Shiseido’s Strategy

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Shiseido announced its medium-to-long-term strategy VISION 2020 in December 2014 and initiated reforms for the future. Our goal for 2020 is to create the basis for ensuring that Shiseido will remain vital for the next 100 years and to generate even greater value for consumers and society. We also aim to be number one in Japan and Asia, with targets for net sales of over ¥1 trillion, operating income over ¥100 billion, and ROE of 12 percent or higher.

Overview of VISION 2020

We will reengineer all activities and shift to aggressive management during the first three years, we will rebuild our business foundation and invest aggressively for growth. During the final three years, we will implement new strategies to accelerate growth that leverage the business foundation we have built to enter new markets. In this way, we will achieve strong growth.

Targeted Outcomes and Roadmap for VISION 2020

2015–2017
Rebuild the Business Foundation
- Brand selection and concentration
- Invest in marketing, R&D and supply chain management
- Restore growth in Japan, rebuild the China business and improve profitability overseas
- Reform organizational culture, nurture employees and build a global management foundation
- Generate ¥30–¥40 billion from cost reductions to fund investment (in 2017)

2018–2020
New Strategy to Accelerate Growth
- Develop new brands, conduct M&A
- Continue to invest and secure returns
- Enter new areas and businesses
- Establish a global management organization
- Review and revise business models

2020
Creating the model for ensuring that Shiseido will remain vital for the next 100 years

Become a company supported and needed by society and consumers worldwide
- Filled with energy
- Overflowing with youthfulness
- Always much talked about
- That the younger generations adore
- Be a multi-cultural company

Net sales over ¥1 trillion
Operating income over ¥100 billion
ROE of 12% or higher
Launch of VISION 2020 with the Resolve to Change

On the launch of VISION 2020 last year, I declared that we must rejuvenate Shiseido. We have seen results since then, but we need to move forward with reforms even more rapidly.

In the past, Shiseido was not quickly and accurately addressing changing consumers and markets. We were also cutting back on investment in R&D and marketing, which caused our brand value and market share to decline.

These problems required a solution, so we transformed all of our activities to focus on consumers. We intend to increase the power of Shiseido Group brands and prevail in Japan and in markets around the world.

Our roadmap for the six years through 2020 has two phases. The first three-year phase is already under way, and involves rebuilding our business foundation so that we can grow. During the second three-year phase we will leverage this foundation to generate greater growth. Our targets for 2020 are net sales over ¥1 trillion, operating income over ¥100 billion, and ROE of 12 percent or higher.

2015: A Year of Change and Success

We made changes for the future in 2015. It was a year of favorable results including sales growth in every region we serve.

The Japan Business finally stopped losing market share and got back on a growth trajectory. We generated steady success in dealing with the challenge of transforming aggressive investment in brand innovation and marketing into sales and growth. Brand sales grew strongly, overcoming the tendency for new product sales to stop growing after their second year on the market, which we refer to as the two-year wall. At the same time, the ICHIGAN Project, which involves cross-divisional, consumer-oriented collaboration among all employees, took root in our corporate culture.

Our sizeable investments in marketing in our prestige category resulted in strong sales growth for the SHISEIDO,clé de peau BEAUTÉ and NARS brands in Japan and overseas.

Moreover, we tackled legacy problems head on. We withdrew from unprofitable brands, liquidated overseas subsidiaries,

Figure 1: 2015 Successes and Key Initiatives for the Future

<table>
<thead>
<tr>
<th>Successes</th>
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<tbody>
<tr>
<td>Steady growth for core brands</td>
</tr>
<tr>
<td>Established the regional headquarters system</td>
</tr>
<tr>
<td>Progress in reforming the cost structure</td>
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<table>
<thead>
<tr>
<th>Key Initiatives for the Future</th>
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</thead>
<tbody>
<tr>
<td>Sustainable growth for the Japan Business</td>
</tr>
<tr>
<td>Improvement of profitability overseas</td>
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<tr>
<td>Rebuilding of the China business</td>
</tr>
</tbody>
</table>

Figure 1: 2015 Successes and Key Initiatives for the Future

Brands with Strong Sales Growth in 2015

- SHISEIDO
- clé de peau BEAUTÉ
- NARS
further optimized market inventories in China, and implemented structural reforms in the Americas. These and other initiatives created the foundation for medium-to-long-term growth (Figure 1).

We made various changes and have achieved some successes, but we have three major issues to deal with before we can achieve the objectives of VISION 2020.

The first is to continue growing our brands in Japan. Totally committed to consumer-oriented activities, we will strengthen our brands through selection and concentration and continue to increase marketing investment to ensure growth in the Japan Business.

For details, see Feature – Growth Strategy by Region – Japan (pages 30-31).

