Q&A from Teleconference Meeting: Financial Results for 2Q of FY12/2020

Date and Time: August 7 (Fri.), 13:30-15:00

Speakers:

Sapporo Holdings Limited: Masaki Oga (President and Representative Director) and Yoshihiro Iwata (Managing Director)

Sapporo Breweries Ltd.: Hideya Takashima (President and Representative Director)

Corporate expenses

Q. Approximately how much of the amount transferred to other operating expenses in the first half is attributable to each business? Please provide details.

Iwata: The total amount transferred was 3.4 billion yen, consisting of 2.6 billion yen attributable to the Alcoholic Beverages segment, which breaks down to 1.6 billion yen for alcoholic beverages (Japan/Asia) and 1.0 billion yen for restaurants; 0.4 billion yen attributable to the Food & Soft Drinks segment, and 0.4 billion yen attributable to the Real Estate segment. For Ginza Lion, in the restaurants business, the main items are personnel expenses and rent associated with temporary closure of restaurants. Also, a breakdown of the combined figure for Sapporo Breweries and Ginza Lion is 0.8 billion yen related to personnel expenses, 0.5 billion yen related to sales promotion expenses, 0.5 billion yen related to fixed costs connected with plant operating performance, 0.2 billion yen for disposal of inventories, and 0.6 billion yen mainly for rent in connection with temporary closure of facilities.

Q. How will you lower the break-even point on a group-wide basis going forward? You have indicated that you will proceed with closure of Ginza Lion restaurants. Isn't the burden of fixed costs a weakness in areas other than the restaurant business as well?

Iwata: Reflecting the COVID-19 situation, the nature of business travel and meetings is changing, and work style reforms are contributing to concrete cost control. Also, in the restaurant business we anticipate closure of 30 to 40 restaurants next year in addition to the closure of 15 this year. Moreover, we implemented a reorganization of Sapporo Holdings this spring and are transferring the logistics business and other operations to operating companies in order to boost efficiency. We want to take advantage of the benefits of this move next year and beyond. With regard to vending machines, we have reduced the number of machines from 76,000 at the end of 2019 to 72,000 as of June 30.

Takashima: Although we have strengthened the earnings structure beginning this year under a three-year plan, it is necessary to further accelerate reforms because of the COVID-19 crisis. In addition to personnel optimization using the Early Retirement Incentive Program and other means, we want to convert fixed costs in the restaurant business into variable costs.

Q. Specifically, what are the areas where you feel costs can still be reduced?

Oga: There are still things we have continued to do in the same way for 30 to 40 years. I consider it an important outcome that in these times, areas where we can still cut costs have come into focus.

Alcoholic Beverages (including restaurants)

Q. You mentioned that the restaurant business struggled in the first half and won't fully recover even in the second half. What sort of recovery do you envisage for next year? Taking the core operating profit of 14.0 billion yen in 2019 as the basis for comparison, how much of a recovery from the 2020 revised targets do you expect next year? Also, with the liquor tax revision coming up, what areas will be drivers leading up to next year?

Iwata: Although it's unclear what impact COVID-19 and the liquor tax revision will have in 2021, at this time we expect overall profit from beer and beer-type beverages to be approximately 92% of the 2019 level, roughly the same as this year. While the tax cut will lead to an increase in demand for beer for household consumption, the negative impact of COVID-19 on the restaurant business will be substantial. For 2021, we forecast profit from beer and beer-type beverages at approximately 87% of the 2019 level (approximately 106% of the 2020 level); profit from the new genre category at 97% of the 2019 level (95% of the 2020 level); profit from the RTD category at 117% of the 2019 level (104% of the 2020 level) due to anticipated outflow from the new genre category; and profit from commercial-use products category at approximately 70% of the 2019 level.

Takashima: In the beer sub-category of beer-taste beverages, profit from canned beer is currently at 95.3% of the 2019 level, while profit from Sapporo beer is at 99.3%, with Black Label, Yebisu, and Sapporo Classic providing a tailwind. There are places where Gold Star isn't yet well stocked on store shelves, and we consider this an opportunity. Also, we are relaunching Mugi to Hop. Since this will be a year of all-out competition for new genre products beginning at the time of the October 1 liquor tax decrease, we intend to take an aggressive posture. We are making preparations to enable us to secure shelf space going forward. Also, since there is little room for optimism about the restaurant business, we will strive to rigorously control costs.

Q. The forecast second-half profit decline of 3.2 billion yen for the restaurant business is even worse than the 2.1 billion yen decline in the first half. At the same time, you say that the topline will recover and you will proceed with store closures. What is your view on the balance between sales and profit?

Iwata: The impact of losses resulting from the COVID-19 crisis on first-half and second-half profit is substantial. We transferred 1.0 billion yen to loss in the restaurant business in the first half, and since we don't anticipate these losses to occur in the second half, this will result in a difference in the balance between sales and profit. We also recorded 0.4 billion yen in employment adjustment subsidies under other income.

Q. I think restaurant closures will result in short-term cost reduction in the restaurant business. What will you do to strengthen the business itself?

