Analyses of Management and Finances

Analysis of Operating Results

1. Summary

During the fiscal year just ended, Japan's economy experienced overall improvement and a gentle expansionary trend against a background of government economic and fiscal stimulus. Economic conditions in Asia, the center of gravity for the Group's overseas business, also benefited from the influence of moderate global growth, with recovering consumption and steady overall expansion.

In this environment, consolidated net sales rose 4.0%, to ¥70,925 million. Consolidated net income increased 8.1%, to ¥4,425 million. (Hereinafter, all figures are stated in Japanese yen, consolidated as of March 31, 2015, and all percentage changes are relative to the previous consolidated fiscal year.)

2. Net Sales and Cost of Sales

Net sales totaled ¥70,925 million, up ¥2,709 million (4.0%). This marks the fifth consecutive year of record sales. The main reason for the increase was positive overseas sales of our core Gatsby products, particularly in Indonesia. As a result, overall sales were solid both in Japan and overseas.

Cost of sales was ¥32,097 million, up ¥1,207 million (3.9%). The principal factor behind this increase was the increase in domestic and overseas sales. However, due to efforts to lower costs both domestically and overseas, gross profit expanded to ¥38,828 million, up ¥1,502 million (4.0%).

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

SG&A expenses amounted to ¥31,832 million, up ¥1,360 million (4.5%). Although in Japan we strove to boost the efficiency of our investment in marketing (sales promotion and advertising expenses), overseas our expenses rose resulting proactive marketing investment (advertising expenses), centered on Indonesia.

As a result, operating income rose to ¥6,996 million, up ¥142 million (2.1%)

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

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 ¥122 million during the term. In extraordinary items, the drop in extraordinary income outpaced the fall in extraordinary expenses, resulting in a year-on-year decline of ¥15 million in extraordinary profit.

As a result, ordinary income totaled ¥7,595 million, up ¥265 million (3.6%). Income before income taxes and minority interests also increased to ¥7,529 million, up ¥250 million (3.4%).

5. Income Taxes, Minority Interests and Net Income

Income taxes totaled ¥2,520 million, down ¥88 million (3.4%), principally due to increases in corporate tax payable by the parent company. Minority interests in income of consolidated subsidiaries rose to ¥584 million, up ¥5 million, due mainly to the increase in net income of the Group's Indonesian subsidiary.

As a result, net income amounted to ¥4,425 million, up ¥333 million (8.1%), a new record high.

Analysis of Financial Position and Cash Flows

1. Assets, Liabilities and Total Equity

Total assets amounted to ¥75,980 million as of March 31, 2015, up ¥8,121 million from one year earlier. This rise stemmed from increases in merchandise and finished goods and construction in progress. Total liabilities amounted to ¥15,000 million, up ¥2,320 million from the previous fiscal year-end, due to increases in short-term borrowings. Thanks to increased retained earnings, among other factors, total equity totaled ¥60,980 million, up ¥5,801 million, and the shareholders' equity ratio was 73.7%.

2. Status of Cash Flows

Cash and cash equivalents (cash) totaled ¥11,265 million, up ¥374 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 ¥5,488 million, down ¥1,815 million from the previous fiscal year. While operating income rose, other factors, including an increase in inventories as well as receivables, exerted an opposite influence.

(Cash Flows from Investing Activities)

Net cash used in investing activities amounted to ¥5,141 million, ¥456 million less than the prior fiscal year. This change was mainly due to a decrease in purchases of tangible fixed assets, despite an increase in time deposits other than cash equivalents.

(Cash Flows from Financing Activities)

Net cash used in financing activities came to ¥341 million, down ¥1,492 million from the previous fiscal year. This was primarily due to proceeds from short-term borrowings.

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 such, 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 as such it 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 2013 (April 1, 2013-March 31, 2014)		Fiscal 2014 (April 1, 2014-March 31, 2015)	
	Amount (millions of yen)	Ratio (%)	Amount (millions of yen)	Ratio (%)
Paltac Corporation	¥19,849	29.1	¥20,007	28.2
PT ASIA PARAMITA INDAH	13,457	19.7	14,263	20.1

As shown in the chart above, during the 2014 and 2015 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 Pharmaceutical Affairs 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 41.0% and 42.4% of consolidated net sales in the fiscal years ended March 31, 2014 and 2015, 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 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 half of consolidated sales and more than 60% 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.

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 through 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 by 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, 2015 and ending March 31, 2016 is a payout ratio of not less than 40.0% of net income on a consolidated basis.

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 ¥76 per share.

As a result, the dividend payout ratio amounted to 40.2% 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.