The second issue is improving profitability overseas. Over the past 10 years our overseas sales ratio has increased dramatically to more than half of net sales, but overseas profitability is still extremely low, which is depressing the Group’s operating profitability. We will strengthen our brands to increase sales further, while also reforming our cost structure in each region to generate funds for investment that will create a solid earnings foundation.

The third issue is rebuilding the China business. Competition has intensified and markets have changed in China. Shiseido needs a powerful presence, so we will build further on our success in the prestige category, reengineer our cosmetics business, and rejuvenate our China-only AUPRES brand.

For details, see Feature – Growth Strategy by Region – China (pages 32-33).

We must be bolder and move more quickly to implement reforms to generate growth over the medium to long term.

Future Policies and Initiatives: Increase the Power of Brands Using Consumer Orientation

First and foremost, our consumer orientation will remain central in VISION 2020. We will generate synergies by fusing marketing and innovation, and increase the value of our brands globally by institutionalizing comprehensive cross-divisional consumer-oriented initiatives (Figure 2).

Our marketing strategy involves building a brand portfolio that centers on the prestige category, where we have been successful, and totally embracing brand selection and concentration. We also intend to increase investment in marketing by a total of more than ¥100 billion during the three years ending December 2017 to nurture

Figure 2: Key Strategies for Increasing Brand Value

Masahiko Uotani
Shiseido Group CEO
numerous potent brands (Figure 3). As a result, we plan to build a portfolio with 15 core brands in Japan comprising 90 percent of sales by 2020. Initiatives in 2016 will include innovating SHISEIDO worldwide to continue strengthening the prestige category. We will also nurture our low-priced cosmetics and personal care brands in Japan.

For details, see Feature – Growth Strategy by Brand (pages 38-39).

We will also create new value using the center of excellence concept (Figure 4). Regions that are at the forefront of categories and have the ability to influence them globally will lead the Group in collecting information, formulating strategy, developing products and other initiatives for shared use in marketing operations worldwide. Japan will be the center of excellence for skincare, the United States for makeup and digital marketing, and Europe for fragrances. We will establish a base in New York for the growing e-commerce and digital markets to ensure a timely, genuine dialogue with the young, and other consumers worldwide.

Our strategy for innovation involves expanding the scale of each of our research centers around the world to develop products that reflect the needs of local consumers. We will also continue to maintain and strengthen our basic and platform research at our research centers in Japan to support growth. We plan to complete the Global Innovation Center (tentative name) in Yokohama at the end of 2018.

For details, see The Value Creation Process to Achieve Beauty – Research and Development (pages 41-43).

We are also formulating a global supply chain strategy that is linked to our marketing strategy. We are constructing a new factory in Osaka that will be our primary manufacturing facility for skincare products globally, and expect to begin operations there in 2020. We will leverage the high-quality image of products made in Japan and expand supply to China, Asia and other regions.

For details, see The Value Creation Process to Achieve Beauty – Production and Procurement (pages 46-47).

Future Policies and Initiatives: Launch a Global Management Organization

We need to enhance our consumer-oriented initiatives, so we have embraced a “Think Global, Act Local” mindset to step up our transition from a system centered on the head office to delegating authority to regions and their local markets. In January 2016, we launched a matrix organization encompassing five brand categories based on consumer purchasing style and six regions. Each regional headquarters has its own president and CFO with broad authority and responsibility for management and finances, which will enhance their ability to address local consumers and markets. The regional presidents are totally committed to increasing sales and improving profitability.

For details, see Feature – Our Global Management Organization Is Fully Operational (pages 26-39).

Committed to an Aggressive Investment Plan

As I have mentioned, we are rebuilding our business foundation during the three years through 2017 to help us achieve our targets for 2020. We therefore plan to increase marketing
investment in brand innovation and growth markets and to con-
duct aggressive capital investments including renewal of sales
counters for our core brands. We plan to support our aggressive
targets for sustainable growth in 2016 with capital expendi-
tures totaling ¥73.8 billion (Figure 5).

Cost structure reforms are generating savings that are help-
ing fund our investments in growth, and our progress exceeded
plan during 2015. We expect to reduce costs by ¥30 to ¥40 bil-
lion in the year ending December 2017 compared with the year
ended March 2014. Our sights are set on
generating a total of ¥60 billion in cost
reductions for the three years ending 2017.

We also need to enhance governance globally. We have created
meetings so that the regional presidents and executive officers
at headquarters can discuss and rapidly share global risks and
opportunities, and to accelerate management decision-making.

For details, see Corporate Governance (pages 64-73).

Committed to Numerical Targets

We are committed to reaching all of our numerical targets
for the year ending December 2017 in
order to achieve the objectives of VISION
2020 (Figure 6). Our operating environ-
ment will be as fluid as ever during the
year ending December 2016, but we will
build our strength by aggressively invest-
ning and by implementing additional
reforms to ensure sustainable growth.

