

## 【Q&A Session Minutes】

### Presentation on FY2018 Financial Results, FY2019 Plan, and 2019-2021 Medium-Term Business Plan

Date: February 15, 2019 (Fri) 10:00-11:30

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

<2019-2021 Medium-Term Business Plan (2019 MTBP) >

Q. Investors feel an uncertainty whether 2019 MTBP is achievable or not because the decline in profits is forecasted in FY2019, the first fiscal year of the MTBP, in which profits in the final fiscal year need to be greatly increased. I'm wondering whether Kirin will be able to increase profits every year.

**Isozaki:** I met our commitments with investors in the past three years. This is the first time that Kirin has ever achieved all targets of MTBPs. I will firmly adhere to the commitments in 2019 MTBP, too, and I am sure I will try to reach higher results. As you mentioned, it is ideal to continue increasing profits for every year, to be sure, but all of the past MTBPs assumed such increases in profits, and Kirin had never achieved them. As a result of plans based on the idea “a company should develop a positive plan,” Kirin was not able to execute the strategies nor fulfill its commitments. In order for us to achieve the growth in three years, we need to invest in the first fiscal year. Otherwise, we will not move to the next step. If this year were the final year of the company, we could show all of you a plan of increased profits. In order for Kirin to achieve sustainable growth in the future, we have decided to spend strategic expenditures and reduce profits in FY2019.

For example, without strengthening the installation of *Tap Marché* to revitalize Japanese beer market, Kirin Brewery, as our core business, might be able to generate more profits than 2019 plan. This year's target of *Tap Marché* is 13,000 units (7,000 units by the end of 2018), and additional installation will be costly but necessary. Despite it, Kirin Brewery plans to increase profits, and comes to be able to well control costs. Furthermore, four Japanese beer manufacturers including Kirin Brewery have determined to cease announcement of tax quantity shipments, based on which media have reported market share of each company. I expect it to be one of the triggers for companies to get rid of the excessive price competition. Please look forward to the next fiscal year and beyond.

Q. From the viewpoint of stock market, 2019 MTBP appears to contain uncertainties. We do not know whether the investments in the new business domain will contribute to Kirin's

future growth, nor do we know whether existing businesses will be able to grow profits. What is the attractiveness of Kirin to investors, do you think?

**Isozaki:** The new business domain planned in the new Long-Term Management Vision (KV2027) and 2019 MTBP impressed investors so strongly that our commitment to growth in existing businesses appeared to be weakened in 2019 MTBP. This is never the case. We are steadily developing new businesses with a view to 10 years into the future, and we will not ease our focus on the existing businesses; rather will prioritize growth of the existing businesses. We think Kirin Brewery can generate more cash by reducing sales promotion expenses, improving profitability through *Tap Marché*, and so forth. Lion in Oceania is expanding its craft beer business in overseas market. We focus on areas where profits can be generated and give top priority to the existing businesses. I want you to see the growth of the existing businesses first. Some investors, on the other hand, say, "Is that all?" We understand that they expect us to show the next growth driver as well as profit growth of the existing businesses. I would like to make steady progress in this regard.

The group's mid-term growth driver, the pharmaceuticals business, was launched in the 1980s. Kirin did not acquire any asset to start the business but gradually carried out researches in a long-term perspective while generating cash from domestic beer business. Kirin has a good track record. Kirin made it with its own resources, and if it had had to undertake a large-scale M&A, it could not have made such a decision to enter the pharmaceuticals business.

It is true that focusing on beer and pharmaceuticals would be easier for the stock market to understand, but I hope you to understand it is not a forward-looking management.

Q. I think the stock market feel anxious because of your policy of investing ¥300bn in the "new businesses bridging Pharmaceuticals and Food & Beverages" and the fact that your message on enhancing shareholder returns were not necessarily clear. What is your view on potential returns from investing ¥300bn in the new business domain? Please explain your future targets of shareholders return beyond dividend payout ratio of 40% plus, in conjunction with your approach to share buyback.

**Isozaki:** I would like you to see not only Kirin's first-time achievement of MTBP but also every fiscal year achievement in the past three years. It is not impossible to increase profits in the short term this year alone, but management must always be forward-looking. It is time we shift gear from revitalization to growth and make forward-looking investments. We believe that investments in ICT, digital marketing, HR, and other areas were not enough, and we cannot move to the next step without investment now. This is why the Long-Term Management Vision was formulated. Results are not readily available. We should look at it

over the long term. We believe we have to spend cash in a short-term, but, at the same time, we understand that it is not sufficient to simply keep investors waiting for the results to be achieved, so we will enhance shareholder returns. I can say additional return measures are also possible.

