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 strong corporate earnings and improvements in the employment situation, balanced however by concerns about growing uncertainty in the global economy. 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 3.0%, to ¥77,351 million. Consolidated net income attributable to owners of the parent decreased 12.8%, to ¥5,566 million. (Hereinafter, all figures are stated in Japanese yen, consolidated as of March 31, 2017, and all percentage changes are relative to the previous consolidated fiscal year.)

2. Net Sales and Cost of Sales

Net sales totaled ¥77,351 million, up ¥2,272 million (3.0%). This marks the seventh consecutive year of record sales. The increase was mainly attributable to steady sales of the Gatsby brand in the men's grooming business and strong sales of the Bifesta brand in the women's cosmetics business.

The cost of sales was ¥35,164 million, up ¥958 million (2.8%) year on year, due mainly to a lower cost of sales ratio in Japan and a resurgence in performance at our Indonesian subsidiary. As a result, gross profit rose ¥1,314 million (3.2%), to ¥42,187 million.

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

SG&A expenses amounted to ¥34,569 million, up ¥291 million (0.8%). Although selling expenses fell overseas, the increase in SG&A was driven principally by aggressive investments in marketing (sales promotion and advertising) in Japan. As a result, operating income rose to ¥7,618 million, up ¥1,023 million (15.5%).

4. Non-Operating Profit (Expenses), Extraordinary Profit (Losses), Ordinary Income and Income before Income Taxes

Non-operating income has been decreasing since the previous term, while non-operating expenses have been rising. As a result, net non-operating profit was down ¥255 million from the previous term. In extraordinary items, extraordinary income decreased by ¥3,089 million because of factors such as the disappearance in the period under review of a gain on the disposal of property, plant and equipment at our Indonesian subsidiary in the previous term.

As a result, ordinary income totaled ¥8,183 million, up ¥768 million (10.4%). Income before income taxes decreased ¥2,321 million (21.7%) to ¥8,378 million.

5. Income Taxes, Net Income Attributable to Noncontrolling Interests and Net Income Attributable to Owners of the Parent

Income taxes totaled ¥2,233 million, down ¥148 million (6.2%), principally due to a decrease in corporate tax payable by the parent company. Net income attributable to noncontrolling interests declined to ¥579 million, down ¥1,356 million from the previous term, due mainly to the decrease in net income of the Group's Indonesian subsidiary.

As a result, net income attributable to owners of the parent amounted to ¥5,566 million, down ¥816 million (12.8%).

Important Factors Influencing Consolidated Operating Results

1. Factors Influencing Profitability

The Group operates in a highly competitive business environment. Particularly in Japan, where merchandizing position in the market is critical, we may strategically revise prices and implement sales promotions. These strategies exert downward pressure on selling prices and can cause selling expenses to rise, eroding profitability. 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 risks 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 innovate 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 2015 (April 1, 2015- March 31, 2016)		Fiscal 2016 (April 1, 2016- March 31, 2017)	
	Amount (millions of yen)	Ratio (%)	Amount (millions of yen)	Ratio (%)
Paltac Corporation	22,473	29.9	24,573	31.8
PT Asia Paramita Indah	15,396	20.5	15,542	20.1

As shown in the chart above, during the fiscal years ended March 31, 2016 and 2017, respectively, 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 (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 42.3% and 41.7% of consolidated net sales in the fiscal years ended March 31, 2016 and 2017, respectively, and the volume 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.

Analysis of Financial Position and Cash Flows

1. Assets, Liabilities and Total Equity

Total assets were ¥83,836 million as of March 31, 2017, up ¥4,013 million from a year earlier, due to increases in investment securities and in merchandise and finished goods. Total liabilities were ¥14,245 million, up ¥279 million from the end of the previous fiscal year, due mainly to an increase in liability for retirement benefits. Thanks to increased retained earnings, among other factors, total equity amounted to ¥69,591 million, up ¥3,734 million, and the shareholders' equity ratio was 75.4%.

2. Status of Cash Flows

Cash and cash equivalents as of March 31, 2017, came to ¥12,880 million, up ¥679 million from the end of the previous fiscal year. This was due to a decrease in accounts receivable and repayment of short-term bank loans despite a 21.7% drop in income before income taxes to ¥8,378 million.
Factors influencing cash flows during the term are as follows.

