

【Q&A Session Minutes】 Presentation on the Second Quarter of 2018 Earnings Results

Date: August 8, 2018 (Wed) 10:00-11:30

Presenters: Yoshinori Isozaki, President & CEO; Noriya Yokota, Director of the Board, Senior Executive Officer; and directors in charge

Q. Does the value of the KIRIN as a corporate brand increase? How does the brand value increase lead to future growth?

Isozaki: We have good survey results. First of all, the brand recall rate and the brand first recall rate have been very high for the product brand *Kirin Ichiban*. In addition, consumer perceptions of KIRIN have changed. Six years ago, consumer perceptions of KIRIN were "history" and "tradition," but the latest survey says they have changed to "creativity", "try" and "pioneer." We are very pleased with the results of this survey, as we have sought to capture these images. Furthermore, in the corporate image survey, "providing unprecedented flavor," "creating unique products and services," and "making consumers feel more energetic" are ranked high. I think that improved image of KIRIN brand has contributed to Kirin Brewery's strong performance. An example of specific initiatives includes craft beer. The key to the craft beer brand is whether the consumer is proud of the brand he or she is drinking. Consumers' pride in the company that brews craft beer also leads to value. We hope to bring this upward momentum to the strengthening of the Kirin Beverage product brands and to the building of brands in the pre-disease area. Compared to overseas markets, in Japan, there is a strong correlation between product brands and corporate brands, so it is necessary to enhance not only product brands but also corporate brands.

Q. In the first half of the year, each company's market share in Japan beer market was highly volatile. Competitors will try to win back next year and beyond. What is your view on the competitive environment in 2019 and the impact of the liquor tax revision in 2020?

Director in charge: The consumption tax will be increased in 2019, and the liquor tax will be revised in 2020. However, the competitive environment is not expected to change significantly immediately. We make consistent efforts to enhance the attractiveness of beer; strengthening *Kirin Ichiban* brand and expanding craft beer market. Under the 2020 liquor tax revision, liquor tax on traditional beer will be reduced and new genre raised. If the traditional beer category expands, it will be a tailwind for craft beer. Even after liquor tax on the new genre is raised, price difference between the traditional beer and the new genre will not be small. Accordingly, we will continue to invest in new genres as well as beer initiatives to enhance brand value.

Yokota: I will supplementally explain the investment in the new genre. Kirin Brewery launched more than 10 new genre products in the past, but this year it identified problems with the products in the past. Nine issues were identified, one of which was the need for long-term brand investment. The marketing ROI has been greatly improved by narrowing down the brand, executing ongoing communication, and incorporating digital marketing. This policy remains unchanged even if the environment changes and competitors take different actions. This approach will also be extended to Kirin Beverage, which will also lead to an improvement in the mix of soft drinks.

Q. What is the profitability of the new genre after the alcohol tax revision? What is the level of profitability?

Director in charge: We believe that the new genre brands will remain even after the revision of the liquor tax. We have already developed a variety of functional products in the happo-shu and the new genre, and are technically knowledgeable. When the Liquor Tax Law changes, the freedom of the manufacturing method will increase. Therefore, the company believes that product development utilizing its knowledge can contribute to improving the value of all beer products.

Q. In the first half of this year, Kirin Brewery outperformed the market. Still, some investors suspect that Kirin's products are selling well this year, but that sales volume may not increase next year. The reason is that previous Kirin Brewery was unable to continue the good performance it had enjoyed immediately after the launch of the new product. Can you continue to grow this time? Also, the total demand in Japan beer market is weaker than we had expected. Do you have some measures?

Isozaki: All we should do is to strengthen the brand. The advertisement of the new genre product which had a big hit hit this year was aimed at a wide range of audiences rather than at specific target customers. However, there is no guarantee that this year's approach will succeed next year, too. We will continue to refine the brand after next year by constantly evolving marketing methods.

I am also worried about the shrinking beer market. Like Japan, the decline in branded products is significant in the United States. Companies can take three measures: emerging countries, women, and craft beer.

Japan's beer consumption has declined by less than 30% since peaking in 1994. There are a variety of factors, including lifestyle changes, but one of the reasons for this is declined attractiveness of beer because beer manufacturers continued production of similar products. We hope to improve the attractiveness of beer by engaging in craft beer.

