【Q&A Session Minutes】Presentation on the Second Quarter of 2017 Earnings Results

Date: August 4, 2017 (Fri) 10:00-11:30 Presenters: Yoshinori Isozaki, President & CEO; Akihiro Ito, Director of the Board, Senior Executive Officer; and the Directors in charge

<Overall>

Q: This term's results have been excellent so far. What are going to be the particular profit growth drivers for the next fiscal year?

Isozaki: We believe that there is still room for growth in profitability for Kirin Brewery, Kirin Beverage, and the Pharmaceuticals and Bio-chemicals businesses. Two years ago, Kirin Beverage's operating income margin was 1.5%, but last year it increased to nearly 5%, which was above the target of 3% stipulated in the medium-term business plan. Our final goal is 10%, the global standard, and we will be undertaking initiatives to achieve that, including considering the possibility of business alliances. In the Pharmaceuticals and Bio-chemicals businesses, we aim to realize the core operating profit of 100 billion yen in 2020, and this will be a growth driver from the next year onwards. In the meantime, while we cannot provide details at the moment, we plan to share with you a new business plan centering on "health and well-being" in the near future.

Q: Do you mean that the growth driver for the next year will be the domestic business?

Isozaki: Not only will the pharmaceutical business drive our domestic business but we plan to generate half of its operating profit from the overseas market. We will also strengthen our businesses overseas, such as in Oceania and Myanmar.

<Japan Integrated Beverages Business>

Q: Is the revitalization of Kirin Brewery achievable realistically? Market share does not change very quickly in the consumer product market. Please provide more specific plans, including the volume and product mix targets that will be needed to revitalize the company.

Isozaki: There are three reasons why we are placing the highest priority on revitalizing Kirin Brewery. First, it is a highly profitable business. Secondly, it is the original business, on which our group was founded, and thus is the equivalent of the DNA of the Kirin Group. Thirdly, the business has a huge impact on the mindset of all Kirin Group employees.

The market for beer products has shrunk by nearly 30% compared to the peak sales recorded in 1994, and it has declined steadily by approximately 1% each year. The total volume of alcohol consumption has been diminishing due to the declining birth rate and an aging society, but the drop in consumption of beer products is higher than that of overall alcohol consumption, which we consider to be the result of a combination of different factors such as changing consumer values and tastes, as well as pricing, etc. In such a shrinking market, profitability would deteriorate were we to try solely to achieve an increase in sales volume. We will therefore aim to make beer more attractive to consumers by increasing brand equity through initiatives such as a full renewal of *Ichiban Shibori*, focusing on the craft beer segment so that we will be able to increase our profitability. Also, we will cut selling expenses. As you know, in Japanese beer market in the past, too fierce price competition in the shrinking market brought about huge sum of selling expenses. This year, however, we have revised our internal guideline, which makes Japanese matket as a whole shift toward increasing profitability. The final point relates to the shift in product categories. More specifically, we are aiming to increase our profitability given that consumers are increasingly changing their preference from beer products to RTDs, etc., while growing the highly profitable non-alcohol beer-taste beverage. These will be the drivers to put Kirin Brewery back on the track of growth.

Director in charge: The beer products market has been transforming significantly in recent times due to various factors, such as revisions to the relevant laws and diversifying consumer tastes. We will focus on achieving our beer product targets by centering on the *Ichiban Shibori* brand, but at the same time we will broaden our focus to include the low/non-alcoholic product market. We are currently witnessing a consumer shift toward different categories such as RTD, and this year we have accordingly set a total sales volume target for beer products, RTD, and non-alcohol beer-taste beverage exceeding that of the previous year. In addition to increasing the profitability of the beer products, it is critical to capture demand shifted among different categories. For example, the beer product market amounts to approximately 5 million kiloliters while that of RTDs is 1 million kiloliters. If 1% of the customers in the beer product category shift, that should result in a 5% increase of customers in the RTD category. We therefore aim to capture such consumers when they change their preferences. At the same time, in order to increase the profitability of the RTD category, in addition to reviewing raw material costs, etc., we will invest in brands more efficiently.

Q: How do you view the decline in sales volume for beer products during the first half of 2017?

Director in charge: Sales promotional opportunities were limited due to the gap in retail price between competitors and us by our revising internal guideline from January and to further increase in retail price in June, resulting in a decrease in sales volume. As for a demand decline, we do not believe that we can make a judgment based solely on the sales trend in June, and it would be premature to analyze the market trend too closely at this stage. We do not intend to revise our beer market forecast, but it is critical to continue to observe the market trend as it may change significantly, as well as to ensure that we compensate for the loss of the customer base in one category with a gain in another.

