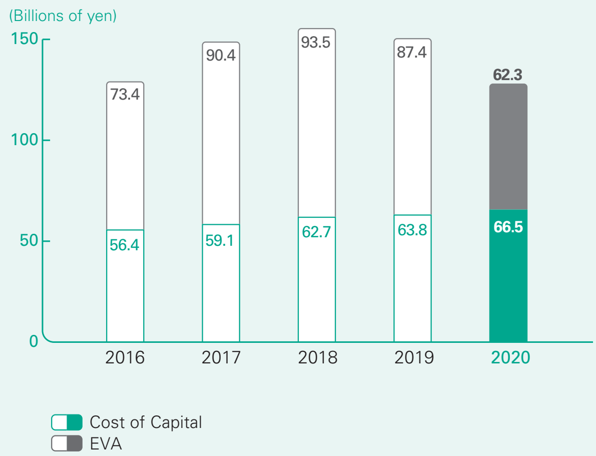
The Kao Group defines a potential negative impact on its management targets and business activities as a "risk" and the materialization of such risk as a "crisis." The Risk and Crisis Management Committee has established a system and activity guideline for risk and crisis management based on the Kao 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 harm to people and property by establishing an Emergency Response Team Organization that corresponds to the level of emergency and responding promptly and appropriately.

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



After deliberation by the Risk and Crisis Management Committee and the Management Committee, the Kao Group has selected the following 14 particularly significant risks as the main risks that have a negative impact on its sustained profitable growth and 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 selects 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 materialize within five years as recognized as of the fiscal year ended December 31, 2020. In addition, there are risks other than the listed risks that may affect investors' decisions.

<table>
<tr><th>Details of Main Risks</th><th>Main Initiatives</th></tr>
<tr><td>
Risks related to the Novel Coronavirus Pandemic

The global spread of COVID-19 is having a significant impact on the global economy, including delays in raw material procurement, manufacturing, distribution and other areas, immigration restrictions imposed in each country and region, restrictions on going outside and mandated temporary store closures. The COVID-19 pandemic has been recurring, with second and third waves in many countries and regions. The uncertain business environment is expected to continue, with years required for the impact of COVID-19 to be reduced through the introduction of vaccines and other measures, and for the global economy to recover.

Under these circumstances, in Japan, which is the Kao Group's main market, the cosmetics market shrank significantly from the previous year due to the impact of factors including a substantial decline in inbound demand and people's voluntary restraint in going outside, while the household and personal care products market has grown due to increased demand for hygiene-related products. The COVID-19 pandemic has caused changes in people's awareness of hygiene, and changes in values regarding makeup and related products as people have voluntarily refrained from going outside and wearing masks has become common practice. It has caused changes in consumer behavior including a rapid increase in the use of e-commerce.

Risks associated with the COVID-19 pandemic and related changes in people's behavior are as follows. Inability to take appropriate measures could cause net sales and profits to deviate significantly from targets.
· Temporary suspension of operations or obstacles to providing products and services due to multiple infections (clusters) at the Kao Group's bases or in its supply chains
· Delays in product development and launch plans due to a resurgence or prolongation of infections, because of work that cannot be performed remotely
· Delays in the recovery of the Cosmetics Business or other businesses due to a resurgence or prolongation of infections
· Inadequate response to changes in people's awareness and values, and changes in consumer behavior
</td><td>
In response to COVID-19, the Kao Group held a meeting of the Emergency Response Team Headquarters headed by the President and CEO to decide on Group-wide policies regarding (1) ensuring the safety of employees and their families, (2) continuity of business activities, and (3) contributions to society, and took the following actions. In addition, these actions have been reported to the Board of Directors.

(1) Ensuring the safety of employees and their families
· As crisis management measures, followed national and local government policies, and implemented work systems and styles compatible with the status of infection in each country and region (promotion of remote work/teleworking, restrictions on business trips, restrictions on training/events/tours, etc.)
· Identified the status of infected employees and family members or those who have been in close contact with infected persons, and implemented care as applicable, and measures to prevent the occurrence of clusters
· Launched the Infectious Disease Risk Assessment Project to reinforce infection prevention measures in the workplace and at home

(2) Continuity of business activities
· To maintain the supply chain, implemented higher-level infection control measures at production sites and rolled them out to subcontractors and other related parties, in addition to conducting relevant activities for raw material procurement
· Enhanced information systems for remote work and promoted digitalization of operations
· Reviewed Group systems for new work styles
· Formulated and implemented a business strategy for dealing with COVID-19 (main response initiatives related to the Cosmetics Business are presented in "Risks related to Changes in the Retailing Environment")

(3) Contributions to society
· Provided a continuous supply of hygiene-related products for cleanliness and worry-free daily life
· Increased production of alcohol disinfectants to 20 times the previous level and supplied them on a priority basis to medical institutions, nursing facilities and other locations with urgent needs
· Through its website, provided information on hygiene in daily life, based on the knowledge of experts and its own know-how. Also, for hygiene researchers, medical professionals, public health nurses working at educational institutions and other professionals, provided a wide range of information, including expert knowledge on measures for preventing the spread of infection based on academic papers
· Contributed to the development of therapies and diagnostic tools for COVID-19, including the discovery of VHH antibodies that can be expected to inhibit infection

• Main Corporate Risk Themes and Countermeasures
Pandemics: The Kao Group implemented the above measures by applying to COVID-19 the guidelines and action plans it had been considering for responding to global pandemics of new strains of influenza and other diseases.
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</table>

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. Moreover, the global spread of COVID-19 is further heightening these trends. 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, making 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 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, while steadily conducting initiatives, the Kao Group is working proactively to disclose these initiatives to stakeholders in order to demonstrate their results at an early stage. 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 contribute to better lives for consumers and 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.
Risks related to Changes in the Retailing Environment	
The retailing environment in which the Kao Group operates is changing significantly. The growth of E-commerce is accelerating due to the COVID-19 situation, and brick-and-mortar retailers are also responding to this changing environment based on discrete strategies such as combinations of offline and online retailing and mergers or integrations across business formats. 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. Changes in the market environment due to COVID-19 have also had a significant impact on the retail industry. If response to the disappearance of inbound demand and the shrinking cosmetics market is inadequate, targets for 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 promoting the evolution of its digital marketing activities. Going forward, the Kao Group will further promote digital transformation (DX) and new initiatives such as D2C.* The Kao Group will also promote co-creation initiatives with retailers to meet cosmetics needs through non-contact methods such as online counseling and live commerce, and to respond to growing hygiene-related demand. * D2C (Direct to Consumer) A business model for selling directly to consumers through a company's own E-commerce site
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, in each country or region, in addition to the impact of COVID-19, in the course of business there is the possibility of events arising including a slowdown in economic growth, political or social instability, problems at retail outlets, agents or other business partners, sudden changes in laws, regulations or tax systems, a spate of counterfeit products, or reputation risk.* If there is a substantial delay in the implementation of business plans due to the impact of these events, 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 related to environmental laws and regulations outside Japan: Among changes in laws and regulations outside Japan, the Kao Group pays particular attention to the risk of inability to adapt to changes in environmental laws and regulations that lead to the suspension of business and operations. In this regard, the Kao Group strengthened its monitoring and response system in China using an external specialist organization to address the impact of a sudden change in environmental laws and regulations on its local plants and major suppliers.

