Minutes of telephone conference on 1Q financial results of FY2018

<Date and time> 9:30 a.m. -10:20 a.m., Friday, May 11, 2018 <Participants> Director of Corporate Strategy, Director of Group Finance

＜Japan Integrated Beverages Business: Kirin Brewery＞

Q. What are the reasons for consecutive successful launches of new products?

(Director in charge) The fact that President Fuse of Kirin Brewery (KB) has been leading the change in the consciousness of employees contributed to this achievement. He physically visited branch offices throughout Japan to have face-to-face dialogues with employees, so that our strategy was communicated to every local site. Through such face-to-face dialogues, issues facing branch offices were identified, and feedback was given to the management team. Such initiatives helped create alignment among manufacturing, sales and marketing divisions.

As for our marketing, we focused on the number of target brands for our investment, and drastically removed less effective sales promotion programs, thus creating an environment where sales representatives can focus on implementing the strategy.

Such initiatives created a virtuous cycle of strong performance. Also, employees have very high morale.

Q. I understand that *Hon Kirin* is the product which KB plans to develop as a new key brand. I'd like you to provide a quantitative explanation of whether the current strong performance is not just an initial success, but the brand will be able to establish a firm position in the future.

(Director in charge) *Hon Kirin* is made from German hops with high-quality bitter flavor, and authentic taste from long-term low-temperature fermentation, etc. is widely supported by customers. We developed the largest-ever advertising campaign around the launch date, and sold 1.4 million cases in a month, which accounted for 30% of the estimated annual sales of 5.1 million cases (65,000 kl). The weekly trial rate in the launch week was 1.5 times of competitive products in the launch week, and 1.7-2.0 times in the second week.

Q. What caused an increase in the sales volume of new genre category? Is that because KB lost its share to competitors last year, or because this year's strategy turned out to be successful?

(Director in charge) It's not a rebound against the significant decline in the sales volume last year. Similarly to the last year's success of the renewal of *Kirin Ichiban*, KB thoroughly reviewed its production method and communications based on deep insight of customers' preference or taste. That led to the success. Accordingly, we consider that we can maintain strong sales of *Nodogoshi STRONG* and *Hon Kirin*, which are new products in the new genre category, in the future as well. *Hon Kirin*'s sales volume exceeded the estimate, and it resulted in the short supply. We plan to increase the number of manufacturing factories from 6 to 9, and produce 3 times more than the initial plan in June.

Q. KB delivered an increase in marginal profit due to an increase in sales volume, while reducing selling expenses. Is this decrease in selling expenses from the last year attributable to temporary factors, or is it an outcome of KB's initiative to improve the return on investment in marketing?

(Director in charge) The decrease in sales promotion expenses was by 2.9 billion yen in 1Q, mainly because this year, we did not carry on the mileage campaign, which is a customer loyalty program, which we implemented last year. On the other hand, advertising expenses increased by 0.8 billion yen, because we launched two new products of new genre category in 1Q this year. Therefore, both changes are attributable to the timing of marketing campaigns. From 2Q, the cost will increase: for example, we expect an increase in sale promotion expenses due to the national launch of *Tap Marché*. According to 2018 annual plan, we are

expected to reduce sales promotion and advertising expenses by 3.1 billion yen in total, and we went as planned in 1Q.
There may be a gap in the timing of spending selling expenses in each quarter, but we still have a consistent policy that is to narrow down the number of target brands for our investment, and drastically remove less effective sales promotion programs. According to this policy, when we implement a marketing program, we continue to check the return on investment in each program.

Q. You explained that KB did not carry on the mileage campaign, which was implemented in 1Q last year. Is the entire industry reducing such campaigns as a general trend? Or is KB trying to lead the industry to this direction? If KB is leading such a movement, is it an outcome of the policy to turn selling expenses from ‘cost’ to ‘investment’?
(Director in charge) There is no general trend of the industry toward the reduction of sales promotion campaigns. KB drastically reviewed its marketing programs for its re-growth. Upon examining the return on investment, we reduced less effective campaigns, and focused on investments in line with brand growth strategies. This is KB’s independent initiative, and there is no such arrangement in the industry. Naturally, we will proceed cautiously, paying close attention to competitors’ moves.

Q. According to the annual plan of this year, it is estimated that raw material costs will increase, but there was no increase in 1Q. Was there a change in the environment associated with raw material expenses?
(Director in charge) Raw material expenses decreased in 1Q 2018 due to a change in the product mix compared to 1Q 2017. Raw material prices are expected to rise worldwide, so we estimate an increase in the raw material costs in the future, as shown in the annual plan.

＜Japan Integrated Beverages Business: Kirin Beverage＞

Q. The product/container mix has deteriorated in 1Q. I understand it was mainly due to a decrease in the sales volume of *FIRE*. How do you plan to improve it in the future?
(Director in charge) As you mentioned, profit was affected by a decline in the composition rate of canned products due to lower sales volume of *FIRE*. As for sales channels, a decline in sales from the vending machine channel is an industry-wide trend. As for containers, due to the success of PET bottled products launched by a competitor last year as well as a change in consumers’ preference, consumption has been shifting from cans to re-sealable packages. We need to address such a change in the environment and market trend, but we do not consider that merely following the competitor’s product strategy will lead to success. It is more important to increase *FIRE*’s consumption among its loyal users. For that purpose, we will increase products with clear concepts so that it will be easier for our customers to choose products from vending machines. The main product in the *FIRE* series is Hikitate Bito, and its concept is “taking a rest”. The product concept of *Saewataru Kilimanjaro*, which was launched in April, is “waking up feeling good in the morning”: its lightly sweetened taste has received favorable reviews, and it has recorded steady sales. We will continue to communicate product concepts in an easy-to-understand way like these products. Messages from *FIRE*’s advertisement sometimes changed in the past, but the current advertisement is well-received and we’d like to continue to communicate brand concepts in a consistent manner. We have already taken actions in response to the trend toward re-sealable packages, and steel-bottled product *Kunsei Black* has recorded steady sales on the convenience store channel. We will further examine the expansion of re-sealable packages, do marketing by combining the package and strong brand, in order to stop the declining trend of sales volume and get back on a recovery track, aiming at achieving the annual target.

