

【Q&A Session Minutes】 Presentation on 2016 Earnings Results and 2017 Plan

Date: February 14, 2017 (Tue) 10:00-11:30

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

<Overall / CSV (Creating Shared Value)>

Q: Even though your company is committed to EPS growth of over 6%, the target growth rate in the 2017 plan is relatively low. In order to achieve the target, you need to accelerate earnings growth in 2018. Which businesses do you plan to reinforce?

Ito: We aim at increasing profit of Kirin Brewery ("KB"); and further improving the margin of Kirin Beverage ("KBC"), which is currently around 5%. We will steadily work on identified challenges in order to contribute to the growth in 2018. Furthermore, the current 2017 Plan set higher targets than those in the initial 2017 plan, which was set out together with the 2016-2018 medium term business plan ("MTBP"). This is because KBC and Brasil Kirin ("BRK") have outperformed the initial plan. In 2018, in addition to KB and KBC, we expect that Kyowa Hakko Kirin ("KHK") will regain its earning power through topline growth.

Q: I'm aware that your company has made significant improvements, including successful turnarounds of underperforming businesses, and further improvement of corporate governance. However, the market has shifted its focus of evaluation to "growth". Considering what can be sources for creating growth, don't you think that it is all about improving the profit margin in Japan?

Isozaki: We'd like to make domestic business more profitable. As for overseas business, we have learned from various experiences that we cannot tell what would happen due to political changes and other similar factors. We will separate areas of competition and areas of collaboration. I have no objection to brand competition, but I believe that price competition is unfruitful: instead. In the meantime, as for the future after that, considering economic growth in the context of the population decline, this is an innovative challenge, and the key would be R&D. We conduct R&D in antibody drugs and the bio-chemicals business, and actively engage in open innovation. By mobilizing such technologies, we are working on business creation, focusing on "health" in Japan. We cannot do it without R&D in the pharmaceuticals business, and we need to work together with KHK. This is not something we can achieve in a year or two, and I believe that we will be able to achieve it by putting CSV at the core.

Q: Concerning the compatibility of high profit and CSV, it is generally considered that CSV efforts may lead to a decline in profit. I'm interested in the compatibility of these two, and would like to hear your opinion.

Isozaki: I feel that the concept of CSV is finally becoming widespread. I assume that the beer, beverage and pharmaceuticals businesses will face various restrictions in the future. As for the pharmaceuticals business, there is a problem of medical care cost containment. As for alcohol, beer consumption has declined after peaking in 1994, and alcohol consumption per capita has also gradually declined. As for beverages, we expect a decline in consumption volume due to a low birthrate and aging population. While we aim at

sustainable growth, the key word is CSV. Although it is extremely philosophical, it is essential that all the employees feel empathy for CSV. We have short-term challenges in front of us: we need to increase profitability. However, we will need to implement CSV in the future. We are not sure whether we can report strong earnings soon, but thinking 10-20 years from now, this is an important initiative.

< Japan Integrated Beverages Business >

Q: You said there is still room to improve profits from existing businesses. What image do you have of the next structural reform?

Isozaki: Kirin Beverage has improved its profitability, but we are not yet satisfied with the current level. We believe that there is still room to improve profitability of existing beer business, and thus must proceed with the structural reform. In order to be more profitable in the market with fierce competition, it is required to pull out of excessive price competition. Otherwise, I don't think that the Japanese beer market looks attractive to investors all over the world, so we'd like to take initiative to increase profitability. As for the beverage business, we ended negotiations with Coca-Cola over capital alliance, but we are still negotiating over business alliance.

Q: At this moment, not all competitors have published their plans yet. The current ratio of sales promotion expense to sales excluding liquor tax is more than 20% (96 billion yen). Is there any possibility to lower the said amount or ratio?

Isozaki: We increased the expense by 10 billion yen in 2015. We'd like to lower it to the 80 billion level first.

Q: Concerning KB's sales promotion expense, although you said you'll walk away from excessive competition, it is not shown in the plan. When do you plan to put it into practice?

Isozaki: Reflecting such a view in the budget is one option. In our experience 10 years ago, even though we took such a move, no other company followed us. We absolutely will reduce sales promotion expense, but we will take cautious steps. This year, we did not incorporate the reduction into the budget in order to see how things will go.

