

# Management's Discussion and Analysis

## OPERATING RESULTS

During the fiscal year under review in domestic operations, in the Food–Manufacturing and Sales segment, the soy sauce and *sake* and wine businesses struggled, while foods and soy milk beverages turned in strong performances. Although sales declined sharply due to the elimination of the Coca–Cola business from the scope of consolidation, profits were up partly as a result of a change in inventory accounting methods.

In overseas operations, business started to recover in the second half of the year, despite the global recession that began in the previous year. Nevertheless, although overall sales rose on a local currency basis, currency translation effects related to the strong yen resulted in lower sales and earnings year on year.

Net income increased significantly, due in part to the absence of income taxes paid in the previous fiscal year as a result of the partial transfer of shares of Tone Coca–Cola Bottling Co., Ltd.

Consequently, on a consolidated basis, net sales decreased by ¥126,958 million, or 30.8%, year on year to ¥285,690 million. Operating income increased by ¥716 million, or 3.5%, to ¥21,085 million, and net income climbed by ¥5,855 million, or 213.2%, to ¥8,602 million.

## SEGMENT INFORMATION

On October 1, 2009, Kikkoman Corporation shifted to a holding company structure with the aims of strengthening Group strategic capabilities, enhancing value creation in each of the operating companies, and capturing Group synergies.

In conjunction with this transition, the Company changed the business segments listed under “Segment Information” in order to reflect the new management structure.

In the past, operations were classified into the following three business segments: Foods–Manufacturing and Sales, Foods–Wholesale, and Other Businesses. The Company has now broken operations into four segments: Domestic Foods–Manufacturing and Sales, Domestic Others, Overseas Foods–Manufacturing and Sales, and Overseas Foods–Wholesale. For purposes of comparison, fiscal 2009 figures have been restated according to the new segment classifications.

## DOMESTIC

### DOMESTIC FOODS–MANUFACTURING AND SALES

This business segment comprises manufacturing and sales in Japan of products from the Soy Sauce Division and the Food Products Division, which includes *tsuyu* (soy sauce soup base), *tare* (dipping and marinade sauces) and Del Monte seasonings, as well as the Beverages Division, which includes soy milk beverages and Del Monte beverages, and the *Sake* and Wine Division, which includes *mirin* (sweet *sake* for cooking) and wines.

Segment sales edged up 0.5% year on year to ¥151,295 million, while operating income rose 105.9% to ¥7,232 million, in part as a result of changes in inventory accounting methods.

#### SOY SAUCE DIVISION

Demand for soy sauce in the home-use sector was stimulated by the introduction of 750ml bottles of *Tokusen Marudaizu Shoyu* (premium soy sauce) and *Gen-en Shoyu* (less sodium soy sauce), and a campaign of television commercials, but sales still fell year on year. In the industrial- and foodservice-use sectors, sales were strong due in part to new business development in the industrial-use sector, but overall division sales declined compared to the previous year.

#### FOOD PRODUCTS DIVISION

In *tsuyu* (soy sauce soup base), home-use sector sales of flagship product *Hon Tsuyu* were on a par with the previous year, while sales of *Straight Tsuyu* struggled, in part due to the impact of the weather during the peak demand season, ultimately recording lower sales year on year. In the industrial and foodservice-use sectors, sales struggled under severe market conditions, and overall *tsuyu* sales fell short of the previous year's level. In *tare* (dipping and marinade sauces), overall sales rose year on year thanks to the contribution of new products in the *Wagaya-wa-Yakinikuyasan* series, our mainstay product in this area, coupled with growth in sales of other seasonings for meat as consumers dined more at home, and growth in the foodservice-use sector customer base. Sales of the *Uchi-no-Gohan* series (a handy Japanese-style seasoning mix) were sharply higher year on year, reflecting aggressive product development and storefront promotion activities as well as benefits from the market penetration of a new series. In Del Monte seasonings, sales were up year on year on strong sales of processed tomato products such as tomato ketchup and the new *Yo-Gohan-Tsukuro* series (seasoning for Western-style dishes). As a result, overall division sales rose year on year.