Details of Main Risks	Main Initiatives
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.
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, 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 proliferation of incorrect methods of use of hygiene-related products during the COVID-19 pandemic and the risk of product incidents involving the elderly are increasing. In addition, there are changes in laws and regulations in each country as well as growing requirements for contribution to the resolution of safety and environmental issues and transparency in relation to product ingredients, safety and other matters. Furthermore, product retailing at an international level is increasing due to globalization, and product quality management activities and response to consumers may become inadequate.	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 Customer Communication Center. In addition, to respond to changes in risks relating to product quality management, the Kao Group is enhancing its communication of information through product FAQs and other methods to disseminate correct methods of use; improving product satisfaction for diverse customers by promoting universal design and by providing multilingual information; 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; increasing reliability by promoting visualization of product quality management activities and by engaging in communication with all stakeholders; and building a system capable of promptly confirming compliance with the laws and regulations of each country, introducing a mechanism for centralized collection of consumer feedback across countries and regions and implementing other measures to enhance quality management activities on a global scale. • Main Corporate Risk Themes and Countermeasures Risk of occurrence of serious product quality issues: The Kao Group is strengthening its Group-wide response in the event serious damage occurs due to product quality issues and is enhancing awareness within the Group to prevent the occurrence of such issues.
Risks related to Large-scale Earthquakes, Other Natural Disasters and Accidents For companies with 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 major obstruction to the supply of products to the market due to injury to employees or damage to facilities or supply chains resulting from a large-scale earthquake or other natural disaster such as a large-scale typhoon or flood brought on by climate change could have a significant impact on business results. In addition, the occurrence of substantial injury to employees or damage to the surrounding area due to events such as a fire or explosion at a plant of the Kao Group 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 Organization headed by the President and CEO. • Main Corporate Risk Themes and Countermeasures Large-scale earthquakes and other natural disasters: In response to recent large-scale typhoons, floods and other natural disasters brought on by climate change, the Kao Group conducted flood risk surveys at each site, stepped up countermeasures in both physical and intangible terms and carried out disaster prevention education for employees regarding hazard maps and evacuation. 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.

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 Risks related to cyberattacks and 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. In addition, while leading lives of voluntarily refraining from going outside due to the COVID-19 pandemic, a wide range of people, regardless of age or gender, have come to use SNS in search of extensive information and connections. However, SNS comments also include negative evaluations and comments about companies, and there are concerns about an increase in reputation risk through their dissemination that could inflict financial or non-financial loss from a decline in brand value and corporate credibility. The Kao Group expects to continue increasing communication of various information and brand marketing activities using SNS. However, the spread through SNS of inappropriate expressions in the advertisements or other publications of the 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.	From the perspective of ESG, the Kao Group is establishing a pre-check system and conducting internal education as measures to prevent 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 a reputation risk incident occurs that adversely affects business and brand activities, the Kao Group responds promptly and strives to maintain its reputation by publicly announcing information, its corporate stance and other matters, as necessary, at the appropriate time. • Main Corporate Risk Themes and Countermeasures Reputation risk: The Kao Group has established a system for monitoring SNS and other external information and is further strengthening its emergency response system in the event a reputation risk incident occurs. Risks associated with the use of digital media: The Kao Group established a pre-check system, enhanced internal education and conducted a review of guidelines and other matters for risks that could become reputation risks, such as inappropriate expressions and stealth marketing in advertisements, and promoted the establishment of advertisement distribution tools for improving and maintaining brand value.
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 inadequate 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, establishment of an auditing system to eliminate compliance violations by suppliers, and the CDP Supply Chain Program. In addition, with the aim of building a sustainable supply chain for palm oil, in 2020 the Kao Group began a program in cooperation with local partners to help oil palm smallholders in Indonesia improve yields and acquire sustainable palm oil certification. The Kao Group strives to disclose these initiatives to its stakeholders proactively and transparently.

Details of Main Risks	Main Initiatives
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 immediate reporting to management and an appropriate response in the event that a serious violation of compliance occurs.
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. In addition, COVID-19 is having a significant impact in areas such as people's values and working styles. 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 management 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. To maximize the power and potential of employees, the Kao Group will further develop its cultivation of a corporate culture in which employees are willing to take on challenges, and further promote diverse work styles.
Risks related to Currency Exchange Rate Fluctuations The Kao Group also 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.
Risks related to Litigation During the fiscal year ended December 31, 2020, 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, 2020

(Millions of yen)

Assets	Notes	2020	2019
Current assets			
Cash and cash equivalents	7, 33	353,176	289,681
Trade and other receivables	8, 33	200,087	208,839
Inventories	9	197,641	199,672
Other financial assets	33	7,257	13,788
Income tax receivables		2,085	2,440
Other current assets	10	18,150	22,606
Total current assets		778,396	737,026
Non-current assets			
Property, plant and equipment	11	430,914	436,831
Right-of-use assets	16	149,543	164,822
Goodwill	12	177,031	179,707
Intangible assets	12	48,256	47,770
Investments accounted for using the equity method	13	8,657	8,287
Other financial assets	33	23,608	26,104
Deferred tax assets	14	42,274	47,876
Other non-current assets	10, 18	6,937	5,496
Total non-current assets		887,220	916,893
Total assets		1,665,616	1,653,919

Liabilities and equity	Notes	2020	2019
Liabilities			
Current liabilities			
Trade and other payables	17, 33	215,842	222,314
Bonds and borrowings	15, 33	30,465	25,505
Lease liabilities	15, 16, 31, 33	19,787	19,653
Other financial liabilities	16, 33	6,571	6,766
Income tax payables		28,109	36,208
Provisions	19	1,811	2,054
Contract liabilities	24	23,098	20,616
Other current liabilities	20	99,721	99,411
Total current liabilities		425,404	432,527
Non-current liabilities			
Bonds and borrowings	15, 33	97,229	101,636
Lease liabilities	15, 16, 31, 33	126,725	141,438
Other financial liabilities	16, 33	7,862	7,527
Retirement benefit liabilities	18	51,858	80,579
Provisions	19	9,175	10,122
Deferred tax liabilities	14	4,584	3,747
Other non-current liabilities		4,585	4,922
Total non-current liabilities		302,018	349,971
Total liabilities		727,422	782,498
Equity			
Share capital	21	85,424	85,424
Capital surplus	21	106,618	108,715
Treasury shares	21	(3,865)	(4,309)
Other components of equity	21	(43,376)	(32,974)
Retained earnings	21	778,886	700,839
Equity attributable to owners of the parent		923,687	857,695
Non-controlling interests		14,507	13,726
Total equity		938,194	871,421
Total liabilities and equity		1,665,616	1,653,919

Consolidated Statement of Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2020

(Millions of yen)

