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[Q&A Session Minutes]
Presentation on 2Q FY2023 Financial Results

Date & Time:	August 9, 2023 (Wed) 10:00-11:30am (JST)
Presenters:	Yoshinori Isozaki, President & CEO Shinjiro Akieda, Senior Executive Officer & CFO Hiroaki Takaoka, Executive Officer & General Manager of Corporate Strategy Dept. Hidefumi Matsuo, General Manager of Finance Dept.

Q. I agree with Kirin's strategy to develop business in the domains of Food and Beverages, Pharmaceuticals, and Health Science. As you mentioned in your presentation, I also think organic linkages are necessary. However, the market still perceives the Food and Beverages, Pharmaceuticals, and Health Science independently, leading to a conglomerate discount. There needs to be a single, coherent equity story for each of these wonderful domains, please let us hear your thoughts.

A. Right now, we are putting together the pieces one by one. Although there are issues in the Food and Beverages and Pharmaceutical domains, they domain almost in shape and have generated results above our expectation. The Health Science domain is just beginning to take shape, and I think we will be able to see the direction we aim for once all three domains are in place. Where the Kirin Group is aiming, it is the "health domain". In addition to the Pharmaceutical and Health Science domains, there are health related products in the non-alcohol business too. We will move forward in this direction with the group's strengths. We believe that a medium-to-long term perspective is important because everything has not yet been fully established and time is needed. However, in any case, it is important to meet short term targets. We will achieve the first-half and annual forecasts that we have promised, but we will not be satisfied with just that; we want to show growth in the mid-to-long term. We are aware that it takes time to create something new, but we must accelerate the process.

Q. Are you saying that it will take a little more time because you have to bring each domain closer to the full form and then create synergies within the domains?

A. Synergies are already emerging in the domains between Health Science and Pharmaceuticals, and in Health Science and Food and Beverages. There is a considerable connection in R&D and product development, and small cumulative results are actually emerging. However, it is true that they must be made into a single strand. My biggest goal is to provide visibility here.

Q. On page 4 of your presentation, you mention productivity improvements at Kirin Brewery and Kirin Beverage, and how you will work to optimize the sales organization in order to further increase profitability from the current top-class profit margin in Japan. Where do you see issues and what kind of initiatives you expect to take to resolve them.

A. The domestic alcohol and beverages market will remain flat or decline in volume due to the declining and aging population. In addition, consumer behavior patterns are changing significantly due to the impact of the COVID-19. For example, Kirin Brewery is experiencing changes in consumer behavior, such as a decrease in the frequency of drinking parties due to a decline in the percentage of people who come to workplace, and a decrease in going to second-tier parties, which is also changing the composition of the sales channel. Kirin Beverage is experiencing a decline in the utilization rate of office vending machines due to a decrease in the percentage of people coming to work. In this situation where the channel structure is changing due to such changes in consumer behavior, we are conducting a fundamental review from the viewpoint of whether the current sales force arrangement is correct and whether we can continue to generate sales that can maintain the overall costs spent on the sales force in the future. We are planning optimization measures to ensure that we can continue to generate profits for the next 10 years, and we will implement them.

Q. Basically, in the review of personnel, is it correct to say that the organization will be reviewed accordingly?

A. This includes in part a review of personnel, but it is not the only focus. We are looking to change the overall structure as we change our sales approach.

Q. Regarding the Australian market, I heard that the market declined by a high single-digit percentage in 2Q, and I recognize that the market situation is severe due to cost inflation. Going forward, could you tell us whether external factors in the market could pose a risk to the basic strategy that you discussed at the recent Investor Day?

A. As you are aware, sales volume declined significantly in 2Q. Sales of on-premises which had been strong, also declined, resulting in a high single-digit percentage decline in total sales. Consumer's disposable income is not increasing amid extremely severe inflation. Data also show that the ratio of households spending on luxury goods is also declining. The consumer confidence index is also falling. On the other hand, figures for June and July are gradually improving, and we expect consumption to return in October and beyond, as we go into the peak season.

Q. Consumption sentiment temporarily declined due to the tax hike and other factors, but since it bottomed out in June and July, is it correct to think that the external environment does not negatively affect Lion so much, and that there is little impact on your strategy?

A. Basically, Lion's sales volume is down because of the market decline, but we believe that Lion will recover and outperform the market as the market recovers in the future.

