Management's discussion & analysis

In the Kirin Group 2016–2018 Medium-Term Business Plan (2016 MTBP), a ROE of 15% or more and a normalized EPS compound average growth rate of 6% or more have been set as quantitative targets and key indicators for measuring the revitalization of the Kirin Group through structural reforms. In addition, the reference value (guidance) at the time the quantitative targets are achieved is indicated by consolidated normalized operating profit. We are managing our business to achieve the three-year medium-term targets by achieving the profit plan for each single fiscal year.

Profit guidance seeks to achieve the plan by attaining the 2018 guidance (2020 guidance for the Pharmaceuticals and Bio-chemicals Businesses) and cost cut targets established for each business. Kirin will achieve the ROE target by raising the margin of profit attributable to owners of the parent through higher profitability of each business. At the same time, Kirin Holdings, Group headquarters, is selling assets and optimizing its business portfolio to generate free cash flow of over ¥260.0 billion, the three-year target. Based on a consolidated payout ratio of 30% or more of normalized EPS, free cash flow will be set aside to provide stable shareholder returns and to repay interest-bearing debt. This will increase financial flexibility and provide for future growth investment.

2016 Medium-term business plan initiatives to improve ROE

	ROE	=	Improve profitability	×	Increase asset efficiency	×	Control leverage
			Margin of profit attributable to owners of the parent		Asset turnover ratio		Financial leverage
	2015 2018 -0.3% → over 15%		2015 2018 -0.1% → over 5.5%		2015 2018 0.85 → approx. 0.91		2015 2018 3.09 → approx. 3.0
Group Initiatives			● Optimize resource allocation ● Streamline HQ		● Prioritize capex allocation ● Consider further optimization of business portfolio/asset sales		● Enhance financial flexibility
Operating Business Initiatives			● Increase profits by improving product mix and brand power ● Cut costs to raise competitive power (overall Group cost cuts of ¥30 bn planned) ● Raise production efficiency		● Reduce inventories to improve working capital ● Consider further asset sales		

Fiscal 2017 progress

In fiscal 2017, the second year of the 2016 MTBP, Kirin Holdings managed its businesses based on the above-mentioned MTBP policy and achieved better-than-expected results. Each business steadily improved profitability to achieve guidance for 2018 (or 2020), cost cut measures steadily produced results for the entire Group, and consolidated normalized operating profit increased ¥12.3 billion (up 6.8%) from the previous year to ¥194.3 billion. Cost cut initiatives achieved the 2016 MTBP target of ¥30.0 billion one year ahead of schedule. In addition to deciding to sell Brasil Kirin, which is positioned as a low-profit business, and completing the share transfer in May, the Group's structural reforms progressed faster than the 2016 MTBP originally expected thanks to management measures to liquidate non-core assets including property, plant and equipment.

These measures generated free cash flow of ¥284.9 billion, achieving our three-year free cash flow generation target one year ahead of schedule. The repayment of interest-bearing debt significantly exceeded the MTBP target, raised the equity level by increasing profits, and sufficiently enhanced our financial flexibility.

Cost cutting progress (Billions of yen)

Operating companies	2016 actual	2017 actual	2016–2017 total
Kirin Brewery	7.2	2.7	9.9
Kirin Beverage	6.1	1.7	7.8
Brasil Kirin (Sold in 2017)	7.2	1.2	8.4
Other	4.5	3.4	7.9
Total	25.0	9.0	34.0

1) Consolidated statement of profit or loss

Revenue

Consolidated revenue including liquor taxes increased by ¥9.8 billion (up 0.5%) to ¥1,863.7 billion (an increase of ¥16.4 billion [up 1.1%] to ¥1,574.3 billion excluding liquor taxes). Broken down by segment, revenue of Japan Integrated Beverages decreased by ¥10.6 billion, Overseas Integrated Beverages increased by ¥20.1 billion, and Pharmaceuticals and Bio-chemicals increased by ¥5.3 billion. However, Overseas Integrated Beverages was affected by foreign exchange rates (+¥20.1 billion), as well as a revenue increase of a soft drinks business subsidiary in the United States due to its acquisition of a manufacturing and sales business in the territories adjacent to its own.

In Japan Integrated Beverages, Kirin Brewery revenue declined by ¥8.4 billion (a ¥1.0 billion decrease excluding liquor taxes) due to declining sales volume for beer products (down 4.2%), while Kirin Beverage revenue decreased by ¥6.8 billion due to declining sales volume for non-alcoholic beverages (down 2.2%) as a whole.