	Notes	2020	2019
Net sales	6, 24	1,381,997	1,502,241
Cost of sales	9, 11, 12, 16, 18	(791,304)	(848,723)
Gross profit		590,693	653,518
Selling, general and administrative expenses	11, 12, 16, 18, 25	(415,826)	(442,912)
Other operating income	24, 26	15,801	15,192
Other operating expenses	11, 12, 16, 18, 27	(15,105)	(14,075)
Operating income	6	175,563	211,723
Financial income	6, 18, 28	1,711	2,027
Financial expenses	6, 16, 18, 28	(5,839)	(5,231)
Share of profit in investments accounted for using the equity method	6, 13	2,536	2,126
Income before income taxes	6	173,971	210,645
Income taxes	14	(45,904)	(60,296)
Net income		128,067	150,349
Attributable to:			
Owners of the parent		126,142	148,213
Non-controlling interests		1,925	2,136
Net income		128,067	150,349
Earnings per share			
Basic (Yen)	29	262.29	306.70
Diluted (Yen)	29	262.25	306.63

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2020

(Millions of yen)

	Notes	2020	2019
Net income		128,067	150,349
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	168	(6)
Remeasurements of defined benefit plans	30	16,365	(1,180)
Share of other comprehensive income of investments accounted for using the equity method	30	25	(17)
Total of items that will not be reclassified to profit or loss		16,558	(1,203)
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations	30	(9,942)	(2,489)
Share of other comprehensive income of investments accounted for using the equity method	30	(167)	(36)
Total of items that may be reclassified subsequently to profit or loss		(10,109)	(2,525)
Other comprehensive income, net of taxes		6,449	(3,728)
Comprehensive income		134,516	146,621
Attributable to:			
Owners of the parent		132,941	144,508
Non-controlling interests		1,575	2,113
Comprehensive income		134,516	146,621

Consolidated Statement of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2020

(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, 2020		85,424	108,715	(4,309)	448	(39,630)	—	6,208	—	(32,974)	700,839	857,695	13,726	871,421
Net income		—	—	—	—	—	—	—	—	—	126,142	126,142	1,925	128,067
Other comprehensive income		—	—	—	—	(9,738)	(0)	184	16,353	6,799	—	6,799	(350)	6,449
Comprehensive income		—	—	—	—	(9,738)	(0)	184	16,353	6,799	126,142	132,941	1,575	134,516
Disposal of treasury shares	21	—	(98)	471	(177)	—	—	—	—	(177)	(194)	2	—	2
Purchase of treasury shares	21	—	—	(27)	—	—	—	—	—	—	—	(27)	—	(27)
Share-based payment transactions	32	—	(394)	—	—	—	—	—	—	—	—	(394)	—	(394)
Dividends	23	—	—	—	—	—	—	—	—	—	(64,925)	(64,925)	(1,269)	(66,194)
Changes in the ownership interest in subsidiaries		—	(1,605)	—	—	—	—	—	—	—	—	(1,605)	475	(1,130)
Transfer from other components of equity to retained earnings		—	—	—	(3)	—	—	(668)	(16,353)	(17,024)	17,024	—	—	—
Total transactions with the owners		—	(2,097)	444	(180)	—	—	(668)	(16,353)	(17,201)	(48,095)	(66,949)	(794)	(67,743)
December 31, 2020		85,424	106,618	(3,865)	268	(49,368)	(0)	5,724	—	(43,376)	778,886	923,687	14,507	938,194

	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."

Consolidated Statement of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2020

(Millions of yen)

	Notes	2020	2019
Cash flows from operating activities			
Income before income taxes		173,971	210,645
Depreciation and amortization		86,080	83,369
Interest and dividend income		(1,571)	(1,885)
Interest expense		2,533	2,840
Share of profit in investments accounted for using the equity method		(2,536)	(2,126)
(Gains) losses on sale and disposal of property, plant and equipment, and intangible assets		3,301	3,323
(Increase) decrease in trade and other receivables		6,443	12,862
(Increase) decrease in inventories		646	(2,848)
Increase (decrease) in trade and other payables		(4,227)	696
Increase (decrease) in retirement benefit liabilities		(28,818)	(3,788)
Other		31,852	(2,936)
Subtotal		267,674	300,152
Interest received		1,516	1,711
Dividends received		2,060	2,146
Interest paid		(2,650)	(2,806)
Income taxes paid		(53,882)	(56,680)
Net cash flows from operating activities		214,718	244,523
Cash flows from investing activities			
Payments into time deposits		(14,053)	(35,188)
Proceeds from withdrawal of time deposits		19,661	36,660
Purchase of property, plant and equipment		(59,396)	(83,959)
Purchase of intangible assets		(10,454)	(9,819)
Other		2,301	(1,960)
Net cash flows from investing activities		(61,941)	(94,266)
Cash flows from financing activities			
Increase (decrease) in short-term borrowings		(41)	19
Proceeds from long-term borrowings		1,080	46,220
Repayments of long-term borrowings		(48)	(40,054)
Proceeds from issuance of bonds		24,939	—
Redemption of bonds		(24,942)	(12)
Repayments of lease liabilities	31	(20,912)	(20,565)
Purchase of treasury shares		(28)	(50,033)
Dividends paid to owners of the parent		(64,987)	(60,512)
Dividends paid to non-controlling interests		(1,235)	(1,287)
Other		(891)	58
Net cash flows from financing activities		(87,065)	(126,166)
Net increase (decrease) in cash and cash equivalents		65,712	24,091
Cash and cash equivalents at the beginning of the year	7	289,681	265,978
Effect of exchange rate changes on cash and cash equivalents		(2,217)	(388)
Cash and cash equivalents at the end of the year	7	353,176	289,681

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Year ended December 31, 2020

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.

(4) Early Adoption of New or Revised Standards and Interpretations

The Group has early adopted amendment to IFRS 16 "Leases," "Covid-19-Related Rent Concessions" (issued in May 2020 in preparing its consolidated financial statements).

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

"Payments for business combinations," which was separately presented as an item within "Investing activities" for the fiscal year ended December 31, 2019, is included in "Other" for the fiscal year ended December 31, 2020 due to its immateriality. The consolidated financial statements for the fiscal year ended December 31, 2019 have been reclassified to reflect these changes in presentation.

Consequently, "Payments for business combinations," which was presented as a cash outflow of 195 million yen within "Investing activities" of the consolidated statement of cash flows for the fiscal year ended December 31, 2019, is reclassified to "Other."

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

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.

With the application of a practical expedient, rent concessions that are a direct consequence of the COVID-19 pandemic and meet specified conditions are accounted for as variable lease payments rather than being treated as lease modifications.

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

(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)

From the fiscal year ended December 31, 2020, the Group early adopted Amendment to IFRS 16 "Leases," "Covid-19-Related Rent Concessions" (issued in May 2020).

With the application of a practical expedient, rent concessions for leases of lessees that are a direct consequence of the COVID-19 pandemic and meet specified conditions are accounted for as variable lease payments rather than being treated as lease modifications.

Variable lease payments are included in selling, general and administrative expenses in the consolidated statement of income for the year ended December 31, 2020, but their impact is immaterial.

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.

Significant accounting estimates and judgments have been made in consideration of the impact of the COVID-19 pandemic. A consensus opinion on when the COVID-19 pandemic will subside has not been made public, and its impact may continue beyond the current fiscal year, but a gradual recovery in the future is assumed.

