Q&A from Financial Results Briefing: Financial Results for 4Q of FY12/2019

Date and time: 10:00–11:30am, February 14 (Fri)

Speakers: Masaki Oga (President and Representative Director), Shinichi Soya (Managing Director), and Hideya Takashima (President of Sapporo Breweries Ltd.)

Alcoholic Beverages (Overall & outlook)

Q. How do you see business panning out in 2020, and how do you intend to boost sales and profit levels through to 2024?

Takashima: In addition to boosting overall profit in Japanese Alcoholic Beverages, we also intend to raise profit levels through sales in Canada and the US and exports. 2020 will be a turning point for us and we will be formulating measures so that we will be able to have a clear view of our future structure around the time of the beer category tax cut in October. More specifically, we aim to come up with some major retail strategies leveraging the 130th anniversary of Yebisu beer to boost year-on-year sales by 50%. Last year there were very few genuine touchpoints, but this year we plan to draw up measures one after the other. We are targeting certain periods before the tax cut, particularly Golden Week and the *Obon* holidays. Also, in conjunction with the provisional opening of the new Takanawa Gateway Station in Tokyo, we plan to implement a project focusing on "Japan" as a brand; we will be handling the beer side of things, while former professional soccer player Hidetoshi Nakata will be responsible for food and saké. After a solid four months of creating genuine touchpoints, we will expand our promotions to supermarkets and other retail stores. In the non-alcoholic beer-taste beverage market we will aim to generate profits that can outpace our targets.

Soya: We believe we will need to adopt supply chain measures in order to overcome anticipated significant cost increases in the Alcoholic Beverages business, mainly for transportation. Under our medium-term management plan, we aim to increase the core operating profit margin to 5%, but 5% is the hurdle for all core operating profit.

Q. What is your outlook for changes in the product mix ahead of the liquor tax revision set to take effect from October 1, 2020, and how did the market respond to the recent Gold Star launch?

Takashima: The shift away from beer and beer-type beverages toward RTD products is not letting up. The liquor tax revision will bode well for beer, but will negatively affect the new genre category. We anticipate a 2% year-on-year decline for non-alcoholic beer-taste beverages, while for the beer category we expect a year-on-year decline of slightly less than 1% and a decline of slightly above 1% for the new genre category. The happoshu category is also expected to decline.

Sales of Gold Star are going according to plan, but we cannot be optimistic because our competitors will also be launching products in the new genre category up ahead. It is crucial that we communicate to consumers the respective values of Mugi to Hop and Gold

Star as our top two products in the category. There is a possibility that the number of new products in the new genre category will continue to increase.

Food & Soft Drinks (Japan)

Q. You are targeting a 5% profit margin in the Food & Soft Drinks business by increasing the ratio of food products in the product mix, but what kind of measures do you plan to adopt to improve the profit margin? Do you have any plans for further investments or assigning of additional human resources?

Soya: It is important that we thoroughly distinguish between the categories in which to make fixed costs more variable and the categories in which we will invest in anticipation of future earnings growth. We will outsource products that are highly dynamic and invest in those that we feel have the potential for growth in order to recoup our spending over the long term. The percentage of products we manufactured ourselves was among the highest for all Japanese beverage companies, but from now on we must change as a company in order to boost profits. You could say that Sapporo Beverage was previously a “fabless” company. We also aim to achieve a 5% profit margin by transitioning to a portfolio with which we can more easily avoid risk.

Q. What are the issues concerning structural reforms to the vending machines sales channel and how much progress has been made so far?

Soya: Concerning the structural reforms to vending machines, large-scale changes will be announced as appropriate. As for current progress, we are continuing to withdraw vending machines from unprofitable locations. We are also considering a wide variety of other options.

Q. Mr. Soya, alongside structural reforms, how do you intend to lead Pokka Sapporo forward?

Soya: Regarding the Food & Soft Drinks business, there is no one word that can sum up Pokka Sapporo as it stands now. At present, the company has taken on the image of a jack-of-all-trades. It needs to have more of a focus, such as a clear association in people’s minds with lemon-based products. In order to sharpen its focus, it is vital that we drag the company into its own domain, narrow down the types of drinks it can produce, and then subsequently strengthen its food products. In the same way that craft brewers entered the market, the company has the advantage of being able to respond quickly because of its small size compared to its competitors.

Food & Soft Drinks (Overseas)

Q. How has the allocation of assets changed following the sale of the North American soft drinks business?

Soya: At one point in time the North American soft drinks business posted a loss of ¥2.0 billion, but had returned to profitability when we made the decision to divest it in order to avoid future business risks rather than simply improve earnings. Given that North America is a key market for the Group, we decided to first focus on alcoholic beverages even though we wanted to pursue both alcoholic and soft drink beverages in the region. The personnel, capital, and time drawn from the North American Soft Drinks business will now be allocated to the Alcoholic Beverages business. The impact on earnings may take some time to materialize, but in the meantime we intend to thoroughly shift our managerial resources.

General Management

Q. Regarding your Early Retirement Incentive Program, the company says it is anticipating structural reform costs of ¥5.5 billion. How many employees do you expect to take early retirement, and how will you use the capital saved through cost reductions?

Oga: Regarding the Early Retirement Incentive Program, we expanded our existing "second career" support system only for this year. It is important that we change our personnel evaluation system in order to achieve our medium-term management goals. And we also need to provide more future options in order to meet the needs of employees wanting to work until the age of 70. At the same time, there is no denying that many of our employees are of the generation that joined the company during Japan's economic bubble years. Since the decision to retire early is entirely up to the individual, we are unable to provide a figure. We will continue to address the matter thoughtfully.

Soya: We cannot say for certain roughly how many employees will take early retirement. As for the impact of the program, we expect it to decline from 2021 onwards. As for the amount saved through cost reductions, one of the company's issues is our high break-even point, and we hope to use the capital to lower this hurdle up ahead.

Q. Your interest-bearing debt level remains the same despite a significant reduction in assets following your withdrawal from the North American Soft Drinks business. How do you plan on reducing liabilities up ahead?

Soya: Although we gave up on pursuing a D/E ratio of 1.0, we think our current ratio of 1.2 is appropriate. The Japanese Alcoholic Beverages and Real Estate businesses have a lot of cash inflow, while the North American Alcoholic Beverages business and the restructuring of the food business involve considerable cash outflow. Sapporo Holdings will be managing cash flow with a high degree of discipline.

Q. Do you have any plans to allocate cash generated from the Real Estate business to shareholder returns?

Soya: There are a variety of different ways to deliver shareholder returns, and at this juncture, we are planning to deliver robust dividends to our shareholders.