Transforming Shiseido into a company that insists on winning by facing realities

December 17, 2014
Masahiko Uotani
Representative Director, President & CEO
Shiseido Company, Limited
Today’s Agenda

Current Status Recap

Targeted outcomes and specific action plans

Numerical targets
Favorability Rating of Company Is Decoupled from Domestic Market Share

Favorability rating and market share to 2002 are based on Shiseido survey. Market share for April 2003 to March 2009 is based on INTAGE Inc. SLI – Diary data. For April 2009 to March 2013, market share is based on INTAGE Inc. SLI- web purchase comparison data (value basis) for general cosmetics (defined by Shiseido; comprising cosmetics, haircare, body care and others).
Operating Profitability Far Below Competitors
Figures for Japan are based on publicly disclosed data. Figures for China are based on actual results of two sales companies in China.
Decline in R&D Investment

R&D Expenses as a Percentage of Net Sales

<table>
<thead>
<tr>
<th>Year</th>
<th>Shiseido</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>2.8</td>
<td>1.8</td>
<td>1.8</td>
<td>3.5</td>
</tr>
<tr>
<td>2013</td>
<td>1.8</td>
<td>2.4</td>
<td>3.5</td>
<td>3.7</td>
</tr>
</tbody>
</table>

Comparison with Other Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>2013</th>
<th>2013 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shiseido</td>
<td>1.8</td>
<td>2013</td>
</tr>
<tr>
<td>Company A</td>
<td>2.4</td>
<td></td>
</tr>
<tr>
<td>Company B</td>
<td>3.5</td>
<td></td>
</tr>
<tr>
<td>Company C</td>
<td>3.7</td>
<td></td>
</tr>
</tbody>
</table>

Billions of yen

- 2003: 17.6
- 2013: 13.5
Fundamental Issues

Brands That Aren’t Growing

- Poor customer orientation
- Too many brands
- Confusing brand portfolio
- Declining investment in marketing and R&D

Inefficient Organization

- Delayed decision-making and response to market changes
- Japan-centric organizational structure
- Barriers between head office and front-line sales
- Unclear allocation of responsibility
- Personnel system that lacks competition and does not nurture young employees
- High ratio of selling, administrative and personnel expenses

“There’s an attitude that the head office is on top and the sales company is the underling. We’re both in the same group, aren’t we? I feel a real barrier between us.”

“No one takes responsibility when we don’t get results, including senior management. We don’t even get an explanation.”

“Now that I’m over 40, at last I’m in a managerial position. Everything up until now has been the waiting period of the seniority system.”
Shiseido’s Potential and Strengths

- Long history, contribution to culture
- R&D and technological capabilities
- Safe, reliable, high-quality products
- Spirit of omotenashi
- Human resources and loyalty
- Global operations

Our Mission, Values and Way
The Shiseido Group corporate philosophy
Today’s Agenda

Targeted Outcomes and Specific Action Plans

Numerical targets

Current status recap
Active Consumer

Connected through various networks, enjoy diversified roles, make their own choices
<table>
<thead>
<tr>
<th>Shiseido-oriented View (Shiseido shall…)</th>
<th>Consumer-oriented View (Consumers expect us to…)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ideal</strong></td>
<td><strong>Individual</strong></td>
</tr>
<tr>
<td>(present a uniform ideal)</td>
<td>(support the pursuit of unique beauty)</td>
</tr>
<tr>
<td><strong>Aspire</strong></td>
<td><strong>Inspire</strong></td>
</tr>
<tr>
<td>(create an image of being the authority on beauty to be aspired to)</td>
<td>(foster mutual trust based on honesty)</td>
</tr>
<tr>
<td><strong>All</strong></td>
<td><strong>Role</strong></td>
</tr>
<tr>
<td>(possess almighty power)</td>
<td>(fulfill the required role)</td>
</tr>
<tr>
<td><strong>Fixed</strong></td>
<td><strong>Mixed</strong></td>
</tr>
<tr>
<td>(respond to general/average situations)</td>
<td>(support flexibility for different situations)</td>
</tr>
<tr>
<td><strong>By</strong></td>
<td><strong>With</strong></td>
</tr>
<tr>
<td>(be in a position to give instructions)</td>
<td>(maintain an equal relationship)</td>
</tr>
</tbody>
</table>
Desired Outcomes and Roadmap

2015-2017
- Restructure the Business Foundation
- Enhance brands
- Increase marketing and R&D investment
- Organizational/personnel system reform
- Strengthen China, Asia, TR* and EC businesses
- ¥30-40 billion Groupwide structural reform

2018-2020
- New Strategy to Accelerate Growth
- New brands/M&A
- Continue investment/Achieve returns
- Build global system
- Establish business in emerging countries/new areas
- Review and revise business models

2020
- “We create beauty, we create wellness”

