

【Q&A Session Minutes】
Presentation on 2Q FY2019 Financial Results

Date: August 7, 2019 (Wed), 10:00-11:30

Presenters: Yoshinori Isozaki, President & CEO; Noriya Yokota, Director of the Board, Senior Executive Officer & CFO; General Manager of Corporate Planning Dept., and General Manager of Accounting Dept.

Q. Today, the stock price has declined significantly, and this is thought to be due to the acquisition of FANCL shares. Investments totaling 129.3 billion yen have yielded too low a return as far as we can see at this time. What synergies do you anticipate in the future? To what extent do you believe that you will be able to increase future returns?

Isozaki: The short-term ROIC of investing approximately 130 billion yen to acquire 33% of FANCL's voting rights would have to be low, and investors could have been skeptical. We will make every effort to provide a persistent explanation of this point. Today we would like you to see the investment from a long-term perspective. In February of this year, we announced the Long-Term Management Vision "KV2027" and its 2019 Medium-Term Business Plan (MTBP), and stated that we would achieve profit growth of existing businesses, mainly the alcoholic and non-alcoholic businesses and the pharmaceuticals business. However, I, as a management of Kirin, cannot necessarily say that existing businesses alone will be sufficient when thinking about a decade from now. Even if it takes some time, we must aim to create new value for the company to achieve sustainable growth. This is the "businesses bridging pharmaceuticals and food & beverages." People ask me "it is true that Kirin possesses a wide range of high-functioning ingredients, but how is it going to be utilized? How do you think the business can be realized? Is it only the iMUSE?" I did not believe that everything could be done by ourselves. Kirin is strong in B to B, not in B to C in the healthcare sector. I wanted to find a good partner. This time, we have been able to get a great offer from FANCL. I talked directly with FANCL's chairman and president, and promised to work together and them to take an initiative on this field. The first thing is to hold 33 percent of the voting rights, but please also see this in a long-term perspective. In the short term, we will not deny your concern, but if viewed over the long term, we believe it will lead to the creation of new value. I believe potential synergy, but I cannot talk big at this point before FANCL and Kirin calculate in detail. Therefore, let me say that at the present stage, we are looking at about 5 billion yen from synergy. Although it is still insufficient, I think that it is meaningless to say that the synergies would account for 10 billion yen or 20 billion yen without logic behind.

In the 2019 MTBP, Kirin aims to achieve ROIC 10% or higher by FY2021, but the current ROIC is below the target. How are you trying to achieve this?

Yokota: We are committed to ROIC 10% by FY2021. We have been explaining to investors that we are looking for 10% returns in 3 to 5 years for each investment. Based on several methods, we admit that the ROIC will be less than 10% if it is only from this investment. Even according to our DCF valuation with conservative growth with inbound demand and overseas development, the NPV is positive and the investment criteria are met. Although it is difficult to achieve sufficient returns by FY2021, as Mr. Isozaki mentioned, we are currently organizing the process to set the targets for FY2027 in addition to the targets for FY2021. We will keep you updated our progress going forward.

Thus, the ROIC 10% shall be achieved mainly by growing the profits of the existing businesses. It is not easy to generate profits only from large investments, therefore we will continue to focus on our key businesses. The company aims to raise Normalized OP margins to 25% for Kirin Brewery and 10% for Kirin Beverage. In Lion, we aim to raise profits by improving unit prices and mix through crafts and contemporary categories. The pharmaceuticals business is growing significantly. We aim to achieve a group-wide ROIC 10% and we are confident that the current calculations are in a range sufficiently achievable.

Q. I understand that the 5 billion yen synergy is a minimum amount, but what is the specific content of the synergy? What range can you expect if you create further synergy?

Isozaki: While Kirin and FANCL's business purposes accords each other, there are little overlaps in business domains. We believe there are opportunities for synergy here. Both companies have e-commerce (EC) websites, but for example Kyowa Hakko Bio's customers are mostly male and seniors, while FANCL's has a wide range of customers including female. We have the potential to expand our customer base by putting our ingredients on their EC. Our own vending machines will be able to sell products in the healthcare domain. FANCL also owns direct sale stores, which we do not. In the area of overseas expansion, FANCL has strengths in China and Kirin in South East Asia. We believe there is a potential to mutually utilize overseas footprints. At this point in time, these are not necessarily based on careful examination, therefore I would not discuss details.