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

The impacts of 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, 2020 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, asphalt additives
		Specialty chemicals	Toner and toner binder for copiers and printers, ink and water-based pigment inkjet ink, fragrances and aroma chemicals

(2) Sales and Results of Reportable Segments

Fiscal year ended December 31, 2020 (Millions of yen)

	Reportable segments								
	Consumer Products Business								
	Cosmetics Business	Skin Care and Hair Care Business[5]	Human Health Care Business	Fabric and Home Care Business	Subtotal	Chemical Business	Total	Reconciliation[1]	Consolidated
Net sales									
Sales to customers	234,068	308,897	233,971	374,367	1,151,303	230,694	1,381,997	—	1,381,997
Intersegment sales and transfers[2]	—	—	—	—	—	38,517	38,517	(38,517)	—
Total net sales	234,068	308,897	233,971	374,367	1,151,303	269,211	1,420,514	(38,517)	1,381,997
Operating income	2,584	50,823	12,850	80,908	147,165	27,692	174,857	706	175,563
Financial income									1,711
Financial expenses									(5,839)
Share of profit in investments accounted for using the equity method									2,536
Income before income taxes									173,971
Other items									
Depreciation and amortization[3]	14,644	14,795	22,214	18,638	70,291	14,733	85,024	1,056	86,080
Capital expenditures[4]	13,366	16,284	16,487	23,831	69,968	14,619	84,587	1,562	86,149

Notes: 1. The operating income reconciliation of 706 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.
5. The Group changed its method of recognizing sales for certain transactions from the gross amount to the net amount.

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.

(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)

	2020	2019
Japan	853,628	947,096
Asia	284,114	293,388
Americas	128,721	137,819
Europe	115,534	123,938
Total	1,381,997	1,502,241

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)

	2020	2019
Japan	588,781	597,950
Asia	100,138	104,643
Americas	92,282	98,730
Europe	37,119	39,444
Total	818,320	840,767

7 Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

(Millions of yen)

	2020	2019
Cash and deposits	328,376	239,781
Short-term investments	24,800	49,900
Total	353,176	289,681

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)

	2020	2019
Trade receivables	195,483	204,322
Other receivables	6,647	6,179
Allowance for doubtful receivables	(2,043)	(1,662)
Total	200,087	208,839

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)

	2020	2019
Merchandise and finished goods	149,471	155,611
Work in progress	12,847	12,893
Materials and supplies	35,323	31,168
Total	197,641	199,672

The amount of inventories recognized as expenses and included in cost of sales for the fiscal years ended December 31, 2020 and 2019 were 668,508 million yen and 729,425 million yen, respectively.

Write-downs of inventories recognized as expenses for the fiscal years ended December 31, 2020 and 2019 were 7,457 million yen and 6,065 million yen, respectively.

10 Other Assets

Other assets consist of the following:

(Millions of yen)

	2020	2019
Other current assets		
Insurance receivable	376	521
Prepaid expenses	7,892	8,587
Other	9,882	13,498
Total	18,150	22,606
Other non-current assets		
Insurance receivable	1,721	2,263
Long-term prepaid expenses	1,522	472
Retirement benefit assets	3,018	2,146
Other	676	615
Total	6,937	5,496

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, 2019	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
Additions	356	240	508	20	58,059	59,183
Sales and disposals	(2,034)	(14,680)	(8,968)	—	(5)	(25,687)
Reclassification	19,967	31,120	10,902	3,210	(65,199)	—
Exchange differences on translation of foreign operations	(1,170)	(5,054)	(343)	(473)	(543)	(7,583)
Other	(159)	388	(456)	—	247	20
December 31, 2020	450,746	773,325	127,052	82,268	34,314	1,467,705

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, 2019	300,433	582,438	93,839	10,320	—	987,030
Changes in accounting policy[1]	(9,434)	(27)	(9)	—	—	(9,470)
January 1, 2019 (after adjustment)	290,999	582,411	93,830	10,320	—	977,560
Depreciation[2]	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
Depreciation[2]	13,760	33,583	12,344	—	—	59,687
Sales and disposals	(1,818)	(13,891)	(8,650)	—	—	(24,359)
Exchange differences on translation of foreign operations	(395)	(3,181)	(287)	—	—	(3,863)
Other	159	498	(272)	—	—	385
December 31, 2020	312,459	614,058	99,954	10,320	—	1,036,791

Notes: 1. It represents the financial effect from the adoption of IFRS 16 "Leases."
2. 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.

Carrying Amount (Millions of yen)

	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2019	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
December 31, 2020	138,287	159,267	27,098	71,948	34,314	430,914

(2) 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.

(3) 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, 2019	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
Additions	—	102	—	—	10,368	10,470
Sales and disposals	—	(5,786)	—	—	(16)	(5,802)
Reclassification	—	7,788	—	—	(7,788)	—
Exchange differences on translation of foreign operations	(2,676)	43	(751)	(621)	(84)	(1,413)
Other	—	26	—	—	(71)	(45)
December 31, 2020	177,031	33,459	13,749	12,613	9,958	69,779

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

Accumulated Amortization and Accumulated Impairment Losses (Millions of yen)

		Intangible assets				
	Goodwill	Software	Trademarks	Customer relationships	Other	Total
January 1, 2019	—	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
Amortization[1]	—	6,896	750	737	307	8,690
Sales and disposals	—	(5,783)	—	—	(16)	(5,799)
Exchange differences on translation of foreign operations	—	43	(103)	(67)	(46)	(173)
Other	—	10	—	—	(4)	6
December 31, 2020	—	16,432	2,136	1,926	1,029	21,523

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)

		Intangible assets				
	Goodwill	Software	Trademarks	Customer relationships	Other	Total
January 1, 2019	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
December 31, 2020	177,031	17,027	11,613	10,687	8,929	48,256

(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)

	2020	2019
Cosmetics Business	130,398	130,605
Kanebo Cosmetics Group	119,400	119,400
Molton Brown Group	10,998	11,205
Skin Care and Hair Care Business	26,968	28,412
Oribe Hair Care and other	23,303	24,545
Other	3,665	3,867
Fabric and Home Care Business	17,219	18,160
Chemical Business	2,446	2,530
Total	177,031	179,707

(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 for the Cosmetics Business that reflect past performance and forecasts. These medium-term plans include information on sales by region and brand. 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 7.3% for the fiscal year ended December 31, 2020 and 6.8% for the fiscal year ended December 31, 2019. For the fiscal year ended December 31, 2020 and 2019, 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)

	2020	2019
Investments accounted for using the equity method	8,657	8,287

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)

	2020	2019
The Group's share of net income	2,536	2,126
The Group's share of other comprehensive income	(142)	(53)
The Group's share of comprehensive income	2,394	2,073

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, 2020 (Millions of yen)

	January 1, 2020	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2020
Deferred tax assets					
Property, plant and equipment and intangible assets	20,715	1,220	—	(76)	21,859
Lease liabilities	46,026	(2,917)	—	(730)	42,379
Retirement benefit liabilities	21,419	(1,395)	(6,888)	52	13,188
Accrued expenses	10,240	800	—	(4)	11,036
Unused tax losses	387	804	—	(1)	1,190
Other	16,005	(983)	—	80	15,102
Total deferred tax liabilities	114,792	(2,471)	(6,888)	(679)	104,754
Deferred tax liabilities					
Property, plant and equipment and intangible assets	9,948	462	—	(262)	10,148
Right-of-use assets	45,926	(3,324)	—	(638)	41,964
Financial assets	2,516	—	97	(294)	2,319
Undistributed foreign earnings	11,533	(474)	—	—	11,059
Other	740	609	133	92	1,574
Total deferred tax liabilities	70,663	(2,727)	230	(1,102)	67,064
Deferred tax assets, net	44,129	256	(7,118)	423	37,690

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."