#### BEVERAGES DIVISION

In soy milk beverages, sales rose significantly over the previous year on the back of a recovery in modified soy milk, as well as sales of new products, and limited-time seasonal products. In Del Monte beverages, although there was steady growth in sales of tomato juice, overall sales were lower than the previous year as vegetable juices struggled amid a general downturn in the market. Overall division sales increased year on year.

#### SAKE AND WINE DIVISION

In the home-use sector, sales of *Hon Mirin* were strong, due to a larger number of stores selling 1-liter bottles of mainstay product *Manjo Houjun Hon Mirin*, as well as sales of small containers. However, in the industrial and foodservice-use sectors, sales in large containers struggled due to a sluggish restaurant industry, and overall sales were flat year on year. Overall sales of domestic wines fell year on year, reflecting the termination of sales of certain products, despite firm growth in sales of a new category of *Manns Wine* products, as well as cooking wines. As a result, overall division sales declined year on year.

## DOMESTIC OTHERS

This segment includes production and sales of clinical diagnostic reagents, hygiene inspection agents, processing enzymes and chemical products such as hyaluronic acid, as well as real estate rental, logistics, back-office functions for the Kikkoman Group, and other businesses.

Sales of hygiene inspection agents and processing enzymes were strong, but clinical diagnostic reagents struggled, and sales fell year on year. Sales of hyaluronic acid were on a par with the previous year, but sales of alginate ester, which is used to improve bubbles in beer and stabilize salad dressings, suffered from price revisions, resulting in lower year-on-year sales of chemical products. Sales in the logistics business, meanwhile, were steady.

As a result, segment sales increased 18.9% year on year to ¥16,674 million, while operating income rose 12.8% to ¥867 million.

## OVERSEAS

### OVERSEAS FOODS—MANUFACTURING AND SALES

This business comprises the manufacturing and sales and export overseas of products from the Soy Sauce Division, the Del Monte Division, and the Other Foods Division, which sells health foods and other products.

After conversion to yen, segment sales fell 0.9% year on year to ¥48,700 million, while operating income also decreased, by 10.4% to ¥8,495 million. On a local currency basis, sales were up while earnings were down.

#### SOY SAUCE DIVISION

In the North American market, the division sought to leverage its brand power to expand business by enhancing the lineup of mainstay soy sauce products and soy sauce-based seasonings for the home-use sector. In addition, in the industrial- and foodservice-use sectors, we worked to carefully meet customer needs. As a result, although economic conditions remained sluggish, sales in all three sectors rose on a local currency basis. In the European market, while certain areas felt the effects of the economic recession, contributions from new products and a vigorous recovery in the Russian market led to year-on-year sales growth on a local currency basis. In the Asia and Oceania market, sales were up on a local currency basis, mainly in the home-use market.

Although overall division sales were down year on year due to foreign currency translation conversion, sales increased on a local currency basis.

#### DEL MONTE DIVISION

This division manufactures and sells canned fruits, canned corn, tomato ketchup and other products in the Asia and Oceania region.

During the fiscal year under review, sales in the key market of South Korea remained lackluster with the won slow to recover against the U.S. dollar. As a result, although the division pressed forward with developing new markets in the Oceania region, overall sales were down year on year.

#### OTHER FOODS DIVISION

This division manufactures and sells health foods, mainly in the North American market.

Overall division sales grew substantially during the fiscal year under review, due in part to the inclusion of a full-year's results from Allergy Research Group, which was acquired in the previous fiscal year.

#### OVERSEAS FOODS-WHOLESALE

This segment is engaged in the purchase and sale of oriental food products in Japan and overseas.

In the North American market, sales were firm on a local currency basis. In the European market, too, the growing popularity of Japanese food contributed to strong growth in sales on a local currency basis. Sales in the Asia and Oceania market also rose year on year on a local currency basis.

