Shiseido Company, Limited

Business Strategy Briefing

November 29, 2024

Event Summary

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[Event Name]	Business Strategy Briefing	
[Date]	November 29, 2024	
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[Venue]	Webcast	
[Number of Speakers]	3	
	Kentaro Fujiwara	President and COO
	Ayako Hirofuji	Chief Financial Officer
	Yuki Oshima	Vice President, Investor Relations Department

Presentation

Fujiwara: Hello, everyone. Thank you very much for joining us. At the financial results briefing on November 7, we announced that we would accelerate structural reforms in 2025 and 2026, and that we would use further structural reforms to improve profitability, get out of the current critical situation and build a foundation for ensuring sustainable growth thereafter.

Today I will explain about SHIFT 2025 and Beyond Action Plan 2025-2026 to be executed over the next two years.

Looking back, since the COVID crisis, we have been affected by many changes in the external environment, and we have quickly responded each time. But as a result, we have not achieved our initial plans. In response to this, the management team felt a strong sense of crisis and reviewed all aspects of our future planning.

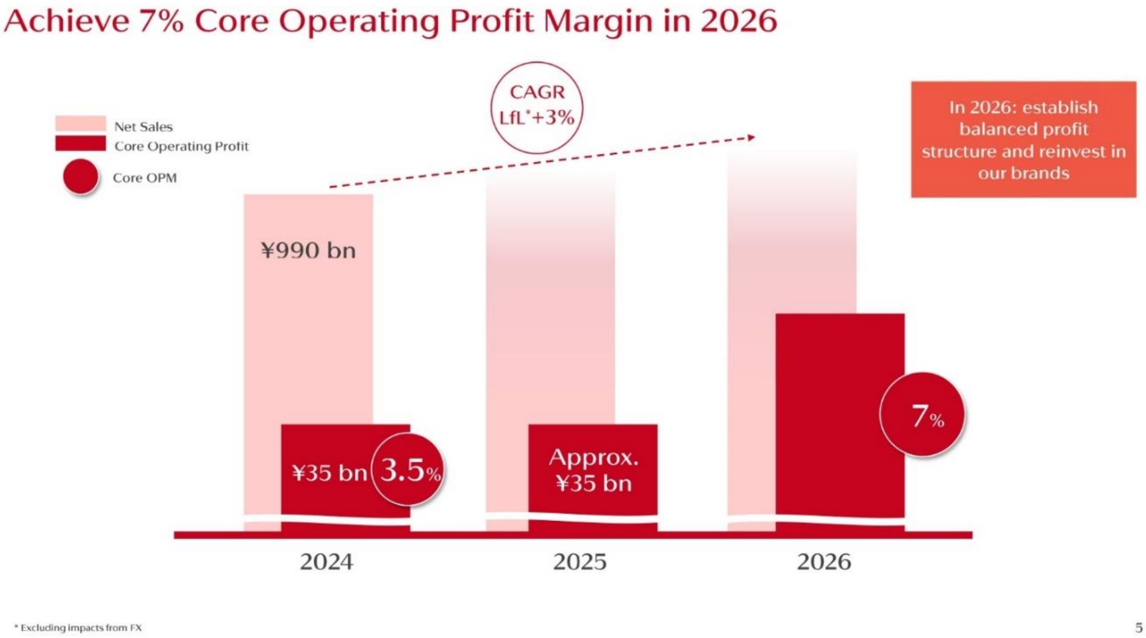
Firstly, we decided to make a growth-oriented plan based on the current situation and, rather than being optimistic about growth based on the premise that unstable situation in the market will continue in the future. Next, we will identify what we can and cannot control and formulate the reform plan without sanctuary in the areas we can control. In order to achieve sustainable growth in the future, it is important to further refine the brand assets that our company has accumulated over many years. Based on these ideas, we will work with all our energy to build the foundations for Shiseido over the period of two years.

Next, on page 3, so this is the aim for the two-year period of 2025 and 2026, and it is to build a resilient business structure that achieves stable profit growth even in a rapidly changing market. A resilient business structure is made up of two important pillars.

The first is the brand, which is the point of contact between consumers and our company. We believe that having brands that are strongly supported by consumers and strengthening the foundations of brand equity are two of the key pillars of a resilient business.

The second pillar, establishing a high profit structure, meaning creating a leaner profit and loss structure, creating a system that ensures that brand growth leads to profits, and improving profitability in all regions to create a well-balanced profit structure. We will also promote the advancement of business management, which will see the entire company working together to advance these initiatives with transparency and cultivate a corporate culture that will continue to act and deliver in a sustainable and autonomous manner.

Next, page 4, the top priority matters to address in the 2025-2026 action plan are as stated. Today, I will explain the specific actions.



Next, page 5. Through the completion of the Action Plan 2025-2026, we aim to achieve a core operating profit margin of 7% in 2026, which is double the level of this year. 7% is just a milestone, but we will use the two-year period to raise our profitability to the highest level since the COVID crisis and use this as a milestone to build a well-balanced profit structure that will allow us to reinvest in our brands.

Regarding 2025, we do not expect to see a significant improvement in the profitability from 2024. First of all, in 2025, we will have achieved cost reductions of JPY20 billion through the structural reforms we have already been working on, and we will definitely complete this. On the other hand, the market environment for China and Travel Retail is not one that allows for optimism, and we do not expect to see an increase in sales.

We need to carefully estimate the profit margin for FY2025, in light of the fact that we need to firmly invest in marketing and people for growth over the medium- to long-term. We will prioritize the steady implementation of necessary actions, and we hope to improve the profit margin from 2026 onwards.

Reinforce Brand Foundation
Establishing Strong Foundation for Sustainable Growth

2025-2026 Key Pillars of Brand Strategy

- Enhancing key brands - developing Core 3 and Next 5
- Rebuilding sustainable business foundation in China and Travel Retail, accelerating growth in Japan, Americas, EMEA and Asia Pacific
- Strategic investment allocation to key brands
- Converting our technology and R&D strength into our brands, maximizing brand equity and growth
- Reinforcing processes, organizations and talent

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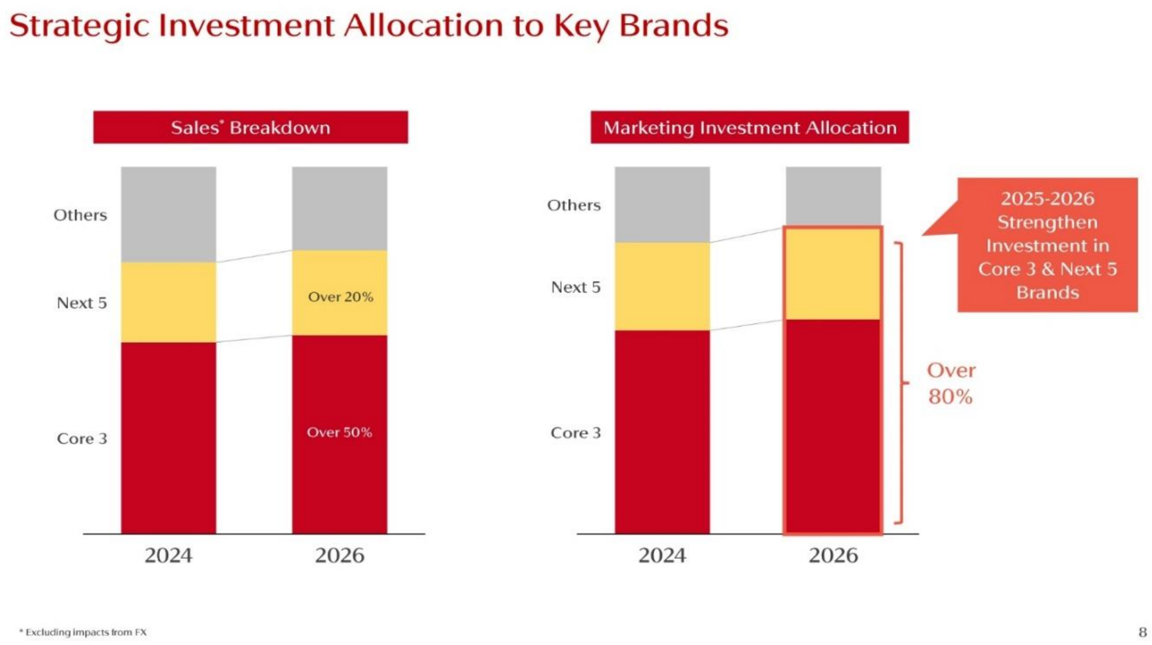
Next, from page 6, I will explain about reinforcing brand foundation. We have set out the five points mentioned here as the pillars for the next two years with the aim of building the brand foundation.