- Become a company that is full of energy for growth
- Become a company that is a topic of conversation around the world
- Become a company that young people adore
- Become a company that is brimming with youthfulness
- • Operating income over ¥100 billion
  • ROE of 12% or more

* Travel Retail
Strategic Directions in Each Region

**Europe**
- Unify European marketing
- Integrate back office operations
- Restructure business operations in low-profit countries

**Asia**
- Increase customer-driven investment
- Localize functions and authority
- Establish independent electronic commerce (EC) business

**Japan**
- Increase customer-driven investment
- Prioritize enhancement of prestige and cosmetics brands
- Focus on bolstering selected brands in personal care category

**Americas**
- Accelerate growth of makeup brands/lines
- Integrate back office operations
- Normalize ADC* operations

**Restore market share**
- Increase customer-driven investment
- Prioritize enhancement of prestige and cosmetics brands
- Focus on bolstering selected brands in personal care category

**Expand growth potential**
- Expand prestige brand market share
- Establish foundation for cosmetics brands
- Enhance TR and emerging country operations

*Shiseido Americas Distribution Center
Toward Brand Enhancement

Integrated customer-driven marketing

Marketing X Innovation

Product development based on innovative core technologies

Human resources and organization with strong ability to execute

Regional, front-line focus
Flat organization
Speed
Accountability
### New Organizational Matrix with Brand and Region Vectors

**Brand Vector**
(4 brand businesses)

**Region Vector**
(6 regions)

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#### New Organizational Matrix Concept (From April 2015)

<table>
<thead>
<tr>
<th>Regions</th>
<th>Japan</th>
<th>China</th>
<th>Asia</th>
<th>Americas</th>
<th>Europe</th>
<th>TR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brands</td>
<td>Prestige</td>
<td>Cosmetics</td>
<td>Personal care</td>
<td>Professional</td>
<td>Corporate/shared functions</td>
<td></td>
</tr>
</tbody>
</table>
Think Global, Act Local in Action

Local Subsidiary Functions
The front line responsible for expanding business by meeting the needs of local customers

Regional Headquarters (RHQ) Functions
Strategic hubs that support locally rooted brand development

HQ Functions
Strategic support team for the Shiseido Group

CEO
Japan: Unify Head Office and Sales Company Functions

Current

Head office
- Brands
- Sales Planning

Sales company
- Area Planning
- Sales
- BC*

After Domestic Organizational Restructuring (From April 2015)

Prestige
- Brands
- Channel planning
- Sales/BC*

Cosmetics
- Brands
- Channel planning
- Sales/BC*

Personal care
- Brands
- Sales

Digital
- watashi+
- Internet/Mail-order business

Wholesalers and distributors

Department stores and cosmetic specialty stores

Drugstores/General merchandise stores/Home centers/Supermarkets/Convenience stores

BC: Beauty Consultant(s)
A Personnel System That Stimulates and Rejuvenates the Organization

**Diversity**
- Global mobility
- External personnel
- Revise the design and working environment for Japan-centric posts
- Active roles for women

**Principles of competition**
- Promote competent (young) personnel
- Selective education
- Evaluation and position/compensation based on abilities and achievements

**Roles & responsibilities**
- Work rule design
- Competency
- Culture of responsibility for commitments

No image content description available.
Personnel System Reform in Japan and China: Motivating Beauty Consultants (BC)

- Transform into a group of beauty professionals
- Encourage recruiting of and promotion to regular employees
- Switch to an evaluation and position/compensation system that is linked to store sales
- Increase roles for young employees
- Expand scope of work and assign people to the jobs they are suited for
- System for career changes
Fundamental Strategy for Prestige Business

• Focus on building the global brand SHISEIDO and the bareMinerals, CPB* and NARS brands

• Expand share in Japan, Americas and Europe through steady growth

• Drive growth in the high-growth markets of TR, China and Asia

* CPB: clé de peau BEAUTÉ
Fundamental Strategy for Cosmetics Business

• **Premium**
  Mid-to-high price/high-value-added category:
  Introduce new *ELIXIR* line for China and Asia in 2016

• **Entry**
  Low-price/youth category:
  Aggressively build *Za* brand mainly in Asia
Select and focus on brands for investment

Shift to investment that focuses on customers

Expand marketing investment by a cumulative total of more than ¥100 billion over three years

Build brand value & loyalty

Create Strong Brands by Expanding and Changing the Nature of Marketing Investment

Marketing Investment

Cumulative increase of more than ¥100 billion

Expand investment

2014
(Forecast)

2020
Expand Core Brands/Lines and Achieve over ¥1 Trillion in Sales through Brand Investment

- Eliminate and consolidate small, unprofitable brands/lines (decrease of 28 brands)
- Redeploy brands/lines according to customer segmentation
- Strengthen product lifecycle management
- Brand M&A
Expand R&D Investment to Innovate