In Overseas Integrated Beverages, Lion revenue decreased by ¥8.9 billion. Lion Beer, Spirits, and Wine business sales volume declined (down 10.5%) due to the conclusion of the ABI brand distribution agreement in Australia in September 2016, and declining sales volumes due to the sale of the Australian wine business to focus its resources on the beer business. Revenue declined ¥15.1 billion, which includes the impact of the foreign exchange rate on consolidation of +¥11.5 billion. On the other hand, if we exclude the impact of the ABI brand loss and wine business divestiture, revenue remained in line with that of the previous fiscal year on a local currency basis. In the Lion Dairy and Drinks business, sales volume declined (down 3.0%) in the juice and drinks category due to a surge in orange juice prices that resulted in a decrease in overall sales volume. Revenue increased by ¥6.1 billion, which included the impact of the foreign exchange rate on consolidation of +¥9.0 billion. Even including the ¥(1.8) billion foreign currency effect, Myanmar Brewery revenue increased by ¥3.0 billion thanks to higher sales volume (up 17.1%), as well as the effects of price hikes carried out in fiscal 2016 and 2017.

Kyowa Hakko Kirin's Pharmaceuticals and Bio-chemicals businesses recorded a revenue increase of ¥5.3 billion thanks to a significant boost from higher technology licensing revenue in the overseas market in the Pharmaceuticals Business.

Normalized operating profit

Consolidated normalized operating profit increased by ¥12.3 billion, and Group profitability improved as the profit growth rate (6.8%) exceeded the revenue growth rate. Operating profit margin to revenue improved from 9.8% in fiscal 2016 to 10.4% (revenue excluding liquor tax rose from 11.7% to 12.3%). The status of each business is as follows.

Japan Integrated Beverages

Kirin Brewery's normalized operating profit increased by ¥0.6 billion to ¥71.6 billion. In January 2017, after revising its trading conditions for beer products and reducing sales promotion expenses associated with beer product sales, retail prices remained higher than those of competing products until the end of May in retail channels. In June, due to a further increase in retail prices caused by the revision of the Liquor Tax Act, and the effects of unseasonable weather from summer through autumn, the sales volume of beer products as a whole declined 4.2%. As a result, the marginal profit of beer products decreased by ¥7.7 billion, but marginal profit increased by ¥5.0 billion due to an increase in RTD sales volume (up 8.4%) and an increase in non-alcohol beer-taste beverage sales volume (up 58.7%). Marginal profit as a whole increased by ¥0.6 billion due to a ¥3.3 billion increase in marginal profit owing to difference of change in composition of products (including an improvement in the marginal profit per liter through the reduction of sales promotion expenses related to beer sales). Advertising expenses increased ¥2.0 billion due to the renewal of *Ichiban Shibori*, but fixed sales promotion expenses decreased ¥2.4 billion (including a reduction in sales promotion expenses for beverage channels due to a review of beer trading conditions). Raw material costs decreased ¥2.6 billion due to cost cutting initiatives, which offset the increase in distribution

2018 and 2020 guidance progress for each business

Strengthen profit foundation of the beer business		2018 guidance
Kirin Brewery	Normalized operating profit margin 19% (excluding liquor tax)	OPM: 7%+
Lion Beer, Spirits, and Wine	No. 2 market position after loss of ABI brands	Maintain market position
	Normalized OP margin approx. 28%	Maintain high OPM
Myanmar Brewery	Market share of approx. 80% maintained	Maintain market position
	Production capacity improvements to be completed before the 2018 peak demand period	Capture share of market growth fields
Restructure and revitalize low-profit businesses		**2018 guidance**
Brasil Kirin	Transfer of all stocks is complete	Pave the way for a positive turnaround in 2019
Kirin Beverage	Normalized OP margin is 8%, significantly above guidance	OPM: 3%+
Lion Dairy & Drinks	Normalized OP margin approx. 4%	OPM: 5%+
Invest to achieve outstanding growth in Pharmaceuticals and Bio-chemicals businesses		**2020 guidance**
Kyowa Hakko Kirin	Good progress achieved in developing global strategic products	Core operating income: 100 billion yen+

costs and other expenses. The normalized operating profit margin on revenue excluding liquor tax was 19.2%, already exceeding the operating profit margin (J-GAAP) of 17%, the guidance for 2018.

Kirin Beverage's normalized operating profit increased a substantial ¥4.4 billion to ¥21.7 billion. Marginal profit declined ¥2.4 billion due to a decrease in sales volume (down 2.2%), but thanks to an increase in the sales volume of *Gogo-no-Kocha* and *Nama-cha*, the difference of change in product mix and composition ratio of containers improved and marginal profit increased ¥3 billion, with marginal profit increasing by ¥0.6 billion overall. The normalized operating profit margin improved to 7.6%, far exceeding the 3% operating profit margin (J-GAAP), which was the 2018 guidance. This was largely due to a ¥2.8 billion reduction in raw material expenses stemming from cost cutting effects.