We will not spend all of ¥300bn establishing new businesses bridging Pharmaceuticals and Food & Beverages. We have a variety of projects going on, including those in the existing business domains. We will make disciplined decisions when making investments. We intend to make necessary investments to further develop our strengths such as our R&D capabilities in the immunology area in particular. As for returns, we are aiming for a Normalized OPM of 20% in the new businesses such as *iMUSE*.

Q. Are ¥128bn for the acquisition of Kyowa Hakko Bio included in the growth investment of ¥300bn? “Other operating income” is forecasted to significantly decline from the previous year in 2019 plan, and is the sale of the Lion Dairy and Drinks business factored in?

**Yokota:** The acquisition of shares in Kyowa Hakko Bio is an exchange within the Kirin Group, and the consideration itself does not constitute a cash outflow. The reason for the decline in “Other operating income” is the large gain on sale was recorded in the previous fiscal year. “Other operating expenses” is expected to remain at the same level as the previous fiscal year because we expect ERP-related expenses to be incurred in Japanese operation and Lion. In addition, Kyowa Hakko Kirin's business improvement expenses are expected to remain at the same level as the previous fiscal year. The sale of Lion Dairy and Drinks has not been reflected in 2019 plan as the sale has not yet been fixed.

Q. What indicators should we see to judge whether the investment is going well?

**Yokota:** The return on investment will be explained at each announcement. Investments to strengthen existing businesses will be verified through business growth. Even though it is not always the case that we can disclose in detail individual project returns, we will share with investors the profit growth of each business, segment, and group in a regular manner.

**Isozaki:** Engagements with shareholders and investors are quite important for us. I would like to fulfill accountability not only at a large meeting like today, but also at one-on-one communication. I put an importance on dialogues with investors and sell-side analysts during 2016 MTBP. There were some harsh opinions, and others were encouragements. I have kept managing Kirin with stock prices and market capitalization in my mind. Going forward, I will open up dialogue on new business investments as well. For example, making comments on what an extent to which I expect the *iMUSE* would grow, I think it is possible that it will reach ¥23bn sales target without waiting for 2027 because it could exceed ¥5bn

revenue in the first year. In the "new businesses bridging Pharmaceuticals and Food & Beverages" as a whole, we aim to generate sales revenue of ¥100bn and profit of ¥20bn by 2027.

Q. I would like to ask of the ¥1tn in total investment under the "Strategic Framework" of 2019MTBP. Approximately ¥400bn will be used to invest in creating intangible value such as brand, R&D, by deducting capital investment of ¥310bn and growth investment of approximately ¥300bn. How much was the sum in 2016 MTBP which corresponded to ¥400bn? How much would you like to increase in 2019 MTBP? What part of them would you like to invest more in? Why did you judge it was necessary to invest? I understand the costs are included separately in each segment, but approximately how much costs are included in 2019 plan?

**Yokota:** Before answering your questions, let me explain to make "¥1tn" investment clearer. In formulating KV2027 and 2019 MTBP, we had a lot of discussions like "spending in HR should be regarded as investments rather than expenses" and "so is brand." We would like you to understand the term "investment" in creating intangible value means so, but some are booked as expenses for accounting purposes. Marketing expenses for strengthening brand and personnel development expenses are included in ¥400bn. In terms of cash inflows and outflows, please refer to page 11 of the presentation on 2019 MTBP. While capex and growth investments are carried out within the sum of operating cash flows and cash inflows from assets sales, investments in creation of intangible value are mainly carried out within the respective businesses. In addition, in FY2019, investments in digital marketing, ICT, and HR are made at Corporate costs, and ¥6bn, if new business investments included, are recorded outside of each business.

The key areas of investments to creation of intangible value are recruitment and development of marketing personnel and investments in brand. Kirin Brewery invests not in new products but in strengthening existing brands in FY2019. We will also invest firmly in four areas including R&D investment centered on pharmaceuticals and ICT including digital marketing. Those are essential intangible value for both growth of the existing business and establishment of new businesses.

Please understand that the increase in the investments in creating intangible value in FY2019 is within the range from ¥5bn to ¥6bn. In addition, allocations of ¥400bn over three years are almost equal.

Q. I understood you think it necessary to invest even if the profits are declined in FY2019; if so, should you have invested ¥6bn in the previous fiscal year or other years so that you can

increase profits?

**Isozaki:** Achieving the previous MTBP was our commitment with investors, and therefore it was our first priority. It is possible to say later it was only ¥6bn, but while we were working on the plan, we made the best efforts to achieve targets. Listening to our employees as we moved to a stage for the new growth, we made up our minds that investment would be necessary in order to grow the Kirin Group in the future, and we had no choice but to decide profits would decline in this fiscal year. In the future, we will need to implement more thorough cost control.