Next, page 7. Here is the brand portfolio strategy for 2025 and 2026.

We will achieve more sustainable growth by cultivating strong global brands and making them the pillars of our business. To this end, we will continue investing through selection and concentration over the next two years. We will focus on the three brands that are already ranked highly globally and have sales of over JPY100 billion: SHISEIDO, Clé de Peau Beauté, and NARS, which we will refer to as our "Core 3" brands going forward. Specifically, we will sharpen brand equity, strengthen marketing focus on the hero products, accelerate growth in the Americas, EMEA, and Asia Pacific, and maintain growth momentum in Japan.

For China and Travel Retail, we will not set overly ambitious growth targets but aim for sales growth and profit expansion that is rooted in brand equity. In addition, we have positioned the five brands that will be the next JPY100 billion brands as the "Next 5." In the next two years, the priority for the Next 5 brands will be to achieve growth by capturing local needs in their current core markets and to establish a revenue base. The idea is that by improving profitability in their main markets and becoming strong brands that can self-fund, they will be able to actively expand into other regions.

In terms of categories, we will strategically strengthen our sun care and fragrances categories. As part of our strategy to strengthen our brand equity, we will be making an additional JPY30 billion marketing investment over a two-year cumulative period from the base year of 2024. In particular, we will be focusing our investment on the Core 3 and Next 5, while at the same time, in light of the profitability and growth potential, we will also be considering strategic brand withdrawals and reductions.

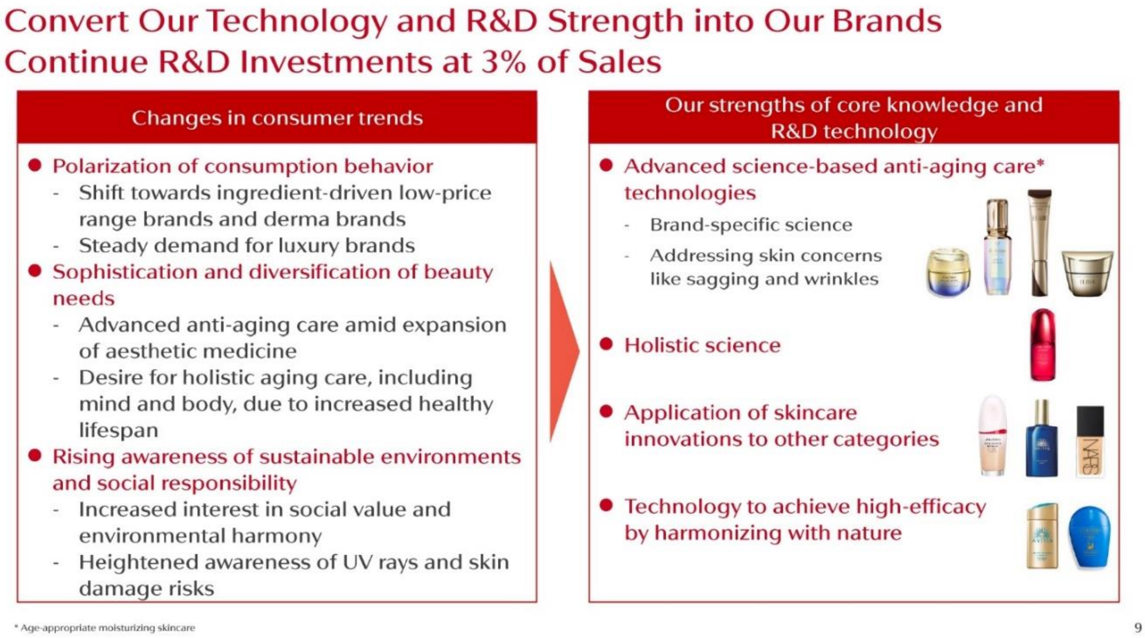


Next on page 8, this slide shows the sales and marketing investment composition ratio for focus brands.

The areas shown in red and yellow account for over 70% of the Company's total sales.

By adding the priority investment, as I mentioned earlier, we will allocate more than 80% of the total of focus brands by 2026.

In addition, the Core 3 and Next 5 brands already have higher brand margins than the average, so concentrating investment to accelerate growth will also lead to improvements in the company-wide brand mix and profitability.



Next on page 9. For these focus brands, we have already built a certain level of brand recognition in each market, but in order to further sharpen their value, we will make it a priority to directly convert our technological and R&D strengths, which are the sources of converting our strength and competitive advantage into brand equity.

In each region, we are seeing a polarization of consumer spending behavior with a solid demand for luxury brands, particularly among the consumers who are seeking the authentic thing, while there is also a shift towards low-priced brands and derma brands. In addition, we are seeing a diversification and sophistication of anti-aging care due to the expansion of aesthetic medicine and the extension of healthy life expectancy. And of course, rising awareness for environmental sustainability and social issues is an irreversible trend that will continue to grow in importance in the future.

Shiseido has the ability or superior science and technology capabilities that can respond to mainstream trends in consumer behavior. With respect to anti-aging care, we have technologies based on many years of research and advanced science that address skin concerns caused by aging, as well as holistic science that focuses on the power that humans inherently possess. In addition, we also have capabilities to apply our skin care technology to other categories while creating high efficacy by harmonizing with natural environment.

Lastly, with respect to coexistence with nature and environment, for example, we have Sun Dual Care technology in the sun care category. This is an innovative technology that blocks UV rays while converting sunlight into light with benefits of beauty care. This is a superior technology that was born from the idea of harmonizing with natural environment, our unique science that not only eliminate UV rays, but also harmonize and coexist with them, transforming into beauty. We will continue our efforts to advance technological innovation that we can more directly and clearly convert into brand equity.

Next, as shown on page 10, these advanced technologies have been cultivated since the Company's founding based on Eastern approach with the idea of viewing everything in its entirety, not just the surface of the skin, but also considering the inside health and beauty, from assessment to prevention and also considering the whole of a person's life, researching skin problems from their onset to the future, and the ability to think about solutions.

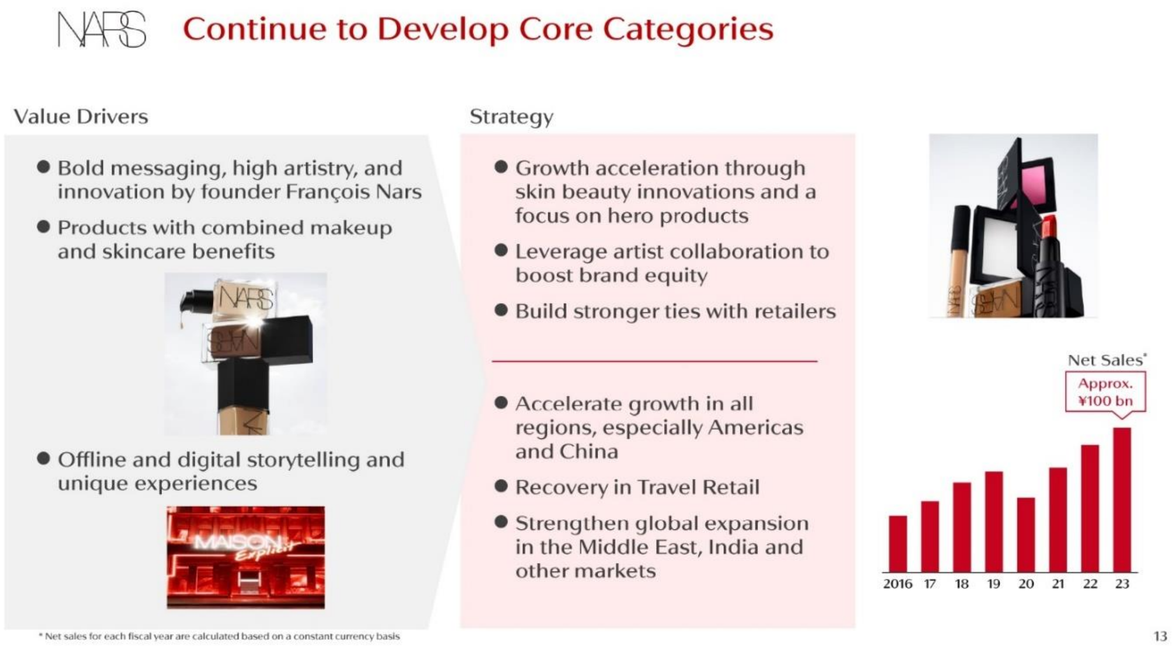
We have cultivated science that uncovers these connections. In other words, our approach of expanding from a single point to a line and then to the surface to derive comprehensive solutions has led to a variety of research results. Our company has won the most awards at the IFSCC, the world's largest research conference for competing cosmetic technologies. This year, we also won the top prize for our research report on age spots. We are planning to develop products that will provide consumers with the value of these latest technologies, and we hope that you will look forward to seeing greater linkage between brand value creation and technological capabilities.

