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# Minutes of telephone conference on 3Q financial results of FY2019

<Date and time> 4:00 p.m. – 5:00 p.m., Thursday, November 7, 2019（JST）
<Participants> General Manager of Corporate Planning,
General Manager of Finance & Accounting

Q. Please share your thoughts on the acquisition of treasury stock and the sale of the Lion Dairy and Drinks (LDD)? We know that the company is continuing to negotiate a sale, but what is the situation and it is the sale practical? I have understood that the company would purchase treasury stock in conjunction with the sale of LDD. Please explain why you have decided to do so at this stage (without the sale).

A. We continue to negotiate the sale of LDD. Until the 1st half of the year, we have mentioned we were in negotiations with multiple candidates, but now the number of candidtates has been narrowed down to a certain extent, and we are continuing negotiations. It would have been ideal if we could announce it at the same time as the own-share purchase, but the negotiations are still underway at the moment, with the intention to close it by the end of the year. We will report on any progress made regarding this fact. In regards to the own-share repurchase, we have explained in the 2Q that the own-share repurchase would not necessarily move in tandem with the sale of LDD. The sale of the specialty cheese business and the sale of the shares held under the cross-shareholding strategy have progressed to a certain extent, therefore the Company has judged that the timing to be appropriate.

Q. For domestic beer, what do you think the demand for beer after the consumption tax hike will be and what impact will it have on the market as well as your strategy?

A. After the consumption tax hike, it is difficult to predict consumption trends, partly due to point redemptions, therefore it is too early to expect direct effects at this point. As we have explained during our Investor Day held in March 2017, the beer market is expected to grow at an average annual rate of △2.1% between 2017 and 2027, and we believe that this trend to continue. At this stage, we are not considering a clear strategy change, however, as there are liquor tax revisions etc. in the future, the company will study the strategy for each of these revisions. Going forward, the Company will continue to promote continuous brand growth centered on its main brands, *Kirin Ichiban* and the *Honkirin*.

Q. What will be the growth drivers for business profits in the next fiscal year?

A. The key drivers will be to steadily secure and grow the profit margins of Kirin Brewery and

Kirin Beverage. In addition, the contribution of Kyowa Kirin's pharmaceutical business will increase.

Q. How will Kirin Brewery and Kirin Beverage increase their profitability?

A. They will continue to implement measures without deviating with what they have been putting into action. Although we are experiencing the impact of the changes in the market environment, such as the revision of the liquor tax, we are confident about the results achieved by what we have done. We will create a structure that can generate even more profits by developing the brand firmly and implement cost control, including selling expenses. We will use selling expense based on the return it generates, invest in growing brands, and make the rest more efficient.

Q. If the Company implements the own-share repurchase of JPY100 billion, and the sale of strategic shareholdings is also progressing ahead of the target set in the 2019 Mid-Term Business Plan (MTBP), I think that the improvement in its balance sheet will also accelerate. I believe this will bring ROIC and ROE level closer to the targets of the MTBP soon. Please explain the company's position.

A. The repurchase of treasury stock in FY2019 is limited, and the impact on the FY2019 is minimal. We would appreciate if you could wait until February next year, as we will announce the ROIC target for FY2020. In the medium term, we are aiming to achieve the quantitative targets of the 2019 MTBP of ROIC 10% or more and normalized EPS growth rate of 5% or more in FY2021.

Q. It seems that in regards to the balance sheet management, the situation has already changed from the forecast stated in the 2019 MTBP due to investments made in FANCL and the acquisition of Kyowa Hakko Bio. The company has explained that you aim for ROIC 10% or more by 2021, but isn't the situation more advanced? Please elaborate your explanation on capital-efficiency.

A. Regarding the figures for the next fiscal year, please wait for the announcement in February next year. We will not change the cash allocation policy under the MTBP: the allocation of operating cash flow of JPY 700 billion to (i) growth investments of JPY300 billion, (ii) capital expenditures of JPY 310 billion, and (iii) dividends of JPY 210 billion, plus additional shareholder returns. We will provide any updates next year, but the basic policy is as stated, and our progress is in line with the scope of the MTBP.

Q. I feel that Kirin Brewery is steadily growing by investing in its core brands, but in terms of Kirin Beverage, I understand that products such as *Gogo-no-Kocha* and *FIRE ONEDAY BLACK* are performing well, but I do not feel that the company is becoming stronger overall. It is clear that *Gogo-no-Kocha* is the overwhelming No. 1 brand, but unlike beer beverages, it is important to constantly launch new products and turn cycles. Although *FIRE ONEDAY BLACK* has become a hit product, please explain whether the organization itself is something which can run product cycles effectively.