As a result, although sales were up on a local currency basis, due to the impact of currency translation, segment sales declined 3.8% year on year to ¥85,416 million. Operating income rose 4.7% year on year to ¥4,306 million.

### FINANCIAL POSITION

#### ASSETS

Current assets at March 31, 2010 were up by ¥1,237 million from the end of the previous fiscal year, mainly due to changes in inventory accounting methods. Total property, plant and equipment, net, and investments and other assets were down by ¥935 million from the previous fiscal year-end, due in part to a decline in intangible assets. As a result, total assets as of March 31, 2010 were ¥311,175 million, an increase of ¥302 million from a year earlier.

#### LIABILITIES

Current liabilities decreased by ¥2,711 million compared to the end of the previous fiscal year due to a decline in accrued income taxes, while long-term liabilities declined by ¥2,254 million, mainly reflecting a decrease in long-term debt. As a result, total liabilities decreased by ¥4,966 million to ¥144,089 million.

#### NET ASSETS

Retained earnings rose year on year, and unrealized holding gain on securities, net of taxes also increased on the back of a recovery in the market price of shares, while foreign currency translation adjustments declined. As a result, net assets were ¥167,086 million, and the equity ratio increased by 1.6 percentage points to 53.1%. Net assets per share increased by ¥26.18 to ¥800.79.

## CASH FLOWS

Cash and cash equivalents were ¥25,008 million as of March 31, 2010, a decrease of ¥2,775 million compared to the end of the previous fiscal year.

Details of the status of cash flows in each type of activity and the major contributing factors during the year under review are described below.

Operating activities provided net cash of ¥18,003 million, a decrease of ¥4,449 million from the previous fiscal year. This mainly reflected an increase in income taxes paid and a decline in income before income taxes and minority interests.

Investing activities used net cash of ¥11,959 million, mainly for the acquisition of property, plant and equipment.

Financing activities used net cash of ¥8,522 million. This primarily reflected outflows for the payment of cash dividends and repayment of short-term bank loans and long-term debt.

## RISK FACTORS

### ECONOMIC CONDITIONS

The Kikkoman Group is developing business in various countries. A decline in demand for the products and services that the group provides, due to worsening economic conditions in particular countries where the Kikkoman Group is doing business, could result in lower sales and earnings and thus adversely affect the Kikkoman Group's business results and financial position.

### JAPANESE MARKET

The Japanese market for soy sauce, the Kikkoman Group's mainstay business, has been contracting in recent years. In this operating environment, the Kikkoman Group has been working to vitalize the soy sauce market and endeavoring to drive growth by shifting resources to the growing market of soy sauce derivative products. However, the inability to achieve results in soy sauce derivative products as planned could adversely affect the Kikkoman Group's business results and financial position.

### OVERSEAS MARKET

The Kikkoman Group is developing business around the world and thus manufactures products and conducts sales activities overseas. The occurrence of problems in these business activities caused by unexpected events such as changes in politics, the economy, or society in countries where it is developing business could adversely affect the Kikkoman Group's business results and financial position.

### EXCHANGE RATE FLUCTUATIONS

Kikkoman converts the financial statements of its overseas subsidiaries and other foreign domiciled entities into Japanese yen for preparing its consolidated financial statements. The line items in the financial statements of these subsidiaries and other entities are thus subject to foreign currency exchange rate fluctuations when converted into Japanese yen. In particular, where there is an appreciation of the yen against other currencies, the converted amount in yen will be lower.

Furthermore, exchange rate fluctuations could affect the provision price of products and services denominated in foreign currencies and the procurement cost of raw materials and products purchased by the Kikkoman Group.

The Kikkoman Group uses various techniques to mitigate and avoid foreign currency exchange risk, but changes in currency markets could adversely affect its business results and financial position.

## FLUCTUATIONS IN RAW MATERIAL PRICES

Some raw materials used by the Kikkoman Group are subject to the effects of commodities market conditions. The soybeans, soybean meal and wheat used in the mainstay soy sauce product are subject to the effects of conditions in international commodities markets. Fluctuations in crude oil prices could also affect manufacturing and delivery costs for PET bottles used to package Kikkoman's products and other products. A rapid increase in market prices for these materials could lead to higher manufacturing and delivery expenses and thus adversely affect the Kikkoman Group's business results and financial position.