Q. The equity stake in FANCL is 33%, less than one thirds. There is a risk that the relationship will become unrestrained, and there is no indication of the level of commitment. To generate synergies to sufficient extent, it is necessary to have 33.4% or more than 50% in the future. Please explain what path you are considering in order to create more synergies in the future. Kirin has no track record of successful M&As in the past, but what is different this time?

Isozaki: The historical records were of MTBPs before 2016 MTBP, and it is regrettable that we have not yet gained trust. The decision is based on lessons learned in the past. Until now, the company has made disciplined investment decisions, but this time again we have made decisions with prospect of success. Please understand that I cannot say anything about what percentage of voting rights in FANCL Kirin is going to own in the future.

Q. Kirin Brewery's 2Q result of increased profits looks excellent, but not ideal. The challenge is to improve the category mix, which has not been achieved in the 1H of the year. How and when will it be improved? Are you planning to take a more elaborate strategy?

Isozaki: All players including Kirin are willing to sell full-malt beer with high marginal profit. It is true that full-malt beer used be the only beer product before the *happo-shu* and *new genre* were developed, and that it was more profitable in the past. At the same time, it is also true that the times are changing, and consumers are increasingly eager to save money. If there were no *new genre*, beer consumers would have shifted to even lower priced alcohol products. In this sense, *new genre* plays a major role. It is true that the marginal profit is higher for beer, but the operating profit after marketing cost is not so different between *new genre* and beer. It is because *new genre* is mostly for off-premise, but full-malt beer accounts for a high percentage of on-premise, where sales promotion expenses are high. As a result, full-malt beer falls in operating profit. Against this backdrop, we are focusing on sales promotion through retail channels, and the *Kirin Ichiban* cans are performing very well. Category mix is the challenge, to be sure, but it is not enough to consider only marginal profits. Among beer products, we continue to focus on craft beer for mix improvement, and results are emerging. In the beer market, which has been declining since peaking in 1994, we will continue to increase revenue by improving the mix while carefully monitoring the market.

Q. With regard to the alliance with FANCL, although Kirin is expecting to generate returns in the future, I think Kirin has purchased what it needs at about 130 billion yen. How far can you approach it and how far can you share the channels with the 33% ownership?

Isozaki: Synergies can be created in 3 areas. This refers to the 1) development of material, product, and brand, 2) co-development of products and business, and 3) mutual utilization of business platform. Some may argue that they would be able to obtain without investing, but it was a prerequisite to form an equity alliance and commit to doing business. It is not easy for us to fully carry out the "businesses bridging pharmaceuticals and food & beverages" by ourselves. This time, the majority of shares of the FANCL's founder will be received. FANCL will remain listed and will work together with Kirin. FANCL has strengths in B to C, and it is

highly likely that FANCL will spearhead this domain. Although they are independent of each other, I believe that acquiring 33% as the first step to create synergy in the 3 areas is by no means too expensive investment. If we were to do it only by ourselves, I don't know how many decades it will take.

Q. I would like to ask about shareholder returns. I think the sale of the Lion Dairy and Drinks business has been delayed, and the external environment is changing, too. I want to be updated. I would like to ask whether the additional shareholder return is linked to the sales amount of the Lion Dairy and Drinks business.

Yokota: Negotiations on the sale are ongoing, but due to the nature of its content, we need to decline to comment on details. We plan to allocate approximately 300bn yen to growth investment and the others to CAPEX and shareholder returns including dividends, sourced from the total of operating cash flows and cash from the sale of assets. If there are good growth opportunities, for example in the beer business, it is more beneficial for shareholders to prioritize investment. At the same time, we think it natural to return cash to shareholders. We cannot mention a specific amount, but we fully understand investor expectations.

General Manager in charge: It is true that the situation regarding the sale of the Lion Dairy and Drinks business has changed, including in the marketplace. We are continuing negotiations with several companies and considering whether it is the best decision for local employees as well. You may feel that the progress is slow, but we want you to understand that the process is progressing. It is not necessarily the case that the amount of gain on sale of a business and the amount of share buyback are linked, but we closely monitor the status of assets sales and stock price trends.

