Shiseido Company, Limited

Conference Call 2023Q1 Financial Results Announcement

May 12, 2023

Event Summary

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[Participants]	
[Number of Speakers]	2

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*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A.

Presentation

Hirofuji: Good evening, investors and analysts. Thank you very much for attending the phone conference of Shiseido Company. I will be the emcee of the session today. My name is Hirofuji from the IR Department.

Today, we have Mr. Takayuki Yokota, the CFO, attending the conference. We will have Mr. Yokota explain the Q1 results for 2023. Then afterwards, we'll follow with a Q&A session.

All the materials are uploaded on our company's website, so please refer to that if you wish. We plan to finish this session in about an hour.

In this document, statements other than historical facts are forward-looking statements that reflect our plans and expectations. These forward-looking statements involve risks, uncertainties, and other factors that may cause actual results and achievements to differ from those anticipated in these statements.

Before we begin, we would like to inform you that the presentation may involve forward-looking statements based on our outlook. Please understand that these involve risks, uncertainties and other factors that may cause the actual results to differ from these statements. Please also be noted that we will be recording today's session to upload on the website at a later timing.

Now we would like to hand the presentation to Mr. Yokota, the CFO. Mr. Yokota, please.

2023 Q1 Key Headlines

Expansion Trend in Japan Primarily from High Price Range
Strong Americas and EMEA Drove Overall Sales,
Recovering YoY Decline in China and Travel Retail
Profit Increased from Higher Sales and Agile Cost Management

- Like-for-like (LfL)* sales:+7%
  - High price range drove the steady growth in Japan, continued strong in Americas and EMEA Sales declined in China due to infection re-expansion in January, and in Travel Retail due to retailer inventory adjustments
  - *SHISEIDO, Clé de Peau Beauté, NARS and Drunk Elephant* delivered stellar results driving the overall sales growth
- E-commerce (EC) sales ratio: 34%
  - Company-wide EC sales grew despite market slowdown of Women's Day promotion in China
- Core operating profit: ¥12.5 bn, +¥8.2 bn YoY, +186% YoY
  - Increased thanks to higher gross profit from increased sales and agile cost management
- Steadfast progress of transformation
  - Transfer of Kuki Factory completed

* Like-for-like increase (decrease) excludes the impact from FX and all business transfers in the first 3 months of 2023 and first 3 months of 2022 as well as the impact of all related transfer agreements ("business transfer impacts") 3

Yokota: I would like to present to you the financial results for Q1 of 2023. Please refer to page three.

These are the key headlines for Q1 of 2023. As you can see, we started the year off with good performance. Like-for-like sales, excluding ForEx and business transfer impact, was up by 7% YoY. Sales declined in China due to infection reexpansion in January and in travel retail due to the retailer inventory adjustments, primarily in South Korea. However, we are on track with the guidance.

On the other hand, Japan realized solid recovery led by strong performing high-price range sales and with the enhanced new product launches that capture the recovering market demand. The market has faced a difficult situation from the COVID-19 impact for some time, but we are finally accelerating the growth momentum.

Americas and India continued to perform strong from last year, contributing to the overall growth.

By brand, our global brands Shiseido, Cle de Peau Beaute, Drunk Elephant and NARS captured strong growth, leading the overall performance. The e-commerce sales ratio was 34%. Although there was market stagnation for the Women's Day promotion in China, the EC sales value globally is growing YoY. Drunk Elephant, the brand with high e-commerce ratio, performed well, contributing to drive the overall EC sales.

Core operating profit was an increase of JPY8.2 billion, primarily contributing to higher gross profit from increased sales and agile cost management as well as ForEx impact from yen depreciation. The Company started off the year on track to the annual guidance of JPY60 billion in core operating profit.

However, as some of the costs such as SG&A will be carried over to Q2, the Q1 cost was lower than expected. Therefore, the annual guidance will not be changed.

In regards to transformation, we are on solid progress and completed the transfer of Kuki Factory on April 1.

2023 Q1 (January–March): Executive Summary

(Billion yen)	2022 Q1	% of Net Sales	2023 Q1	% of Net Sales	YoY Change	YoY Change%	YoY Fx-Neutral%	YoY LfL*2 %
Net Sales	234.0	100%	240.0	100%	+6.0	+2.6%	−3.6%	+6.6%
Core Operating Profit	4.4	1.9%	12.5	5.2%	+8.2	+186.3%		
Non-recurrent Items	−0.0	−0.0%	−2.0	−0.8%	−2.0	-		
Operating Profit	4.4	1.9%	10.5	4.4%	+6.1	+140.5%		
Profit Before Tax	8.2	3.5%	10.3	4.3%	+2.2	+26.5%		
Income Tax Expense	2.5	1.1%	1.1	0.5%	−1.3	−54.4%		
Profit Attributable to Owners of Parent	4.4	1.9%	8.7	3.6%	+4.3	+97.3%		
EBITDA*1	17.1	7.3%	24.9	10.4%	+7.8	+45.3%		

*1 Core Operating Profit+Depreciation and Amortization (excl. amortization of right-of-use assets) *2 Excludes impact from FX and business transfer

Net Sales:
- Japan on expansion trend mainly in strong high price range
- Americas and EMEA continued strong, driving overall sales, recovering decline in China and Travel Retail

Core Operating Profit :
- Increased thanks to higher sales and continued agile cost management

Non-recurrent Items:
- Impairment losses and structural reform expenses related to Kuki Factory transfer in 2023, etc.