## ACCOUNTING FOR IMPAIRMENT OF ASSETS

The Kikkoman Group owns a variety of assets, including real estate used in the course of business operations. Should recovery of the Group's investment in such assets become unlikely due to a decline in market value or a decrease in profitability, the assets will become liable for asset impairment accounting. This could adversely affect the Kikkoman Group's business results and financial position.

## FLUCTUATIONS IN THE MARKET VALUE OF SECURITIES

The Kikkoman Group holds marketable securities with fair market values. Should there be a significant decline in the market value of these securities, this could adversely affect the Kikkoman Group's business results and financial position.

## WEATHER

The Kikkoman Group sells beverages such as soy milk and vegetable beverages that are subject to the effects of weather. In particular, a cool summer could result in lower sales of these products, and thus adversely affect the Kikkoman Group's business results and financial position.

## PRODUCT DEVELOPMENT

The Kikkoman Group strives to develop products that match consumers' tastes, guided by the fundamental principle of "consumer-oriented." However, if the Kikkoman Group is unable to sufficiently identify those needs and develop products of value for customers, its sales and earnings could fall and could thus adversely affect the Kikkoman Group's business results and financial position.

## COMPETITION

The Kikkoman Group must promote sales in the markets where it is developing business to differentiate itself from the competition and remain competitive. However, an escalation in competition could result in a decrease in the Kikkoman Group's sales volume or increases in sales, promotion and advertising expenses, which could adversely affect its business results and financial position.

## PRODUCT AND SERVICE QUALITY RISK

At all times, the Kikkoman Group implements strict quality assurance based on the fundamental mission of producing and providing high-quality products in a safe and stable manner. In the event that a defect is found in one of its products or services, the Kikkoman Group's policy is to place priority on customer safety and quickly disclose applicable information, and to restore normal operations and to contain any damage. However, a major defect could cause the Group to incur substantial costs or suffer reputational damage that could result in lower sales, and the Group's business results and financial position could be adversely affected as a result.

## INTELLECTUAL PROPERTY

The Kikkoman Group is acquiring industrial property rights, including patent rights, utility model rights, and trademarks, as necessary with respect to the technology it develops. These intellectual property rights have many advantages from an operational perspective and are thus regarded as an important management resource. However, if another company develops similar rights or technology that is superior to its own, the Kikkoman Group could lose its competitive advantage, which could adversely affect its business results and financial position.

## ALLIANCES AND CORPORATE ACQUISITIONS

The Kikkoman Group has formed alliances with other companies in specific fields of business with the aim of raising its enterprise value. Furthermore, the Kikkoman Group plans to actively utilize resources from outside as necessary resources for its business, and thus may form strategic alliances, including equity-based alliances and corporate acquisitions. However, the inability of the Kikkoman Group to carry out its business plan as expected after forming an alliance or conducting an acquisition as a result, for example, of disagreement among the parties concerned about management, finances, or other policies could adversely affect its business results and financial position.

## LAWS AND REGULATIONS

In Japan, Kikkoman is subject to laws and regulations such as the Food Sanitation Law and the Product Liability Act. In addition, the group is subject to the laws and regulations of each country in which it develops business. Changes to these and other laws and regulations in the future could restrict the Kikkoman Group's activities and thus adversely affect its business results and financial position.

## FORCE MAJEURE

The Kikkoman Group gives sufficient consideration to countermeasures in the event of an earthquake or other force majeure and conducts regular inspections of its facilities, such as earthquake-resistance inspections.

However, damage to production bases caused by a large-scale earthquake or other force majeure could result in a lower production capacity due to interruption to operations. This in turn could lead to lower sales and higher expenses to repair facilities, which could adversely affect the Kikkoman Group's business results and financial position.