VISION 2020 is designed to ensure that
Shiseido will remain vital for the next 100
years. We can only achieve this if we
increase the value of Shiseido’s brands
globally. I am convinced that we can do this if our employees
worldwide tap into the enduring strengths we have acquired dur-
ing our history of more than 140 years and always focus on win-
ing with a consumer orientation. We want to transform “from a
leader in Japan to a winner worldwide,” and will continue to take
on challenges to achieve the objectives of VISION 2020. We
invite you to share our expectations for success.

Creating an Organizational
Culture and Nurturing
Employees Who Drive Success

We must reform our organizational cul-
ture and leverage employee diversity to
achieve the objectives of VISION 2020. I
have been telling our people that there is no shame in failure
as long as we take on challenges. Our people are gradually
becoming open to giving it a try, and we are building an organi-
zational culture that enables people to keep trying after
errors. We will concentrate on unleashing the potential in each
and every Shiseido employee and on creating a culture in
which teams and the organization focus on winning. We will
also reassign our people internationally and provide training
opportunities to nurture managers who excel on a global level.

For details, see Nurturing People Who Can Win Worldwide (page 58).

Committed to Taking on Challenges

Figure 5: Aggressive Capex to Achieve Medium- and
Long-Term Growth

Figure 6: Numerical Targets up to 2017

Notes: 1. As a transitional period, the period ended December 2015 is the 9 months from April to
December 2015 for Shiseido and its consolidated subsidiaries in Japan and the 12 months
from January to December 2015 for all other subsidiaries.
2. Outlook for the year ending December 2016 is as of February 9, 2016.

For details, see CFO Norio Tadakawa on
Shiseido’s Financial Strategy (pages 24-25).
Transition to Growth
We got off to a good start in 2015, the first year of VISION 2020. Increasing sales was a top priority, and we generated 5 percent period-on-period growth on a real basis excluding extraordinary factors such as the rebound from the drop in demand caused by the consumption tax hike and inbound demand. Shiseido had been unable to generate growth since the financial crisis of 2008, so our transition to growth in the first year of VISION 2020 represents a major achievement. We also established a virtuous cycle for earnings in which aggressive investment supported sales growth and we generated earnings that exceeded outlays. Now, our challenge is to maintain and increase this growth momentum.

Business Structure Reforms
We are implementing business structure reforms to generate capital for investing in growth. Our target for the year ending December 2017 is cost reductions of ¥30 to ¥40 billion compared with the year ended March 2014, with a total of about ¥60 billion for the three years ending December 2017. Results were good for the year ended December 2015: We reduced costs by ¥7.5 billion, exceeding our plan of ¥4 billion. We will continue to execute initiatives worldwide, conducting reforms that extend to our organizational structure and businesses (Figure 1).

A More Sophisticated Financial Strategy
We are also seeing clear progress in enhancing management precision since shifting in 2015 to a system under which I coordinate with regional CFOs. This is exemplified by our success in enabling timely understanding of expenses and earnings. In January 2016, we launched a management system that links brands and regions. Our aim is to make further progress in raising return on investment (ROI) for marketing and other investments. We will also enhance information disclosure by disclosing results in new reportable segments by region to ensure accountability.
under the global management system we launched at the begin-
ning of 2016.

In addition, we will focus on increasing capital efficiency. We are implementing reforms that link supply chain management with stores to handle inventory more efficiently and shorten our cash conversion cycle (Figure 2).

**Approach to Debt-Equity Balance**

We will make decisions about the balance between assets and liabilities in light of capital costs, recovery period and other characteristics of capital available for investment, the market environment, and operational status. We also have the benchmarks of 25 percent for the interest-bearing debt ratio and a 1:1 ratio of interest-bearing debt to EBITDA so that we can maintain favorable access to funding for attractive projects.

The ratio of interest-bearing debt to EBITDA as of December 31, 2015 was 0.8 times, indicating that we have rebuilt a strong financial base. We will expand investment to aggressively pursue sustainable growth.

**Shareholder Returns**

Our total shareholder return policy targets returns to shareholders directly through dividends and by generating medium- and long-term share price gains. We will also conduct share buybacks if we consider them appropriate in light of free cash flow and the market environment. This policy is our basis for making strategic investments that drive earnings growth and increase corporate value. Shiseido’s goal for returns over the medium term is a consolidated payout ratio of 40 percent, with stable, consistent dividends supported by earnings growth (Figure 3).