Profit Before Tax:
- Finance income/costs: declined by ¥3.8 bn

EBITDA:
- EBITDA margin: 10.4%

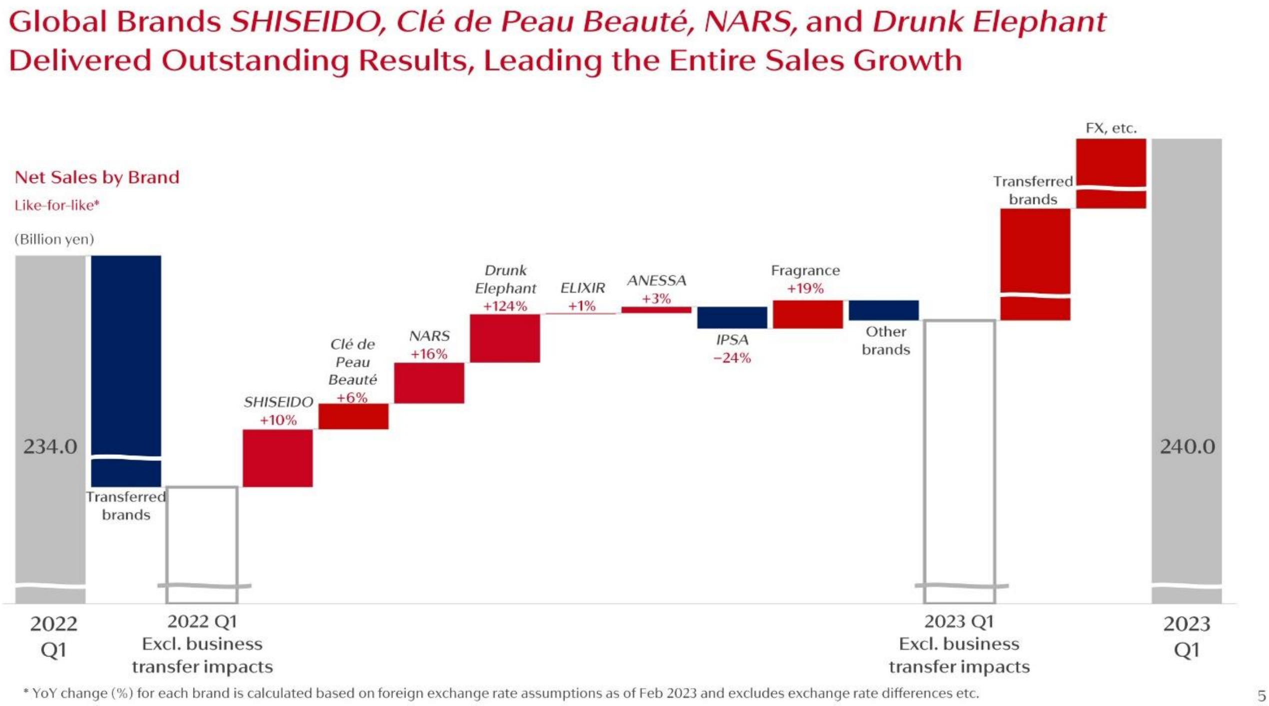
4

Next is page four, the P&L executive summary.

Core operating profit was JPY12.5 billion, an increase of JPY8.2 billion YoY. Operating profit was JPY10.5 billion, an increase of JPY6.1 billion YoY.

There is a JPY2 billion loss in nonrecurring items for the quarter from the impairment losses and structural reform expenses and others related to the Kuki Factory transfer.

Profit before tax for the quarter was JPY10.3 billion, an increase of JPY2.2 billion YoY. Profit attributable to owners of parent for the quarter was JPY8.7 billion, an increase of JPY4.3 billion YoY. EBITDA was JPY24.9 billion, an increase of JPY7.8 billion versus last year. EBITDA margin was 10.4%.



Next is page five, the results by brand.

Global brands Shiseido, Cle de Peau Beaute, NAS, and Drug Elephant significantly contributed to the overall sales growth. Shiseido and Cle de Peau Beaute captured solid sales in EMEA and Japan and also achieved double-digit growth in China. The brand strategies, appealing effects, and efficacies of the brand and products were successful. Along with a robust high prestige market, these brands captured outstanding growth.

Last year, NARS grew significantly with their new product, Light Reflecting Foundation, creating a high hurdle for the year, but the brand continues to perform strong.

As for Drunk Elephant, the brand experienced negative performance last year compared to the previous year but this quarter achieved outstanding growth which is more than double than last year. Consumer purchase has been showing very strong growth momentum from H2 of last year. For this year, the shipment is also accelerating its growth.

On the other hand, the brands ELIXIR, ANESSA, and IPSA that cover a big sales portion in China and travel retail faced difficult situations.

The fragrance business continues to perform strong.

Net Sales Trend: Steady Recovery in Japan, Americas & EMEA Remained Strong, China on a Recovery Trend after January Bottom, Travel Retail Impacted by Retailer Inventory Adjustments

Like-for-like	2022					2023	
	vs. 2021					vs. 2019	vs. 2022
	Q1	Q2	Q3	Q4	FY	Q1	Q1
Japan	−3%	−2%	+9%	−3%	+0%	−32%	+8%
China	−14%	−14%	−2%	−8%	−10%	+10%	−3%
Asia Pacific	−0%	+20%	+12%	+21%	+13%	+1%	+16%
Americas	+7%	+15%	+3%	+12%	+9%	+67%	+30%
EMEA	+9%	+1%	+21%	−9%	+4%	+30%	+22%
Travel Retail	+21%	+15%	+9%	+11%	+14%	+30%	−4%
Total	−1%	−1%	+7%	−1%	+1%	+0%	+7%

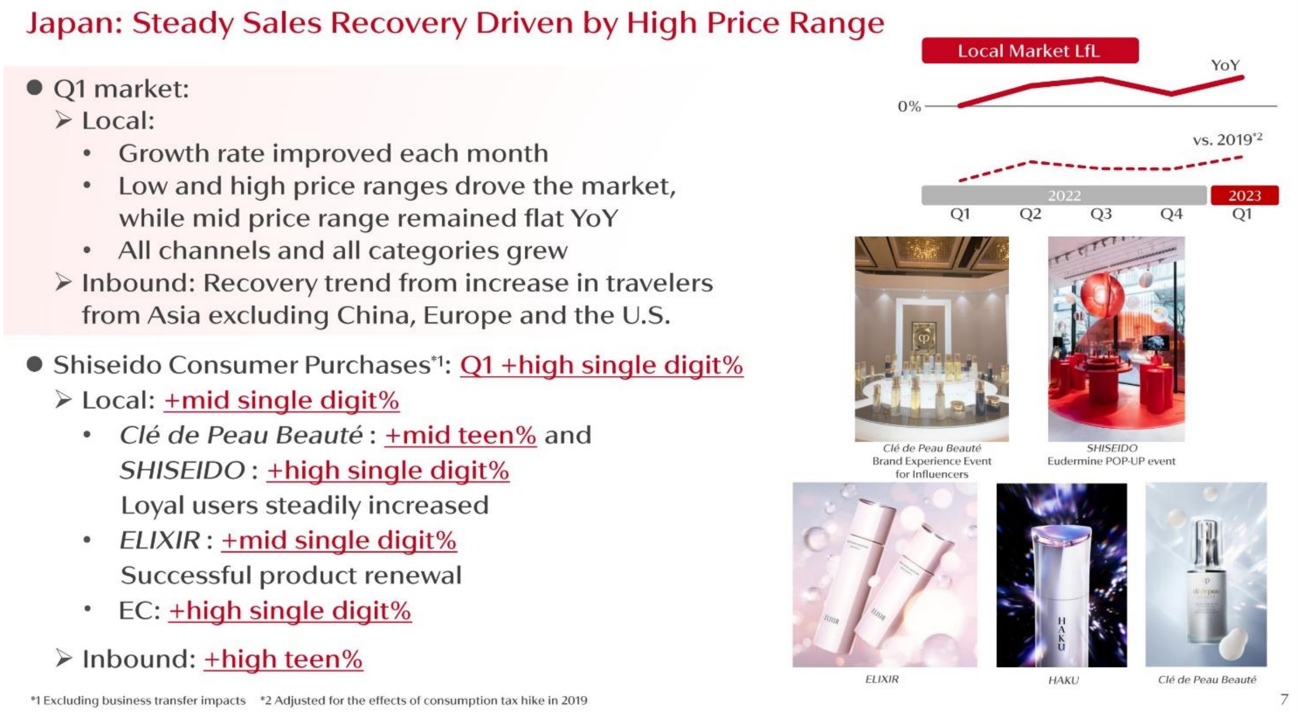
* Excluding FX and business transfer impacts

6

Next, page six, the net sales trend.

