Management Analysis of Financial Position, Operating Results, and Cash Flows

1. Operating Results

Overall business conditions

The Kirin Group aims to be "A global leader in CSV, creating value across our world of Food & Beverages to Pharmaceuticals." The Group's business activities in 2019 were guided by the Kirin Group Medium-Term Business Plan 2019–2021 (2019 MTBP).

The Japan Beer and Spirits Businesses, Japan Non-alcoholic Beverages Businesses, and Oceania Integrated Beverages Business focused on advancing strategies to consolidate their core brands. Japan faced a challenging business environment during the year, which included an unseasonably cool summer, natural disasters, and an increase in the consumption tax. In this environment, Kirin Brewery in Japan Beer and Spirits Business and Kirin Beverage in Japan Non-alcoholic Beverages Businesses posted sales growth that outpaced the market growth. The Oceania Integrated Beverages Business prepared the foundation for future growth in the alcoholic and non-alcoholic beverage businesses by deciding on the buyer for its non-alcoholic operations. The Pharmaceuticals Business boosted its ability to generate cash by enhancing the value of its three strategic global products.

The Kirin Group also focused its unique strengths on developing products for the Health Science domain to be in position to pursue opportunities for business growth that emerge from social issues and the highly unpredictable business environment. In addition, during 2019, Kirin Holdings acquired Kyowa Hakko Bio from Kyowa Hakko Kirin and made it direct subsidiary in April and concluded a capital and business alliance agreement with FANCL Corporation in August. The Company also continued to revise its cross-shareholdings and in November determined to repurchase up to 100 billion yen of its own shares to enhance shareholder returns.

(Billions of yen)

	Fiscal 2019	Fiscal 2018	Increase (decrease)	Increase (decrease)
Consolidated revenue	1,941.3	1,930.5	10.8	0.6%
Consolidated normalized operating profit	190.8	199.3	(8.6)	(4.3%)
Consolidated operating profit	87.7	198.3	(110.6)	(55.8%)
Consolidated profit before tax	116.8	246.9	(130.0)	(52.7%)
Consolidated profit attributable to owners of the Company	59.6	164.2	(104.6)	(63.7%)
(Key performance indicators)				
ROIC*1	5.2%	12.0%		
Normalized EPS	158 yen	167 yen	(9 yen)	(5.4%)

*1 ROIC for 2018 has been retroactively adjusted due to a change in the accounting policy.

KPI Targets*2 in Plan 2019 MTBP

Performance Indicator	2019 MTBP Targets	2019 Actual
ROIC	10% or higher	5.2%
CAGR of normalized EPS	5% or higher	160 yen

*2 The attainment assessments for the financial targets are intended to provide a performance evaluation that factors out the impacts from currency fluctuations when converting financial statement items from overseas subsidiaries for the fiscal year. As such, the actual result figures have been replaced by amounts adjusted to exclude the impacts from foreign currency conversions and other factors.

The outcome of these strategies and conditions was growth in overall revenue in fiscal 2019 driven by increased sales in the Japan Non-alcoholic Beverages Business and Pharmaceuticals Business. Normalized operating profit declined overall as profit growth in the Japan Beer and Spirits Business and Japan Non-alcoholic Beverages Business and increased profits in the Pharmaceuticals Business from growing sales of global strategic products were offset by factors including reduced contribution from the Oceania Integrated Beverages Business owing to a highly competitive environment and the foreign exchange impact. Operating profit declined sharply as a result of the impairment loss booked in association with the fair value assessment of business assets as part of the transfer of a beverage operation of the Oceania Integrated Beverages Business. Profit before tax and profit attributable to owners of the Company also decreased substantially owing to the decreased operating profit and the high figure in the previous fiscal year from the gain on sale of shares from the transfer of Kirin Amgen shares.

Among the key performance indicators, ROIC declined significantly from the previous fiscal year. However, the decline is largely attributable to the temporary factors of the impairment loss in the Oceania Integrated Beverages Business booked during the year and the gain on sale of Kirin Amgen shares in the previous fiscal year. The actual ROIC result when adjusted for these factors gave us the confidence to continue working to improve the efficiency of invested capital and to set the 2019 MTBP target to ROIC of 10% or higher. In addition, we calculate weighted average cost of capital (WACC) for the Kirin Group to be near 6%, and we will aim to raise the level with ROIC at a minimum of 10% and continue to improve the efficiency of our investments into the long term. Normalized EPS declined from last year and, while each business made different degrees of progress, we are generating profit in line with our plan. With the added boost from the share buyback program, we progressed as expected in the first year of the medium-term business plan. We are continuing to build our corporate value toward achieving the targets of the 2019 MTBP.