Q. Please tell us about the market and Lion's sales performance for on and off premise.

A. The April-June market for on-premises was down 1-2%, while the market for off-premises was down less than 10%; for Lion, on-premise was in the -1% range and off-premise was down 10%. Overall, Lion is slightly underperforming the market. This is due to the background of higher volumes in 2Q last year as a reaction to the flood in 1Q, so without these factors, we consider us to be on par with the market.

Q. I understand and support your efforts to reorganize your business portfolio. In order to accomplish this, I believe still Kirin Brewery and Kirin Beverage are the main profit generators. I think that the high road is to replace the portfolio while maintaining these businesses, but I think that these businesses, which are cash cows, are losing ground to the competition. It is good that Kirin Brewery is reviewing its sales structure and cutting marketing expenses to generate a profit in a single year term, but the volume plan has not been achieved, so my question is at this point in time, is it still necessary to cut marketing expenses to generate a profit in a single year? I think Kirin Beverage needs to generate profit from *Nama-cha* and *Gogo-no-Kocha*, but I think the core of the business is falling apart. Please comment on whether these businesses are not inferior to the competition.

A. We are not aware that we are significantly inferior. As you recall from the past, Kirin Brewery had marketing issues and was weak until around 2016 to 2017, but has evolved through marketing reform along with its sales activities changes. We believe that Kirin Brewery's own marketing organizational capabilities have increased and have become our strength. Some of our competitors are studying our methods and adopting similar approaches. We recognize that we are in a phase where we need to take one more step forward. We are currently working on this, but we are still in a situation where we have to take on new challenges. The reason why we are seeing a severe situation in terms of volume is because there are competitors who are aggressively pursuing the market with price reduction, and if we respond to this in the same way, the profit pool for the industry as a whole will decrease. We would like to have the customers and consumers understand and buy our products for its value, not just price. Although there may be some concerns in terms of short-term volume compared to last year, we are not in a situation where we are significantly underperforming.

For Kirin Beverage, the June renewal of *Gogo-no-Kocha* Brands have taken root and the trend is improving. In particular, the *Oishii Muto* (sugar-free) series are doing well, with the addition of new items and matching health-conscious consumers. The challenge is *Nama-cha*. We need to demonstrate our uniqueness since we are the third or fourth green tea brand. We will work to further enhance our brand power. We are already working on product development for next year that will enable us to compete in the market. Finally, our Health

Science products, including LC-Plasma are entering a phase of stable sales. Kirin Beverage as a whole is building up its sales force to sell Health Science-related products. We believe that *Gogo-no-Kocha* , Health Science-related products, and *Nama-cha* will be the three pillars of Kirin Beverage's growth.

Q. Regarding Kirin Brewery, I am comfortable with your explanation that other companies are following Kirin's lead and that their competitive advantage has shrunk. However, I believe that other companies are trying to change the game by spending more marketing expenses. Under these circumstances, Kirin Brewery is reducing its marketing expenses, and I am concerned that this may reduce its mid-to-long term competitiveness.

A. There was a phase during the COVID-19 term where we controlled our marketing expense to generate profit. From there, we have changed the stage and are planning to make strong marketing investments in the necessary brands. At this point, we have no plans to reduce the marketing investment planned for the second half of the year. The amount of marketing investment is not the only factor at play; marketing strength, including quality, will also be a factor. We are not trying to generate profit by reducing marketing investment.

A. The Japanese market for beer has been shrinking since its peak in 1994. There are two types of marketing expenses: discounting and investment in brand development. Are we going to engage in the former type of discounting again? This is something that is always pointed out to us, especially by foreign investors. We will invest in marketing to build an attractive brand, but we will not engage in a war of attrition like the price-reduction battle. The easy way to gain volume is to provide discount, but Kirin Brewery will choose to add value.

Q. Regarding Kirin Beverage's medium-to-long term strategy. I am aware that Kirin Beverage has been able to improve its profit margin through measures such as improving the mix by increasing the number of products in the Health Science domain and reviewing sales channels. The first question is, do you expect the non-alcoholic beverages market to see a decline in sales volume in the future? I believe that there is a difference in the perception by each company regarding the future outlook of the market, and the way each company formulates its strategy is different. Please explain how Kirin Beverage will compete in this situation.