The like-for-like net sales for the quarter was plus 7%. The decline in China and travel retail was covered by the steady recovery in Japan and the significant growth in Americas, EMEA, and Asia Pacific. China has been experiencing a continued decline but the minus range that was 10% last year has shrank to 3% for this quarter. With January hitting bottom, it has been showing a recovering trend since February.

Now, if you could take a look at the second column from the right, the total net sales was equivalent to 2019. The good news is Asia Pacific and EMEA that was underperforming against 2019, as of last year, turned into positive. However, even though Japan is on its recovering trend, it is still over minus-30% versus 2019, so we will continue to work on its growth acceleration from Q2 and onwards.



Next is page seven on Japan business.

First of all, in terms of the Japan market, it showed solid recovery every month over Q1. We see that the mask regulation being lifted on March 13 has had its impact on market recovery.

For Q1 total, the local market growth was mid-single digit. To highlight, January was low single digit, February and March was high single digit in growth expansion, and April is continuing this high single-digit market growth, seeming to prove its momentum improvement.

In terms of price range, high and low price ranges drove the market while mid-price range remained flat YoY. On the other hand, inbound market showed recovery trend from increase in travelers from Asia, excluding China, Europe, and the US. We will start various initiatives as the timing of Chinese tourists to visit again, fully preparing ourselves to seize the opportunity when inbound market fully resumes.

Japan business in Q1 realized share acquisition in mid to high price range, which is our core competitive market. We concentrated the investments on innovation and marketing through our core brands, primarily in mid to high price range, which allowed us to expand our loyal users. The growth of consumer purchase was high single digit for the total, mid single digit for local and high-teen percentage for inbound.

In terms of local market, which is the core area of business, the brand Cle de Peau Beaute had a growth of mid-teen percentage, far exceeding the market growth. This contributed significantly to the profitability improvement as well. Brand Shiseido also expanded the loyal users with the launch of Eudermine Essence Water. This product is the next core item of the brand after Ultimune, realizing a growth of high single digit.

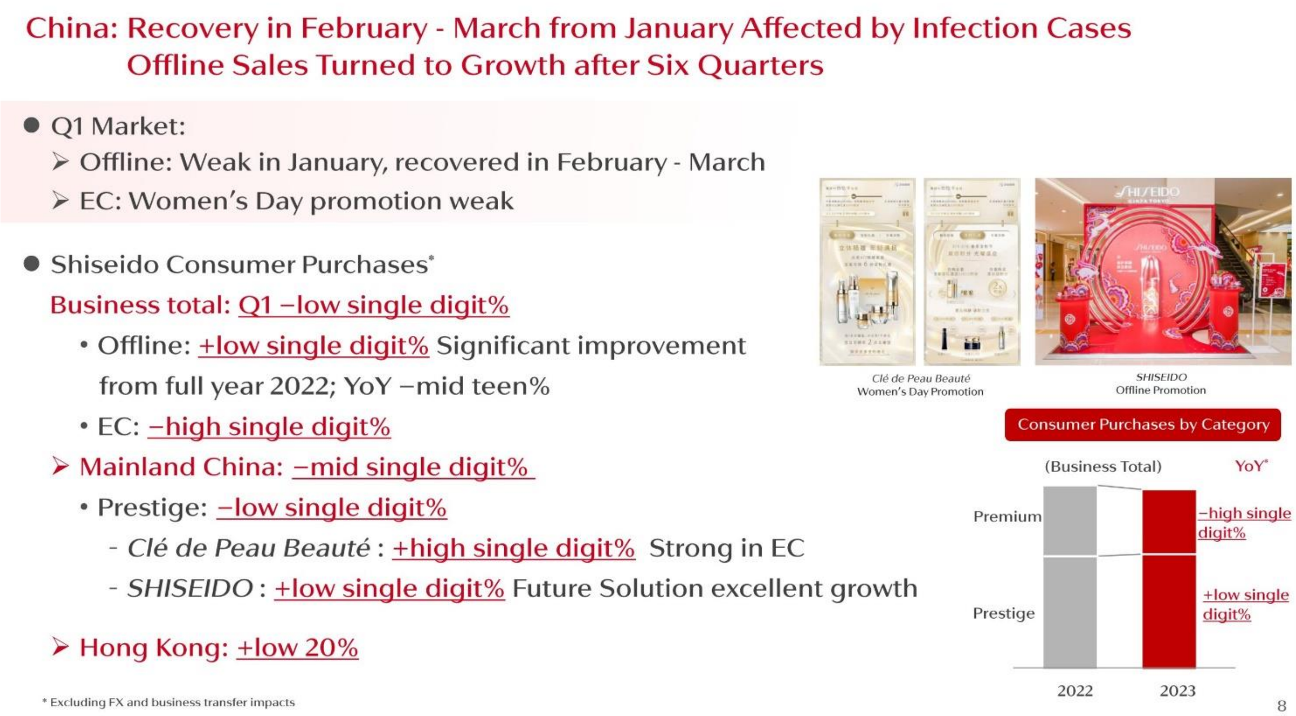
Furthermore, ELIXIR, which had turned into a growth trend after the renewal lotion and emulsion last September, it continued its growth in mid-single digit this quarter with the renewal of the Brightening line in February. It received many beauty awards and is solidly creating the number one share position in the skin care market.

One of the important initiatives of the Company for the year is strengthening the position in the brightening market across all brands and we are making good progress to achieve the target. Haku, the number one in brightening market share, had a good start with the new innovation that was launched on March 21.

Followed by that, products such as Cle de Peau Beaute's Brightening Serum, ELIXIR's brightening line are establishing Shiseido's strong presence in the brightening market.

So overall, we are capturing solid progress in our core area of mid to high price range by strengthening loyal user base and share expansion and we will continue to make this one of the strongest areas of focus.

In terms of the lower price range, we are actually seeing stronger growth more than expected, so we will strengthen initiatives to accelerate the sales in brands such as Aqua Label and IHADA.



Next is page eight, about the China business.

After the end of Zero-COVID policy last December, the number of COVID-19 cases surged again in January, creating a difficult market environment, but February and March turned into a recovering trend. E-commerce underperformed last year's numbers for Q1 and for prestige market overall with the low-performing Women's Day promotion.