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

(Millions of yen)

	2020	2019
Deferred tax assets	42,274	47,876
Deferred tax liabilities	4,584	3,747
Deferred tax assets, net	37,690	44,129

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

(Millions of yen)

	2020	2019
Unused tax losses	2,434	2,687
Deductible temporary differences	12,037	11,879
Total	14,471	14,566

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

(Millions of yen)

	2020	2019
Not later than 1 year	465	343
Later than 1 year and not later than 2 years	291	458
Later than 2 years and not later than 3 years	520	288
Later than 3 years and not later than 4 years	388	493
Later than 4 years	770	1,105
Total	2,434	2,687

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, 2020 and 2019 were 15,353 million yen and 13,648 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)

	2020	2019
Current taxes	46,160	58,540
Deferred taxes[1]	(256)	1,756
Total	45,904	60,296

Note: 1. Deferred taxes include 145 million yen and 79 million yen for the fiscal years ended December 31, 2020 and 2019, 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:

(%)

	2020	2019
Effective statutory tax rate	30.62	30.62
Tax credit for experimental research costs and other	(2.24)	(1.90)
Different tax rates applied to subsidiaries	(1.81)	(1.42)
Reassessment of recoverability of unused tax losses and deferred tax assets	0.15	0.69
Change in tax rates	0.08	0.04
Other	(0.41)	0.59
Average actual tax rate	26.39	28.62

15 Bonds and Borrowings and Other

Bonds and borrowings and lease liabilities consist of the following:

(Millions of yen)

	2020	2019	Average interest rate[1] (%)	Maturity
Short-term borrowings	408	450	1.19	—
Current portion of long-term borrowings	30,045	48	0.11	—
Long-term borrowings	47,232	76,582	0.75	2022-2029
Current portion of bonds[2]	12	25,007	—	—
Bonds[2]	49,997	25,054	—	—
Lease liabilities (Current)	19,787	19,653	0.54	—
Lease liabilities (Non-current)	126,725	141,438	0.93	2022-2066
Total	274,206	288,232		
Current liabilities				
Bonds and borrowings	30,465	25,505		
Lease liabilities	19,787	19,653		
Subtotal	50,252	45,158		
Non-current liabilities				
Bonds and borrowings	97,229	101,636		
Lease liabilities	126,725	141,438		
Subtotal	223,954	243,074		
Total	274,206	288,232		

Notes: 1. The average interest rate is the weighted average interest rate on the balance as of December 31, 2020.
2. Details of bonds issued are as follows:

(Millions of yen)

Issuer	Bond name	Issue date	2020	2019	Interest rate (%)	Collateral	Maturity date
The Company	4th unsecured bonds	June 14, 2013	—	24,995	0.62	None	June 19, 2020
The Company	5th unsecured bonds	June 19, 2018	24,971	24,958	0.08	None	June 20, 2023
The Company	6th unsecured bonds	September 18, 2020	24,942	—	0.13	None	September 19, 2025
Subsidiaries	Other bonds	—	96	108	—	—	—
Total			50,009	50,061			

16 Leases

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)

	2020	2019
Depreciation charge for right-of-use assets[1]		
Buildings and structures	16,249	16,171
Other	1,454	1,671
Total	17,703	17,842
Interest expense on lease liabilities[2]	1,490	1,676
Expenses relating to short-term leases[3]	1,686	1,562
Other	669	907
Total	3,845	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 years ended December 31, 2020 and 2019 were 24,777 million yen and 24,722 million yen, respectively.
Carrying amount of right-of-use assets consists of the following:

(Millions of yen)

	2020	2019
Right-of-use assets		
Buildings and structures	141,728	156,965
Other	7,815	7,857
Total	149,543	164,822

Note 31 “Cash Flow Information” presents additions to right-of-use assets.
Note 33 “Financial Instruments” presents lease liabilities by maturity date.

17 Trade and Other Payables

Trade and other payables consist of the following:

(Millions of yen)

	2020	2019
Trade payables	137,680	144,864
Non-trade payables	78,162	77,450
Total	215,842	222,314

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)

	2020	2019
Present value of defined benefit obligations	351,077	362,080
Fair value of plan assets	(302,237)	(283,647)
Net defined benefit liabilities	48,840	78,433
Amounts recognized in consolidated statement of financial position		
Retirement benefit liabilities	51,858	80,579
Retirement benefit assets	(3,018)	(2,146)
Net defined benefit liabilities	48,840	78,433

2) Defined benefit obligations

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

(Millions of yen)

	2020	2019
The present value of the defined benefit obligations at beginning of year	362,080	342,130
Current service cost[1]	10,639	9,804
Interest expense[2]	2,209	2,710
Remeasurements		
Actuarial (gains) losses arising from changes in demographic assumptions	(337)	2,389
Actuarial (gains) losses arising from changes in financial assumptions	(8,622)	17,402
Actuarial (gains) losses arising from experience adjustments	399	365
Benefits paid[3]	(14,120)	(12,381)
Exchange differences on translation of foreign operations and other	(1,171)	(339)
The present value of the defined benefit obligations at end of year	351,077	362,080

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. The weighted average duration of the defined benefit obligations in Japan was mainly 17.2 years at December 31, 2020 and 18.0 years at December 31, 2019.

3) Plan assets

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

(Millions of yen)

	2020	2019
The fair value of plan assets at beginning of year	283,647	258,744
Interest income	1,675	1,911
Remeasurements		
Return on plan assets (excluding amounts included in interest income)	14,826	19,456
Contributions to the plan by the employer[1]	15,714	14,870
Payments from the plan	(12,880)	(11,242)
Exchange differences on translation of foreign operations and other	(745)	(92)
The fair value of plan assets at end of year	302,237	283,647

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 17,236 million yen to the defined benefit plan for the fiscal year ending December 31, 2021.