Q: As to *Ichiban Shibori*, sales activities have been activated through aggressive sales promotional activities that have been underway for several years to revive the brand. To what extent do you think the brand has enhanced its equity so far?

Director in charge: The sales volume has increased year-on-year for three consecutive years, thereby showing signs of recovery. The brand consideration rate has also been increasing, especially among consumers in their thirties, but there is still room for increase among people in their forties and above who constitute the primary consumers. We will revise our communication according to our target customers. We have given *Ichiban Shibori* a unique brand positioning. For the full-scale renewal, we employed a new brewing process to enhance the *Umami* of malt. We want to communicate this to as many people as possible through various measures including a large-scale sample distribution to around 3 million consumers.

Q: Please tell us about the concrete marketing strategies in place for Kirin Brewery to capture the younger generations who will be the main consumers in the future.

Director in charge: Our marketing strategy is based on a range of segments, such as age and drinking situation. As we primarily target consumers in their forties and above, it may appear that our focus is on increasing our presence among consumers in these age brackets, but we do have products in the RTD and functional categories targeted at young consumers. However, regarding marketing aimed at the younger generation, the main focus is on craft beer that is supported mainly by young consumers, which is also the case in Australia and other overseas markets. We will leverage brands such as *Spring Valley Brewery* and *Brooklyn Brewery* and will aggressively expand our touch points with young consumers through *Tap Marché*, etc.

Q: Selling expenses in Kirin Brewery have been estimated to increase by 0.7 billion yen on a full-year basis. What is your position on selling expenses?

Director in charge: The upward revision of 0.7 billion yen in the mid-year forecast is due to increased transportation costs; the total amount of advertising and sales promotional expenses remains unchanged from the start-of-year target. Revisions to the internal guideline have had a positive impact on reducing selling expenses. We will invest the amount thus saved in *Ichiban Shibori*, RTDs, and non-alcohol beer-taste beverage in order to grow our sales.

Q: What kinds of steps are you going to take to reduce selling expenses from next year on? Please also give us your views on the upward price revision.

Isozaki: Kirin Brewery's current operating income margin, excluding liquor tax, is 17-18%, while the global standard is over 20%. Our goal is to attain this level although it may not be achievable in the short term. Since it is difficult to increase sales volume in this shrinking market, an increase in profitability is determined mainly by the amount by which we can reduce selling expenses. We are undertaking initiatives to achieve that, if not by next year then as soon as possible. As to the price increase, the ongoing increase in retail prices is pushing down sales volume. We will give this careful consideration as we run the risk of losing the customer base to other categories.

Q: The definition of beer will change next year due to revisions to the Liquor Tax Act, and the sales volume of craft beer is expected to increase accordingly. What is your strategy under this circumstance?

Director in charge: We launched the craft beer business ahead of our competitors. It is currently showing a growth rate in the range of 10-20%, but the percentage of the segment in the overall beer market remains less than 1%. Our current target is to grow it to 3%. We don't think we can achieve this target by ourselves; we will therefore cooperate with other craft brewers through *Tap Marché*, etc. to activate the market. The most important thing is to communicate the value of craft beer as it is different from regular beer. For this, we need to generate touch points with consumers to enhance their understanding of the individual characteristics of each beer as well as their different tastes. So, our focus has been increasing touch points via bars and restaurants. We will step up our efforts to raise the recognition level of craft beer, and to convey its attractiveness to the younger generations in particular.

Q: Why is the market penetration of craft beer in Japan low compared to the United States? Where is the bottleneck? Is it because Japan doesn't have a consumer base for this segment?
Director in charge: There are market differences. In the United States and Australia, there are many small brewers who are passionate about craft beer and make it their life; they have a significant impact on consumers. Of course, those in charge of brewing in our company are passionate about their work, too. While it is important to increase coverage of retailers, we believe the only way to expand the market is to create more touch points with consumers where we show our passion for brewing and consumers get an idea of the personalities of the brewers. As part of such efforts, we will launch a new *Spring Valley Brewery* outlet in Kyoto next month.

Q: Please tell us your digital marketing strategies. What are you doing to increase the percentage of e-commerce? How do you see this change affecting the breakdown of sales promotional expenses in the future?
Director in charge: We have created a data management platform and have been accumulating data for mutual use among group companies. We also have an e-commerce channel of our own. Since the percentage of e-commerce is likely to increase in the future, we will accumulate knowledge and develop specific products and packaging to meet the demand. As to sales promotional expenses, we will continue to make prior investments. Alongside this, we will also focus on human resource development, including the recruitment of external talent.