Q. Given the offer was from FANCL's chairman Mr Ikemori, was the 33% ownership also an offer from him? If this is the first step, is there any decision as to when to proceed to the second step? I think that various arrangements have been made in the strategic alliance with Kyowa Hakko Kogyo (now Kyowa Kirin), but are there arrangements between the two companies to maintain listing or management systems?

Isozaki: 33% of voting rights is what Mr Ikemori the Chairman and his relatives own. There is no specific agreement about our future ownership. I mentioned the first step from the standpoint of acquirer, but there is no mutual agreement. There is not the same agreement as between Kyowa Kirin and us in the past. Listing is to be maintained.

Q. Kirin Beverage's difference of change in product mix and in composition ratio of containers etc. has been revised from 2.3bn yen at the beginning of the year to 4.6bn yen this time. I think these include impacts from changes in the Tropicana sales scheme, changes in the packaging mix, and price revisions. Please explain.

General Manager in charge: All of the factors you mentioned are included. Mix will be negatively impacted by the decline in the ratio of cans due to the sales results of *FIRE* cans in 1H, and the revision of the full-year volume target as well as rising logistic costs. On the other hand, these will be offset by an increased sales volume of small PET bottles, price increase of large PET bottles and effects of the *Tropicana* scheme change. The impact of *Tropicana* cannot be described in any specific amount.

Q. Sales of the *Kirin Ichiban* cans and *Honkirin* were strong, but marginal profits declined for Kirin Brewery. How do you think the marginal profits of beer will change in the future amid such environmental changes as the consumption tax hike, the revision of the liquor tax?

General Manager in charge: In the 1H of the year, increase in *new genre* was unable to cover the negative effects of full-malt beer and *happo-shu*. In 1Q, the shift of demand to *new genre* was a factor behind the deterioration in the mix. In 1Q, competitors launched a number of *new genre* products, which accelerated consumers move away from beers and *happo-shu* to *new genre*. As a result, marginal profit has declined. Looking after the 2Q, the trend seems to have stabilized. *Kirin Ichiban* and *Honkirin* we are focused on has been strong, and we expect them to contribute to marginal profits in the 2H of the year as well. With regard to the consumption tax hike, although the rate of increase is lower than at the time of the previous tax hike, due to continuing consumer price consciousness, we believe that demand for *new genre* categories will continue to be firm. Therefore we need to continue strengthening *Honkirin*. Even after the revision of the liquor tax in 2020, despite the shrink of the tax gap, there remains such a certain price gap that we expect demand for *new genre* to continue. We also continue to focus on the most profitable *Kirin Ichiban* cans, a full-malt beer where the liquor tax is going to be lowered and whose profitability is high.

Q. With regard to the alliance with FANCL, in order to generate synergies that are expected over the medium to long term, I think it will be necessary to build an organizational structure to achieve this. How will the organization change?

General Manager in charge: We are in a process to build the structure in each of the 3 areas. Since the spring of this year, we have organized a team in charge of the "businesses bridging pharmaceuticals and food & beverages" and this team will take the lead in promoting these activities.

Yokota: We have lessons learned from past M&As. In addition to decisions on investment, there has been a significant improvement of PMI. Myanmar Brewery is the good example that we have been successful in generating synergies by forming a structure. In the same way, we will develop organizations and implement promptly in the areas of ingredient development, joint research, and infrastructure utilization.

Q. About a global expansion, you once mentioned you were considering Southeast Asia and craft beer as a primary target for growth investment. Are there any opportunity like Myanmar Brewery? Are you still interested in global M&As?

General Manager in charge: We do not give up exploring opportunities in global markets. In the beer business, there are no distinctive opportunities, but the search for growth markets or opportunities that are likely to increase profitability is continuing. Not only for beers and soft drinks, but if there are any projects that would generate even greater value from the “businesses bridging pharmaceuticals and food & beverages” in addition to alliances with Kyowa Hakko Bio and FANCL, we will watch them.