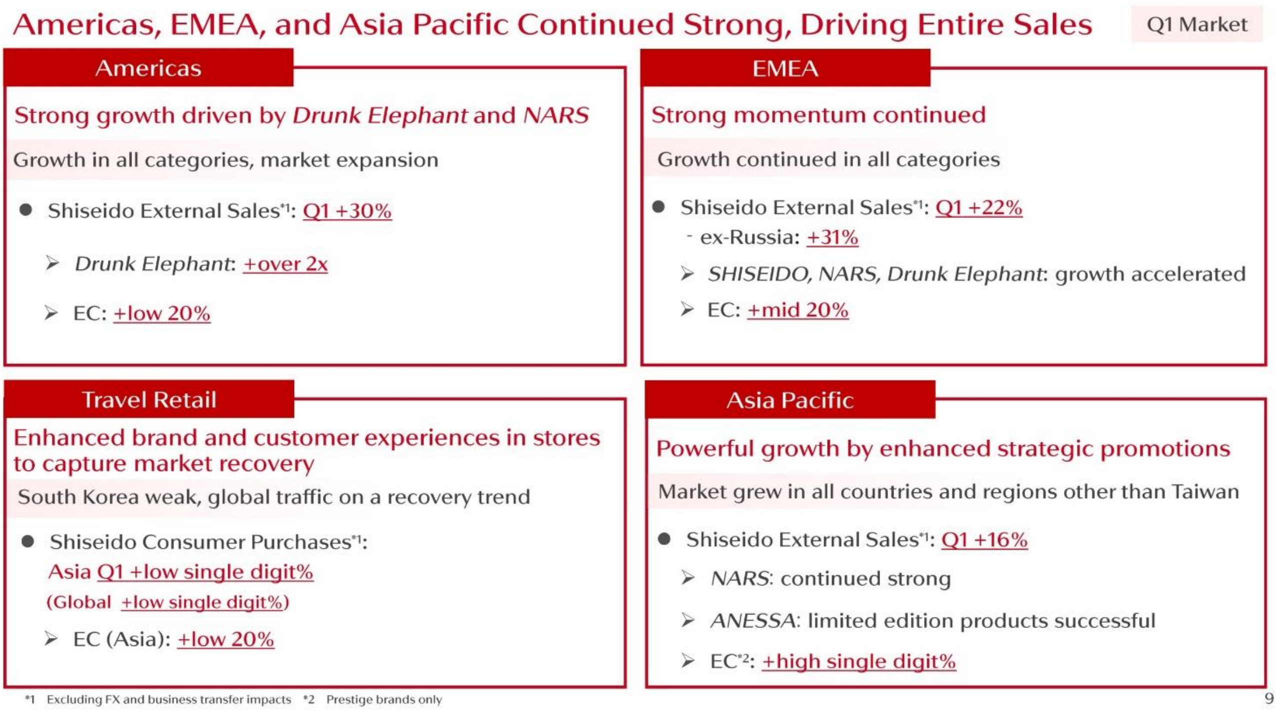
Shiseido consumer purchase was minus-low single digits. This ended being a minus from the sluggish performance of Women's Day and our strategic conversion to not being too reliant on discount promotions.

On the other hand, we have some positive news with the offline sales, which have been underperforming YoY due to COVID-19 impact. Offline sales turned into a positive after six quarters of negative results.

The Company continues to work on sustainable sales growth through strengthening of brand equity this year as well. So even though the market momentum for the Women's Day was weaker than expected, we evaluate that the overall progress is on track to our strategy.

By brand, Shiseido and Cle de Peau Beaute trended well, supported by the strong high-prestige market and successful marketing activities, capturing the recovery in foot traffic. There is no change in strategy for Q2 and onwards, along with the strong investment to offline as traffic recovers.

Although there is the 6-18, June 18, shopping day online, we will continue to turn away some heavy reliance on extreme promotion and execute appropriate allocation of resource for sustainable and profitable growth. At the moment, in April, with the impact from last year's lockdown, we are achieving significant recovery. Hong Kong experienced strong growth along with the recovery of foot traffic from eased COVID-19 restrictions.

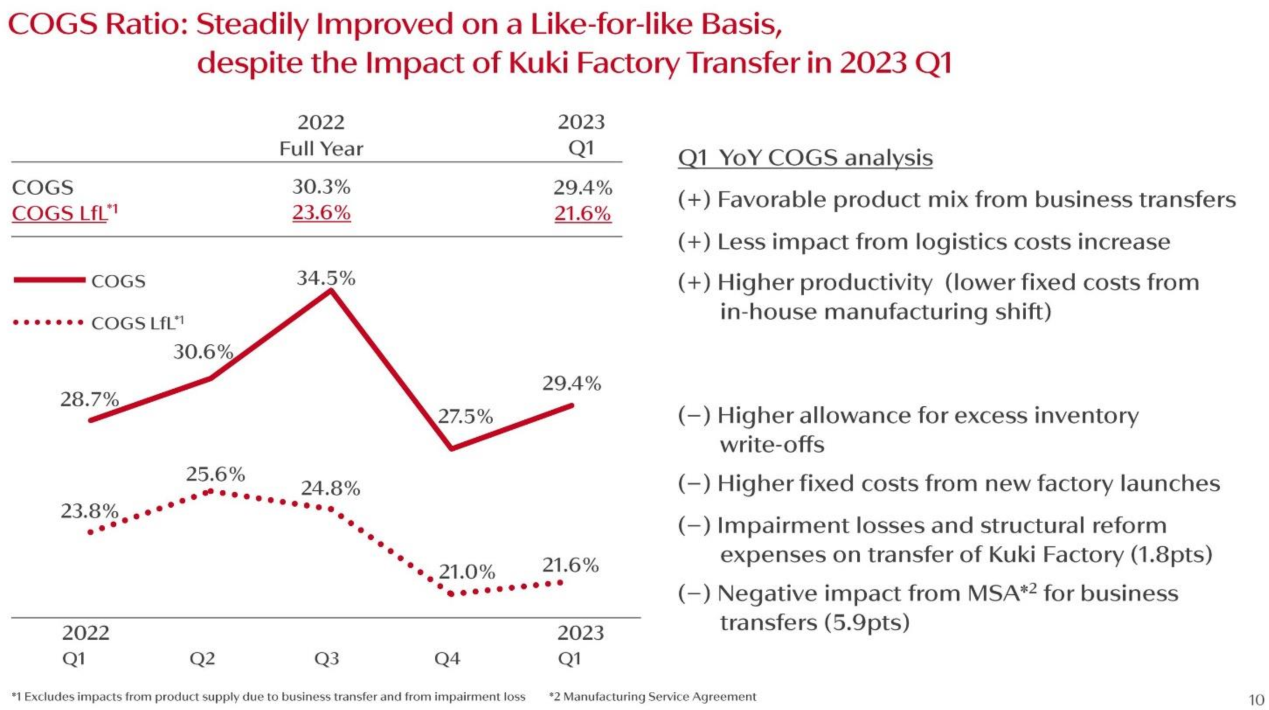


Next, on page nine, I would like to discuss our other regional businesses.