Q: As for streamlining marketing expense for domestic beer business, the top management of each company may have changed their consciousness, but what about people in the field? I got an impression that selling prices at mass-retailers have not improved.

Isozaki: Kirin has significantly improved the pricing. I cannot tell you more.

Q: You explained that considering the upcoming revision to the liquor tax, *Nodogoshi Nama* will be important. What is the rationale of strengthening the product subject to the tax increase?

Isozaki: Kirin has been strengthening *Ichiban Shibori* and craft beer, and we believe that these products will eventually draw more popularity. However, the revision to liquor tax will not be implemented in a year or two – but in 10 years at the earliest. Moreover, there will be collateral conditions. I won't say that Japan is suffering from deflation, but consumers are budget-minded, so we will focus on the new genre category. However, we don't want to go for price competition. Instead, we'd like to compete on brand.

Q: Concerning the profit structure reform, you mentioned that reducing the number of players would lead to a fundamental reform, and thus would like to actively work on it. Including the beer business, is there a possibility to form an alliance with Asahi or other companies?

Isozaki: We already implemented cooperative distribution with Asahi in certain geographical areas. Depending on the progress of negotiations, there is a possibility to expand such distribution to other areas. As for negotiations with the Coca-Cola Company, we ended negotiations over capital alliance, but will continue negotiations over business alliance in terms of SCM, since we can expect cost synergy with its bottlers in Japan. In order to eliminate fierce competition, we believe that merely reducing players through consolidation is not the best solution.

Q: Concerning Japan Integrated Beverages Business, I think that a decrease in the number of players will have the largest impact on the beer business. What is your next step, including capital alliance? When you talk about ensuring more orderly pricing in the industry, profit will significantly differ depending on whether the number of players is 3 or 4. What do you think about it, including the view of the entire industry?

Isozaki: It is argued that it would be better, if the number of beer companies decreased from 4 to 3. Easier said than done – it is difficult to make such a decision. Over the past 25 years, the market has shrunk by roughly 30%. Regardless of how fierce the price competition is, sales volume will decline. Now the first step is to raise our consciousness of profitability. Having done it, if there is consolidation, it will be the second step, in my opinion.

Q: Is there synergy between the beer business and the beverage business?

Isozaki: In terms of brands and sales, I don't think that there is much synergy. However, in terms of total cost reduction including SCM, having two businesses makes a difference in the effect.

Q: I'd like to know the flow of negotiations with the Coca-Cola Company. What are the reasons for terminating the negotiations?

Isozaki: I had a face-to-face meeting with Muhtar Kent, CEO. In addition to discussing capital alliance, he proposed to change the industry structure. Since negotiations involved four parties - Kirin, the Coca-Cola Company, Coca-Cola West and Coca-Cola East, the progress was rather slow. Accordingly, I had a telephone conference with Muhtar Kent, CEO, and then met him in person. Furthermore, this year, we negotiated such issues as (1) capital, and (2) valuation. As for valuation, although Kirin is a listed company, it is a group of multiple businesses. KBC is an unlisted company, so both parties could not find valid explanations. Nonetheless, since he said that he would like to make business in the Japanese market steady and profitable, as announced on February 13, although we terminated negotiations over capital alliance, we will continue to discuss business alliance.

Q: In case the business alliance with the Coca-Cola Company is realized, media reported that you will be able to reduce cost by 10 billion yen. In what way, to what extent, when can you realize such cost reduction?

Isozaki: We believe that the cost reduction by 10 billion yen is possible, depending on

negotiations in the future. The proposed business alliance is limited to back office operations. I hope to conclude all negotiations within this year, and implement the alliance from the next year.

Q: If you can realize cost reduction by 10 billion yen, taking into account the adoption of IFRS in the next year, do you expect the margin of nearly 10%?

Isozaki: Our current operating profit margin is 5%, which is below the global standard. CCNNE, a Coca-Cola bottler owned by Kirin located in the northeastern region in the United States, recorded operating profit margin of 10%. We'd like to increase our operating margin to that level. It is difficult to increase the margin by 5% from the current level, we'd like to achieve 10% margin through such initiatives as the business alliance.