Plan assets consist of the following:

(Millions of yen)

	2020			2019		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Equity securities	11,651	62,649	74,300	11,623	57,118	68,741
Japan	—	30,996	30,996	—	28,412	28,412
Overseas	11,651	31,653	43,304	11,623	28,706	40,329
Debt securities	7,248	208,061	215,309	7,863	195,263	203,126
Japan	—	138,520	138,520	—	130,418	130,418
Overseas	7,248	69,541	76,789	7,863	64,845	72,708
Other	462	12,166	12,628	334	11,446	11,780
Total	19,361	282,876	302,237	19,820	263,827	283,647

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:

	2020	2019
Discount rate	Mainly 0.8%	Mainly 0.6%

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)

	2020	2019
The impact on defined benefit obligations		
0.5% increase in discount rate	(25,482)	(27,430)
0.5% decrease in discount rate	26,815	28,821

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 3,488 million yen and 3,820 million yen for the fiscal years ended December 31, 2020 and 2019, 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, 2020 and 2019 were 277,244 million yen and 274,937 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, 2020	5,959	4,506	1,711	12,176
Increase	—	231	555	786
Interest expense on discounted provision	11	55	—	66
Decrease (provision used)	(844)	(108)	(1,042)	(1,994)
Decrease (provision reversed)	—	—	(38)	(38)
Exchange differences on translation of foreign operations	—	11	(21)	(10)
December 31, 2020	5,126	4,695	1,165	10,986

(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 1,128 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.

20 Other Current Liabilities

Other current liabilities consist of the following:

(Millions of yen)

	2020	2019
Accrued expenses	72,701	72,551
Consumption tax payables	10,508	10,663
Obligation for unused paid absences	8,201	7,948
Other	8,311	8,249
Total	99,721	99,411

21 Equity and Other Equity Items

(1) Share Capital

The numbers of shares authorized and issued are as follows:

(Shares)

	2020	2019
Authorized	1,000,000,000	1,000,000,000
Issued[1]		
Beginning balance	482,000,000	488,700,000
Change during the year[2]	—	(6,700,000)
Ending balance	482,000,000	482,000,000

Notes: 1. All of the issued shares of the Company are ordinary shares that have no par value and no limitations on rights. Issued shares are fully paid.
2. The number of issued shares during the fiscal year ended December 31, 2019 decreased by 6,700,000 shares 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)

	2020	2019
Beginning balance[1]	1,083,466	2,043,272
Increase[2]	28,823	5,786,409
Decrease[3]	(58,270)	(6,746,215)
Ending balance[4]	1,054,019	1,083,466

Notes: 1. 556,492 shares of treasury shares held by associates were included at December 31, 2020 and 2019.
In addition, 226,550 shares and 242,675 shares held by the Board Incentive Plan Trust (hereinafter "BIP Trust") were included at December 31, 2020 and 2019, respectively.
2. The increase of 28,823 shares of treasury shares during the fiscal year ended December 31, 2020 resulted from an increase of 25,605 shares due to changes in treasury shares held by associates accounted for by the equity method and the purchase of 3,218 fractional shares.
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.
3. The decrease of 58,270 shares of treasury shares during the fiscal year ended December 31, 2020 resulted from a decrease of 43,000 shares due to the exercise of stock options, a decrease of 15,000 shares due to the grant to the Board of Directors by the BIP trust and the sale of 270 fractional shares.
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.
4. 582,097 shares and 556,492 shares of treasury shares held by associates were included at December 31, 2020 and 2019, respectively.
In addition, 211,550 shares and 226,550 shares held by the BIP Trust were included at December 31, 2020 and 2019, 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 uses surplus funds to flexibly conduct share repurchases, aiming to continuously increase dividends to reflect improvements in business results.

While making returns to shareholders and improving EVA, the Group retains the capital necessary to make timely investments for growth and to ensure the appropriate resources to deal with unexpected situations.

For the fiscal year ended December 31, 2020, EVA decreased 25.1 billion yen compared with the previous fiscal year to 62.3 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, 2020

Date of resolution	Total dividends[1] (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
114th Annual General Meeting of Shareholders held on March 25, 2020	31,260	65	December 31, 2019	March 26, 2020
Board of Directors meeting held on July 29, 2020	33,666	70	June 30, 2020	September 1, 2020

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 114th Annual General Meeting of Shareholders held on March 25, 2020 was 31,310 million yen before the deduction. The dividend resolved at the meeting of the Board of Directors held on July 29, 2020 was 33,721 million yen before the deduction.

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.

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

Fiscal year ended December 31, 2020

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
115th Annual General Meeting of Shareholders held on March 26, 2021	33,722	70	December 31, 2020	March 29, 2021

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

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, 2020 (Millions of yen)

	Japan	Asia	Americas	Europe	Total
Cosmetics Business	164,165	45,354	5,539	19,010	234,068
Skin Care and Hair Care Business	177,720	25,332	68,619	37,226	308,897
Human Health Care Business	144,867	88,942	119	43	233,971
Fabric and Home Care Business	324,250	40,643	9,338	136	374,367
Consumer Products Business	811,002	200,271	83,615	56,415	1,151,303
Chemical Business	111,084	56,472	42,773	58,882	269,211
Elimination of intersegment transactions	(34,029)	(2,626)	(72)	(1,790)	(38,517)
Consolidated	888,057	254,117	126,316	113,507	1,381,997
Revenue of logistics services to third parties included in other operating income	10,203	—	—	—	10,203
Total revenue from contracts with customers	898,260	254,117	126,316	113,507	1,392,200

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. The Group has changed its method of recognizing sales for certain transactions for the Skin Care and Hair Care Business in Japan from the gross amount to the net amount.

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.

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, 2020 (Millions of yen)

	January 1, 2020	December 31, 2020
Contract liabilities		
Advances	384	298
Refund liabilities	20,232	22,800
Total	20,616	23,098

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

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, 2020 and 2019 were recognized as revenue during the fiscal years ended December 31, 2020 and 2019, respectively. The amount of revenue recognized during the fiscal year ended December 31, 2020 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, 2020 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)

	2020	2019
Advertising	71,984	77,545
Sales promotion	45,543	56,943
Employee benefits	148,281	148,431
Depreciation	18,586	18,775
Amortization	8,632	7,950
Research and development	58,509	59,143
Other	64,291	74,125
Total	415,826	442,912

26 Other Operating Income

Other operating income consists of the following:

(Millions of yen)

	2020	2019
Revenue of logistics services to third parties	10,203	8,973
Royalty income	1,002	1,244
Other	4,596	4,975
Total	15,801	15,192

27 Other Operating Expenses

Other operating expenses consist of the following:

(Millions of yen)

	2020	2019
Expenses of logistics services to third parties	9,311	8,293
Losses on sale and disposal of property, plant and equipment	3,347	3,600
Other	2,447	2,182
Total	15,105	14,075

28 Financial Income and Financial Expenses

Financial income consists of the following:

(Millions of yen)

	2020	2019
Interest income		
Financial assets measured at amortized cost	1,415	1,707
Retirement benefit assets	23	28
Dividend income		
Financial assets measured at fair value through other comprehensive income		
Financial assets derecognized during the year	16	8
Financial assets held at year end	135	162
Financial assets measured at fair value through profit or loss	4	7
Other	118	115
Total	1,711	2,027

Financial expenses consist of the following:

(Millions of yen)

	2020	2019
Foreign exchange loss[1]	2,624	1,521
Interest expenses[2]		
Financial liabilities measured at amortized cost	1,043	1,164
Lease liabilities	1,490	1,676
Retirement benefit liabilities	557	827
Other	125	43
Total	5,839	5,231

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)