From page 11, I would like to explain about the strategies of some of our key brands.

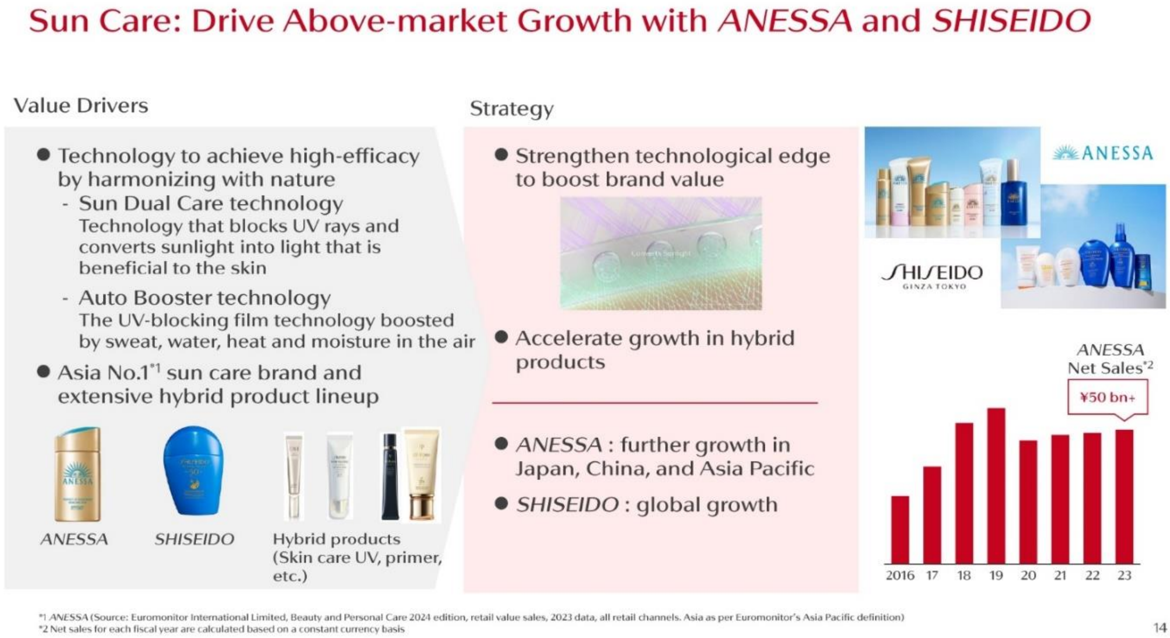
First, for SHISEIDO, leveraging the strength in holistic science that addresses diverse needs of the skin, we have powerful hero products placed in each product line. Moving forward, we will aim to strengthen the prestige through consistent branding, spanning from products to consumer experiences, while enhancing value delivery to meet the increasingly diverse needs. This will include further value development of each of the product lines such as Ultimune, Vital Perfection, and Future Solution LX.

Additionally, by customizing these offerings with regional variations, we will cultivate its flagship brand, SHISEIDO, as the global core of the Company. Since the impact of the treated water issue last year, brand SHISEIDO has been struggling in China and addressing this challenge has become an urgent priority. We are currently working on rebuilding brand equity.

Next, Clé de Peau Beauté. We will continue to strengthen the brand as a high-value skin care brand and work on enhancing its profitability. Going forward, we aim to capture the growth momentum of the luxury market, which is expected to remain strong and establish a solid position as a high-end skin care brand. We will leverage the luxurious brand image, skin science, and strengthen the base makeup category, not only in our core market of Asia, but also in nurturing the brand in EMEA and the Americas.



Next, NARS, with its original advantages of bold messaging, high artistry, and innovation established by its founder, Francois Nars, has in recent years been driving growth through hit products that embody our skin beauty strategy, such as Light Reflecting Foundation. This has helped establish a strong global brand equity. In addition to accelerating growth in the Americas and EMEA, NARS is steadily expanding business scale in currently smaller regions, aiming for global profit expansion.



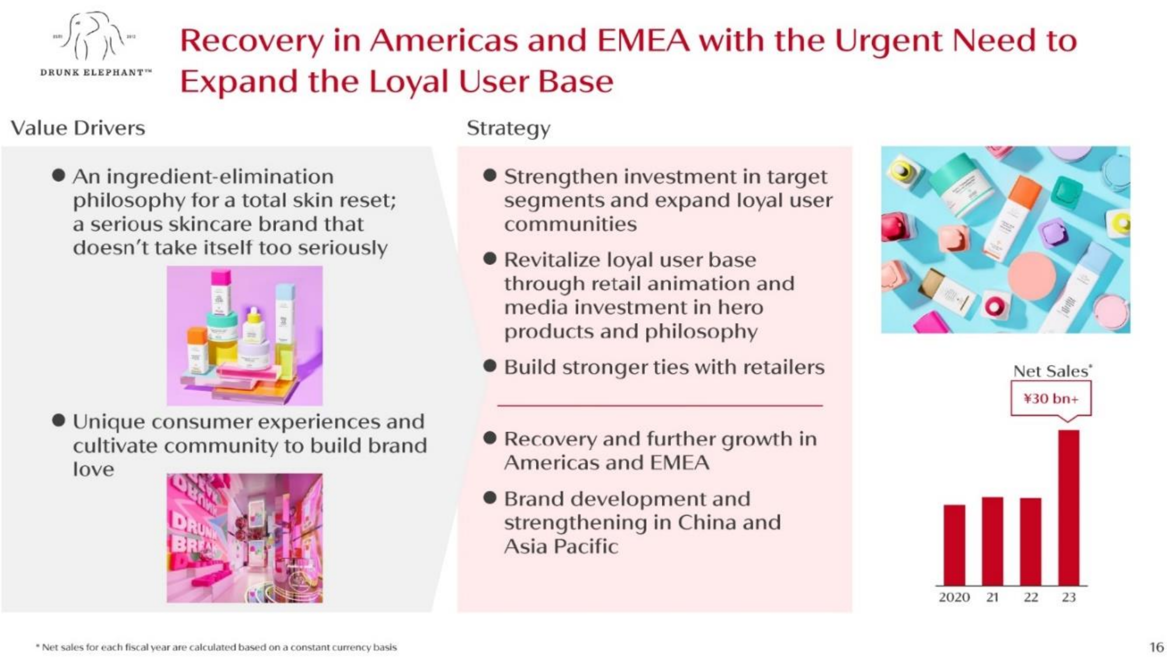
As mentioned earlier, due to the increasing awareness of skin damage caused by UV rays, the sun care category is expected to experience high growth globally, driven by factors such as daily use and enhanced product functionality.

Our company, based on the philosophy of environmental coexistence, possesses numerous unique and innovative technologies that deliver high efficacy. We see this as a key area where we should aim to expand market share through technological advancement. We will not only aim for high growth in sun care with ANESSA, the number one sun care brand in Asia and SHISEIDO sun care products, which have built strong brand equity in Americas and EMEA, but also strengthen hybrid products such as skin care UV with SPF and primers. This will help expand our market share in the sun care category.

ELIXIR's greatest strength lies in the cutting-edge collagen science and anti-aging care technology. We have actively developed products that leverage these as competitive advantages and differentiators driving growth in Japan this year.

Moving forward, we will continue to focus on hero products as part of our strategy, accelerating growth in Japan and Asia Pacific. At the same time, we will enhance our focus on profitability in overseas market and aim for recovery in China.

As a Japan's number one aging care brand and an expert in collagen science, we aim to further strengthen our brand equity and establish a position that others cannot easily catch up to.



The next is Drunk Elephant, which is facing challenges this year, urgently needs to focus on recovery in the Americas and EMEA, as well as expanding its loyal user base. We will strengthen investments in hero products, both in-store and through media while developing tailored communication strategies for each target demographic. This will help us re-engage with consumers and expand loyal user community.