In the Americas, the market continued to grow across all categories and we saw particularly strong sales growth for Drunk Elephant, which more than doubled, as well as for NARS, which continued to perform well. In year two, the market continued to grow in all categories and will maintain strong momentum, especially for brands Shiseido, NARS, and Drunk Elephant.

In travel retail, while the Korean market was weak, global traffic continued to recover and we achieved strong growth in Europe and in Japan. We will continue to expand and enhance our inter-store brand and customer experience to capture the market recovery.

In Asia Pacific, markets recovered in all countries and regions except Taiwan in Q1. We also continued to achieve strong growth, led by NARS and ANESSA by strengthening our strategic promotions.



Next, on page 10, is the cost of goods sold ratio.

The COGS for Q1 was 29.4%, worsened by slightly less than 2 points from 27.5% in Q4 2022. This is due to impairment and restructuring costs associated with the transfer of Kuki plant which were recorded in the current period.

The real COGS ratio shown by the dotted line was 21.6%, showing a steady improvement in real terms. In the second quarter, the impact of product supply as the Kuki Factory will be eliminated and the cost ratio shown by the solid line will improve by about 4 percentage points from Q1.

Core Operating Profit by Reportable Segment: Profit Improved thanks to Higher Sales and Continued Agile Cost Management

Japan :	Increased thanks to higher margins coming from sales growth, and cost efficiency initiatives
China :	Increased thanks to cost management, etc., despite lower margins coming from decline in sales
Asia Pacific :	Declined due to enhanced marketing spending, despite higher margins coming from sales growth
Americas, EMEA :	Increased thanks to higher margins coming from sales growth, etc.
Travel Retail:	Declined due to lower margins coming from decline in sales, etc.
Other:	Increased due to FX and cost management, despite an increase in DX-related investments

(Billion yen)

Core Operating Profit (Core OPM)	2022 Q1		2023 Q1		YoY
Japan	−4.1	(−7.0%)	−1.5	(−2.3%)	+2.6
China	−2.8	(−5.4%)	−2.1	(−4.0%)	+0.7
Asia Pacific	1.2	(7.1%)	0.4	(2.3%)	−0.9
Americas	1.1	(4.2%)	1.5	(5.5%)	+0.4
EMEA	2.0	(6.2%)	2.6	(8.8%)	+0.6
Travel Retail	8.1	(21.8%)	7.5	(19.4%)	−0.6
Other	−1.8	(−2.5%)	3.4	(4.3%)	+5.3
Adjustments	0.8	-	0.8	-	+0.0
Total	4.4	(1.9%)	12.5	(5.2%)	+8.2

11

Next, page 11 is core operating profit by reportable segment.

Japan saw an increase in profit mainly due to higher margin from higher sales and the promotion of cost efficiency measures. China increased profit as cost management and other measures offset the margin decrease due to lower sales. Americas and Europe recorded an increase in profit due to an increase in margin increase and higher sales.

Also, the resources allocated to the brands to be transferred will redeploy to the ongoing businesses to accelerate growth. The increase in profit was achieved despite the absence of large scale of Dolce & Gabbana and other products that existed in the previous year. This is a very encouraging result.

Travel retail reported a decrease in income due to margin decrease from [annual] sales. The increase in other businesses was mainly due to the impact of exchange rate fluctuations and cost management in line with the weaker yen, while expenses increased due to strength through the DX-related investments.

Next, on page 12, we will discuss initiatives in Japan business for Q2 and beyond.

In Q2, we will continue our efforts to expand market share in skin care and stressing activities in base makeup, point makeup and sun care. We will aim to increase the number of loyal customers and achieve strong sales growth by strategically launching innovative products and strengthening the communication of their values.

We regret that we are unable to show you today, but each of our brands will launch groundbreaking, innovative products in H2.

We will also strengthen our activities to capture the customer trend of demasking. Since March 13, we have seen an increase in demand for skin care products that address skin concerns such as lines and wrinkles around the mouth as well as an increase in customers seeking base makeup and point makeup, especially lipstick.

Seizing this opportunity, the launch of Cle de Peau Beaute cushion foundation in March and cream rouge shine in 24 colors in April have been extremely successful. Brande Shiseido also got off to a good start with the launch of 20 colors of TechnoSatin gel lip on May 1.

In the mid-price MAQuillAGE brand, we are strengthening eye color and mascara products to meet their demand for eye makeup. In May, we introduced Loose Poreless Powder to the growing market for face powder to capture makeup demand.

In the sun care business, which is entering the period of full-fledged demand, the Company aims to expand market share by linking the in-store sales and less promotions for ANESSA. With such innovation and aggressive marketing, we will simultaneously improve productivity and restructure our cost structure.

In terms of costs, we will ensure cost reduction by improving mix, thoroughly reducing uneven distribution and returns and improving factory productivity by way of increasing the promotion of skin beauty brand and core SKUs in particular. The reduction of returns is an important initiative not only in terms of profitability but also in terms of environmental friendliness. We have been accelerating the timing for order suspension prior to renewal and minimizing the over-the-counter inventory, which had a certain effect in Q1.

In addition, we're also formally advancing actions to achieve the low 60% level of SG&A expenses. We are working to establish an appropriate personnel structure and improved productivity per employee, which has resulted in a significant YoY decrease in SG&A expenses in the period under review, mainly due to natural decrease.

In addition, the office reorganization has been underway and has been proceeded as planned. The number of offices is to be reorganized from 58 to 23 in July. We will continue our efforts to further improve our operational efficiency in conjunction with the acceleration of the hybrid workstyle.

In addition, [inaudible] withdrawal from convenience stores as part of our selection and concentration of customer contact points in line with the strategy for sustainable growth. We will provide a more specific road map for achieving a SG&A ratio in the low 60% range in August or later.

Next, on page 13, I will explain our future initiatives in China.

In our China business, we will accelerate off-line growth and strengthen our responses through the diversification of all our platforms with an emphasis on sustainable profitability improvement by the brands such as Cle de Peau Beaute, Brand Shiseido, and NARS.

In Cle de Peau Beaute, we will capture the momentum of actual users in the higher prestige market. In addition to continuing to strengthen the Supreme Series, our top end line, we will implement a Height of Radiance campaign, a measure to increase awareness of the brand's unique value of radiance. The campaign aims to attract new users with La Creme and La fond de teint, the face of the brand.

We will also work to promote demand by rolling out set-boxes to coincide with the gift-giving seasons such as Mother's Day and 5-20, known as the Day of Love in China.

As for Brand Shiseido, to rebuild its brand value and prestige image, we will strengthen the brand experience and top-end future solutions lines through the offline events focused on the high function products and launch of the wrinkle cream Vital Perfection Wrinkle Lift as one way to expand the appeal on its efficacy and stimulate demand for 618 products.