	2020	2019
Net income attributable to owners of the parent	126,142	148,213
Amounts not attributable to ordinary shareholders of the parent	—	—
Net income used to calculate basic earnings per share	126,142	148,213
Weighted average number of ordinary shares (Thousands of shares)	480,929	483,252
Basic earnings per share (Yen)	262.29	306.70

(2) The Basis for Calculating Diluted Earnings per Share

(Millions of yen, unless otherwise noted)

	2020	2019
Net income used to calculate basic earnings per share	126,142	148,213
Adjustments to net income	—	—
Net income used to calculate diluted earnings per share	126,142	148,213
Weighted average number of ordinary shares (Thousands of shares)	480,929	483,252
Increase in ordinary shares		
Subscription rights to shares (Thousands of shares)	68	104
Weighted average number of ordinary shares after dilution (Thousands of shares)	480,998	483,356
Diluted earnings per share (Yen)	262.25	306.63
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, 2020 (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	265	—	265	(97)	168
Remeasurements of defined benefit plans	23,386	—	23,386	(7,021)	16,365
Share of other comprehensive income of investments accounted for using the equity method	36	—	36	(11)	25
Total of items that will not be reclassified to profit or loss	23,687	—	23,687	(7,129)	16,558
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(9,936)	(6)	(9,942)	—	(9,942)
Share of other comprehensive income of investments accounted for using the equity method	(167)	—	(167)	0	(167)
Total of items that may be reclassified subsequently to profit or loss	(10,103)	(6)	(10,109)	0	(10,109)
Total	13,584	(6)	13,578	(7,129)	6,449

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)

31 Cash Flow Information

(1) Changes in Liabilities Arising from Financing Activities

Fiscal year ended December 31, 2020

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

(Millions of yen)

	January 1, 2020	Changes from financing cash flows	Non-cash changes: New leases	Non-cash changes: Other	December 31, 2020
Lease liabilities	161,091	(20,912)	16,358	(10,025)	146,512

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, 2020.

Fiscal year ended December 31, 2019

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

(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: New leases	Non-cash changes: Other	December 31, 2019
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.

(2) Non-cash Transactions

For the fiscal year ended December 31, 2020 and 2019, the non-cash transactions comprised the acquisition of right-of-use assets resulted from leases of 16,496 million yen and 23,199 million yen, respectively.

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

	2020		2019	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
	(Shares)	(Yen)	(Shares)	(Yen)
Beginning balance of outstanding	95,000	1	125,000	1
Granted	—	—	—	—
Exercised	(43,000)	1	(30,000)	1
Expired at maturity	(1,000)	1	—	—
Ending balance of outstanding	51,000	1	95,000	1
Ending balance of exercisable	51,000	1	95,000	1

Notes: 1. The weighted average share price on the date of exercise for the fiscal years ended December 31, 2020 and 2019 was 8,400 yen and 8,118 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:

2020			2019		
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	51,000	1.7	1	95,000	2.2

(2) Performance Share Plan

1) Outline of performance share plan

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

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

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

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

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

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

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

	2020		2019	
	Achievement-linked points	Fixed points	Achievement-linked points	Fixed points
Number of points granted during the period	34,125	14,625	35,000	15,000
Weighted average fair value (Yen)	6,821	6,443	6,821	6,551

(3) Share-based Payment Expenses

The amount of share-based payment expenses recognized in the consolidated statement of income for the fiscal year ended December 31, 2020 and 2019 were 394 million yen of reversal of expenses and 337 million yen of expenses, 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	2020	2019
Financial assets measured at amortized cost		
Cash and cash equivalents (Note 7)	338,276	269,781
Trade and other receivables (Note 8)	200,087	208,839
Other	17,907	25,893
Financial assets measured at fair value through profit or loss		
Cash and cash equivalents (Note 7)	14,900	19,900
Derivatives	81	214
Other	3,034	3,063
Financial assets measured at fair value through other comprehensive income		
Equity securities	9,843	10,722
Total	584,128	538,412
Current assets		
Cash and cash equivalents	353,176	289,681
Trade and other receivables	200,087	208,839
Other financial assets	7,257	13,788
Subtotal	560,520	512,308
Non-current assets		
Other financial assets	23,608	26,104
Total	584,128	538,412

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, 2020

(Millions of yen)

Company name	Fair value
Aeon Co., Ltd.	1,433
Seven & i Holdings Co., Ltd.	1,375
Saiwai Trading Co., Ltd.	1,308
Livedo Corporation	1,286
Japan Alcohol Trading Co., Ltd.	739
Tokio Marine Holdings, Inc.	677
Keytrading Co., Ltd.	431
Izumi Co., Ltd.	374
Kawaken Fine Chemicals Co., Ltd.	272
Kyoto Seisakusho Co., Ltd.	194

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

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)

	2020	2019
Fair value	1,224	400
Cumulative gains (losses)	968	328

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, 2020 and 2019, were 668 million yen and 227 million yen, respectively.

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

(Millions of yen)

Financial liabilities	2020	2019
Financial liabilities measured at amortized cost		
Trade and other payables (Note 17)	215,842	222,314
Bonds and borrowings (Note 15)	127,694	127,141
Lease liabilities (Note 16)	146,512	161,091
Other	14,065	13,898
Financial liabilities measured at fair value through profit or loss		
Derivatives	368	395
Total	504,481	524,839
Current liabilities		
Trade and other payables	215,842	222,314
Bonds and borrowings	30,465	25,505
Lease liabilities	19,787	19,653
Other financial liabilities	6,571	6,766
Subtotal	272,665	274,238
Non-current liabilities		
Bonds and borrowings	97,229	101,636
Lease liabilities	126,725	141,438
Other financial liabilities	7,862	7,527
Subtotal	231,816	250,601
Total	504,481	524,839

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, 2020 and 2019 totaling 12,789 million yen and 12,790 million yen, respectively. The average interest rate on deposits received as of December 31, 2020 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 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	2020 Contract amount	2020 Contract amount over 1 year	2020 Carrying amount (fair value)[1]	2019 Contract amount	2019 Contract amount over 1 year	2019 Carrying amount (fair value)[1]
Foreign exchange forward contracts:						
Selling						
U.S. dollar	10,776	—	(0)	21,052	—	4
Euro	80	—	2	19	—	0
Buying						
Euro	31	—	(0)	105	—	(1)
Chinese yuan	111	—	(0)	458	—	(9)

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, 2020 (Millions of yen)

	U.S. dollar	Euro	Chinese yuan
Net exposure	23,198	2,201	11,074

As of December 31, 2019 (Millions of yen)

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

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)

	2020	2019
U.S. dollar	(2,320)	(2,364)
Euro	(220)	(173)
Chinese yuan	(1,107)	(1,163)

(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 4,699 million yen and 5,830 million yen at December 31, 2020 and 2019, 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 7,001 million yen and 6,829 million yen at December 31, 2020 and 2019, respectively.