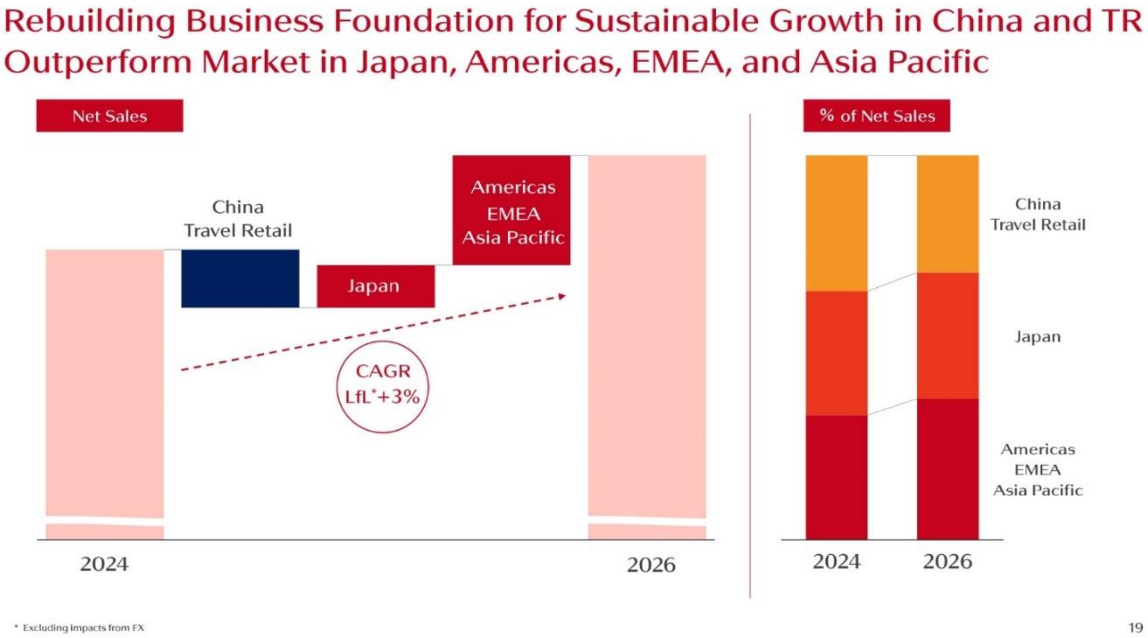
Japan	Rapid growth post-pandemic has moderated, while market remains stable Inflation and rising real wages deliver certain positive impact Number of foreign visitors to recover, yet cosmetics consumption stays below pre-pandemic levels
China Travel Retail	Continued weak consumer appetite and high uncertainty China: price sensitivity continues, prestige remains soft Travel Retail Asia: gradual recovery, still expect YoY decline in 2025 and 2026 Travel Retail Japan, Americas and EMEA: remain solid
Americas EMEA	The pace of growth to slow down slightly, but maintain momentum to lead global beauty market All categories remain strong
Asia Pacific	Mature markets grow slowly, Southeast Asia shows strong growth

From page 17 onwards, we have outlined our outlook for the market environment over the next two years. For China and Travel Retail, we have developed the business plan with a cautious and measured approach, avoiding overly optimistic assumptions. However, we expect steady growth in Japan, Americas, and EMEA.

Next is page 18. As mentioned before, we will be working towards a transformation for sustainable growth and profit expansion in China and Travel Retail. While there are short-term headwinds and we do not expect the rapid growth seen in the past, the Chinese market remains a vast and growing market in the mid- to long-term. It is the world's largest skin care market, with a solid consumer base among the wealthy and an expanding golden senior demographic.

As a market leader in Japan, which is a country with an aging society and as experts in Asian skin, we believe that there is much value we can offer in China. In this context, we aim to build a portfolio that captures the diversification of needs in order to achieve sustainable profit growth. To execute this, we will establish brand holder satellite offices and strengthen our social marketing capabilities. This will enable us to quickly capture and respond to changes in the market while enhancing our execution capabilities.

To achieve sustainable growth, we will strengthen the integrated operations of China and Travel Retail. We will enhance our consistent brand value messaging to Chinese consumers, transcending the boundaries between Travel Retail and China. Additionally, from the perspectives of promotional timing, product offerings, pricing strategies, and investment allocation, we will optimize cross-regional operations and create synergies.

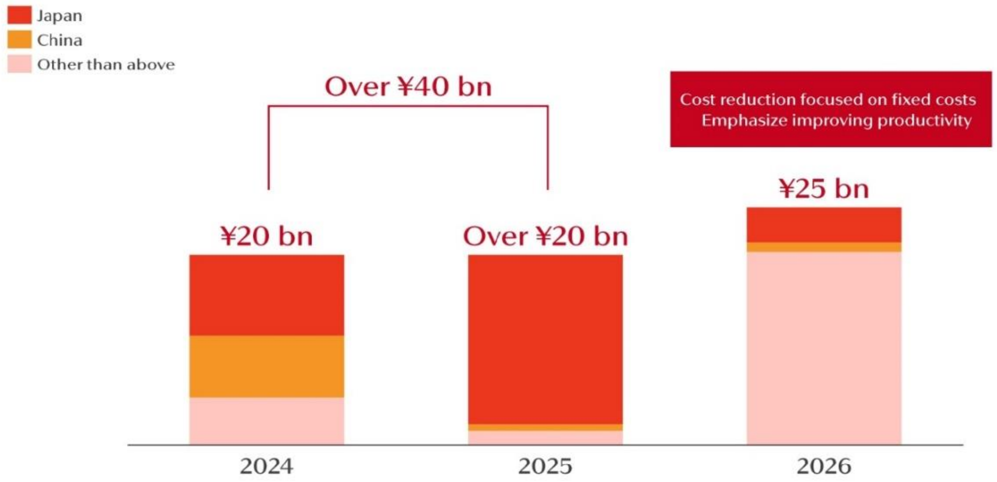


Next, on page 19. Based on these market assumptions and strategic considerations, the regional sales projection for 2025 and 2026 are expected to look as shown on this slide.

For China and Travel Retail, the priority will be rebuilding the business foundation. In contrast, Japan, Americas, EMEA, and Asia Pacific are expected to achieve growth exceeding market averages.

As a result, the consolidated CAGR, excluding the impacts from FX for the two years, is projected to be 3%. As you can see in the bar graph on the right, consequently, the regional mix will shift with the proportion of sales from Japan, Americas, EMEA, and Asia Pacific increasing, driving a rebalancing of the regions.

Cost Structure Transformation with "No Sacred Cow"



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Next, on page 20, we move on to the theme of establishing a high profit structure. The cost reduction and profit improvement measures exceeding JPY40 billion over the two years of 2024 and 2025 will primarily focus on Japan and China. In contrast, the JPY25 billion target for 2026 will be implemented mainly by the Americas and global headquarters, including the COGS reduction in manufacturing. We will focus on reducing fixed costs and improving productivity per employee to enhance profitability.

Target of ¥25 bn in 2026
Accumulate Initiatives to Reduce Breakeven Point and Improve Contribution Margin

COGS	•Reduction in raw material costs (optimization of products, sample materials and packaging) •Reduction in excessive & obsolete inventory (forecast accuracy improvement with FOCUS go-live, reduced lead times, brand and SKU selection and concentration) •Automation of factory production lines, etc.
Marketing investments	•Enhancement of global procurement functions for indirect materials •Global centralization of in-store materials production •Expansion of local sample production and operational efficiency (China, Japan)
Personnel expenses	•Streamline of organization •Streamline corporate functions to enhance operational efficiency, etc.
Other SG&A	•Reduction of outsourcing cost •Reduction of depreciation: system optimization and integration, selective new investments •Other cost savings: efficient office management, etc.

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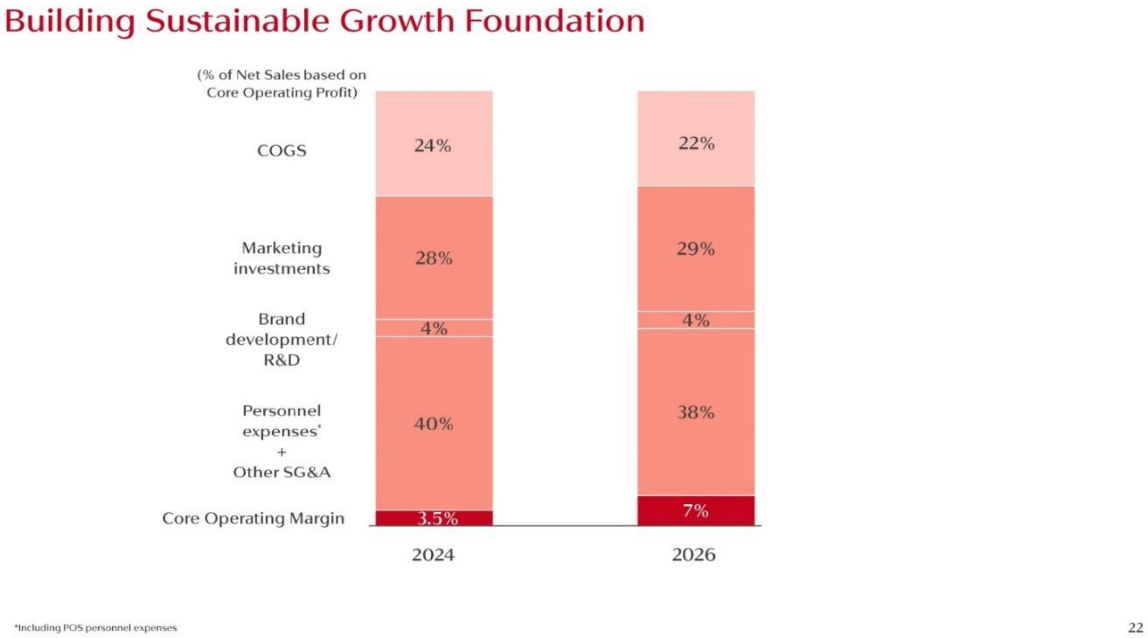
Page 21 provides a detailed breakdown by category. While the specific amounts are undisclosed, we hope you would understand that we have built a solid set of actionable plans.