In addition to the light-reflecting foundation, which performed extremely well last year, [we announced] plans to further strengthen and expand the foundation category [inaudible] lip product in May to cultivate new product categories.

In addition, we will look to promote [inaudible] launching limited edition packages to capture the travel season. We will steadily implement these initiatives to accelerate growth from Q2 and onwards.

This concludes my presentation on Q1 results and future initiatives.

Lastly, I would like to introduce the Looking Good corporate message campaign on page 14.

Starting with the newspaper ad on April 3 and the commercial on May 7, we rolled out the Looking Good message, corporate message. On May 8, the status of our new coronavirus infection was moved to Category 5, and we are developing this campaign with the hope that the power of cosmetics and beauty will encourage people all over Japan to have good faces, [expressive and unique]. We have received many comments from consumers about this message such as it's heartwarming, very motivating, and it's nice to be able to see faces.

In specialty stores, drug stores, GMS and department stores, the campaign message is being used in conjunction with activities to utilize the power of people, such as skin diagnostics, skin care and makeup application training while addressing the needs of [these] customers.

We will continue to support each customer's Looking Good by meeting their individuals. In this way, we will accelerate our growth potential by simultaneously expanding our market and market share that will energize the industry as a whole in response to consumer awareness, inbound demand which have greatly impacted by COVID-19.

Question & Answer

Operator [M]: Now we would like to go into the Q&A session.

From JPMorgan, Kuwahara-san. Ms. Kuwahara from JPMorgan.

Kuwahara [M]: Hi. This is Kuwahara from JPMorgan. Thank you. One question per person, I understand. I want to hear about the comparison versus [the guideline]. The Japanese market is recovering well and EMEA, it's all doing good, overall doing well compared to the guidance or the outlook; I think, overall, you mentioned that we are on track to the outlook. But are there any discrepancies or some gaps between regions?

Now, for profit, [some of] the costs will be carried over is what you mentioned. How much are some of the costs or expenses being carried over? Anything related to the profit? Along with some of the discrepancies you may expect to the outlook and guidance, can you share along with the profit as well?

Yokota [A]: On a consolidated basis, like-for-like, Q1 is positive 7%. I think that's pretty much in line with what we had expected.

In terms of EMEA, we had the rush to buy before the price increase, so that probably gave us a little bit of a hike or pushing sales. To the 11% on a consolidated basis, it may seem a bit weaker but, originally, China and the inbound sales in Japan, we are forecasting that we will have a better recovery from Q2 onwards. So, that included, I think, we are on track.

For profit, there are some gaps of about JPY4 billion of when the cost will be booked. But excluding that is what you're seeing on a YoY basis. But that too is within what we have expected. That will be it with my answer.

Kuwahara [Q]: The gap of when the timing of the booking is JPY4 billion, that's going to be carried over to Q2 from Q1, so JPY4 billion will be carried over to Q2. Okay. What I'm concerned about is the investments being delayed, too. Especially for Japan, the mid-price range overall isn't really coming back. But your company is investing and talking about innovation and bringing back your brand power. That is one of the contributors for the profit improvement for the Japan business and I think that's the key to making the Japan business. But the investments to those areas are not behind, right?

Yokota [A]: That is correct. We're not behind on the investments but there are some other expenses that will be carried over to the next quarter. There are some shipments of the samples as well, but that's different from the timing that's actually going to be used, so we don't think of that as a problem. In terms of the marketing activities of the expenses being carried over to Q2, there's no impact. It has no impact to the marketing activities.

Operator [M]: I would like to move on to the next question. Hirozumi-san from Daiwa Securities, please.

Hirozumi [M]: Hirozumi from Daiwa. Thank you. I'm sorry I haven't looked into all the materials but there's the profit from other segments, quite significant. There seem to be some adjustments making a lot of changes or the differences. But profit from other segment seems to be quite significant. What is the background of this large profit from the other segment?

Yokota [A]: YoY, plus-JPY5.3 billion, half of it is ForEx associated with export. This is about the brand held by the headquarter, sales associated with it is we make sales from the headquarters. Shipment is associated with the margin increase, which is about JPY3 billion. In addition to that, there is the ForEx impact. There's JPY3 billion of ForEx impact. I think the brand holder, is it a brand holder of the headquarters?

Hirozumi [Q]: IPSA didn't do so well, as in the case of page five. Yes, having said that, but then the shipments of other brands was much more significant. What brand is doing well in terms of the shipments in the other segment? Brand Shiseido and Clé de Peau Beauté were the main brands from the headquarters.

Yokota [A]: Okay. On the left, page five, under “brand,” Shiseido, Cle de Peau, these did quite well.

Hirozumi [Q]: I understand now. Going forward, how to interpret the other segment? Brand Shiseido and Cle de Peau will do well. Then there's the ForEx with the yen depreciation. How are we to make an assumption?

Yokota [A]: I think this is going to shift as planned. We have difficulty in accurately assessing how the ForEx will move. But as long as the sales will shift as expected, then I think the result will be as expected, as planned. Some of the shipment may not happen but then this will be within our assumptions. Brand Shiseido and Cle de Peau have the higher margin. When they ship more, then it drives the profit higher.

Hirozumi [Q]: So the brand holder related profit will be recognized there in the other segment. Okay, I understand. Thank you.

Operator [M]: We will go onto the next question, from Morgan Stanley MUFG Securities, Miyake-san.

Miyake [Q]: Thank you. I have a question around sales in EMEA and Americas. On page six, it's growing 20%, 30%, and it's performing well. I wanted more detail or clarity on that. Drunk Elephant doubled. NARS grew. I know these are the drivers. But of this increase in sales, it was this [bad]. If I can add more clarity around that, that would be great. So I understand, is it doing well because the market is doing well, are there other reasons, or is it linked to the storefront sales? Some details around that as well?

Yokota [A]: In the Americas, the biggest driver was Drunk Elephant. If you may remember, last July to August, we started doing paid media to increase the Drunk Elephant awareness, which had gone up, and along with that, the sellout. The actual sellout was growing by about 30%. But the sell-in, there was some retailer inventory, so the sell-in wasn't catching up to the pace.

Therefore, from about December onwards, we saw the sell-in started to catch up, too. Finally, the sell-out and sell-in gap has kind of come together and gave us the strong numbers in Q1, which has given us over double performance or sales performance for Drunk Elephant.

The serum D-Bronzi was a big hit. Last December alone, I heard that December sales was about the last full year’s sales, so it’s a halo effect for the other products.

Yokota [A]: There was a halo-effect from the [inaudible] and sustaining the Drunk Elephant strong sales. To accelerate the strong sales, we are strengthening our investment. I think [these] were all the contributors and drivers to the strong sales of Drunk Elephant.