On the other hand, there is a demand shift from beer to RTD and whisky. Therefore, along with enhancing beer attractiveness, we will also address RTD and whisky. In the past, there have been volatilities in increasing demand for each category in the Japanese alcoholic beverage market. For example, wine used to be on an uptrend, but may fall in the future. A single category is easy but risky. It is important to control to maintain a good balance. The categories we are currently focusing on are beer and RTD.

Q. Explain the background of the contract manufacturing of private brand (PB). Don't you think PB contracting is going against expanding the profit pool of the overall market?

Isozaki: Major retailers have an enormous influence on home-use beer, which accounts for about 80% of Kirin Brewery's sales volume. In-store merchandising in retail channels plays an extremely important role in branding. It is important to create sales floors that attract consumers in supermarkets and convenience stores. Accordingly, we decided to support retailers that have a major impact on branded product sales through accepting contracting production of their PB. A win-win relationship can be established if there are advantages to strengthening the Kirin's product brands. We don't agree on contracting production of PB with the retailers who are unable to strengthen branded product sales.

From the point of view of the profit pool of Japan beer market, it is meaningless to use the benefits gained from PB production for branded product discounts. We will continue to maintain a consistent stance on price so as not to return to excessively low price competition.

At the same time, craft beer will be strengthened to improve the mix. We contribute to the overall profit pool of the industry.

Q. Kirin Brewery's sales volume target has been revised upward, but the new genre's target seems too high. Is the basis for this target that Kirin Brewery has contracted with retailers to sell PB?

Isozaki: PB beer market is not expected to continue to expand, but rather to stabilize at a certain level. The company set sales volume targets for the second half of the year, based on strong trends that continued in July and favorable weather conditions. I thought that setting conservative targets under these circumstances would not be a good message to the stock market. PB sales volume is not guaranteed.

Director in charge: Beer sales volume grew about 15% in July. There was a decline in reaction to the *Kirin 47 Todofuken no Ichiban Shibori Beer*, but the *Kirin Ichiban* alone rose 7%. The revamped *Nodogoshi* grew 4% and *Hon Kirin* continued to perform well. The unseasonable weather in August and September last year was also taken into account. The

targets of *Kirin Ichiban* and *Hon Kirin* were revised upwards, while some brands revised downwards. Total sales volume target is as a result of the outlook for each product. We are confident in achieving.

Q. Kirin Holdings share price fell 5% today. The other day, competitor's share price also fell. This is because the stock market is concerned that the profit pool in Japan beer market will decrease. Do you believe that the profit pool will expand over the next several years? What do you think should be done to expand the profit pool from the viewpoint of volume and costs such as selling expenses?

Isozaki: In the past, in Japan beer market, fierce price competition for market share continued. However, last year, the enforcement of the revised Liquor Tax Law and other regulations forced beer makers to comply with their respective guidelines, raising beer prices in the retailers and raising the profitability of each manufacturer. Kirin will stay on the same footing to ensure that Japan beer market does not return to its previous state.

Given the declining birthrate and the aging of society, how can we have consumers return to beer? We will take an approach to add value rather than increase volume. As a manufacturer, we will strive to return consumers to beer with high added value. Even if sales promotion expenses are not increased, consumers can be more satisfied by communicating the attractiveness of beer to consumers. Kirin Group intends to further enhance the profit pool of Japan beer market.

Q. How can you improve the profitability of the RTD?

Isozaki: Three challenges need to be addressed in order to improve the profitability of RTD: competitiveness in transaction conditions, higher raw material costs, and distribution networks. As for raw material costs, we are implementing a product strategy to increase the proportion of products with relatively low costs. The distribution network can be improved by establishing a new RTD production line at the Nagoya Plant. The biggest challenge is the transaction conditions. It is true that Japan RTD market has more players than the beer market and tends to have higher transaction costs. We will look at competitors while improving raw material costs and distribution networks.

Q. On-premise beer market has fallen sharply since the end of last year, and the trend continues to be sluggish. What's happening in the on-premise market and what plans do you have for revitalization?