Next, on page 22. Here is the projected P&L after implementing the growth strategy and cost reduction measures explained earlier. By 2026, we aim to double the current core operating profit margin to 7%. As we advance the regional sales rebalancing, the main drivers of profit margin improvement will be reduction in COGS and fixed costs. We have also assumed a relatively high marketing investment level of 29% focused on building brand equity.

On page 23, I would like to touch on our organizational approach. To navigate through these crucial two years, it is essential to build a global one-team structure to pursue all of the initiatives globally together as one team. We believe it is very important to leverage the strength of local talents who have a deep understanding of local needs for brand development and value creation. Additionally, we will pursue operational excellence to achieve a lean organization. Both of these pillars are necessary.

FOCUS, which we have pursued, will transition from the implementation phase to the phase of realizing return on investment in 2025. It is crucial to ensure stable operations and to improve data visibility, standardize business processes, and enhance transparency. We will also pursue synergies and efficiency improvements across regions and segments.

In China and Travel Retail, we will strongly drive an integrated approach for Chinese consumers and strongly promote the streamlining of operations. Furthermore, we will focus on optimizing back-office functions.

And next, I would like to hand over to Hirofuji-san for her presentation.

Hirofuji: From my perspective as CFO, I will explain how we will drive the implementation of this Action Plan 2025-2026.

Strategic Pillars: Strengthen Shiseido Financially

Establish businesses with strong profitability and competitiveness	● Support key brands growth with focused investments ● Prioritize return-oriented investments aligned with growth strategy
Strong balance sheet and maintaining A-rating	● Accelerate asset-light initiatives ● Maintain A-rating to enable agile and competitive financing
Growing sustainable cash flows and maximizing corporate value	● Enhance performance management based on ROIC tree ● Sharpen financial governance and accountability ● Cultivate cash culture
Lowering WACC	● Enhance disclosure ● Boost transparency and predictability ● Elevate ESG management

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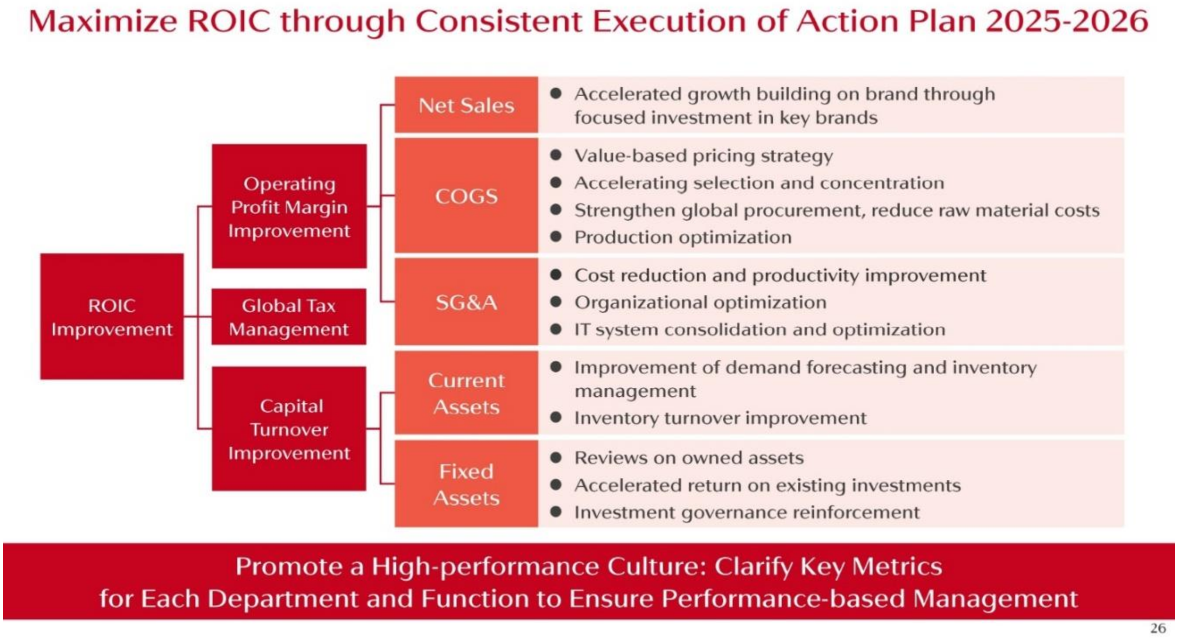
First, on page 25, in order to make Shiseido a stronger company, we will welcome four points as the basic policy of our financial strategy. On the P&L side, we will make focused and selective investments in our key areas. We will direct our investments towards building businesses with high profitability and competitiveness, and we will strongly support the growth of our core areas, promoting investment with a focus on returns.

In addition, we will strengthen our management control, which has been centered on the profit and loss statement in terms of the balance sheet and cash. In terms of the balance sheet, we will accelerate asset-light initiatives. As before, we will be reiterating the policy to maintain A-rating, and we will strengthen our management to ensure that we can promote the funds necessary for growth investments in a timely manner at low cost.

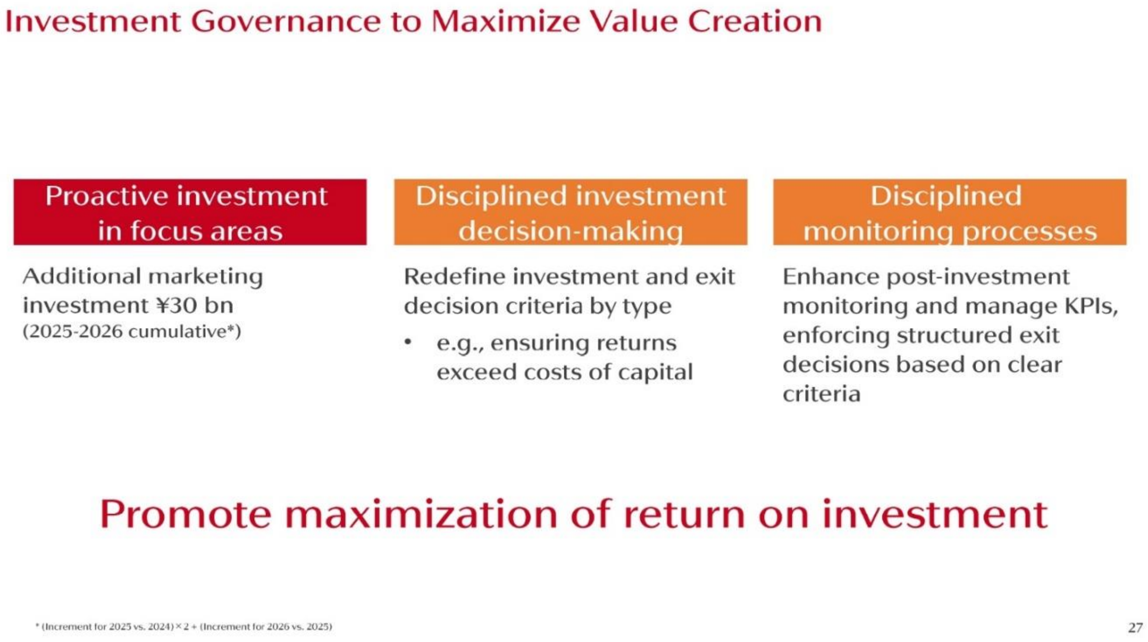
Next, from the perspective of cash, we will aim to maximize shareholder value by continuously improving our ability to generate cash. We have already used ROIC as the most important indicator for measuring capital efficiency, but in order to improve the effectiveness of this investment improvement, we will work to improve company-wide performance management and evolve financial governance. We will also focus on reducing our cost of capital as an important lever for maximizing corporate value. We will continue to actively engage in dialogue with our shareholders and investors, and work to improve information disclosure, enhance transparency and predictability, and advance ESG management.