**Figure 3: Cash Dividends per Share and Consolidated Payout Ratio**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Dividends per Share</th>
<th>Consolidated Payout Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/3</td>
<td>50</td>
<td>50.0</td>
</tr>
<tr>
<td>2013/3</td>
<td>137.1</td>
<td>50.0</td>
</tr>
<tr>
<td>2014/3</td>
<td>30.5</td>
<td>50.0</td>
</tr>
<tr>
<td>2015/3</td>
<td>23.7</td>
<td>50.0</td>
</tr>
<tr>
<td>2015/12</td>
<td>34.4</td>
<td>50.0</td>
</tr>
<tr>
<td>2016</td>
<td>28.5</td>
<td>50.0</td>
</tr>
</tbody>
</table>

*Not presented for the year ended March 2013 because of the net loss

**2016 Outlook (As of February 9, 2016)**

We expect an uncertain operating environment during the year ending December 2016 due to factors including the deceleration of China’s economy; fluctuations in the foreign exchange, stock and oil markets; and movements in the U.S. economy. However, we will continue to invest aggressively in marketing and to implement structural reforms that rebuild our business foundation and ensure growth over the medium to long term.

We forecast net sales of ¥872.0 billion, a 3 percent increase year on year on a local currency basis. We are targeting increased growth in every region we serve, but factors such as the expiration of a fragrance brand license agreement may impact results.

Earnings will be subject to positive factors including the effect of structural reforms and increased marginal income due to higher sales, but we will also make bold investments centered on marketing. In addition, we will implement additional contingency measures at a cost of ¥5.5 billion in light of concerns about the rapid slowdown in the global economy at the beginning of 2016. We forecast operating income of ¥38.0 billion, a 12 percent decrease year on year on a local currency basis, and net income attributable to owners of parent of ¥28.0 billion.

**Results for the Period Ended December 2015 and Outlook for the Year Ending December 2016**

*(Billion yen)*

<table>
<thead>
<tr>
<th></th>
<th>2015/12</th>
<th>2015/12 (Adjusted)</th>
<th>2016/12 (Outlook)</th>
<th>Change from 2015/12 (Adjusted)*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales</strong></td>
<td>763.1</td>
<td>863.3</td>
<td>872.0</td>
<td>10.0%</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>37.7</td>
<td>44.3</td>
<td>38.0 (14.3%)</td>
<td>(12%)</td>
</tr>
<tr>
<td><strong>Extraordinary Gain</strong></td>
<td>5.3</td>
<td>6.0 (32.1%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net income Attributable to Owners of Parent</strong></td>
<td>23.2</td>
<td>29.5</td>
<td>28.0</td>
<td>(5.0%)</td>
</tr>
<tr>
<td><strong>ROE</strong></td>
<td>6.0</td>
<td>7.0</td>
<td>6.0</td>
<td></td>
</tr>
</tbody>
</table>

*For comparison purposes, figures for the period ended 2015 have been adjusted to a 12-month period ended December 31, 2015 for Japan and overseas to correspond with the year ending December 2016, 2016 outlook and change from 2015/12 (adjusted) on a local currency basis are based on exchange rate estimates as of February 9, 2016.

**Exchange Rates for Major Currencies**

<table>
<thead>
<tr>
<th>Period Ended December 2015</th>
<th>Year Ending December 2016 (Outlook)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD 1 = JPY 121.1</td>
<td>USD 1 = JPY 119</td>
</tr>
<tr>
<td>EUR 1 = JPY 134.3</td>
<td>EUR 1 = JPY 130</td>
</tr>
<tr>
<td>CNY 1 = JPY 19.2</td>
<td>CNY 1 = JPY 18</td>
</tr>
</tbody>
</table>

**Year Ending December 2016: Breakdown of Changes in Operating Income Outlook**

*(Billion yen)*

<table>
<thead>
<tr>
<th>Source of Changes</th>
<th>2015/12</th>
<th>2015/12 (Adjusted)</th>
<th>Outlier</th>
</tr>
</thead>
<tbody>
<tr>
<td>China distribution &amp; inventory reform</td>
<td>+5.0</td>
<td>+7.0</td>
<td></td>
</tr>
<tr>
<td>Increased marketing investment</td>
<td>+28.0</td>
<td>+28.0</td>
<td></td>
</tr>
<tr>
<td>Higher personnel expenses and organization enhancement</td>
<td>+12.5</td>
<td>+15.5</td>
<td></td>
</tr>
<tr>
<td>One-time structural reform costs</td>
<td>-5.5</td>
<td>-5.5</td>
<td></td>
</tr>
<tr>
<td>R&amp;D and IT investment savings</td>
<td>-3.4</td>
<td>-3.4</td>
<td></td>
</tr>
<tr>
<td>Additional contingency measures</td>
<td>-3.5</td>
<td>-3.5</td>
<td></td>
</tr>
</tbody>
</table>

*China distribution & inventory reform: +5.0
Accelerated structural reform: +3.0

**Different fiscal periods:**

9 months in Japan
12 months overseas

**Fiscal periods:**

12 months in Japan
12 months overseas