Secondly, what do you want to do in the future if the business shrinks in size? I would like you to tell us what you intend to do with this business from a longer-term perspective.

A. I was the head of Corporate Planning Department of Kirin Beverage from 2015-2017, and I believe that this period was just the turning point for how we should look at the non-alcoholic beverages market in the future. Until then, the non-alcoholic beverages market was in a phase of growth. On the other hand, when the market was forecasted at that time for the next 10 years and beyond, the result was that the volume would shrink. I believe this is the same for other companies too. In other words, while it may be possible for a single company to increase volume or gain market share to increase volume, when considering the market as a whole, the decline in the population itself is directly related to a decrease in sales volume. We recognize that the timing for this to become apparent is now approaching. We are in fourth or fifth place in the non-alcoholic beverages industry, and under these circumstances, we do not think it makes much sense to aim for growth by increasing sales volume (number of boxes). Therefore, since around 2015, Kirin Beverage has been shifting to a management approach that focuses not on the number of boxes, but on how much sales revenue can be increased, and if the profit margin is increased accordingly, the amount of profit will increase as a result. The results of this shift have led to a profit margin that is among the highest in the industry. The direction we are aiming for is to focus on "health", which is our goal as Kirin Group, and for Kirin Beverage to also focus on this as well, so that Kirin Beverage can be recognized as the non-alcoholic beverages manufacturer that contributes most to "health" within the industry. We believe this can be achieved by adding value using our technological capabilities, including R&D. We will aim to be a beverage company that shines not because of our size, but because of our distinctiveness.

Q. In the fourth to fifth place position, it seems that negotiations with distributors may not always go smoothly etc. If you can solidify your positioning in the industry a little more, we can expect on the business in the future, but is it difficult in the current environment? Also, you said at the time of the 2015-2017 forecast that the market would shrink after 10 years at that time, does

<u>that mean that the market will not shrink in the next 5 years?</u>

A. Looking at the non-alcoholic beverages market by category, some categories are expected to grow, such as the water category. We are looking at which category in the non-alcoholic beverages market will grow. We are slow on the water business because the water market has become a commodity and can only compete on price. We are looking at the market from the perspective of whether increasing volume will bring value to consumers and lead to profits or not. Although COVID-19 has made it difficult to see how total demand is moving, we believe that the phase of increasing non-alcoholic beverages sales has already ended and that the overall demand is almost flat. In terms of negotiating power with distributors, while scale is one of the requirements, we believe that there are opportunities to expand business with a completely different approach, such as with the buyers in charge of the chilled products with whom we have negotiated in the Health Science domain for ultra small containers of "*Kirin Oishii Immune Care*" and other products. We believe that there is an opportunity to expand our business by taking a completely different approach.

<u>Q. Could you give us an update on the progress of Kyowa Hakko Bio's structural reforms? The storyline was that the company would recover its performance and aim to return to profitability in the next fiscal year, but this time the plan has been revised downward. Is there any change in your thinking?</u>

A. I apologize for any concerns about Kyowa Hakko Bio's performance. From the time we announced our plan at the beginning of the year, we said that although we would post a loss this year, we would make it a year to return to profitability next year, and there has been no change in this. We have two businesses: one is to grow our specialty materials such as Citicoline and HMOs by making them highly profitable, and the other is the amino acid business, which is becoming a commodity. The challenge is the amino acid business, which has become a commodity, and we are working simultaneously to reduce the deficit in this domain and to expand the specialty materials business. For specialty materials, a new vice president in charge of sales was assigned in December of last year, and we are making progress in developing new users, mainly overseas, and reforming new applications. We are preparing for negotiations on amino acids, although we cannot stop immediately due to the fact that there are other parties involved. In the course of our preparations, there has been a greater-than-expected contraction in the amino acid top line, and that part of the contraction has led to a revision of the mid-term plan. We are determined to bring Kyowa Hakko Bio back into the black next year. We will realize a return to profitability for Kyowa Hakko Bio and a positive effect for Health Sciences as a whole with the addition of Blackmores, so please bear with us.

<u>Q. Is it correct to assume that the main factors behind the recovery of the current 6 billion deficit next fiscal year will be the reduction of the commodity business and fixed costs? Please tell us the factors.</u>

A. There are two things that will help us recover next year: one is related to specialty materials. New facilities for both Citicoline and HMO will start operating this year, which will increase supply capacity and enable us to attract new users, which will lead to higher profits. The second is to improve the cost of sales in the amino acid business through further structural reforms, which we have been implementing this year.