Next, page 26. Steady implementation of the Action Plan 2025-2026, we will use ROIC not as a result indicator, but as a powerful tool for instilling a high-performance culture. We believe that ROIC is the most important indicator for connecting management and individual employees, and for increasing the momentum of management involvement and fostering the Company. In order to ensure that all employees around the world take responsibility for improving ROIC, we will promote the organizational reform by breaking down the specific actions required to improve ROIC and showing them in a way that makes it clear how each individual action will lead to improve ROIC.

This slide shows an image of this breakdown. As Fujiwara-san has already explained, we will steadily implement the plan that we have put together to improve sales, cost of sales, and SG&A expenses in order to increase operating profit margin. In addition, we will strengthen our efforts to optimize inventory management and efficiently utilize the assets in order to improve our capital turnover ratio.

With regards to the fixed asset, we will review our assets appropriately and strengthen our investment governance. In order to ensure that these action plans are carried out, it is important to clarify the indicators that each department should manage and reflect them in performance evaluations. We will incorporate important KPIs across the Company into evaluation criteria, monitor progress, and establish and operate a system for continuous improvement.



Next, on page 27, we will discuss investment governance and financial discipline. In order to achieve sustainable growth and maximize shareholder value, we will seek to strike a balance between acceleration, which accelerates growth through investment in focus areas and breaking, which ensures appropriate investment management. We will continue to actively invest in our focus areas to accelerate growth, and to improve the transparency on our investment process, we will clarify the evaluation criteria for each type of investment. And by redefining and applying company-wide unified criteria, we will accurately evaluate the risks, returns of each investment project, and achieve optimal capital allocation.

In addition, we will strengthen monitoring after investment is made, and we will thoroughly make decisions based on disciplined criteria regarding the review of strategies and redistribution of resources and withdrawal as necessary.

Achieve 7% Core Operating Profit Margin in 2026

	2024	2026
Sales Growth*1	−1% (2023-2024)	CAGR +3% (2024-2026)
Core Operating Profit Margin	3.5%	7%
ROIC*2	0.4% (3% in previous definition)	5% (6% in previous definition)
ROE	1.0%	7%

*1 2023-2024 growth: Excluding impacts from FX, business transfer and acquisition. 2024-2026 CAGR: Excluding impacts from FX
*2 Change of ROIC definition : Shift from Core Operating Profit to Operating Profit to manage investment efficiency across the group, including extraordinary losses.
Calculate interest-bearing debt, including lease obligations, and strengthen management by addressing the trade-off between asset acquisition and leasing
New definition: Operating Profit × (1 − Tax rate) ÷ (interest-bearing debt (including lease liabilities) + Total equity)
Previous definition: Core Operating Profit × (1 − Tax rate) ÷ (interest-bearing debt (excluding lease liabilities) + Total equity)

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Next, on page 28 is a summary of the financial targets. As already explained, regarding sales growth, the focus for 2025 to 2026 will be on reinforcing brand foundation and rebuilding profitable foundation. Therefore, the 2024 to 2026 CAGR is projected to be 3%. Regarding core operating profit margin, the goal is to achieve 7% by 2026, which would be the highest level since the COVID-19 pandemic and double the current level.

Regarding ROIC, the definition has been revised starting from this time around. Previously, the numerator used core operating profit, which was an indicator of recurring profitability, excluding nonrecurring items. However, this time, the numerator has been changed to operating profit, which includes nonrecurring items. Regarding the denominator, we have included lease liabilities along with interest-bearing debt in the calculation.

As a result of these changes in the definition, the figures will appear lower than those disclosed previously. However, by eliminating deduction items from both the numerator and the denominator, we aim to more accurately monitor the Company's capital efficiency from the same perspective as investors. The 2026 target under the new definition is 5%, which is still below the cost of capital and is not yet a satisfactory level.

Along with the core operating profit margin and ROE, we aim to achieve double-digit growth as early as possible. To achieve this, we will focus on building a resilient business structure over the next two years. And from 2027 onwards, we will work to accelerate growth and improve profitability.

Enhance Cash Generation Capability with Profitability Improvement as Main Driver

		2024	2026
Improve cash generation capability	EBITDA*	¥86.5 bn	¥130.0 bn
	Free Cash Flow	–¥19.0 bn	¥50.0 bn
Sound financial position	Net D/EBITDA	1.4×	1.3× or less
Improve capital turnover rate	Inventory turnover rate	6.3	7
	Fixed asset turnover rate	1.8	2

* Core Operating Profit + Depreciation and Amortization (excl. depreciation of right-of-use assets)

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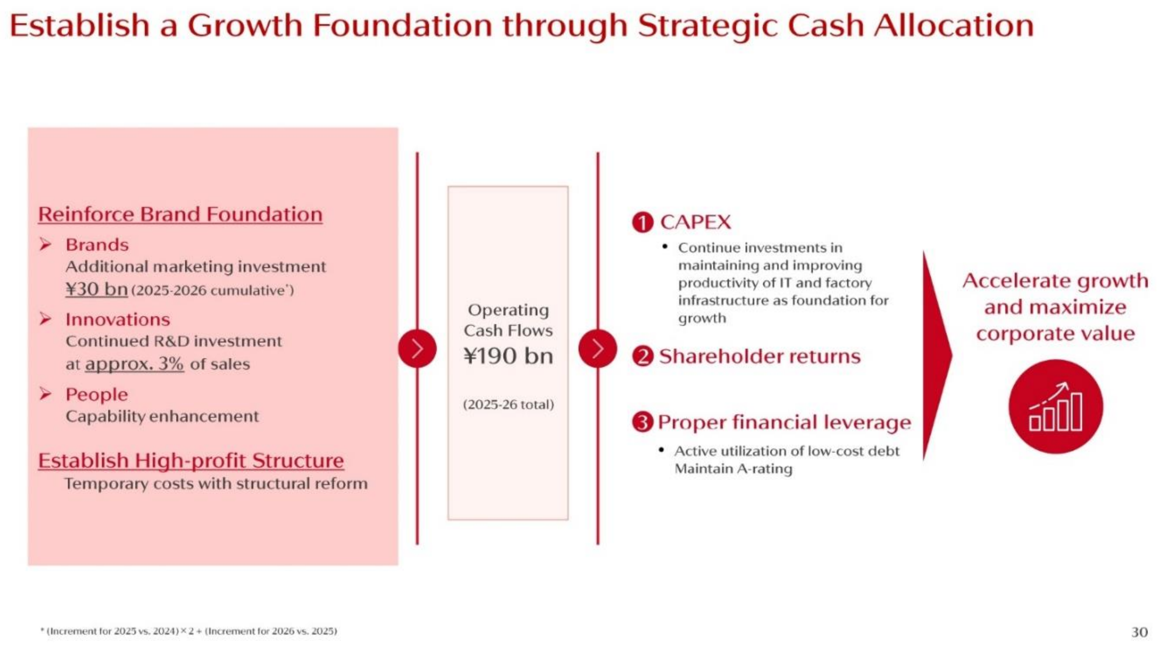
Next on page 29 is the financial target for improving cash and capital efficiency. Regarding cash generation, improving profitability is the key. The target for EBITDA is JPY130 billion in 2026. Regarding free cash flow, this year, the acquisition of Dr. Dennis Gross Skincare has resulted in a negative cash flow. However, in the short term, we will take a cautious approach to M&A. Additionally, as capital expenditures are expected to peak in 2024 and 2025, the target for free cash flow in 2026 is JPY50 billion. After that, with improvements in operating cash generation, we aim to exceed JPY100 billion in free cash flow at the earliest opportunity.

Next, in terms of financial stability, the target for Net Debt-to-EBITDA Ratio is set at 1.3 or below. In addition to profitability, improving the capital turnover ratio is also a key focus. Inventory turnover rate and fixed asset turnover rate are positioned as important KPIs.

Specifically, we aim to improve the accuracy of demand forecasting and reduce inventory levels. The FOCUS project, which is expected to be fully operational globally starting in 2025, will play a key role in achieving this goal. The journey of implementing FOCUS will not be without its challenges. However, our priority is to stabilize operations and capture returns. We recognize this as a critical management challenge, and we will continue to focus on our initiatives. Regarding fixed asset turnover rate, we will carefully select capital expenditures and continue to work on improving this ratio even after 2026.



Lastly, on page 30, regarding cash allocation. In the two-year periods of 2025 and 2026, we will not focus solely on cost cutting, instead, we will reinvest the cash generated through cost efficiency and improvements into strengthening the brand foundation.