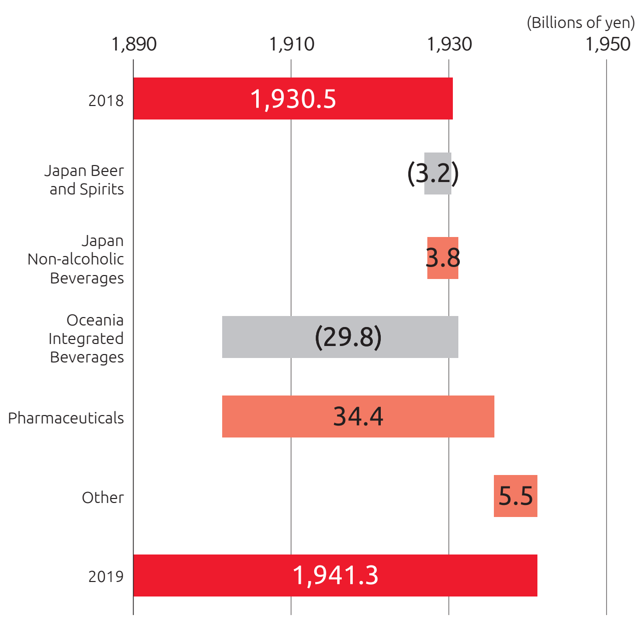
Performance by reportable segments

Results by segment are as follows.

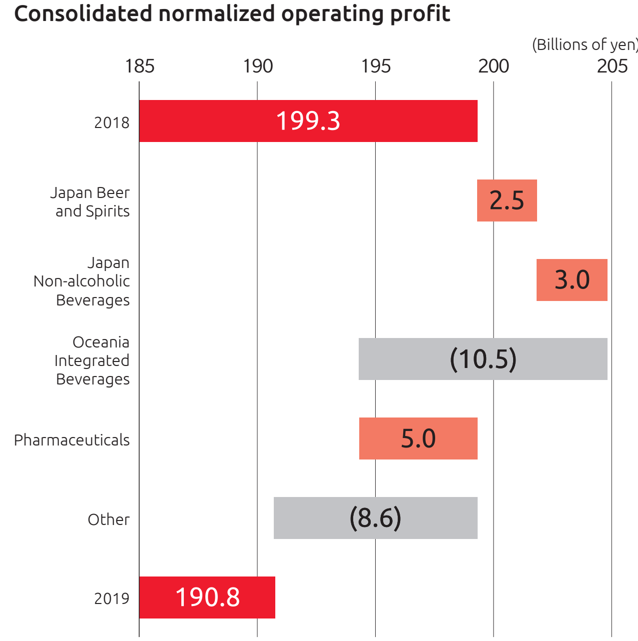
(Billions of yen)

	Fiscal 2019	Fiscal 2018	Increase (decrease)	Increase (decrease)
Consolidated revenue	1,941.3	1,930.5	10.8	0.6%
Japan Beer and Spirits	681.9	685.1	(3.2)	(0.5%)
Japan Non-alcoholic Beverages	286.8	283.0	3.8	1.4%
Oceania Integrated Beverages	299.7	329.5	(29.8)	(9.0%)
Pharmaceuticals	304.9	270.4	34.4	12.7%
Other	368.0	362.5	5.5	1.5%
Consolidated normalized operating profit	190.8	199.3	(8.6)	(4.3%)
Japan Beer and Spirits	85.2	82.7	2.5	3.0%
Japan Non-alcoholic Beverages	26.4	23.3	3.0	13.0%
Oceania Integrated Beverages	41.4	51.8	(10.5)	(20.2%)
Pharmaceuticals	55.4	50.4	5.0	9.9%
Other	(17.5)	(8.9)	(8.6)	-

Consolidated revenue



Consolidated normalized operating profit



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• Japan Beer and Spirits Business

Kirin Brewery deepened each employee's customer understanding and implemented consistent marketing across advertising and in-store displays. The company concentrated investment on its leading brands and continued to construct a robust brand portfolio geared to 10 years in the future.

The company's continuing focus on promoting its flagship *KIRIN ICHIBAN* brand helped generate a 3% year-on-year increase sales volumes for the year, extending the volume growth to three straight years. In the new genre category, sales of the *Honkirin* brand surged 60% year on year. The strong results enabled Kirin Brewery to increase beer sales volume for a second straight year even as the contraction in the overall domestic beer market extended to a 15th year. The company also successfully expanded the market for craft beer with the aim of creating a new beer culture in Japan. The number of stores that have installed Tap Marché beer dispenser units roughly doubled from the previous fiscal year to 13,000. As part of our CSV Commitment to community engagement, we worked with craft breweries across Japan to raise the value of Japanese hops and revitalize the craft beer market. In the ready-to-drink (RTD) category, sales were strong for the three core products *Kirin Hyoketsu®*, *KIRIN The STRONG*, and *Kirin Honshibori™ Chuhai*, and overall RTD category sales grew 6.3% year on year.