Overseas Integrated Beverages

Lion Beer, Spirits, and Wine Business' normalized operating profit decreased due to the loss of the ABI brands. The profit impact of a sales volume decrease (down 10.5%) was A$122 million, but a A$77 million increase in profits due to unit price and mix improvement owing to price increases, an increase in sales volume in focus categories, and other cost decreases, resulted in normalized operating profit of A$632 million, down A$51 million. Normalized operating profit, which excludes the impact of the loss of the ABI brands, remained in line with that of the previous year, and the normalized operating profit margin of 27.9% enabled the Company to maintain high profitability. Normalized operating profit, after conversion to yen, came to only ¥0.9 billion due to a positive exchange rate effect of ¥3.2 billion.

The Lion Dairy and Drinks Business was affected by soaring orange juice prices, but because the inventory revaluation conducted in October 2016 pushed normalized operating profit downward in the previous fiscal year, normalized operating profit remained unchanged with that of the previous fiscal year. The impact on profits of a decrease in sales volume (down 3.0%) was A$22 million, but was offset by A$23 million, including unit price and mix improvement effects, due to increased sales volumes in focus categories. Normalized operating profit, after conversion into yen, increased ¥0.5 billion, including a consolidated foreign exchange effect of +¥0.3 billion.

Myanmar Brewery's normalized operating profit increased 18.3% on a local currency basis. Although the product mix deteriorated due to a sharp increase in sales volume in the economy category, the increase in sales volume, the effects of price hikes in fiscal 2016 and 2017, and cost cutting initiatives had a positive effect. As the impact of foreign exchange rate on consolidation was ¥(0.7) billion, normalized operating profit, after conversion to yen, increased ¥0.9 billion to ¥9.9 billion.

Pharmaceuticals and Bio-Chemicals

Kyowa Hakko Kirin's normalized operating profit increased by ¥10.7 billion (up 20.9%) to ¥62.2 billion. In the Pharmaceuticals Business, profits increased ¥9.1 billion due to higher gross profit from higher technology licensing revenue in the overseas business, and a decrease in R&D expenses. In the Bio-chemicals Business, profit rose by ¥1.6 billion due to a more highly profitable sales mix.

Profit attributable to owners of the parent

Equity in earnings of affiliates increased by ¥9.6 billion due to strong performance of San Miguel Beer, as well as an increase in normalized operating profit. Furthermore, structural reforms progressed at a faster pace than initially anticipated due to the sale of Brasil Kirin, which was positioned as a low-profit business, and the liquidation of non-core assets. Profit from discontinued operations increased by ¥76.8 billion due to tax effects associated with the transfer of Brasil Kirin shares, resulting in a ¥93.1 billion rise in profit.

The margin of profit attributable to owners of the parent in fiscal 2017 reached 13.0% due to a one-time increase in earnings on progress made in structural reforms, but the improved profitability for each business excluding this effect was nearly in line with progress made in the 2016 MTBP.

The tax rate in fiscal 2017 was 22.2%. This was attributable to the effects of non-amortization of goodwill and brands following the adoption of IFRS, a reduction in the statutory tax rate in Japan, an increase in investment profit accounted for by the equity method, and other factors. There were no tax effects associated with the sale of Brasil Kirin included in profit from discontinued operations.

2) Consolidated cash flow status and financial strategy progress

Operating cash flow was ¥221.7 billion, investing cash flow came to ¥63.2 billion, and free cash flow was ¥284.9 billion. This was attributable to the improved profitability of each business, progress made in structural reforms including the sale of Brasil Kirin, and the liquidation of non-core assets.

The Company allocated ¥45.9 billion for shareholder returns (dividends) based on a consolidated payout ratio of 30% or more of normalized EPS, and ¥147.3 billion for interest-bearing debt repayment. As a result, the repayment of interest-bearing debt over the two-year period came to ¥258.3 billion, exceeding the target of ¥135.0 billion in the 2016 MTBP. Interest-bearing debt, as of the end of fiscal 2017, was ¥486.5 billion.

