Analyses of Management and Finances

Analysis of Operating Results

1. Summary

During the fiscal year just ended, Japan's economy experienced a gradual recovery against a background of improvements in corporate earnings and the employment situation, balanced however by a deceleration of emerging-market economies and concerns about fluctuations in global financial markets. Nevertheless, the Group achieved moderate growth despite a general slowdown in economic conditions in Asia, the center of the Group's global business.

In this environment, consolidated net sales rose 5.9%, to ¥75,078 million. Consolidated net income attributable to owners of the parent increased 44.2%, to ¥6,383 million. (Hereinafter, all figures are stated in Japanese yen, consolidated as of March 31, 2016, and all percentage changes are relative to the previous consolidated fiscal year.)

2. Net Sales and Cost of Sales

Net sales totaled ¥75,079 million, up ¥4,153 million (5.9%). This marks the sixth consecutive year of record sales. This growth was attributable primarily to the favorable performance of Lúcido in Japan and positive results in Japan and overseas in the field of women's products—factors that compensated for sluggish sales in Japan of our core Gatsby product and the impact of a fire that broke out at our Indonesian subsidiary on July 10, 2015.

Cost of sales was ¥34,207 million, up ¥2,109 million (6.6%). The increase was mainly due to higher gross profit, stemming from higher sales, which rose ¥2,043 million (5.3%) to ¥40,872 million, despite such factors as rising cost-of-sales ratios in Japan and overseas and the impact of a fire at our Indonesian subsidiary.

3. Selling, General and Administrative (SG&A) Expenses and Operating Income

SG&A expenses amounted to ¥34,278 million, up ¥2,445 million (7.7%). This increase was driven principally by aggressive investment in marketing (sales promotion and advertising expenses) both in Japan and overseas. As a result, operating income declined to ¥6,594 million, down ¥401 million (5.7%).

4. Non-Operating Profit, Extraordinary Profit, Ordinary Income and Income before Income Taxes

Non-operating income has been increasing steadily since the previous term, while non-operating expenses have been falling. As a result, non-operating profit was up ¥221 million during the term. In extraordinary items, a gain on the disposal of property, plant and equipment at our Indonesian subsidiary led to a year-on-year increase of ¥3,350 million in extraordinary income.

Ordinary income totaled ¥7,415 million, down ¥180 million (2.4%). Income before income taxes increased to ¥10,698 million, up ¥3,169 million (42.1%).

5. Income Taxes, Net Income Attributable to Non-Controlling Interests and Net Income Attributable to Owners of the Parent

Income taxes totaled ¥2,381 million, down ¥138 million (5.5%), principally due to a decrease in corporate tax payable by the parent company. Net income attributable to non-controlling interests rose to ¥1,934 million, up ¥1,350 million, due mainly to the increase in net income of the Group's Indonesian subsidiary.

As a result, net income attributable to owners of the parent amounted to ¥6,383 million, up ¥1,957 million (44.2%), a new record high.

Analysis of Financial Position and Cash Flows

1. Assets, Liabilities and Total Equity

Total assets amounted to ¥79,822 million as of March 31, 2016, up ¥3,841 million from one year earlier, due to increases in cash and cash equivalents and investment securities. Total liabilities came to ¥13,965 million, down ¥1,034 million from the previous fiscal year-end, due to decreases in short-term bank loans and other categories. Thanks to increased retained earnings, among other factors, total equity amounted to ¥65,857 million, up ¥4,875 million, and the shareholders' equity ratio was 74.8%.

2. Status of Cash Flows

Cash and cash equivalents (cash) totaled ¥12,200 million, up ¥935 million. Principal factors influencing cash flows during the term are as follows.

(Cash Flows from Operating Activities)

Net cash provided by operating activities amounted to ¥7,233 million, up ¥1,744 million from the previous fiscal year. This increase stemmed from a decrease in inventories, among other factors, despite a fall in operating income.

(Cash Flows from Investing Activities)

Net cash used in investing activities totaled ¥2,383 million, ¥2,758 million less than the previous fiscal year. Proceeds from sales of land-use rights were the primary reason.

(Cash Flows from Financing Activities)

Net cash used in financing activities came to ¥3,535 million, up ¥3,193 million from the previous fiscal year. Repayments of short-term bank loans were the main factor behind this change.

Important Factors Influencing Consolidated Operating Results

1. Factors Influencing Profitability

The Group operates in a highly competitive business environment. Particularly in Japan, we are competing in a mature market. Such competition exerts downward pressure on retail prices while placing upward pressure on sales expenses, with inevitably lower profit margins. Furthermore, since our key product lines have a relatively short life cycle, the success or failure of new products is a principal factor influencing our results. We always carry out brand renewal before the end of the product life cycle, and develop and market new products based on underlying consumer preferences. As a result, merchandise returns from retailers also impact our profitability.

In addition, since the inventory on which the Group's continued operations depend is produced mainly on the basis of projected future demand and market trends, this strategy may, depending on actual demand or unanticipated trends, require inventory disposal. This disposal is recorded as a loss under cost of sales and adversely affects the Group's performance. It is the Group's policy to dispose of inventory immediately after market value impairment is confirmed, rather than postponing such disposal.