A. *Gogo-no-Kocha* has remained solid, and the market as a whole has been revitalized by the entry of our competitors into the black tea category. We believe that small PET products, including the 3 regular *Gogo-no-Kocha* products, are quite strong. In order to maintain this momentum, we will continue to pursue this strategy. While we will basically increase the proportion of small PET teas, there is no change in our position of raising profitability through products in the tea category centered on our strong *Gogo-no-Kocha* brand. In addition, we are always preparing for the development of new products. As stated in the MTBP and the Long-Term Management Vision, the company is preparing a variety of new product lineups, including ones in the health field. It is also true that the product life cycle is short, but in addition to cultivating strong brands, we would also like to increase the speed of the launch of new products.

Q. What is the market competition situation of Myanmar Brewery? We recognize that there were some new entrants, but I would like to know the situation.

A. As you have pointed out, our Myanmar Brewery's competitor has entered the market in October, leading to an intensified competition, and we knew it would become a power game. However, we have envisaged this situation from last year, therefore Myanmar Brewery is strengthening its brand and sales promotions. There are concerns about a deterioration in the product mix due to the growth of the economy category - *Andaman Gold*, over the mainstream category - *Myanmar Beer*, but our manufacturing capacity has kept pace with the substantial growth in the Myanmar market, and we believe that we will be able to compete sufficiently if we capture market growth.

Q. The Lion Beer, Spirits, and Wine segment's 3Q results appear to have recovered in terms of sales volume, but operating income has declined by AUD36 million over the past 3 months. "Others," under the breakdown of changes in profits, also saw a decline in profits, but I would like to know the background behind this decline. Further, in the 2Q, you have explained that competition with other companies was intense. Has the situation eased?

A. Over the 3 months from July - September, sales volume remained flat YoY, but fell 6.3%

in the last nine months, reflecting the rebound from last 4Q's promotional efforts and the impact of tougher competition in Australia between May - June. As a result, profits declined by AUD51 million due to volume differences. The impact on the “Other” column is related to factors such as aggressive sales promotion measures aimed at recovering the customer base affected by intensifying 2Q competition, and higher supply chain costs, including raw material costs.

<u>Q. Does it mean that the competitive environment is easing and selling expenses are decreasing?</u>
A. During the 3Q, we concentrated on returning volume to the level of 2Q, therefore in return of putting back the volume to the previous year's level in the 3 months, we incurred costs which affected profits.

<u>Q. The category strategy for Kirin Brewery from after the consumption tax hike to next year is to increase the new genre tax and reduction of the beer tax due to the revision of the liquor tax. The common view is that demand for beer will increase, but it is conceivable that there will be a temporary demand for a new genre that will affect next year’s sales. For the consumption tax increase this time, there had been a variety of possibilities before the tax hike, so similarly, I do not think that the next fiscal year will necessarily be about beer alone. How do see the strategy of beer and new genre?</u>
A. As for the impact of the liquor tax revision, although the composition ratios of beer and happoshu will increase, the demand for new genres will continue to be strong due to the persistence price differences among the categories, therefore the increase in the composition ratio of beer is expected to be limited. Since we are focusing on *Kirin Ichiban*, we will continue to invest in this brand under the same strategy in the next fiscal year. Although it is difficult to read out the trend after the consumption tax hike, the level of demand for the new genre category remains high. We will continue to engage in the same strategy and continue to strengthen the brand power of *Honkirin*.

<u>Q. Kirin Brewery's marginal profit does not differ greatly between beer and new genre, so we believe that the increase or decrease in the volume of new genre product will affect the future results. How do you think about the risk of the quantity of new genre of Kirin Brewery from the next fiscal year onward? Can the sales promotion expenses for on-premises channel of domestic beer be further reduced?</u>
A. In the new genre category, there are 2 brands, *Kirin Nodogoshi Nama* and *Honkirin*, which are completely different positions in the portfolio. There is no cannibalization between them.

The recognition rate for *Honkirin* is still lower than that for Nodogoshi, so we see the potential of further growth. We expect growth by continuing marketing investments. For the on-premises channel, sales promotion expenses are kept low which is used just to capture market share. While we need to consider each store, we think there is still room for cost reductions, so while keeping a watchful eye on competitors' moves, we will lead to improvements step by step.