Yoshimura: Sales of the izakaya restaurants are sluggish. Also, we are struggling to develop new customers. We propose Tap Marche with which consumers can enjoy a variety

of beer. I will retain beer drinkers by having consumers know about the attractiveness of beer more.

Isozaki: The price for on-premise channel was revised from March to April. Consumers who drink beer frequently need to think about how to drink it cheaply. The on-premise market is devising various ways to meet such needs. There is an increase in small drinks and standing drinkers. We also intend to make proactive proposals to meet their needs.

Q. Describe strategies for improving margins and mixes of Kirin Beverage. In the short term, how can you achieve the mix improvement in the second half of this year? What kind of top-line growth strategy will be implemented in addition to the cost benefits of collaborating with Asahi Calpis Beverage Co., Ltd. over the medium to long term?

Director in charge: Kirin Beverage's mix deteriorated in the first half of the fiscal year as the ratio of cans declined and the ratio of large PETs rose. Future initiatives include strengthening the three core brands of *Gogo-no-Kocha*, *Nama-cha*, and *FIRE*, and increasing sales volume of small PET products.

FIRE's struggle is driven by competitors' PET coffee strategies. The company's PET coffee brands have increased their sales volumes and expanded shelves at convenience stores and supermarkets. *FIRE* products are mainly SOT-canned and sold in vending machine channels. Measures for containers are being prepared after autumn. For channels, the company will take effective measures based on customer data obtained from the vending machine Tappiness. We are considering PET container product, too, but the PET coffee market has become red ocean, and we should identify a good strategy and timing of entry. There is another way to capture the demand created by PET coffee. The other day, we launched a new product called *CEBADA* under *Kirin Sekai-no-Kitchen Kara* brand. The studies in SNS indicate that women are more likely to drink than PET coffee to drink. In addition, there were a lot of consumers' voices that *CEBADA* was easier to drink than black coffee, and that caffeine-free product was also highly rated. We will develop products with different value propositions.

As for increasing sales volume of small PETs, sales of *Kirin Lemon*, which celebrated its 90th anniversary, are tremendously strong. After revamped, sales of three main products (straight, milk, lemons) of *Gogo-no-Kocha* have been strong at 500 ml PET, and it has been able to attract younger customers. *Nama-cha* grew double digit. Further efforts will be made in the future.

Q. To increase Kirin Beverage's profit margins to 10 percent, is it sufficient to have a cost-cutting alliance alone, or is it necessary to have an alliance that goes beyond cost reductions?

Isozaki: We announced the collaboration with Asahi Calpis Beverage Co., Ltd. in July. I have a picture of the final goal from what we announced. We will take each step to the goal. Kirin aims for single-digit billion yen cost advantages. If that doesn't happen, it's hard to achieve a 10% profit margin.

Q. Kirin Beverage's alliances with other companies remain in non-competitive areas for the time being. Competitors say they are not considering alliances in top-line and competitive areas. In order to expand the profit pool of the soft drink industry, Kirin Beverage should decide, for example, to withdraw from canned coffee.

Isozaki: The biggest problem in the soft drink industry is logistics. I think this is a social issue. We believe that the start of joint logistics activities with Asahi is a big step forward. We are already working on column exchange with Dydo Drinco Incorporated, but in the future we will be expanding it to other competitors as well. There are many players in the industry, but what is important is to implement activities companies agree on with each other. I think column exchange is a non-competitive area. By putting strong brands on each vending machine, we can speed up the return on investment. Without these efforts, single-digit billion yen cost benefits will not be realized.

The rest depends on discussions with the other party and cannot be commented on at this time.

Q. Please explain the future cash allocation. You are currently repurchasing own stocks up to 100 billion yen; in spite of it, DE ratio has already fallen below 0.5. In the past two years, Kirin generated cash flow of more than 400 billion yen, and this year it is expected to generate cash flow of about 200 billion yen. Furthermore, if the company accelerate the sale of its cross-shareholdings, Kirin will become a cash-rich company. Where are you investing?

Isozaki: We intend to use cash for strategic investment. Instead of spending on product discounts, we will invest in brand building and new investments that will lead to the sustainable growth of Kirin in the future. We place top priority on investing in growth, but if it still has cash, we will plan to allocate them to shareholder returns although specific figures cannot be given.