(Cash Flows from Operating Activities)

Net cash provided by operating activities was ¥9,045 million, up 25.1%. Contributing factors include ¥8,378 million in income before income taxes and ¥3,166 million in depreciation and amortization, while income taxes paid were ¥2,312 million.

(Cash Flows from Investing Activities)

Net cash used in investing activities was ¥5,921 million, up 148.5%. Uses of cash included ¥19,699 million for the acquisition of short-term investment securities and ¥3,302 million for the acquisition of property, plant and equipment. The main source of cash was ¥17,700 million generated from sales and the redemption of short-term investment securities.

(Cash Flows from Financing Activities)

Net cash used in financing activities was ¥2,216 million, down 37.3%, due mainly to dividends paid of ¥2,200 million.

Management Policy

1. Management Policy and Operating Environment

Looking forward, we expect the economic environment in Japan to be characterized by an ongoing, modest recovery, driven by certain domestic improvements, though with some delays. Overseas, however, the sense of uncertainty is growing, due to the normalization of US financial policies and concerns over an economic downturn in China and emerging markets in Asia.

Operating in this uncertain environment, which makes forecasting problematic, we have formulated VISION 2027 to express how we would like the Group to look in 2027, our 100th anniversary, taking relatively certain population trends into account. We have adopted an approach using backcasting* that is not swayed by past achievements. In this way, we aim to be a cosmetics company that is peerless in its strengths, rather than an integrated provider of cosmetics.

*Method that starts with defining a desired future or target and then works backwards to identify the necessary policies and programs to achieve them

2. Management Strategy and the Targets of Management Indicators

We are positioning the first three years of VISION 2027, the fiscal years ending March 31, 2018 to 2020, as the time for putting in place corporate foundations under a middle-range planning. We have formulated the following basic management policies and basic management targets, which we aim to achieve through this planning.

(Basic Management Policies)

1. Promote category-based strategies and thoroughly enhance brand value
2. Enhance growth in overseas business, particularly in Indonesia
3. Create a Group operating structure and boost productivity per unit

(Basic Management Targets)

- Consolidated net sales of ¥90 billion
- Consolidated operating margin of 10%
- Consolidated payout ratio of 40% or higher

Note: Excluding extraordinary factors

3. 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.

4. 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, 2017 was 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 dividends per year, a mid-term and a year-end dividend.

The entity for approving the distribution of these funds is the Board of Directors for mid-term dividends, and the General Meeting of Shareholders for year-end dividends.

Total dividends for the term under review were set at ¥96 per share. As a result, the dividend payout ratio amounted to 40.3% 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.

Challenges to Be Addressed

1. Maintaining or Growing the Men's Business and Reinforcing the Women's Business

To achieve sustainable business growth, we believe it is necessary to maintain or expand the men's business, the core of our operations, accounting for 60% of net sales and the foundation that support profits. We also consider it important to strengthen business development in the women's business, which is expected to grow further. To achieve these goals, we will employ stronger initiatives that sustain our cultivation of existing brands and categories. At the same time, we will concentrate on business domains in new categories.

2. Developing Stronger Global-Minded Human Resources

The Mandom Group aims to continue growing as a global company with Asia as its focus. We recognize the need to develop globally- minded employees who will serve as the foundation for supporting this business. To this end, we will make a thorough effort to educate our employees about our ideals and bolster their communication skills. We will also step up the development of personnel who can provide the foundation to support us as a global company through initiatives that promote an understanding and deepening of cultures, business practices and values of the countries where we operate.

3. Strengthening Programs that Improve Stability

Believing that stability is an absolute requirement in the manufacturing sector, the Mandom Group considers the pursuit of productivity and economy as a constant endeavor. To augment the stability that underpins this pursuit, we will strive to continually improve activities at each of the Group's manufacturing sites.

4. Bolstering Corporate Social Responsibility Activities

Among our missions is "co-existence, mutual growth and mutual creation with society." Consequently, we undertake CSR initiatives that provide ongoing quality guarantees and continuing support for the environment. We are also putting in place structures that promote social contribution activities throughout the entire Group.