

【Q&A Session Minutes】 Presentation on 2017 Results and 2018 Plan

Date: February 15, 2018 (Thu) 10:00-11:30

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

<Overall / 2018 plan>

Q. What are the initiatives or profit growth drivers? For example, what percent of the profit growth will be attributable to craft beer and RTD, which are drivers of Kirin Brewery?

Ito: The biggest factor for profit growth at Kirin Brewery will be cutting the sales promotion expenses by 20 billion yen. At Kirin Beverage, it will be alliances with competitors.

Kirin Brewery is working to expand the craft beer market to 3% of the total beer product market in 2021. This 3% is equivalent to 150 thousand KL, and using the average marginal profit of beer products, it is equal to about 15 billion yen. Moreover, marginal profit in the craft category is higher. We are working to acquire a leading position in the market. The RTD sales volume is growing at double digits, and profit will grow in line with this. In addition, we can increase profitability of RTD, including the possible revision to the transaction conditions.

Q. Regarding the new businesses in the “pre-disease and prevention” area, when and how much profit do you expect to achieve?

Isozaki: We will formulate the detailed plan as we move forward. At the present time, I expect sales of 23 billion yen and a profit margin of 20%. This is equal to 10% of the market for snacks and supplements that use lactic acid bacteria, which is currently valued at 230 billion yen.

<Japan Integrated Beverages Business>

Q. You mentioned that you will increase the normalized operating profit margin at Kirin Brewery to the global level. When do you plan to fully realize this?

Isozaki: When announcing the 2017 business plan, we stated that we would cut sales promotion expenses by 20 billion yen. By realizing this during the next Medium Term Business Plan, a normalized operating profit margin of 25% will come into view. We were able to cut sales promotion expenses by 4 billion yen in 2017, and we will cut selling expenses as a whole by the same amount in 2018.

The normalized operating profit margin at Kirin Brewery for the sales revenue excluding the liquor tax is about 20%. The global level in mature markets like Japan is about 25%.

Because the overall beer market is expected to contract, it will be necessary to cut costs, and in particular, we will work to cut sales promotion expenses.

Q. Have you been able to strengthen the sales capability of Kirin Brewery? The marketing and cost awareness has definitely changed, but sales are lagging behind competitors. It appears that sales of Kirin Ichiban are currently strong, but I am uncertain whether sales will continue to remain strong. Are there any positive signs in terms of the sales capability and sales force?

Isozaki: The Sales Division at Kirin Brewery has greatly restored its self-confidence. The reason for this is that many mass retailers, restaurants and bars have evaluated positively Kirin Brewery's brand initiatives and the results are starting to appear. Sales of Kirin Ichiban have remained strong in January of this year, and we are achieving a recovery in the new genre category through the launch of Nodogoshi STRONG in January. Also, the mass retailers are extremely looking forward to the launch of HONKIRIN in March. Sales staffs in charge of on-premise customers also achieved the target for Tap Marché installation. As Tap Marché becomes more established in the craft beer market, I believe it will lead to increase demand for craft beer in the mass-market channel.

One of the initiatives for strengthening the sales force is appointing young personnel as leadership. We are preparing an environment in which our excellent sales personnel can make full use of their abilities.

Q. Please specifically explain the "marketing reform" at Kirin Brewery.

Yokota: In line with the integrated marketing, we will make the way branch offices create the sales areas consistent with the head office marketing campaigns. Taking the Kirin Ichiban renewal as an example, by conducting consistent branding to create a story from advertisements through the store or restaurant, Kirin Brewery effectively conveyed the message to consumers. We will apply this to the new genre products, too. Also, by reducing sales promotions and brand-extension products in number, we are narrowing down the investments. We are managing the investment versus returns using figures and has been able to increase profitability. It has prepared a framework that will generate results.

Regarding branding, we have created a 36-month plan, fostered the products from a long-term perspective and worked to measure the benefits.

Because the Marketing and Sales Division were able to generate clear results with Kirin Ichiban, they are now working with the aim of connecting those results to further growth.

Q. Will you increase the profit component ratio of RTD by improving its profitability, which is lower than that of beer?

Isozaki: We need to be careful in how we revise the transaction conditions in order to prevent the loss of consumers. We are preparing RTD products with higher profitability than existing products. First, we will improve product mix by establishing RTD brand portfolio.

Q. Specifically, what do you mean by “growth-based profit generation” at Kirin Beverage? It appears as though the 2018 business plan relies on increased volumes, but how, specifically, will you achieve the plan?

Ito: “Growth-based profit generation” means that through the initiatives over the past 2 years, profitability has increased and Kirin Beverage has become a business that can generate over 20 billion yen in profits, so going forward, we will aim to grow the top line. Regarding the specific initiatives, as we have done to date, efforts will be based on growing the foundation brands. In addition, we will work to establish brands in growing categories such as wellness and sugar-free tea. In the wellness area, in 2017, we strengthened the Supli brand and launched the iMUSE brand, and we will foster these into drivers of future growth.