3) Consolidated statement of financial position

Assets

Total assets decreased ¥23.7 billion to ¥2,399.1 billion (compared with ¥2,422.8 billion at the end of the previous fiscal year). Property, plant and equipment decreased ¥82.0 billion on the sale of Brasil Kirin, which was a wholly owned subsidiary, as well as the reduction of assets by selling off the brewery site and other property, plant and equipment. Because of that and other factors, non-current assets decreased by about ¥120 billion. This amount included over ¥40 billion that had been transferred to current assets due to the transfer of Kirin Amgen shares (gain on sale of equity-accounted investees), which was recorded in non-current assets. The shares were transferred in the first quarter of 2018. Capital expenditures came to ¥85.9 billion, which was lower than the ¥89.9 billion in fiscal 2016, and the timing and amount of investments for nonessential and nonurgent items were reviewed and kept within plan.

As mentioned above, revenue increased ¥9.8 billion, but since it was lower than the 2016 MTBP expectation based on J-GAAP, the asset turnover ratio remained at 0.77. Factors behind the decline in revenue compared to the 2016 MTBP included a deduction of sales promotion expenses linked to sales from revenue due to the adoption of IFRS from fiscal 2017, the sell-off of Brasil Kirin, the conclusion of ABI brand distribution in Australia by the Lion Beer, Spirits, and Wine Business, and a decrease in domestic beer product sales volume.

Equity and liabilities

Profit of ¥242.1 billion, which increased significantly due to the improvement of profitability and structural reforms, contributed to the increase in retained earnings, and total equity (excluding non-controlling interests and treasury shares) increased ¥251.9 billion to ¥955.9 billion (¥704.0 billion as of the end of fiscal 2016).

Financial leverage declined to 2.9 and the debt-equity ratio dropped to 0.51 (1.14 at the end of fiscal 2015) due to progress in reducing assets and repayment of interest-bearing debt, which exceeded the target of the 2016 MTBP, and financial flexibility improved.

4) Quantitative target progress and shareholder returns

ROE was 29.1% due to a margin of profit attributable to owners of the parent of 13.0%, including one-time factors. Although adjustments excluding non-recurring items (profit from discontinued operations due to the transfer of Brasil Kirin shares, and other operating income and expense after taxes and other adjustments) were

	2015 results	2016 results	2017 results	2018 forecast
ROE (%)	- 0.3	22.0	29.1	16.0
Margin of profit attributable to owners of the parent (%)	- 0.1	8.0	13.0	7.9
Asset turnover ratio (Times)	0.85	0.77	0.77	0.82
Financial leverage (Times)	3.1	3.4	2.9	2.5

made, normalized EPS increased ¥12 (8.6%) to ¥151.

Shareholder returns (dividends) were ¥46, an increase of ¥7 per share, based on a consolidated payout ratio of 30% or more for normalized EPS. We therefore expect to allocate ¥54.0 billion from free cash flow to dividends in fiscal 2018. However, due to the expected cash inflow from the transfer of Kirin Amgen shares, we decided to conduct an own-share repurchase with a maximum of ¥100.0 billion as an additional shareholder return.

Outlook for fiscal 2018

In fiscal 2018, we expect an operating cash flow of ¥230.0 billion. This amount will be used for investment cash flow, repayment of interest-bearing debt with repayment deadlines, and shareholder returns, including the above-mentioned own-share repurchase.

Regarding capital expenditures, we will allocate resources according to the positioning of each business while limiting the total amount based on the 2016 MTBP financial strategy. In 2018, we plan ¥98.0 billion in capital expenditures, but expect a positive investment cash flow of ¥10.0 billion, which includes the cash inflow from the sell-off of Kirin Amgen shares. We expect interest-bearing debt repayment of ¥80.0 billion, and shareholder returns of ¥154.0 billion, which include dividends of ¥54.0 billion and the own-share repurchase of ¥100.0 billion. As a result, an ROE of 16.0% is forecasted.

Profit attributable to owners of the parent is expected to decline due to a decrease in profit from discontinued operations, which increased in fiscal 2017 on the sale of Brasil Kirin. However, the expected decline of both revenue and normalized operating profit in Pharmaceuticals and Bio-chemicals should be covered by increases in other businesses.

Our policy is to maintain an appropriate capital structure considering the balance between cost of capital and financial flexibility while enhancing our capacity to generate cash through profit growth.

Future cash allocation policy

Our cash allocation policy after FY 2019 will be determined by the financial strategy of the next medium-term business plan, but our priority will be to first invest in growth opportunities, and then return profits to shareholders after repaying interest-bearing debt with repayment deadlines. As growth investment targets, we will continue to explore opportunities in Southeast Asia, as well as the area of "health and well-being" as future drivers of growth. We will also take a disciplined approach to future investments.

In the years ahead, we will boost investment in human capital, brands, R&D, and supply chain and IT, which are intangible assets that support the Group's sustainable growth. (Please see pages 17 – 20).