In Japan and Indonesia, our dependence on specific partners is high, formally exposing us to credit risk. However, we believe that for both countries, the increasingly dominant market presence of a few players actually tends to reduce this risk, and it therefore effectively has no influence on our current business results.

2. Foreign Exchange and Resource Price Fluctuations

In overseas operations, foreign exchange fluctuations or increased petroleum prices may affect Group competitiveness by increasing the costs of raw materials required at production sites in Indonesia and China. The Group's overseas manufacturing is carried out in Asia, and some regions are subject to event risk from possible legal or economic changes that may accompany sudden political events. Such developments could impact the Group's management and financial performance.

Business and Other Risks

1. Consumer Alignment Risk

Competition in the cosmetics market in Asia, including Japan, is becoming increasingly intense due to the activities of peer companies as well as new competitor entry. In addition, the market is experiencing ongoing changes in consumer needs and wants, and consumer contact is taking place through increasingly diverse distribution channels. In this competitive environment, the Group is working to sustain and enhance its brand value and to develop, introduce, promote, and reinforce new products; withdraw from, reposition, or revamp existing products; and achieve innovation in its marketing activities, including its sales methods.

Notwithstanding these efforts, various uncertainties may cause the Group to experience delays in responding to factors in its environment. Particularly in Japan, these factors include the impact of retailers reducing inventories of standard products by rebalancing inventories, and the return of surplus inventory from sales agents, the value of which may impact the Group's performance.

2. Partner Dependence Risk

Business partner	Fiscal 2014 (April 1, 2014- March 31, 2015)		Fiscal 2015 (April 1, 2015- March 31, 2016)	
	Amount (millions of yen)	Ratio (%)	Amount (millions of yen)	Ratio (%)
Paltac Corporation	20,007	28.2	22,473	29.9
PT ASIA PARAMITA INDAH	14,263	20.1	15,396	20.5

As shown in the chart above, during the 2015 and 2016 terms ended March 31, the Group was dependent on certain wholesalers for more than 10.0% of its consolidated sales. The Company and PT Mandom Indonesia Tbk have long-term, stable, ongoing business relationships with these wholesalers. In the future distribution of cosmetics and other products, there will be an increasing tendency toward market dominance by a limited number of large-scale wholesalers. This may lead to further dependence on specific distributors who account for a significant percentage of Group sales.

3. Regulatory Risk

The Group manufactures (and in some cases imports) and sells quasi-drugs and cosmetics in accordance with various regulatory statutes, including the Pharmaceuticals and Medical Devices Law, as well as in compliance with quality and environmental statutes. In the event, however, of a major breach of statutory or regulatory requirements, production activities may be affected, with a resulting impact on the continuing viability of the business involved. Moreover, restrictions may be placed on the Group's business due to revisions to existing legislation or the enactment of new laws. In the event that the Group incurs higher costs in its efforts to comply with statutory and regulatory requirements, its operating performance may be affected.

4. Foreign Exchange Risk
The Group's overseas business focuses on Asia, where solid market growth is expected. Overseas net sales accounted for 42.4% and 42.3% of consolidated net sales in the fiscal years ended March 31, 2015 and 2016, respectively, and the weight of overseas business is expected to increase. Accordingly, short-term, as well as medium- to long-term fluctuations in foreign exchange rates have the potential to impact the Group's performance and prevent the operating results of overseas Group companies from being accurately represented in our business performance when translated into yen.

5. Overseas Business Development Risk
The Group continues to focus on expanding its business in the Asia region, which is positioned as a growth engine under its business strategy. In the event of a natural disaster or significant breach of applicable laws, trading policies, or customs and taxation regulations in the area, or a drop in consumer demand, the Group's business activities may be constrained, impacting its overall business performance.

Challenges to Be Addressed

1. Maintaining and Expanding the Men's Grooming Business, Reinforcing Female-Oriented Business
Grooming products for men represent the Group's core business. In this and other categories in which we operate, we are experiencing increasing competition by established as well as new market participants, both in Japan and overseas, and we believe that the business environment will become even more challenging. Within this environment, the Group places utmost importance on its men's grooming products business, which accounts for more than 60% of consolidated sales and more than 70% of sales in Japan. Since this business is a mainstay of our profitability, we will continue striving to uncover new needs and wants through research from the consumer's point of view. We will also hone our capability to introduce new products, and undertake to maintain business expansion.

At the same time, we will reinforce our women's products business, including the skin care and base make-up categories, and strive to expand into new business areas.

2. Bolstering Personnel Development as the Foundation of Group Business
The Group seeks continuing global growth with a focus on Asia. Management considers global personnel development to be one of the foundations supporting its business, and believes that equipping personnel for success in any country will become increasingly important. Consequently, we will bolster personnel development to enhance the capacity of our employees to communicate and acquire a deep understanding of the customs and values of each culture where we market our products, to strengthen the Group's overseas foundation.