Q. I hope that you will be able to change the soft drink industry in Japan into a highly profitable industry. The competition in the industry is fierce, but you stated that you will consider alliances with other companies.

Isozaki: I will take the initiative in changing the industry in to a profitable industry. We will start from the areas in which we can work with other companies through alliances. I believe it will be possible.

Previously, I said that I will transform the beer industry in Japan, but I doubt many people believed me. However, we were able to produce results. The beer market in Japan has been shrinking for over 20 years, and during this time, the volume has declined by 2 million KL, which is equivalent to 1/4 of the total market. The heads of each manufacturer understand this situation, and they understand that excessive price competition fatigues the industry as a whole. I believe there is a similar environment in the soft drinks market.

Q. In order to achieve a normalized operating profit margin of 10% at Kirin Beverage, will it be necessary to form a capital alliance or can it be achieved through a business alliance? What normalized operating profit margin can you expect to achieve without forming an alliance?

Isozaki: Frankly, it is unlikely Kirin Beverage will be able to achieve a normalized operating profit margin of 10% alone. Some type of alliance will be necessary, and I think we will start from a business partnership. Even without forming a capital relationship, it will be possible to realize merits through an alliance with competitors in Japan. Even if the alliance does not include a capital relationship, we will pursue wide-ranging partnership. Without limiting the perspective to areas where the hurdles to cooperation are low, such as logistics, I hope to expand the scope of potential alliances to areas such as vending machines and procurement.

<Overseas Integrated Beverages Business>

Q. During the presentation, you explained about the Japan alcoholic beverage and non-alcoholic beverage businesses. How will you grow the profit at your overseas businesses? The markets for the existing businesses in Australia are mature, and although the market is growing in Myanmar, it is still small.

Isozaki: The sale of a majority stake in SABECO by the Vietnam government has ended, and from a medium term perspective, I think it will be difficult to find opportunities for M&A that will lead to major growth in Asia, including Southeast Asia. We will pursue opportunities that can realize small or medium scale growth. From a long-term perspective, we will pursue investments that can drive growth in the areas of wellness and pre-disease. Without relying just on the resources already possessed by the Kirin Group, I hope to consider investments if there are partners we can work with through open innovation.

Q. Please tell me about the progress in the post-ABI strategy at LION.

Director in charge: The profit recovery through the post-ABI strategy is progressing smoothly.

First, from October 2016 to September 2017, which is the consolidated period under J-GAAP, sales achieved the plan and operating income overachieved the plan. While the overall market contracted by over 2%, the sales volume was able to beat the market by only declining about 1%. Also, the improvement to the mix proceeded smoothly. Sales of Iron Jack that was launched in September in 2017 have been strong, and the contemporary category grew in the upper single digits. The international premium category grew by approximately 3% thanks to the contribution from Kirin Megumi, and the craft category grew by over 20% thanks to contributions from Furphy and Little Creatures, which have a strong customer base in Victoria. Lion will continue to maintain and accelerate this positive trend.

<Financial Strategy>

Q. Are there any remaining non-core assets that can be sold? Going forward, how will you allocate the free cash flow? What indicators will you focus in relation to balance sheet management?

Itō: There are still non-core assets remaining that can be sold, but the sale of such assets has already progressed to a significant extent. In regards to the balance sheet, we will manage it to maintain the D/E ratio within the range of 0.4-0.6 as a level that will enable us to retain an A rating. On the other hand, in regards to free cash flow, top priority will be given to allocating it to investments that will drive growth, and if there are good investment opportunities, we will proactively allocate cash, including additional debt finance and so forth, to such investments.

Q. I think the time has come for the Kirin Group to start reaping a return from its current capital. In the past when the company was actively expanding through M&A, the CEO at the time explained that synergies would be generated with the newly acquired businesses. Thereafter, the balance sheet deteriorated, and Mr. Isozaki has made significant progress in improving it. Going forward, how much cash can you generate through synergies within the Group?

Itō: From a medium term perspective, similar to the basic policy set forth in the 2016 Medium Term Business Plan, we will increase returns by growing profits. We set ROE as a quantitative target in the 2016 Medium Term Business Plan and have carried out initiatives directed at increasing the net profit margin. The manner of thinking will not change in the next Medium Term Business Plan. For this reason, we will increase the normalized operating profit margin at Kirin Brewery by cutting sales promotion expenses and increasing the sales volumes in growth categories such as craft beer. At Kirin Beverage, including alliances with competitors, we will increase the normalized operating profit margin. At the overseas businesses, we expect to recover the profits in Lion's beer, spirits, and wine business in Oceania and achieve further growth in Myanmar.

From a long-term perspective, we will create synergies capitalizing on business strengths. We will leverage the research and development capital of Kyowa Hakko Kirin, and we will continue to pursue opportunities for investments that will drive growth.