<u>Q. It is difficult to understand the drivers of profit growth in the domestic beverage business from the next fiscal year onward. In domestic alcoholic beverages business, in addition to reducing marketing costs, fixed costs will be streamlined through restructuring. Please tell us if you plan to further accelerate initiatives for domestic beverages in terms of costs.</u>

A. In terms of cost, we need to consider the entire group as a whole and not just Kirin Beverage. On the cost side, the first profit driver is fixed sales promotion expenses. We will reduce expenses that do not directly lead to brand enhancement. The same idea applies to advertising expenditures. SG&A expenses for the next fiscal year's budget is now under planning, therefore we will consider how they can be reduced.

<u>Q. I would like to ask about the second career support of Kirin Brewery covered in the media. If we look at this initiative from the perspective of reducing fixed costs, how does it differ in terms of size, whether it leads to reductions in fixed costs, or whether it has a sense of continuity in scale from that of the past, and what is the image of cost reductions?</u>

A. The second career support which is covered in the media do not entail large-scale personnel reductions. Amid changes in the business environment, we have launched a new MTBP and continue to implement structural reforms. We are seeing progress on the transformation of the marketing department and the company’s performance has been positive. However, as this is a part of a company-wide review of jobs and organizational changes, including those in other departments the second career support is an initiative which the company continuously implements.

<u>Q. Kirin Brewery's reduction in marketing costs is a virtuous circle, but what kind of reductions exceed your expectations? I would also like to know about its continuity.</u>

A. We believe that the results of employees' efforts are beginning to appear. There are some delays, but the company has been making efforts to improve efficiency and has been able to reduce costs by shifting from fixed sales promotion costs for on-premises market to variable costs. On the other hand, the positive impact of tentative demand is also reflected in the 3Q results, and expect the rebound in demand during the 4Q, therefore we plan to use sales promotion expenses to stimulate demand.

Q. Marketing expenses have been reduced by JPY3 billion up to 3Q. Can we expect to achieve the same level of efficiency in the next fiscal year as well?

A. We think it is necessary to use marketing expenses where it needs to be used. Although we cannot fully read the changes in the environment, we will look at it not only in terms of absolute values, but also in terms of rates. We would like to make efforts that ultimately lead to an improvement in the business profit margin.

Q. I think the sale of strategic cross-shareholdings worth JPY36 billion is one of the factors behind the own-share purchase. What is the amount of cash-in capital related to the sale of shares held under the strategic cross-shareholdings in the future? What is the scale during the MTBP?

A. Kirin Holdings has steadily reduced its shares held under the cross-shareholdings strategy. In addition, Kirin Brewery and other subsidiaries hold some shares, but those companies are proceeding with the sale of such shares. Those which we consider are not worth holding will be negotiated to sell and if agreed, we will sell them. As we are in the process of negotiation, we can't tell you the amount. At Kirin Holdings, there are several tens of billions of yen worth of shares held under this regime, and we think there is a possibility that we sell such shares during the next fiscal year.

Q. About the Oceania business. From the next fiscal year onward, the decline in profits will be halted, but costs appear to be increasing in 3Q. Is this going to continue in the next fiscal year? Please tell us your outlook for the next fiscal year. Also, please explain whether it is not necessary to worry about the LDD business not being sold?

A. As to the Lion Beer Spirits and Wine business, it is difficult to expect significant growth. The increase in malt costs is attributable to drought but is not likely to recover quickly. Among them, what to focus on is the improvement of the mix. In particular, we would like to increase the number of Contemporary and Crafts categories. We believe it is essential to increase brands such as *Iron Jack* and *Hahn* of the contemporary category and *Furphy* and *Heineken* of the premium category.

The sale of the LDD business is in the negotiation process, so we cannot explain in detail. However, as I mentioned at the beginning, we anticipate to reach agreement by the end of the year.

Q. Profits in the LDD business declined up to the 3Q, but how do you view the full year and whether there is a possibility of further impairment depending on the amount agreed to sell?

A. It's true that LDD business is falling short of the plan. As we will reach the peak demand period in Australia, we will strengthen sales of Milk Based Beverages category and continue to reduce costs with the aim of achieving the full-year target. If it is difficult to achieve the plan on a business-by-business basis, we will balance out the entire Lion, including the head office expenses to reach the plan.

Regarding the possibility of further impairment, we are still in the process of negotiations, therefore we cannot say anything definite, but at this point, we are not aware of any further impairments.

Q. In this fiscal year, expenses are increasing due to the posting of impairment and other factors. How much should we consider the level of "other operating expenses" in the next fiscal year? Are we able to expect it to reach around JPY 15-20 billion?

A. As other operating expenses are mainly event-driven, it is not anticipated that major expenses will be incurred during the next fiscal year at this point in time. However, system development expenses up to 3Q were JPY8.1 billion this year and last year were JPY6 billion, so it is possible that the same level of expenses will continue in the next fiscal year.

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