<u>Q. Given the decline in on-premises in Australia and the weakness of the off-premises market, isn't there a need to change your thinking about the Australian beer market over the medium to long term? You say that you plan to recover volume and profit margin in the second half of the year, but please tell us why the trend changes between the first and second half.</u>

A. The negative figures for both off and on premises were reported for the April-June period, but the on-premises channel was strong in the January-March period and grew at a high single-digit rate from January to June. In the medium to long term, we expect the market volume to remain flat to slightly increase, and we will increase the value of the market by promoting premiumization. In the second half of the year, Lion will also capture the growth of the market since the peak season is from October onward. We expect to improve profitability in the second half of the year, as sales will recover as a result of increased brand investment in the first half of the year, which will also be linked to the second half, and the effects of structural reforms that we have been considering since last year will be realized in the second half of the year.

Q. You are launching your first RTD in Australia. What are the prospects for success?

A. RTD is a growing category in the Australian market, and Lion imports and sells White Claw, a hard seltzer, and the category is showing steady growth. This new brand will be in the light RTD category, and we are taking on this challenge because of the potential for selling Japanese RTDs in the Australian market, including expectations for market growth in this category and the high quality of Japanese RTDs when compared to local brands.

Q. What is your view of profit growth for the next fiscal year? While we understand that Kyowa Hakko Bio will recover and that the Health Science domain will make a partial contribution, we are concerned that it may be difficult for Coke Northeast to grow as it has in the past, and we also remain concerned about the low price of raw materials and the growth of Lion.

A. We will not expect any one company to take on next year's profit growth. In the pharmaceuticals business, the steady expansion of Crysvita in North America continues to be a factor in profit growth. However, the R&D phase of KHK4083 is in its final stages, and we do not expect a significant increase in profits due to R&D and other expenses. Lion's profit will be A$20-30m this year as a result of the restructuring, and will increase by about A$100m next year.The revitalization of the brand will also contribute to higher profits. Kirin Brewery is also investing in its brands this year, and we expect to see the effects next year. However, for future growth, we will not cut back on marketing expenses in order to generate profits, but rather design the company to grow profitably steadily while continuing to invest in marketing next year. Coke Northeast is indeed not in a phase of more and more growth, but costs are under control, and if the environment for raising prices in North America does not change, there is a possibility of a little more profit growth.

Q. This year you have been stagnant in the Food and Beverages domain, but you want next year to be a year of earning in the Food and Beverages domain, correct?

A. That is correct.

Q. Regarding Blackmores, you have set a target of 100 billion yen in sales revenue and 15% business margin. Also, we are aware that the EBITDA margin will be around 18% by 2018, and that the business profit margin is currently declining due to temporary inventory adjustments and other factors. Based on this assumption, why is the business profit margin target set at 15%, and why can't you aim a little higher, such as 18%?

A. The closing is tomorrow (August 10), so we will be designing the PMI and other details. We will also discuss the details again at the upcoming Health Science Day. At this point, I can say that the EBITDA margin was 18% in 2017 and 2018 before amortization (DA) was subtracted, as you mentioned. However, looking at the most recent COVID-19 and beyond term, it is currently around 12-13%. Based on this assumption, if we consider business profit after deducting amortization expenses, we think that 15% is a reasonable level to aim for. In addition, the market is expanding in Southeast Asia, and competition is emerging, so we would like to conduct a thorough market analysis and closely examine future forecasts. We would like to achieve our target by around 2030. We will consider what we can do further after achieving cost synergies in this time frame.

Q. Is it correct to think that the top line will continue to grow by double digits while the profit margin will gradually increase?

A. Exactly.

Q. I understand that the reason for the downward revision to Kyowa Hakko Bio is the decline in amino acid sales. However, I think the amino acid business is a commodity and was originally planned to be scaled back. Even if sales decline more than expected, if fixed costs are reduced, a downward revision would not be necessary. Are there any areas where fixed cost reductions, which are being carried out in parallel, are lagging behind?

A. There is no delay in reducing fixed costs. We created a revitalization plan several years ago, and we are working on it a little earlier this year. The biggest change from the beginning of the year is the reduction in the volume of amino acids for culture medium for vaccines due to the end of COVID-19. In addition, although the product has become a commodity, we are negotiating on prices, and depending on how these negotiations go, there may be a decrease in volume. The structural reform plan is not behind schedule.

