October 31, 2013
Shiseido Co., Ltd.

Q&A for the Second Quarter of the Fiscal Year Ending March 31, 2014 (Summary)

Q) How do you see the Japanese cosmetics market today, and what are your thoughts on its outlook?

A) In the cosmetics market, the deflationary trend has persisted, but following the introduction of new economic policies under the Abe government, we see some signs this year of the deflation ending. For example, recent growth in sales amount has been faster than growth in sales quantity. In particular, sales are firming in the mid price range. The situation may improve further if consumers start to feel that their incomes are really rising, but any optimism needs to be tempered.

Q) Last year, you made a number of downward revisions, but for the first half of the current fiscal year, operating income was much higher than forecast. Does this show that your attitude towards profits has changed?

A) Our stance of securing profits steadily despite a sales slide has not changed at all. For the current year, we moved up our cost structural reform and made other efforts to earn profits across the company. That resulted in results outperforming forecast.

Q) What is your forecast for full-year sales by region for FY 2013?

A) Domestic sales are expected to reach 367 billion yen, down 2% from the preceding year, and overseas sales 373 billion yen, up 2% in real terms from the preceding year. Sales on a local currency basis will be flat in China but we anticipate low single-digit growth in the Americas and in Europe.

Q) What is the outlook for the full-year operating margin in China for FY 2013 and recent business trends?

A) The annual operating margin will be below 10% after a margin decline due to shipment control at the end of year. For FY2014, we forecast a doubt-digit operating margin and the figure will rise in subsequent years. We have achieved high single-digit growth year on year for the third quarter, and we expect mid single-digit growth for the second half. Full-year sales will be nearly unchanged from the preceding year's level. (All of these are on a local currency basis.)

Q) Exactly what types of products are included in the domestic store-level inventories that are planned to be recovered in the second half? Also. does the extraordinary loss for the first half include the store-level inventory adjustments in China?

A) A reduction in shipments in the first half decreased store-level inventories by 7.5 billion yen. For the second half, we are planning to cut them by 10.3 billion yen in total with the recovery of store-level inventories. Consequently, the full-year inventory reduction will reach around 18 billion yen. Among the 10.3 billion yen recovery, 4 billion yen provided for operating expenses consists mainly of the inventory recovery of low-ranked products from drugstores and cosmetic specialty stores. The amount of 6.3 billion yen for the extraordinary loss derives from the recovery of discontinued products. It does not reflect the recovery in China. Our current major challenge is to establish frameworks to prevent an accumulation of store-level inventories. For this purpose, we will not merely recover inventories but adopt management reforms so that performance of employees will be measured solely by store sales.

Q) What progress has been made in revisions to the personnel costs concerning beauty consultants and other personnel?

A) We will reduce the total number of employees, including beauty consultants, by around 1,000 in the three-year period that starts in FY 2013 by limiting recruitment and through natural attrition. Expenses for beauty consultants account for a large proportion of personnel costs. It is important to further increase their productivity because our performance in high-end products has recently been showing an improvement. In the long run, we will consider revising the seniority-based wage curve.

Q) What was behind your revision to the full-year operating income forecast?

A) The forecast figure was raised by 1 billion yen from the previous forecast figure to 40 billion yen. That reflects an increase in income of 5.4 billion yen for the first half, an increase of 1.5 billion yen following a revision to the foreign exchange rate for the second half, another increase of 1 billion after expenses reduction, a decrease of 3 billion yen resulting from the deferment of expenses from the first half and a margin decline of 4 billion in China due to the planned shipment reduction.

Q) Are you confident that the shipment reduction will bring store-level inventory in China to an appropriate level?

A) The circumstances remain uncertain following the lingering public sentiment against Japan, but the inventory in China will be closer to an appropriate level after our reduction of shipments. For China, shipments tend to concentrate in the period before the Chinese New Year, to ensure that stores have sufficient quantities in stock for the selling season, but we will curtail shipments at the end of this fiscal year to balance shipments with store sales.

Q) Do you think that your foreign exchange rate assumption is conservative?

A) We do not see it as particularly conservative, as conversion is carried out on the basis of the nine-month average rate.

Q) You were reappointed president in April. What do you think of the progress of reform in the past six months?

A) As I mentioned in my presentation, I think that, as a result of our efforts in the first half, we now have a prospect of resolving most of the business challenges that are blocking growth.

Q) You said that the rate of wholesale prices to retail prices for the *BENEFIQUE* line will be decreased. What other measures will you take to strengthen cosmetic specialty stores?

A) In addition to the change in the rate of wholesale prices to retail prices, we will revise the terms and conditions of contracts and the rebate system to place greater emphasis on store sales in an attempt to achieve coexistence and mutual prosperity with specialty stores.

Q) From FY 2014, which will have more priority when it comes to boosting profitability: sales expansion or cost cutting?

A) The new three-year plan that will commence in FY 2014 is being developed and I am unable to give details, but we think it is vital to seek to both increase sales and cut costs in a well-balanced manner to consistently raise the income level with each year. Given that massive growth of sales of top lines is difficult in Japan, we regard overseas markets, especially Asia, as important. We have started to take action from an early stage for India, the Middle East, Indonesia and other markets, to follow our efforts in China.

Q) You are adopting a strategy of promoting locally produced *AUPRES* and *URARA*. Will this move eventually give an impression of SHISEIDO as a medium price range manufacturer rather than a prestige cosmetics company?

A) In light of the current operating environment, we give priority to promoting *AUPRES* and *URARA*, which are relatively unsusceptible to sentiment that is adverse to Japan. If market conditions improve in the future, we will change our brand focus.