Specifically, we plan to invest approximately JPY30 billion in additional marketing over the two-year cumulative period from the base year of 2024. Regarding innovation, we will continue to allocate a stable 3% of sales to R&D investments. Additionally, we expect some one-time costs associated with the execution of structural reforms. However, after implementing these initiatives, we project an operating cash flow of JPY190 billion over the two-year period. The cash generated will first be directed towards maintaining and upgrading IT and factory infrastructure, as well as improving productivity. This will create a positive cycle that drives further profitability improvements.

As of 2026, the financial KPIs will still be work in progress, but I am confident that addressing the key priorities over the next two years will strengthen the foundation for future growth. With a focus on enhancing mid- to long-term corporate value, we view these next two years as a critical period and are committed to tackling the challenges ahead with determination. And that is it for from me.

Fujiwara: Today's presentation focused on the two years of 2025 and 2026. And all of these actions are part of building a foundation for sustainable growth and achieving the profitability we aim for as a global company. We, as a company, will work as one team to establish a resilient management foundation over the next two years. Thank you very much.

Question & Answer

Kuwahara [Q]: Kuwahara from JPMorgan Securities. I have a question about Page 5. I would like to ask how this will lead into "taking all actions that must be taken" as described by Fujiwara-san. Looking at this, if sales to grow at CAGR of, say, 3% in 2025, gross margin will be about JPY18 billion, and there also is cost reduction of about JPY20 billion. I think it will probably be a little higher than that even if marketing costs will increase by 30 billion yen. But there will be a gap there, and I would like to know your idea about how that would likely be used? I would like to ask you if you have a similar scenario expected in 2026.

In addition, you mentioned that the part of non-recurring items is asset-light, and that it also incorporates impacts from structural reforms. What are your thoughts on this, and if possible, it would be good if you could provide some figures, but if that is difficult, could you explain about your thoughts?

Fujiwara [A]: First of all, I would like to explain about what we want to do in 2025 and estimated figures related to that. First, for China and Travel Retail with higher profitability, we expect negative growth. So, that is where there will be significant declines in gross profit. On the other hand, growth will likely accelerate in the EMEA, Americas, and Asia Pacific, but as we will be implementing structural reforms in these regions at the same time, please understand that profit contribution will still be limited. As a result, gross profit is expected to decline significantly, and unfortunately, that will offset 20 billion yen benefits from structural reforms in Japan, staying flat versus 2024.

What is most important for us is that we continue to invest in brands while firmly implementing structural reforms in Japan and other regions, including global headquarters. In other words, we will establish a solid foothold to achieve core OPM of 7% by completing cost reductions in 2025.

Next, to be honest, we expect to see only marginal growth in China and TR from 2025 to 2026 at the moment. However, that will be offset by growth in other regions and improvement our profit structure which will in turn contribute to 7% core OPM as a result. So, we will maintain strong momentum to advance structural reforms over the next two years with control and focus.

Hirofuji [A]: Let me add a few more things about the numbers. To put it simply, there are some factors increase in costs that exist specifically in 2024 and 2025. Now, having said that we expect CAGR sales growth at 3%, that will remain almost unchanged in 2025 and 2026, so basically a common assumption for 2024-2025, and 2025-2026. We expect growth to continue at that level with an increase in gross profit coming from that. Regarding cost reduction, we expect significant benefits in both 2025 and 2026, JPY 20 billion and JPY 25 billion respectively, through cost structure reforms.

On the other hand, as you pointed out, there will be incremental increase in marketing investment in 2025 and 2026. Also, the impact of salary increases will be another negative factor. Due in part to inflation, we will incur the necessary expenses to secure and recruit talented human resources, so that is the same for from 2024 to 2025 and from 2025 to 2026.

Conversely, what is unique in 2025 and 2026 is that we will be reviewing bonus due to the downward revisions in earnings estimates this year. Also, there has been an unusual impact from foreign exchange this year, so from that baseline, we will likely accelerate growth from there onwards.

Kuwahara [Q]: I am not sure if my understanding is correct, but are you saying that profitability in China and Travel Retail will drop temporarily, but gross margin is going to increase by 3%. However, contribution margin will slightly decline. This means that China and Travel Retail will not increase very much by 2026, but if it will remain unchanged, contribution margin will eventually recover, is that correct?

Therefore, do you think we do not need to be concerned about the non-recurring items?

Hirofuji [A]: I cannot share details, but we do expect to recognize some non-recurring items associated with certain areas of structural reforms. We will disclose actual figures for 2025 next year.

Kuwahara [Q]: And you also mentioned about the asset-light initiatives, so I look forward to hearing about positive outcomes regarding that as well. Thank you.

Kawamoto [Q]: Kawamoto from Jefferies. I wanted to ask about the top line. I would like to know the reason for changing your view towards the top-line incorporated in the medium-term plan from 10 months ago. How do you incorporate your assumptions about price hikes and inbound sales? You mentioned that M&A will be done cautiously going forward, but I would like to know how much upside or downside expected in your estimated figures.

And in terms of profitability, please give us a breakdown of your forecast and explain as to whether 50 billion yen profit in Japan has been withdrawn or not.

Fujiwara [A]: For price increase which we started from last year, that is something that we will continue to increase margins next year onward. However, we have not reflected any significant impact here yet.

As for inbound, this year, especially looking at the Japan situation, we are not getting as much as we would have expected. So therefore, we do not want to be overly optimistic about the benefits from inbounds, and that is something that we do incorporate in our plan for Japan.

Again, as for Travel Retail, at the same time that the market has not yet come back, the word "tourists" and "non-tourists (Daigou)", but in a sense, it is a plan that consciously and deliberately restrain our estimates.

So, at the beginning, I mentioned about what we can control and what we cannot control. But looking at the market growth, especially China and Travel Retail markets, which is very dynamic in terms of growth, it is something that we cannot control and difficult to manage. And for that, we look at it quite conservatively given the situation.

Hirofuji [A]: And for profitability in Japan, the JPY50 billion, it is still effective. We continue to aim for JPY50 billion in profit in Japan.

Fujiwara [A]: So, for profitability in Japan, this year, we have 1,500 people for early retirement. And also, benefits from a reduction in marketing promotional items, as well as COGS reduction by concentrating resources on 7 brands to drive growth has already been seen at an early stage this year.

Now as we aim for JPY50 billion next year, we must build up about JPY30 billion more than this year. Of which, about JPY17 billion will come from cost reduction which means that reduction in personnel expenses will have a full impact in next year. So, I believe that this number that we aim for next year should be quite accurate and about JPY13 billion that we have remaining that will come from the growth, and that is how we will try to achieve JPY50 billion in Japan.

Kawamoto [Q]: Just to confirm, so next year, do you expect the overseas businesses to be negative while the Japan will be positive with JPY50 billion in profit?

Hirofuji [A]: No, that is not correct. We also have other regions other than Japan and expenses for headquarters as well. But if I may answer to the first question you raised regarding our sales assumptions, we do expect negative growth in China and Travel Retail. And since both China and Travel Retail are highly profitable businesses, negative growth in these will have significant adverse impact overall, which is reflected in our assumptions.

We expect +mid-single% growth in Japan, which is based on our assumption that we will firmly capture market share. For the Americas, EMEA, and Asia Pacific, we are expecting +high-single% growth, so we are planning to increase our market share more intensively.

Miyasako [Q]: Miyasako from Mizuho Securities. I would like to confirm the probability of achieving your target of JPY25 billion cost reduction in 2026. I would think that there were some reasons for not incorporating that in 2024 and 2025, and I want to know if that is achievable when you are trying to increase the top line quite sharply.

Fujiwara [A]: First of all, let me show you slide 20. This shows that in 2024 and 2025, the cost reduction is mainly from Japan and China. We focused on China mainly because there have been major changes in the market environment there while we expected a certain level of growth. And for Japan, we have already put in place what we have already planned for.

However, the changes in the environment happened a lot in China and Travel Retail which used to be the primary source of our earnings which have led to a significant downturn. And now we are assuming that this will likely continue for some time to come. And with that in mind, we will also improve cost efficiency in other regions as well.

On page 21, we have a number of action plans for cost reductions. With respect to COGS, our estimates are quite accurate, reflecting a reduction of raw material costs and excess and obsolete inventory. In addition, automation of factory production lines should result in more cost savings than ever before.

And with respect to marketing investments, what has been done independently in a region to a certain extent but are commonly implemented across regions, for example, indirect materials procurement can be globalized to increase scalability. We have already begun preparations from this year, and have accumulated these figures.

And next, personnel expenses and other SG&A. As I explained earlier, we have been doing quite a bit in Japan and China during the past 2 years. So, we will be going a step further in other regions. We will focus on reducing COGS and fixed costs as much as possible to achieve a 7% core OP margin. And so that by actions and also by region, the matrix has already been formulated, so we are ready to press the button for starting up the actions. That is where we are right now.