Q. You have been working on the regrowth of *FIRE* brand in the past few years, but have not achieved a favorable outcome. If no significant improvement is made this year as well, can you achieve the profit plan through cost management? When do you expect to see the effect of improvement efforts?

(Director in charge) We are not optimistic about achieving the sales target of *FIRE*, but we are continuing cost reduction efforts in every possible area. Furthermore, in terms of mix, similarly to KB, we will focus our investments in marketing focus brands. We will also continue to work on increasing the composition rate of small containers. Concerning renewed *Namacha* and *Kirin Lemon*, small containers record very strong sales. We are aware that there is a concern about a possible deterioration of the product mix due to an increase in sales volume of Large PET bottled water, we see an increase in sales on the e-commerce channel, and selling prices on the e-commerce channel are higher than the ordinary retail channel. Accordingly, we do not expect any major negative impact on profit. We launched a new product in small PET bottle *Hare-to-Mizu* throughout Japan. We plan to specialize in sales of highly profitable products in the future: for example, in summer, we will release small PET bottle products of carbonated beverage *Mets*. Although it is not meant to replace *FIRE*, we plan to launch *CEBADA*, the new barley tea product brewed as a coffee, under *Sekai-no-Kitchen-Kara* brand in July. We will improve the mix through these initiatives. We already see the effect of improvement in the sales result in April, but we will announce detailed results in due course.

Q. While raw material costs decreased in 1Q, you estimated an increase in the costs in the full year in the annual plan. Will the costs really increase in the coming quarters?

(Director in charge) Conditions of raw material markets, including tea leaves, have deteriorated. In 1Q, we could offset it with the effect of cost reduction.

＜Overseas Integrated Beverages Business: Lion＞

Q. Lion Dairy & Drinks (LDD) recorded lower revenue and profit in 1Q. You explained that the main factor of such results was a decline in the juice category. I got an impression that it was due to a continuing negative trend from before. What is the time frame within which you think LDD can reverse this trend?

(Director in charge) LDD recorded a decline in the sales volume by 7%, and the juice category marked a 4.5% decline. LDD reduced SKUs due to lower profitability of the juice category, and that is a reason for the decline in the sales volume. The remaining 2.5% decline is attributable to a decrease in sales of white milk, cream, etc. which do not really contribute to profit. In Australia, energy cost increased, and prices of juice and milk-based beverage products (up to 1 litter) increased due to the introduction of the Container deposit scheme in some states. LDD was adversely affected by these factors. However, please understand that such impacts are smaller than those on beer, spirits, and wine business. As the brand strategy, we further concentrate on focus categories. *Dare* recorded a high single digit-growth of the sales volume. In order to improve the top line, LDD integrated its production of milk-based beverages into a factory with the latest facilities. With this integration of the production site, LDD can extend best before dates through the aseptic filling process, and realize easy-to-use shrink packaging. In doing so, LDD is expanding the retail channel. In addition to enhancing sales and distribution capabilities, LDD will work on streamlining indirect costs of the Head Office and factories. We expect to see the effect of these efforts gradually starting from the second half of this year.

Q. Do you consider 1Q results of LDD were as planned?

(Director in charge) The results were generally as planned. The peak demand season is in the second half of the year, so we expect to see outcomes of its efforts for achieving the plan to increase the full-year revenue in the months ahead.

Q. I am aware that Mr. Peter West, the former Managing Director (MD), resigned from LDD, and Mr. Stuart Irvine, CEO of Lion's corporate division, concurrently manages LDD. Don't you think the change in the leadership caused negative impacts on the financial results?

(Director in charge) Stuart, CEO, manages the entire businesses of Lion. Last year, MD of LDD was taken over from Peter West to Kathy Karabatsas who is familiar with the business. Kathy has assisted former MDs, was responsible for planning and accounting divisions, and has passion and ability to organize people. We believe that Kathy will powerfully push forward initiatives taken over from Peter, demonstrating her leadership.

＜Pharmaceuticals and Bio-chemicals: Kyowa Hakko Kirin＞

Q. It is written that there was a reversal of impairment loss for 3.4 billion yen. What was that? Was it included in the initial plan?

(Director in charge) In Kyowa Hakko Kirin, the research on a therapeutic medicine for diabetic kidney disease suffered a setback for various reasons. Accordingly, at the time of introducing IFRS, we booked an impairment loss from in-process R&D expenses. However, subsequent clinical trials delivered positive results, so the medicine was appointed as a candidate for diabetic kidney disease medicine under the SAKIGAKE designation scheme. The phase advanced from phase 2 to phase 3, and the probability of success increased. Therefore, we reversed the impairment loss. It was not included in the initial plan.

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