3. Bolstering Corporate Social Responsibility Activities
The Mandom Group strives to maintain and enhance positive, trust-based relationships with its stakeholders, as well as to act in collaboration and harmony with society as a good corporate citizen, thereby contributing to development. CSR initiatives of particular note are our ongoing quality guarantee and environmental countermeasure efforts. We are also putting in place structures to promote social contribution activities throughout the Group.

4. Reinforcing Safety Improvement Initiatives
A fire that broke out at the Indonesian subsidiary brought home the reality that safety is an absolute condition that precedes the pursuit of productivity and economic benefits. Accordingly, we resolved to bolster safety, and are implementing thorough measures to prevent accidents and recurrences at production locations throughout the Group.

Management's View of Challenges and Policy Going Forward

Management strives to formulate optimal policies in light of the current business environment and available data and information. Management's key concern is to sustain business expansion. Recognizing that the engine for this expansion lies in overseas markets, management will strive to achieve further growth by developing the Southeast Asian market—where there is likely to be increasing demand for our products—as well as new markets in other Asian regions. We will also position our women's cosmetics business for further growth.

Management prioritizes efficient use of capital and regards the return of profits to shareholders in the form of dividends as a key capital policy. Consequently, management will undertake to return more profit to shareholders and rein in increases in equity (retained earnings).

1. Current Management Strategies and Outlook
Sustained growth is the core element of the Group's medium- to long-term business strategy. To achieve phased expansion of Group business, we will deploy a carefully planned input of business resources to achieve sustainable growth in income and profits. In the current

three-year Middle-Range Planning (fiscal 2014 to fiscal 2016), we will continue to focus on three strategic themes: (1) promoting continued growth for our core men's grooming business; (2) accelerating the start of our women's cosmetics business through global marketing in Asia; and (3) promoting the continued expansion of our overseas business.

Furthermore, when implementing our strategic objectives, we will be expeditious in making use of external capital through M&A activities and business alliances.

(1) Sustained growth of our core men's grooming business

We will work to reinforce our core Gatsby brand as a global brand in Asia to better serve male consumers in all our markets. In Japan, we will work to expand sales centering on the styling as well as the face and body categories, targeting younger consumers. We will also place the styling category at the center of our overseas business while undertaking to reinforce and expand the face and body categories.

Under our Lúcido brand, we will continue to offer aging-care concept products for middle-aged consumers, including body odor care.

(2) Accelerating our women's cosmetries and cosmetics businesses through global marketing in Asia

The Group will expand our women's cosmetries and cosmetics businesses centering on the skin care and base make-up products. In Japan, we will work to grow this business with a focus on expanding our share in the cleansing products market. Overseas, we will seek to expand sales in existing markets through greater lateral deployment of products developed for Japan, and grow our cosmetics business through expansion and reinforcement of the sales area for base make-up products.

(3) Continued expansion of overseas business

Our overseas business maintains its positioning as our engine of growth, with Indonesia as our principal international market and China, India, and Southeast Asia as our developing markets. We will reinforce our investment in targeted marketing and undertake to develop an even deeper understanding of the consumer point of view in markets where we operate, to further expand the scale of our overseas business.

2. Financial Policies

The Group's financial policies include maintaining a sound balance sheet and the liquidity necessary to pursue its objectives. Capital is used primarily to fund operations and for capital investments, and is derived from internal reserves. If a domestic subsidiary lacks necessary funds, the shortfall is covered by a loan from the parent company, while demand for short-term funds from overseas subsidiaries is met by local-currency-based short-term loans taken out by the Group's main representative office in the region. The Group regards any additional funds in hand as cash reserves for business investment, and places the utmost priority on ensuring their liquidity and security.

Management further believes that even if the need should arise for investment funds exceeding current liquidity, it can procure the funds necessary to ensure dramatic growth based on sound finances and the capacity to generate cash flows through operating activities.

3. Earnings Distribution Policy

Returning profit to shareholders through dividends is a core management policy, subject to internal reserve requirements for medium- to long-term operational development and new business development, and for addressing corporate risks. Under this strong commitment to dividend policy, the Group will endeavor to deliver shareholder return through dividend payouts. The numerical target for the year ended March 31, 2016 is a payout ratio of not less than 40.0% of net income attributable to owners of the parent on a consolidated basis, excluding extraordinary factors.

The Group's fundamental policy is to distribute surplus funds via two annual dividends, a mid-term and a year-end dividend.

The entity for approving the distribution of these funds is the Board of Directors for the mid-term dividend, and the General Meeting of Shareholders for the year-end dividend. Total dividends for the term were set at ¥80 per share. As a result, the dividend payout ratio amounted to 29.3% on a consolidated basis.

We allocate internal reserves to strategic investments aimed at boosting corporate value, including investment in facilities to expand existing business operations, overseas operations and research and investment. Furthermore, we view internal reserves as a safety net to deal with various corporate risks. We are also considering the potential for stock buybacks to return profits to shareholders and improve capital efficiency.