Q. Is it correct to understand that the reactionary decline in demand for COVID-19 was more than expected, since the assumption is based on amino acid business is to be retained to a certain extent, and not all of it will be reduced? Will you need to further reduce fixed costs?

A. The amino acid business has some customers, such as bulk pharmaceuticals, with whom we cannot immediately discontinue operations. In the future, the amino acid business will be downsized to focus on specialty products, but there is a timeline for when to discontinue commoditized products. The plan is to scale back facilities and other items in sequence according to that timeline, but there are no delays in that plan. The downward revision was made because there were issues on the top-line side that were assumed at the time.

Q. Regarding the point of continuous review of the business portfolio, you explained on page 8 of your presentation that you are earning solid EPS, and on page 9 you explained that the regional portfolio is also balanced, so I do not have the impression that you have a sense of issues in the business portfolio. I would like to know where you feel the challenges lie and what you are doing to strengthen them.

A. The Australian alcohol business, which is our core business, needs to be solidified. The first issue is to improve productivity, including structural reforms, and contribute to profits amid a softening market. We will firmly establish the Health Science business as a new portfolio after the closing of Blackmores. In order to generate synergies, we need to expand the Group's materials in the Asia-Pacific region. We will do everything in our power to add value. We plan to do our utmost to achieve this, and if we can do so, we will be able to achieve overall balanced management.

Q. For example, on page 8, it says that equity method investment income contributes to EPS, but one could argue that it is not fully taken up because you do not hold majority. I believe that additional capital investment would enable the company to fully contribute to EPS.

A. We avoid mentioning FANCL because of its impact on the capital market. There are various views on San Miguel, as it generates nearly 20 billion yen of cash as dividends every year. Some say it is wonderful and we should review the equity holding level. It would be good if we could get a majority share, but the beer business is also important for San Miguel Corporation, and we are negotiating with them every time, but it is difficult. For Kirin, the 20 billion yen dividend is a significant contribution to cash.

Q. I would like to ask about page 8 of your financial results presentation. You mention visualization of synergies and creation of synergies among business domains in the measures section. Of the operating companies, San Miguel Breweries and Coke Northeast contribute significantly to the business results, but I don't think they create any synergies. I would like to know if you are trying to visualize synergies and create synergies among business domains, including Sam Miguel Breweries and Coke Northeast.

A. Regarding synergies, San Miguel Breweries sells Kirin Ichiban in the Philippines, but the synergies are not large. Coke Northeast is also a bottler, so there are no major synergies. However, we are very conscious of our shareholders, and the contribution to EPS is important to us, so these two companies are very important to us. When we expanded the Coke Northeast territory some years ago, the margin ratio dropped significantly. At that time, many shareholders suggested that we should sell the company. However, now that the company has achieved growth, there are very few shareholders who would say such a thing. In addition to the existence of synergies, we will consider our business portfolio based on geopolitical risks, contribution to cash and EPS, and other factors.

Q. The Kirin Group's strategy has not wavered. On the other hand, what do you think is the reason why the strategy is not being realized or producing results?

A. Things don't always go the way you think they will. For example, regarding Health Science, I did not expect the COVID-19 to happen. As for Kyowa Hakko Bio, we did not expect the quality problems in 2019. Also, the Russia-Ukraine war has prevented us from doing what we had hoped for in sales in Russia, and many other things have happened. It is important to be agile in determining our direction and responding flexibly to these changes in the environment each time. It is taking longer than expected, but the impression from my time as CEO is that it is difficult to achieve results in all businesses at the same time. However, once we have decided to do something, we will do it until the end. It is also important not to ignore short-term problems. Because we will not let go of this domain, I would like to ask for your understanding of our medium- and long-term strategies.

Q. The problems at Kyowa Hakko Bio are exactly the same, which is really unfortunate. My impression is that you have not been able to manage the company in the way as you said. I believe that the company has not been able to build an organizational structure that has high feasibility of the strategy. I think that the deterioration of the external environment is an ordeal for Kirin, but it seems that the sense of agility is not growing at Kirin right now, which is why I asked the question.

A. As you said, things are not going as I envisioned, and it is taking time, but I will continue to work until the end to achieve my goal.

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