And additionally, I have learned from Japan and China over the past 2 years. While I have built up a lot of things one by one, estimating the potential of each of them to put into action. Of course, the feasibility of some actions may decrease along the way, but I think it is quite important for us to accumulate the next measures when they fall, and to assess the feasibility of their implementation, while continuing to do so every month, in order to generate the targeted amounts. With this iteration, as an organization, we have higher capability in reducing or finding, identifying the items for cost reduction.

The menu for 2026 has been prepared, and if there is something that is not achieved in all of these menus, we will go through such processes by accumulating new initiatives for achieving the goal. With that, we should be able to achieve the JPY25 billion cost reduction.

Miyasako [Q]: This JPY25 billion reflects what have not been done in 2024 and 2025 but can be done in 2026, and things that should have done in the past from the first place. What is the difference?

Fujiwara [A]: According to our original plan, we assumed that market would come back and profitability will improve without significant cost reductions. However, looking at the current situation, we come to believe that it would be better not to rely on growth in terms of profitability, so I would like you to understand that we need to continue with quite significant cost reductions going forward.

Hirozumi [Q]: Hirozumi from Daiwa Securities. Next year you expect JPY35 billion in Core OP, which is flat from this year but then you expect it to double in 2026 to JPY73.5 billion which is from my calculation. I thought you said that you will complete structural reforms outside of Japan in 2025, so what does that mean? Does it mean that by completing that you expect to see tremendous benefits in 2026? What would be the key driver of profit to double in 2026 after being flat in 2025, and what is the meaning of structural reforms, particularly those outside of Japan? If you finish that in this fiscal year, why isn't there any increase in profit? It is difficult to understand what is the mechanism of core OP remaining flat next year but doubling in 2026?

Hirofuji [A]: Regarding the first question, although our core OP estimates in 2025 will be unchanged from our 2024 outlook of JPY35 billion, there is a one-time effect on JPY35 billion core OP in 2024. We adjusted bonus payments in light of downward revisions in earnings. We also expect unfavorable impact on profitability due to change in our FX assumption forecasting higher JPY for the next fiscal year. Taking these factors into account, it will be actually over a hundred billion yen lower than JPY35 billion in 2024. So, it looks like it is flat, but we are actually increasing in profit.

Hirozumi [Q]: What kind of impacts do you expect to make profit to double in 2026?

Hirofuji [A]: So that will come from structural reforms that we are currently making progress with over the period from 2024 through 2025, achieving tangible benefits. And of course, there will be an increase in gross profit from topline growth as well.

Hirozumi [Q]: The reason for not giving us any detail is because it is very sensitive and there are a lot of different structural changes taking place here and there globally, is that correct?

Hirofuji [A]: The reason that we have not mentioned any details about the JPY25 billion is because, yes, there are sensitive content that we cannot share with you. But in terms of the scale of structural reforms, we expect that more than half of the JPY25 billion come from personnel expenses and other SG&A, and then, the next biggest is COGS, then marketing investment. And that would be kind of in the order of the size.

Hirozumi [Q]: You mentioned that you will be done with the reform in 2025? So, there will be a lot of things happening in 2025, is that correct?

Fujiwara [A]: From what is listed on page 21, COGS will be the area where we will continue to see the fruit of structural reforms. And that is something, of course, that we will continue to do, but in particular, with regard to cost reductions, there will be various actions that will be implemented in 2025, so that the impact will be maximized in 2026. If you could image that in Japan, we make a range of things done by the end of this year and maximize profits in 2026, resulting in a profit of over 20 billion yen this year, but it will be 50 billion yen next year. So that is a kind of image you could draw.

Ohana [Q]: Ohana from Nomura Securities. I would like to get an image of regional profit composition for over 70 billion yen core OP in 2026. I think Japan will probably improve in 2026 year, based in the assumption that you will achieve 50 billion yen in 2025. In that case, even topline relatively grow strong in the Americas, EMEA, and Asia Pacific, but it will not contribute that much in terms of profitability, is that correct? I would like to know your thoughts on that.

Hirofuji [A]: I believe that profitability improvement in Japan certainly will be the major driver. And for China and Travel Retail, we expect negative growth, and since Travel Retail is a highly profitable business in particular, negative contribution in earnings in that segment until 2026 will have significant impact on profitability. However, we are well positioned to drive profits across other regions. As I mentioned, sales will grow at a pace of +high single% and accordingly, we expect the growth in profitability there. While the regional profit figures are not disclosed, we expect to see a change in the structure of sales going forward as shown on page 19.

Ohana [Q]: So, considering of an increase from JPY35 billion in 2025 to JPY70 billion in 2026 with an increase of JPY35 billion, it is unlikely that Japan will contribute to the same extent as 2025. So, taking that into account, with expectation for negative growth to persist in China and Travel Retail, then it would be quite difficult to achieve your target unless, for example, Americas, EMEA, and Asia Pacific will make a significant contribution.

Hirofuji [A]: Yes, we are expecting positive impacts from structural reforms in Americas and EMEA.

Sato [Q]: Hello, this is Sato. I have been watching your company for the last 30 years, I thought this Plan is the most realistic and serious than ever, and I have a lot of expectation that finally, the Company is about to change. Now looking at the brands that you will be focusing on, it has not changed -- the marketing investment is going to increase probably, but looking at the number of brands that you are focusing on will remain unchanged which is fairly small. Also, sales growth at 3% is probably the lowest ever which is realistic, but for these brands, are you going to overhaul rather than pursuing sales, and once everything is done, then you will move on to brand expansion and potential M&As in your portfolio?

After the profit level is achieved in 2027, do you intend to keep the size of the current brand portfolio? If that is the case, do you think sales will turn around because I think the number of brands in your portfolio seems too small. I think it would be good to strengthen other brands a little more as well. So, what is your approach in terms of brand portfolio? Is this going to be just for the next two years or if something different awaits along the way.

Fujiwara [A]: Thank you very much. For the next two years, we intend to focus our investment on these eight brands. What we want to do is to develop our brands so that they can drive growth and profitability, but at the same time we must also enhance brand equity. That is something that we really want to focus on during these two years as it will lead to rebuilding a resilient foundation that I mentioned at the beginning. And I, myself, by engaging in day-to-day operations of the Company, what I have felt is that we can achieve higher returns by utilizing our cutting-edge technology and innovation in key brands and leverage their scalability.

Although we have not talked about details here, we will narrow down technologies quite a bit and identify which technology should be applied to which brand so as to maximize the scale. Moreover, our strategy also incorporates the idea to utilize major technology and insights across different brands as well. Therefore, considering that our competitive advantages will ultimately be communicated to consumers, we have reached a conclusion that there will be eight brands in focus for the next two years.

On the other hand, as you have pointed out, in terms of scale and the diversification of consumer values, we believe that the eight brands will not suffice. As shown on page 7, we will adjust our strategies for other brands according to profitability and growth potential of each brand. The other is that we will narrow down focus on where we really think as a "battlefield" by consumers' segment, country, channel, and demand. It may not be correct way of saying, but we will naturally achieve greater efficiency in marketing and generate more profit by clearly identifying niches. While the scale of our activities will likely be limited, but we will also contribute to brand positioning and new consumer acquisition. So, for the next two years, our existing brands will be filtered.

From 2026 and onwards, we will completely shift gears to growth. The reason for having the Next 5 brands in addition to the Core 3 brands here is that while we believe that these are brands that can definitely aim for JPY100 billion in sales, we must build a foundation for these brands in the two years. By preparing for the brand to quickly become our growth engine, we intend to transform our business structure to drive further growth for profitability from 2027 onwards with the Next 5 brands.

Sato [Q]: On page 7, it says "exit/ downsize options based on brand growth and profitability." Is that factored into your estimate? In other words, while you would like to see a little bit more growth but these divestitures will have a considerable impact in the coming two years, is that correct?

Fujiwara [A]: There will be many other factors aside from that of course, but I hope you understand that we are creating a growth plan by incorporating various aspect.

Sato [Q]: What concerns me the most is that there is not much room left to increase your share in drugstores in Japan. Assuming that it will be unchanged for the next two years, do you think it would be enough by just having ELIXIR in the mid-price range in Japan? I mean, you will not have any other brands coming along in the lower price range for the next few years?

Fujiwara [A]: As for Japan, I do not know if "cash cow" is the right way of saying this, but a lot of the brands are actually increasing sales and profit even without having any brand manager, meaning we are not doing much. So, instead of exiting these brands we will maintain them as they do not have any brand manager. In the case of Japan, we have those 8 key brands, and few other brands which are exclusive to Japan. As you have pointed out, these are the brands that will be targeting for drugstores. As a result, we will hall a bit broader portfolio for Japan in the next two 2 years.

[END]

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Document Notes

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