Q. If Normalized OP grows at mid-single-digit CAGR, it will reach around ¥230bn in 2021, but it will need to jump up several tens of billions of yen in the third year of the 2019 MTBP. What will be a driver? Also, please share your thought on sale of assets with us.

**Yokota:** The level of Normalized OP in fiscal 2021 is as you pointed out. We relatively aim high as the results in FY2018, which is a comparative year, exceeded the plan, but we are working on reaching it. The existing businesses will grow profits. New business bridging Pharmaceuticals and Food & Beverages will be still small, even in *iMUSE*. Technology development is also required, and is time consuming. Although we plan profit growth in alcoholic and non-alcoholic beverage businesses, the pharmaceuticals business is expected to grow significantly.

There are still some assets from which we cannot gain more returns than the cost of equity. For example, we plan to sell cross-shareholding to the same extent as in the previous MTBP. If low-profitability businesses seem unlikely to improve, we will reconsider business portfolio. We will allocate the generated cash to growth investments with the first priority, and then will consider allocating what is left to additional shareholder returns. We will make decisions with discipline.

Q. ROE in FY2018 was 17.5%, which is a considerably high even if compared with global peers. What level are you aiming to maintain at in 2019 MTBP?

**Yokota:** We replaced ROE with ROIC as KPI in 2019 MTBP, to be sure, but we think ROE is also important in terms of how much return can be generated against shareholders' equity costs. Although it is expected to decline in FY2019 from the previous fiscal year due to the decrease in Normalized OP, we will maintain at least 10% or higher. For 2021, we will improve it to the same level as 15%, target in 2016 MTBP.

Q. How can you achieve Normalized EPS growth?

**Yokota:** I would like to refrain from presenting the projected earnings for each year in

numbers at this stage. We will make investment decisions with discipline, and in principle, will not implement investment unless the ROIC exceeds 10% within a few years. As a result, all of ¥300bn for growth cannot be used, and our policy is considering additional shareholders return. Although the amount cannot be indicated, we would like to achieve EPS growth, including the share buyback.

Q. How and when can Kirin Brewery achieve 25% Normalized OPM?

**Director in charge:** Not planning to achieve within FY2021. The goal of Kirin Brewery in 2019 MTBP is to increase revenues and profits. In order to achieve it, Kirin Brewery will strive to improve profitability by combining marketing improvements and cost reductions, and it will continue to set the goal of achieving 25% OPM.

Q. In terms of improving Kirin Brewery's OPM, amidst the increasingly severe business environment, what are the possibilities for controlling marketing costs and realizing price increases in line with the liquor tax revision going forward and the timing of the consumption tax hike?

**Isozaki:** Over the past three years, we have been able to regain growth in the Japan beer business. We increased sales volume and increased profitability. Going forward, we will continue to pursue profit growth by not relying on new products. We believe we can still improve profitability. As each beer manufacturer prioritizes profitability, there will be a brand competition in Japanese beer market, meaning less possibility of excessive price competition.

<2019 Plan>

Q. Kirin Brewery: Is the consumption tax hike an opportunity?

**Isozaki:** We should keep an eye on changes in consumer behaviors, but economy-category-shift is likely to continue. We will further refine our brands in new genre category. I think we can make it an opportunity.

Q. Kirin Beverage: Despite the launch of PET container coffee, which is less profitable than canned product, in *Fire* brand, why do you plan to improve the mix? The increase in logistics costs, price hike in large PET container products, and mix improvement of products and containers lead to +¥2.3bn in FY2019, but is it really possible to improve the mix in the year of PET coffee launch?

**Director in charge:** First of all, Kirin Beverage has also made disciplined investments in terms of marketing ROI. We understand there is a concern that *Fire's* sales target is too

ambitious as +8% over the previous year. The *Fire* brand with high percentage of canned products is struggling due to a shift in demand from can to PET container. The vending machine channel is also declining, but Kirin Beverage will continue to target heavy users of canned coffee, focusing on core SKU "*Hikitate Bito*." On the basis above mentioned, PET coffee will be launched in April. We would like to add marginal profit from PET coffee to the profits earned by cans. We understand there is a concern about the deterioration of the mix, but Kirin Beverage has assessed and analyzed the trend of PET coffee during the past year, and has decided to launch it as a good product could be developed. Kirin Beverage has a contingency plan unless sales target of *Fire* brand as a whole can be achieved, which we cannot talk about in detail. We will make best efforts to achieve *Fire*'s sales target.