Q: You touched upon business alliances; what is your future strategy for the non-alcoholic beverages business?
Isozaki: We are continuing our discussions with Coca-Cola Bottlers Japan, Inc. We realize it is difficult to survive in the Japanese beverages industry in isolation. Given that infrastructure costs are high in Japan, we will cooperate with other companies to address common issues and will subsequently reduce costs to improve profitability.

<Overseas Integrated Beverages Business>
Q: Lion Dairy and Drinks business is the only business, of those positioned as low profit businesses in the medium-term business plan, that has not shown any clear signs of recovery. What is your view on Lion Dairy and Drinks business given that one more year remains of the medium-term business plan?

Isozaki: Although this term it has suffered the impact of high raw material costs resulting from the high orange juice price, the business is nonetheless on a recovery track; the operating income margin has now improved to approx. 4.5% against the target of 5% stipulated in the medium-term business plan. Our final goal is to realize the global standard level of 7-8%. Meanwhile, interest in health and well-being in the Australian market has greatly increased, and the dairy and drinks business is attracting attention and thus has the potential for growth. We are currently conducting "The Goodness Project" in cooperation with the Australian government to tackle social issues such as the prevention of obesity. A big issue in the past was fluctuations in milk prices, but this situation has stabilized. Going forward, we will also aim to increase sales on top of cost-cutting.

Q: Consolidation has been occurring on a global scale. In light of that, how do you see the beverages market of the future, including both alcoholic and non-alcoholic beverages? How do you intend to position Kirin from that viewpoint?

Isozaki: One of our characteristics is that we have a unique business portfolio. When our domestic non-alcoholic beverages business was not profitable, we were asked why we were retaining the business in addition to the beer business, but we are no longer asked that question. We believe it is important to have both alcoholic and non-alcoholic beverages businesses so as to offer drink products for every generation. It is not easy to be such a giant beer company as Anheuser-Busch InBev or Heineken in the global market, so we will achieve our growth through our unique business portfolio. Not only do we have both alcoholic and non-alcoholic beverages businesses, we also have pharmaceuticals and biochemicals businesses, which is another unique strength that we will capitalize on.

Q: As to the Overseas Integrated Beverages business, the biggest factor in this year's profit increase has been the sale of Brasil Kirin. There will be not many factors for profit increase unless Lion Beer, Spirits, and Wine business grows in the future. Please tell us your forecast for Lion's beer business in the year ahead.

Director in charge: In the Australian market, the competitive environment continues to comprise two giants and our business has been strong, including a high level of sales at Easter. As to our post-ABI strategy, some brands have started to show significant results. We will increase the percentage of profitable categories such as craft beer, international premium, and contemporary, in order to achieve the EBIT level recorded in FY2016 over the next five years. As to the on-premise market, we have maintained our top position in terms of barrel products, and our sales and marketing strengths have not diminished. In the state of Victoria where we have a low market share, performance of a craft beer brand, *Furphy*, made of ingredients from Victoria has been strong, strengthening the craft beer category while advancing the CSV initiative. In the declining classic beer category, we intend to halt further decline by a sponsorship activity. Next month, in the category that is positioned between the classic and contemporary categories, Lion will launch a unique new product which is valued highly by our customers. Despite some concerns about the business because, for example, of increased energy costs, we hope to bring the business back onto a profitable track from the next year onwards through these initiatives.

<Financial strategy>

Q: Your free cash flow has been increasing. How big is your capacity for investment in opportunities for growth? Please give us a rough idea based on an optimal financial structure.

Ito: We have already realized free cash flow above the mid-term business plan target. Going forward, we will place a priority on investment for growth, and will determine specific details as we discuss the development of the next mid-term business plan. Regarding M&A, we will exercise financial discipline and will not buy any business at too high cost. In terms of the net DE ratio, the figure has declined to 0.47. However, after adjustment of cash from Kyowa Hakko Kirin, the figure is around 0.6. Since our target in terms of optimal financial structure is in the range of 0.4-0.5, we are approaching the right level. As to investment for growth, it will depend on the amount of cash anticipated from that investment. Considering that the net DE ratio was higher than 1.0 in the past, we believe we definitely have the ample capacity to invest.

<Pharmaceuticals and Bio-chemicals Business>

Q: I felt that your explanation on Kyowa Hakko Kirin was longer than usual. You said you would keep your equity in the company, but will you consider increasing it in the future?

Isozaki: At this point in time, we are not planning to increase our equity in the company. That is because the pharmaceuticals business is very specialized, and we think the company will be able to conduct its business activities, such as new drug development, more independently if it continues to be a listed company.