For NARS, we have the light-reflecting foundation, the reflection foundation that was successful last year not just in Americas but it's a huge hit globally. [With] that high performance of NARS, they're sustaining the strong performance as a brand. Also, versus last year, it's over 20% and continuing to grow. So these two brands, in terms of Americas, Drunk Elephant and NARS, were the strong drivers.

In terms of the market for Americas, the market is experiencing double-digit growth. For makeup, it's in the mid-20% growth, so the market overall is very strong. Of that, where we're [showing up the core], skin care, Drug Elephant, we are capturing the market share. I think, in the Americas, these are the high contributors to our sales.

For EMEA, similarly, the market itself is very strong. It's experiencing double-digit growth. The strong drivers to the EMEA performance is also the fragrance. The market itself for fragrance is doing well. Our fragrance is a bit lower in terms of growth rate to the market growth of fragrance, but we do have plans for big launches ahead of us, so we are preparing for that. In H2, we should be able to make a comeback in the fragrance market as well. But outside of that, Brand Shiseido, NARS, Drunk Elephant, similarly are performing well.

As for Brand Shiseido, last year, we launched the Bio-Performance Skin Filler and that's been a huge hit, so a major part of the contributors.

Miyake [Q]: Okay. Thank you. The market is strong and you're very competitive in that, too. And is the market still growing strong with double-digit growth in April timing?

Yokota [A]: We don't have the exact market data of April but we do believe that the strong market growth is continuing.

Miyake [Q]: Understood. Looking at the economy and [forward], your balance?

Yokota [A]: As for the market outlook and economy, it's what you hear on the news, similar to all of us. In Americas, we'll be focusing on what will happen in H2 for the US, for example. But as for our outlook, this is a recession. We think of it to be a mild recession. To that mild recession, the beauty market is quite resilient. We are planning and outlooking ourselves to plan to that kind of outlook.

Miyake [M]: Thank you very much.

Operator [M]: We would like to take our next question from SMBC Nikko Securities, Yamanaka-san, please.

Yamanaka [Q]: Hello. Yamanaka from SMBC. Earlier in your explanation, on the [formation on] the cost on page 10 I'm looking at. From Q2 and onwards, did you say that it's going to improve by 4 points? So about the cost of goods flows and its assumption from next quarter or the next year and onwards?

Yokota [A]: The upper line, the solid red line, is the cost ratio on our P&L. The reason why, as you see here, there is this, the cost on the real terms is the 21.6% with the remaining business, existing remaining business. There is a gap between the COGS and COGS LFL. This particular quarter, there's an impact of the impairment losses from the Kuki factory transfer, which is 1.8 points associated with the transfer. This is a onetime phenomenon, so this will be eliminated going forward.

Also, in association with the business transfer, from Kuki factory, there's a contract manufacturing as in the case of the normal business. Unlike the normal business, it doesn't earn as much margin. Therefore, there will be about a 4-point improvement in the cost of goods sold.

Going forward, in relation to the business transfer, the main impacts will be eliminated. Therefore, by and by, we're going to get closer to the numbers described with the dotted line in a row [inaudible]. Between now and 2025, we would like to lower this to about 21%. And so, a number of actions are taken by different departments.

Yamanaka [Q]: Thank you. Then in regards to Q2, this 1.8 points deriving from the Kuki factory will be eliminated. Therefore, there will be a 4-point improvement YoY. Am I correct in my understanding?

Yokota [A]: This is not the case of YoY comparison but the transfer of the Kuki factory will happen on April 1. There may be some costs associated with it. But then the 4 points will be eliminated for the provision and the supply.

Operator [M]: Going on to the next question, from Nomura Securities, Ohana-san.

Ohana [Q]: Hi. My name is Ohana from Nomura Securities. I have a question regarding travel retail. Your travel retail sales compared to other competitors' travel retail, you performed well. You were competitive. Your materials said South Korea did not perform well.

But what about Asia? Hainan Island, South Korea, Hong Kong, and Japan? What kind of plus and minus were there to result in these numbers? For China, there have been some topics about inventory adjustments. What is happening around that? Could you share with us?

Yokota [A]: For the South Korea ratio of our company sales, about 40% is usually the portion. But with the South Korea different policy change, there's been adjustments in inventory. For Q1 versus last year, it impacted us by 50%. That is the biggest impact reason. In China Mainland and the rest of travel retail, Japan and travel retail West is covering for this loss. As a result, though, we could not offset all of it. Therefore, it ended at minus-4%.

For Hainan Island, our sellout is in the mid-20% in terms of the sellout sales. If you are aware or if you remember from last year, there was the China lockdown. As a result, our sell-in went [up] first. We have the advanced selling. At the timing of the planning, Hainan was about 5 points lower than what was expected. As a result of that, that was at the timing of the marketing planning. This year's Q1 sellout was mid-20%. Then our sell-in was pretty much flat. I think that shows us that the destocking had been quite good for this Q1.

Ohana [Q]: Thank you. Looking at the travel retail China market, the distribution inventory or suppression of inventory, is that something we should be worried about? Is there something to be concerned about in terms of this inventory control?

Yokota [A]: Looking at the current Hainan Island momentum, we only have the data from the air flight travelers. So looking at just the flights, excluding ships and others, but by flight, January to February, there is about plus 20% in terms of the flight travelers. Compared to Q4, which had the lockdown last year, it's about double the number of passengers flying. I think we're seeing the recovery in traffic to these travel retail areas.

Ohana [Q]: Q2 onwards, along with that, do you think that you will be recovering along with the foot traffic recovery in travel retail?

Yokota [A]: In terms of travel retail, the impact of South Korea was the biggest in Q1 with this inventory adjustment. So South Korea recovery is probably only from about Q3. For Hainan Island, we are doing inventory adjustments. So rather than sell out, sell-in will be slightly lower and we are trying to continue that to optimize, but that's all been planned.

Ohana [M]: Okay. Thank you very much.

Operator [M]: Going to the next question, Miyasako-san from Jefferies Securities.

Miyasako [Q]: Miyasako speaking. I would like to ask a question about inbound. It is recovering high 10%, and you have a plan for plus 70%. The Chinese inbounds are not recovering so much. So, what is your assumption on the shopping patterns or the behavior?

Yokota [A]: The Chinese inbounds at the time of planning was to consider that the recovery will happen from Q2 and onwards. Also, when we look at the current situation, yes, indeed we're seeing some recovery in Q1, but not so much.

But as far as the April situation is concerned, there is a clear recovery. There's a visible recovery. However, this is the recovery from inbound except Chinese travel. The more robust recovery should happen at the timing of a recovery or restart of the Chinese tourism to Japan.

Miyasako [Q]: When do you think that will happen? What's your assumption of the timing? And are you going to stay with your original planning or assumption?

Yokota [A]: At the moment, we don't have information on that, so we will stay with our original plan.