Q: In order to produce the effect of cost reduction in SCM, is there a difference between business alliance and capital alliance?

Isozaki: I think that it depends on negotiations between two parties. We do not necessarily insist on capital alliance. Trust relationship is important. If it is better to draw in capital, then we will discuss it.

< Overseas Integrated Beverages Business >

Q: After your company decided to sell your Brazil business, I cannot see any growth strategy for your overseas businesses. I got an impression that the existing businesses are not really sufficient. What is your view of the strategy for increasing the profit growth rate, including possible M&A?

Isozaki: Concerning M&A, there remain only few good candidates for acquisition. Although Vietnam is an attractive market, we must assess the rationality of purchase value. In overseas businesses, even if it is difficult to increase the sales volume, we'd like to proceed with the profit structure reform, including price revision.

Q: As for the recovery plan of Lion, Australia, when will it recover its profitability to the last year's level? What are potential risks in doing so?

Director in charge: Within the next 5 years, we plan to recover its EBIT to the 2016 level. We will concentrate our resources on its core brands, and Kirin brands. We have already seen some effects: for example, *Kirin Megumi* sold there recorded an increase of 35%. We will establish a highly profitable portfolio, and also manage to raise funds for marketing through the sale of the wine business as well as cost reduction.

Q: Is the increase in personnel costs at Myanmar Brewery limited to the current year, or over the medium term? Please let me know how to look at the margin.

Director in charge: As for excellent human resources at the levels of department heads and division heads, there is a risk of headhunting by foreign companies. To retain such human resources, we need to increase compensation. The current budget includes training costs. You can expect that the level of personnel costs will be raised in the future, but training costs are not necessarily required every year.

Q: I consider that the acquisition of Mandalay Brewery was a good case where the synergy effect is demonstrated. What was the background of this acquisition?

Isozaki: Mandalay Brewery was an affiliated company of Myanma Economic Holding, which is our partner. Since Myanmar Brewery was also its affiliated company, the acquisition was the result of deepening mutual trust.

< Sale of Brasil Kirin >

Q: BRK was sold at the price of 77 billion yen. You explained that there is a positive impact on the net income, based on accounting figures as of the end of FY2016. How much was the loss on sale, and how much was the tax effect – I mean a decrease in tax burden as a result of inclusion in deductible expenses?

Ito: The timing of sale is to be decided, so it depends on the timing. If the sale is completed by the end of FY2017, gain on sale of shares will be roughly 40 billion yen, and foreign currency translation adjustment will amount to roughly -70 billion yen, resulting in loss on sale for 30 billion yen. As for the tax effect you mentioned, deferred tax assets for roughly 50 billion yen will be recorded, and therefore net income will be 20 billion yen. Please note that this is based on the assumption that the sale is completed at the end of FY2017.

< Shareholder Return / Financial Strategy >

Q: Concerning shareholder return, your company underwent restructuring, and expects cash inflow. What about the leverage position on the balance sheet? Is there an option to use such cash to return to shareholders?

Ito: It is our basic policy to provide a stable dividend payment, at least 30% of normalized EPS. Partly because FCF was generated earlier than planned, we raised the dividend by 1 yen in 2016. If we are asked whether our earning power has improved, we cannot say the recovery was sufficient. Two rating agencies issued a negative outlook on us. We'd like to maintain the rating in normal times. We expect cash inflows from the sale of Brasil Kirin in the near future. When they lift a negative outlook, we'd like to consider additional return to shareholders.

Q: You mentioned maintaining the rating. What about funds available for investments in M&A? Which indicator do you use as a guide?

Ito: By repaying interest-bearing debt of 135 billion yen during the 2016-2018 MTBP period, the DE ratio will be at the level below 0.7-0.8. Two rating agencies assess companies based on their earning power, so we'd like to make a decision based on our earning power at the time. As we will receive funds from the sale of Brasil Kirin, we will have more funds available for investments.

Q: I'd like to confirm CF of the current year once again. You explained that your company would achieve the MTBP ahead of schedule. How much is the realistic amount of interest-bearing debt repayment?

Ito: FCF will be around 110 billion yen. We plan to use 45 billion yen for dividend payment, and 65 billion yen for repayment of interest-bearing debt.

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