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

Fiscal year ended December 31, 2020

(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, 2020	203,690	632	204,322
Change during the year (Recognition and derecognition)	(7,907)	(30)	(7,937)
Transfer to credit-impaired financial assets	(59)	59	—
Other changes	(919)	17	(902)
December 31, 2020	194,805	678	195,483

(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, 2020	1,114	520	1,634
Increase during the year	565	82	647
Decrease during the year (charge-offs)	(157)	(1)	(158)
Decrease during the year (other)	(95)	(16)	(111)
Transfer to credit-impaired financial assets	57	(57)	—
Other changes	6	15	21
December 31, 2020	1,490	543	2,033

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

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, 2020 (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	183,636	6,066	1,685	1,150	2,946	195,483
Allowance for doubtful receivables	265	57	134	199	1,378	2,033
Expected credit loss (%)	0.1	0.9	8.0	17.3	46.8	1.0

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

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, 2020 (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	215,842	215,842	215,842	—	—	—	—	—
Bonds and borrowings	127,694	127,781	30,465	5,879	66,126	22	25,022	267
Lease liabilities[1]	146,512	157,905	21,088	16,985	12,495	10,403	9,634	87,300
Long-term deposits payable	7,001	7,001	—	—	—	—	—	7,001
Derivative financial liabilities								
Currency related	222	222	164	48	10	—	—	—
Interest rate related	146	146	—	44	—	102	—	—
Total	497,417	508,897	267,559	22,956	78,631	10,527	34,656	94,568

Note: 1. Lease liabilities by maturity date consist of the following:

As of December 31, 2020 (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	146,512	157,905	21,088	49,517	33,987	22,787	18,588	11,938

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[1]	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

Note: 1. 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

(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, 2020 or 2019.

As of December 31, 2020 (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	—	14,900	—	14,900
Derivative assets	—	81	—	81
Other	—	3,034	—	3,034
Financial assets measured at fair value through other comprehensive income				
Equity securities	4,699	—	5,144	9,843
Total	4,699	18,015	5,144	27,858
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	368	—	368
Total	—	368	—	368

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

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

(Millions of yen)

	2020	2019
Beginning balance	4,892	4,500
Gains (losses)[1]	203	391
Purchases	50	—
Sales	(0)	(0)
Other changes	(1)	1
Ending balance	5,144	4,892

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, 2020 (Millions of yen)

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	50,009	—	50,094	—	50,094
Borrowings	77,685	—	78,164	—	78,164

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

34 Principal Subsidiaries

Principal subsidiaries consist of the following. Voting rights at December 31, 2020 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.	Cosmetics Skin Care and Hair Care Human Health Care Fabric and Home Care Chemical	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	66.8
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)

	2020	2019
Short-term benefits	1,213	1,069
Post-retirement benefits	32	33
Share-based payments	(394)	337
Total	851	1,439

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)

	2020	2019
Acquisition of property, plant and equipment	22,611	25,041
Acquisition of intangible assets	1,883	3,735
Total	24,494	28,776

37 Significant Subsequent Events

At a meeting held on February 3, 2021, the Board of Directors resolved to purchase up to a maximum of 7 thousand shares or 50,000 million yen of the Company's common stock from February 4 to April 30, 2021, in accordance with Article 156 of the Companies Act applicable pursuant to Article 165, paragraph 3 of the said Act.

38 Approval of the Consolidated Financial Statements

The Consolidated Financial Statements were approved by Yoshihiro Hasebe, President and Chief Executive Officer, and by Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting and Finance, on March 18, 2021.

Independent Auditor's Report

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Kao Corporation:

Opinion

We have audited the consolidated financial statements of Kao Corporation and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as of December 31, 2020, and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2020, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in Japan. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the provisions of the Code of Professional Ethics in Japan, and we have fulfilled our other ethical responsibilities as auditors. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Valuation of Goodwill (Kanebo Cosmetics Group)	
Key Audit Matter Description	How the Key Audit Matter Was Addressed in the Audit
Kao Corporation (hereinafter the "Company") recognized goodwill of ¥177,031 million in the consolidated statement of financial position as of December 31, 2020. As described in Note 12 to the consolidated financial statements, included therein was goodwill of ¥119,400 million arising from the acquisition of Kanebo Cosmetics Group, which accounted for 7.2% of the total assets. The assumptions used for the impairment test for goodwill were described in Note 12. The Company measured the recoverable amounts based on value in use calculated by the discounted present value of future cash flows, which are based on Cosmetic Business medium-term plan (hereinafter "medium-term plan") that reflects past years' performance and future forecasts. The medium-term plan includes a forecast of sales growth by region and by brand. The growth rate used in the determination of the forecast is consistent with the growth rate of the market to which the cash-generating unit belongs. The estimated cash flows in the period beyond the timescale considered in the medium-term plan approved by management are calculated using an annual growth rate of zero percent and are discounted to present value using a weighted average cost of capital ("WACC") of 7.3%. The growth rate of sales and discount rate involve uncertainties, such as future forecasts in the cosmetic market, and require management judgment; as such, we determined this to be a key audit matter.	Our audit procedures to assess the reasonableness of the estimates of value in use for addressing the valuation of goodwill related to Kanebo Cosmetics Group included, among others, the following audit procedures: (1) Internal control testing We tested the design and operating effectiveness of certain internal controls over the determination of whether an impairment loss on the groups of cash-generating units that include goodwill should be recognized. (2) Assessment of the reasonableness of the estimate of value-in-use • Concerning estimated cash flows, we compared the forecasted sales growth by region and by brand included in the medium-term plan for previous year's impairment test with actual results and evaluated the achievement of those results in the medium-term plan retrospectively. • We made inquiries of the person responsible for the Cosmetic Business regarding the sales strategy, which supports sales growth by region and brand and is utilized in the impairment test. • Concerning the forecasted market growth rate which is one of the significant assumptions for estimating value in use, and was included in the medium-term plan, we performed trend analysis using actual results and the data of cosmetic market inspection reports published by an external specialist agency. • We involved valuation specialists from our member firm to assist us in assessing the appropriateness of the discount rate by comparing our estimate of WACC to the one made by management. • We compared the value in use that would result from changes, within a reasonable range, in the significant assumptions used for the impairment test, to the carrying amount of the cash-generating units that include goodwill.

Responsibilities of Management and Audit & Supervisory Board Members and the Audit & Supervisory Board for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern in accordance with IFRSs and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Audit & Supervisory Board members and the Audit & Supervisory Board are responsible for overseeing the Directors' execution of duties relating to the design and operating effectiveness of the controls over the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in Japan will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with auditing standards generally accepted in Japan, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks. The procedures selected depend on the auditor's judgment. In addition, we obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain, when performing risk assessment procedures, an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate whether the overall presentation and disclosures of the consolidated financial statements are in accordance with IFRSs, as well as the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with Audit & Supervisory Board members and the Audit & Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide Audit & Supervisory Board members and the Audit & Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with Audit & Supervisory Board members and the Audit & Supervisory Board, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Interest Required to Be Disclosed by the Certified Public Accountants Act of Japan

Our firm and its designated engagement partners do not have any interest in the Group which is required to be disclosed pursuant to the provisions of the Certified Public Accountants Act of Japan.

Deloitte Touche Tohmatsu LLC

March 18, 2021

Enriching lives, in harmony with nature.

Kao Corporation

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