- Establish a regionally based research organization
- Increase research facility personnel worldwide from 1,000 to 1,500*
- Strengthen basic research
- Establish a Global Innovation Center
- Increase R&D expenses from 1.8% to 2.5% of net sales*

* Forecast for 2020
Invest in Categories That Are Essential for Growth

Aggressively expand in the TR category, which is highly profitable and offers excellent growth potential

- Develop exclusive products
- Expand investment in sales counters
- Establish an independent organization to strengthen operations in Asia

Strengthener electronic commerce (EC)/digital category to reach young consumers

- Establish independent organizations for each region
- HQ to plan strategy
- Expand IT and marketing investment
Restructure the China Business

Issues in China

- Slow response to market changes
- Overemphasis on sell in/increase in inventories
- Complex organization and processes
- Poor management of BC
- High cost structure
- Increasingly competitive environment

Business structure reform

- Reduce costs
- Restructure and increase investment in brand portfolio
- Unify activities to increase store sales
- Restructure and reinvigorate BC organization
- Localize authority/Promote local employees
- Establish independent EC business to become #1 digital company
Ceaseless Structural Reform

- Find new suppliers and enhance collaboration
- Reform the cost planning process

- Source promotional items more efficiently
- Scrutinize return on investment

- Revise evaluation and position/compensation system
- Control the number of employees

- Revise the demand forecasting and planning process
- Aggressively utilize new suppliers

- Shift to area-based shared services
- Review and optimize IT investment

- Marketing costs
- Cost of sales
- Personnel expenses and productivity
- Inventory/SCM
- Back office costs
Raise Structural Reform to the Next Level

**Until Now**

Began by reducing and streamlining

- Generated effects with a focus on Japan
- Made issues visible through reduction initiatives
- Directed cost improvements from the head office
- Optimized inventories and increase store sales by unifying activities in Japan

**From Now**

Reform that addresses core issues

- Global rollout in all categories (leverage economies of scale globally)
- Organizational and process reform (change the way of working)
- Reengineer the China business
- Corporate officers commit to results and make decisions on a weekly and monthly basis.
Generate Investment Resources to Build a Foundation for Growth

Generate ¥30-40 billion over three years, by 2017
Today’s Agenda

Numerical Targets

- Current status recap
- Targeted outcomes and specific action plans
Toward Net Sales of Over ¥1 Trillion

Net Sales
Billions of yen

CAGR 3-5%

2014 (Forecast)  ¥770
2017
2020  ¥1,000+

CAGR 5-7%
Expand Earnings by Reengineering Businesses

<table>
<thead>
<tr>
<th></th>
<th>2014 (Forecast)</th>
<th>2017</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of sales</td>
<td>25.1</td>
<td>24.0 to 24.5</td>
<td>23.0 to 24.0</td>
</tr>
<tr>
<td>Marketing costs*</td>
<td>24.8</td>
<td>27.0</td>
<td>27.5</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>1.8</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Personnel expenses*</td>
<td>27.6</td>
<td>24.5</td>
<td>22.5</td>
</tr>
<tr>
<td>Other expenses</td>
<td>17.5</td>
<td>15.5</td>
<td>14.5</td>
</tr>
<tr>
<td>Operating income</td>
<td>3.2</td>
<td>6.5 to 7.0</td>
<td>9.0 to 10.0</td>
</tr>
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</table>

* Counter depreciation expenses and costs of BC who are hired by distributors and retailers previously included in other expenses have been reclassified as marketing costs and personnel expenses, respectively.
Toward Operating Income of ¥100 Billion

Operating Income

(Billions of yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>17</th>
<th>2020</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>44.5</td>
<td>39.1</td>
<td>26.0</td>
<td>49.6</td>
<td>25.0</td>
<td>50-60</td>
<td>100+</td>
</tr>
</tbody>
</table>
Shiseido’s Key Performance Indicators (KPI)

Sustained growth

- Invest in brands
- Increase brand equity
- Grow net sales
- Increase operating income
- Increase corporate value

Increase management efficiency

- Strengthen management of CF and BS
- Emphasize FCF\(^1\) and CCC\(^2\)

1. Free cash flow  2. Cash conversion cycle
Allocate the Value Created to Investments for Growth and Shareholder Returns

- **Investments for growth:** Strengthen marketing, R&D and M&A investment
- **Dividends:** Target a 40% payout ratio, and pay stable, sustained dividends
- **Share repurchases:** Execute when free cash flow and market conditions are appropriate
Signs of Change at Shiseido: ICHIGAN Project

YoY Store Sales (10-day periods)

%; 2014

July
November

100
Total Commitment of Management

Reform and strengthen management

Commitment to structural reform

Leadership that emphasizes operating realities

Accountability
Rejuvenate Shiseido

Excerpt from January 2015 issue of GOETHE, Gentosha

Article by Toru Uesaka     Photograph by Tadayuki Aritaka
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