Q. Coca-Cola Bottlers Japan will enter the RTD market nationwide. What is the risk awareness?

General Manager in charge: The RTD is a category with a large contribution to marginal profit, but competition is fierce. In order to take advantage of competition, it is necessary to make certain investments, including variable sales promotion expenses, to achieve growth and increased presence in the market, needless to say with focused investment looking at ROI. With regard to the nationwide deployment of Coca-Cola Bottlers Japan’s RTD product, we will keep a close watch on it although we think it better for the entry to boost the RTD market growth.

Q. What does "aggressive competition seen in the Australian market in the 2Q" mean for Lion BSW? What changes do you foresee after the acquisition of Asahi Group Holding's Australian brewery (CUB)?

General Manager in charge: Sales volume of Lion BSW was affected by price competition from CUB. Looking ahead, Australian beer market as a whole has been saturated, and demand mainly of young generation will continue to shift from the classic category to the contemporary category. We also see the growth of Craft beer, therefore I think there will become a competition in these categories.

Q. According to FANCL's CEO Mr. Shimada, Kirin has a lot of ingredients, but is not so advantageous on B to C marketing particularly in healthcare segment, where FANCL could demonstrate leadership. Which company will take the initiative of the "businesses bridging pharmaceuticals and food & beverages" to generate synergy? Also, majority of FANCL's sales lie in cosmetics, and how will the cosmetics affect Kirin's business model?

Isozaki: FANCL's cosmetics are rather to treat health of skin. In this sense, Kirin also has *Lactococcus lactis strain Plasma*, which is expected to improve skin-barrier functions, and ingredients such as *tranexamic acid*. Both companies will consider a detailed plan and work together including marketing strategy.

Q. I understand that the alliance with FANCL is a medium-to long-term strategy, but the competition in the healthcare field is becoming so intense that I believe speed is the key to success. What kind of organization are you going to build and how long will it take? You mentioned it did not matter which would take the initiative, but will you have opportunities to discuss organizational structures and other matters?

Isozaki: We hope to achieve results at an early stage. As mentioned earlier by the General Manager, the PMI will be implemented based on the experience of how to make a profit. CEO Mr.Shimada and I were talking to hold regular meetings with a sense of speed.

Q. Liquor tax revisions will begin next year. Will there be a shift to full-malt beer in the market from next year? What is Kirin's strategy? Kirin's beer and *new genre* have been sold in a well-balanced manner to date, but are you going to be more focused on full-malt beer?

General Manager in charge: Focusing on full-malt beer remains unchanged but it does not necessarily mean we will be less focused on *Honkirin*. There must be strong brands in each of the categories to survive the tax revision by 2026.

Q. CEO Isozaki has been talking about expanding the profit pool for several years, but it has not been realized yet. Given the more severe markets than anticipated, are there additional initiatives to increase Kirin Brewery's Normalized OP margin to 25%?

Isozaki: Please understand we have never lowered prices and is pursuing strategies based on what consumers need. As the name *Honkirin* ("honki" means serious in Japanese) and the red packages demonstrates, we are very serious of this brand. As we are not allowed to discuss an expansion of profit pool with competitors, for example Kirin's initiative in 2017 resulted in higher retail prices. Investors were doubtful at first, but we have succeeded in it. As in the past, the next steps will be taken, although we cannot explain nor discuss on it. We aim to achieve a 25% Normalized OP margin in Kirin Brewery. I hope you can expect this.

Q. Are the synergies of 5 billion yen with FANCL revenues or profits? Is it a combined amount for two companies?

Isozaki: I assume total of two companies on a profit basis.

Q. Although I am looking forward to what kind of synergy will be created, it is so unclear at this time that I cannot completely envision it. FANCL has mentioned that it can not only increase sales of supplements but also reduce costs of ingredients. Please explain the concrete image of the company's initial initiatives.

Isozaki: Overseas expansion and other developments are future potential. What is immediate is the existing channels, materials, and so on. Discussions have already begun, with FANCL and Kyowa Hakko Bio's e-commerce in particular. iMUSE can also be used quickly. We recognize that cosmetics are for a health of skin. We already supplied raw materials from Kyowa Hakko Bio to FANCL, and will accelerate this process.

Q. Are the synergies generated more by increased sales, or cost savings?

Isozaki: Contribution from the increased sales would be larger.