Oga: The link between beer as a product and restaurants as places to drink beer is important. This is no longer an era of competition to have the most outlets. It seems likely that the approach of opening similar restaurants in multiple locations in central Tokyo will no longer match people's lifestyles in the future. Also, it's not good to operate similar restaurants nationwide. Eating and drinking are local activities in the first place, and while a certain level of volume is necessary, we will examine and consider what sort of restaurants are necessary for Sapporo Group. It's important to create distinctive restaurants like Sapporo Beer Garden and our Ginza beer halls. Closure of restaurants that lack distinctive identities is unavoidable. We want to create a new style of eating out, including new restaurant formats.

Q. Gold Star still isn't stocked on shelfs at some retailers. How will you improve distribution? What is the current situation and future outlook?

Takashima: Gold Star has been well received by distribution channels in which it is stocked as a regular product, and we will make use of this data in sales activities. We will strongly emphasize in-store promotion over advertising. We intend to proactively secure shelf space through this approach.

Food & Soft Drinks

Q. You mentioned that the aim of structural reform of POKKA SAPPORO is to achieve profitability next year. Removal of unprofitable vending machines is an industry-wide trend. The company could once again go into the red if the situation doesn't return to how it was prior to the COVID-19 crisis. Do you have a strategy other than removing machines?

Iwata: In structural reform of the vending machine business, we are steadily proceeding with removal of unprofitable machines, partially in response to the COVID-19 crisis. With regard to the business as a whole, we plan to review the organization in autumn. We will increase the speed of decision-making by simplifying the organization through integration of the division in charge of vending machines and the over-the-counter sales team, and push ahead with reform.

Q. On the subject of the vending machine business, you mentioned that the number of machines was 72,000 as of the end of June. What is the ratio of machines installed indoors? Also, I think that there are locations, such as workplaces, where sales won't return to the prior level because of the impact of COVID-19. What is the outlook for the final number of machines?

Iwata: We are aware that the ratio of machines installed outdoors is higher than for the industry in general. Before the COVID-19 crisis, the main thrust was to change from outdoor to indoor locations. However, since the indoor-outdoor classification has lost importance due to the impact of telework and other factors, we will proceed while monitoring the situation. The number of vending machines was 72,000 as of the end of June. However, since there will be removals and new installations going forward, I can't really provide specific numbers. In general terms, we must consider the bottom 20% or so as unprofitable machines. Since some new installations offer good prospects for sales, notably partner company machines, we want to reduce losses by improving quality, not quantity.

Management, investment, and finance

Q. I have a question about the company's management stance. With the impact of COVID-19 expected to be prolonged, what areas will you prioritize going forward?

Oga: We will further strengthen businesses that are supported by customers as strengths of the company. Two businesses constitute Sapporo's backbone, namely beer and real estate, and we will clearly define strategies for these businesses. Also, it has become clear from the impact of COVID-19 that there remains room to further reduce costs. Costs will fall in the beer business, and although total demand may decline, things won't be worse than this year. Also, the fact that demand for beer for home consumption is increasing has convinced me that the beer industry is an industry desired by the public. It is no good if businesses have structures that do not prevent them from immediately falling into the red when something happens in the business environment. We will carefully manage cash and costs to be able to clarify whether to discontinue or reform such businesses.

Q. The plan is for capital expenditure to sharply decrease this year. How much capital expenditure will slip into next year due to the impact of COVID-19? Also, as you manage Sapporo Holdings going forward, what are your thoughts on investment next year and beyond and how will you raise the necessary capital resources? Financial liabilities will increase, and the EBITDA ratio will rise. What about the possibility of a capital increase?

Iwata: We are curbing capital expenditure this year, and the amount that will slip into next year is approximately 2.0 to 3.0 billion yen. Also, we have laid out the objective of fortifying our core businesses in the Medium-Term Management Plan, and the focus of investment will be the alcoholic beverages business, including overseas, the real estate business, and strengthening of the food business. With regard to the scale of investment, our policy is to fund investment cash flow from operating cash flow. Since operating cash flow is decreasing this year, we are currently discussing within Sapporo Holdings how to allocate investment. With EBITDA falling to about 10.0 billion yen this year, the EBITDA ratio will be about 10. However, we want to quickly restore the EBITDA multiple to 6, the level at the end of last year, by boosting earning power and increasing EBITDA itself.

Real Estate

Q. The occupancy rate of the main properties in the real estate business is 100%. With demand for offices and other properties fluctuating, what is the outlook? Also, what is the state of progress with negotiations to find a tenant after the closing of Ebisu Mitsukoshi? What is the company's view on the value of Ebisu?

Iwata: We expect no major change in the outlook for this year. However, the occupancy rate next year and beyond could decline a few percent due to the increase in telework. Since Ebisu Mitsukoshi will close in February of next year, we are currently in the process of finding a new tenant.

Oga: Looking at real estate as a whole, conditions are difficult for the market for commercial properties, such as restaurants and retail stores, and I think the rental business in some areas has been affected. However, there is little competition in Ebisu, and I think the impact is small. Also, although Ebisu Mitsukoshi will close, since value enhancement can be expected from revamping Ebisu Garden Place to keep it in step with the times, I think the real estate business still offers room for growth.