Miyasako [Q]: I believe that Chinese tourists are coming back to a certain extent. What is their purchase behavior in relation to new products? I think you make an assumption based on the assumed consumption behavior but I think there's different opinions about whether their purchase will come back or not.

Yokota [A]: In any case, our plan is to expect 70%-plus YoY. From the end of Q3 to Q4, our assumption is to see the recovery. Depending on how things will go, this timing may be delayed or come even earlier than our assumptions, so we will keep an eye on this.

What we need to be careful about is the Japanese local market recovery, which has been quite stagnant. We are beginning to see the signs of its recovery. How to accelerate it is something that we are focusing on at the moment. For the Japanese local market recovery, there is a tendency that recovery is happening sooner than expected, so we would like to capture the moment.

Miyasako [Q]: Thank you. I would like to go back to the inbound topic. Do you think that there will be some inbound from Korea and Hainan to Japan?

Yokota [A]: We're not looking into that much.

Miyasako [Q]: So it's not realistic then.

Yokota [A]: There are some complex factors that would affect the market. In any case, we would like to increase the local Japanese market or the business. If that is compounded or supplemented by the inbound business, that would be great. That's sort of the assumption that we are making.

Operator [M]: We'd like to move on to the next question. From JPMorgan Asset, Osada-san.

Participant [Q]: Ohana-san asked a similar question, but about China and travel retail. The sellout, the consumer purchase, excluding China's beauty, I feel that you are outperforming the other competitors, not sell-in but sell-out. Your high performance, is that because your strategy from last year has been performing well? Along with that, what is your current situation on the market share?

Also, for the source of demand, what is your core [such as] global Shiseido and Cle de Peau Beaute? What is supporting these consumer purchases?

Yokota [A]: In terms of China Prestige, the market is in low single-digit growth. The growth is about mid-single digits. So about 5% was from offline. E-commerce dropped as a result in low single digit for the Prestige market. Of that, for Shiseido, for our company, we strategically wanted to lower the ratio of extreme promotion and want to heighten, improve on the brand equity.

That's been the strategy. So, the huge promotions, the expectations of these huge promotions were not very high because of our strategic conversion of how we want to approach these promotions. As for that, we are lower in share to competitors, but that's because of our strategy. We don't want the extreme promotions.

But offline, where it's the recovering of the market, especially Brand Shiseido, we believe that we are capturing the market share and we are on progress to capturing the market share for Brand Shiseido offline. So I believe that, overall, we are doing well and are well to the progress that we want to achieve in terms of the China market.

Participant [Q]: In China and travel retail, so my image was, when you think about the Chinese people demand, Chinese people demand overall, I feel like you are capturing the sellout. Looking at the global suppliers, excluding, let's say, the South Korean players, I feel that the other players are not performing as well as Shiseido was in terms of the Chinese audience in terms of sellout.

Yokota [A]: You're talking about Hainan Island?

Participant [Q]: Travel retail overall.

Yokota [A]: What was good was the travel retail Japan. Some Chinese tourists are not back yet but the travel retail Japan is growing versus last year. That's one of the points to highlight. Asians, excluding people from China, were the driver to the growth of Japan TR. TR West had solid growth. How are we against the market? I do not know. We do not know. But the Travel Retail West is doing well too.

Then the rest will be for Hainan. As mentioned earlier, it's in the mid-20%. Along with the traffic recovery, I think we are capturing the demand.

Participant [Q]: Thank you. So for travel retail, the mix of consumers is different from Japanese players?

Yokota [A]: In the travel retail offer for Hainan, the traffic is coming back. We'll [inaudible] we can only capture some of the information for domestic flights. For January, it's been increased by 20% to Hainan Island from the domestic flights. I think, from that, by capturing the mid-20% in growth, I think we're pretty much in line with the foot traffic recovery.

Participant [M]: Okay. Thank you very much.

Operator [M]: The next question, I would like to do the two last questions and so please ask one short question per person. From UBS, Kawamoto-san.

Kawamoto [M]: Thank you very much for your presentation. My name is Kawamoto. Just on the increase of operating income, JPY8.2 billion, I would like to understand it better. According to the answer to the previous question, half of it comes from ForEx impact. From Q2, I think the ForEx impact is going to settle. I believe that there may be some shift in this number, so there will be a higher profit earned in China following the cost management. What did you do exactly? Did you try to reduce the fixed cost?

Another question is that JPY600 billion.

Operator [M]: I'm very sorry, but we can only take one question.

Yokota [A]: About the assumption on the increase in the operating profit, as you said, last year, the ForEx since February/March, it started going up against the dollar. The yen was very much appreciated.

This time, the reflection of that will not happen from Q2 onwards, not in the same manner as we saw earlier, based on the currency assumption that we have. Of course, if there is a movement in the ForEx, there's the potential there may be some shift. So yes, your assumption is correct at this point in time.

Kawamoto [Q]: With the increase in the operating income in China, is it due to lower fixed cost? Are we talking about Q1?

Yokota [A]: Yes. The sales, certainly, yes, we have worked on reducing the fixed cost. But the biggest element is the impact of the timing shift.

Kawamoto [Q]: Also in Europe, about the last-minute purchase before the price increase, was there any impact?

Yokota [A]: It is really difficult to cut out which part of the purchase comes from the last-minute purchase. But then, yes, there will certainly be some contribution to the revenue but it's not so significant. Having said that, the price increase was carried out in Q1 in EMEA and the US.

Kawamoto [M]: Thank you very much.

Operator [M]: Thank you. Next will be the last question. Mitsubishi UFJ Morgan Stanley, Sato-san.

Sato [Q]: Hi. This is Sato. I didn't think I would be called upon. Thank you. Page 20, SG&A, JPY4 billion. You said JPY2 billion will be carried over to Q2. When I look at what's happening here, what from here is carried on? Why? Can I have the reason? Brand development is going down significantly, for example. So what's going up? What's going down?

Yokota [A]: For some of the booking delays, it’s mainly in the marketing cost. Samples, shipment of samples, for example, that's a big chunk of it.

For brand development expense, that's going down. That is not due to the booking gap or lag. But compared to last year, at this time, for brand development, last year, we had the Dolce & Gabbana transfer. We had the TSA-related things that were going on before D&G were transferred.

So it's more the commission that we have to pay to D&G. That was why it looks lower than last year.

Sato [Q]: The JPY4 billion, that's only in China?

Yokota [A]: No, it's not only in China. It's others as well, but half is China.

Sato [M]: Okay. Thank you.

Hirofuji [M]: Thank you very much. With this, we would like to wrap up the Q&A session.

We will be sending you a questionnaire survey from the IR Department. We would love to get your feedback on this survey so that we can continue to improve our IR activities.

With this, we would like to close the phone conference. Thank you very much for your attendance today. Please don't forget to hang up your phones. Thank you very much.

[END]

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