Japan Beer and Spirits Business posted overall revenue of 681.9 billion yen for the year, representing a year-on-year decline of 0.5%. The higher ratio of new genre and RTD products from the increase in demand for those products more than offset the boost from the 0.3% increase in beer sales volume. Normalized operating profit grew 3.0% to 85.2 billion yen. Although marginal profit declined from the lower ratio of beer product sales and variable costs increased from the sharp rise in logistics costs, the company successfully reduced selling expenses and controlled fixed costs while increasing sales volume.

• Japan Non-alcoholic Beverages Business

Kirin Beverage is aiming to generate profits through business growth, and made progress fortifying its business base during the year toward establishing a robust brand portfolio and improving its logistics system. Sales volume of the core *Gogo-no-Kocha* brand rose 9% year on year to 55.4 million cases, supported by strong releases for *The Meister's Milk Tea* in March 2019 and the revamped *Oishii Muto* (sugar-free) in June. Sales volume grew 4% for *FIRE* brand coffee led by the new *One Day Black* offering released in April, but fell 3% for *Nama-cha* tea, mainly due to the price revisions for large PET bottle products in May. With an eye to the future, the company also began the nationwide rollout of KIRIN naturals, a new business model in the health and well-being domain.

The increased sales volume helped the Japan Non-alcoholic Beverages Business raise revenue 1.4% year on year to 286.8 billion yen. The company boosted normalized operating profit by 13.0% to 26.4 billion yen by offsetting the impact from sharply higher logistics costs with increased revenue and efficient advertising spending.

• Oceania Integrated Beverages Business

Lion concentrated its investments in the Beer, Spirits and Wine segment on developing its leading brands and enhancing its brand power in growth categories. These activities boosted sales volumes of *FURPHY* and *IRON JACK* products, but normalized operating profit fell a steep 58 million Australian dollars on a local currency basis due to intensified sales offensives by rivals in the first half as well as increased promotional spending and supply chain management costs. At the same time, the company continued to invest in craft beer and premium crafted adult beverages. Lion has been taking concrete steps to expand its global craft beer business in the past two years. In the United Kingdom, the company acquired Fourpure Brewing Co. in 2018 and made Magic Rock Brewing Co. a full subsidiary in 2019. In the United States, Lion reached a definitive agreement to acquire New Belgium Brewing Co. in 2019.

In the Dairy and Drinks Business, sales were strong for Lion's leading *Dare* brand offerings. However, unseasonable weather, including a drought, adversely impacted the price and disrupted supply of raw milk, led to a sharp drop in normalized operating profit, to 42 million Australian dollars on a local currency basis.

During the year, Kirin and Lion continued preparations to sell Lion's Dairy and Drinks Business in accordance with the decision in fiscal 2018 that selling the business was the best strategy for its future growth. In October 2019, Lion's specialty cheese business was sold to Saputo Inc., a leading Canadian dairy company, and in November, the milk, milk beverage, yogurt, and fruit juice businesses were sold to a subsidiary of China Mengniu Dairy Company.

These developments during the year led to declines in both sales and profits on a local currency basis for the Beer, Spirits and Wine Business and the Dairy and Drinks Business. A weaker Australian dollar versus the yen compared the previous year further led to the Oceania Integrated Beverages Business recording overall declines of 9.0% year on year to 299.7 billion yen in revenues and 20.2% to 41.4 billion yen in normalized operating profit.

• Pharmaceuticals Business

Kyowa Kirin entered a new phase where it is making the leap to a Global Specialty Pharmaceutical Company and started putting in place its One Kyowa Kirin management structure based on a dual-axis matrix with a regional axis of Japan, EMEA (Europe/Middle East/Africa), North America, and Asia/Oceania and a functional axis of drug product categories.

During the year, the company boosted sales substantially in the United States and Europe, driven by strong sales growth for *Crysvita* and *Poteligeo*. The company also released *Nourianz* in the United States in October 2019 and is now marketing three global strategic products in the United States and Europe. Sales in Japan were impacted by diminishing sales of long-listed drugs and the patent expiration of *NESP*, while sales were strong for *G-Lasta*, *Orkedia*, and other new products. The company also continued to make steady progress with its drug pipeline.

The solid growth in overseas pharmaceutical sales helped Kyowa Kirin post overall revenue growth of 12.7% year on year to 304.9 billion yen. Normalized operating profit increased 9.9% to 55.4 billion yen as the sales growth outpaced the rise in selling, general and administrative expenses associated with establishing the sales structure overseas and the increase in R&D spending to fortify the drug pipeline.

Performance results of operations in the Others category are described below.

Mercian

Mercian Corporation worked on improving profitability during the year by focusing on strategies for key brands in its wine categories. Domestic sales were strong for *Château Mercian*, with sales volume growing 20% from the previous year. In September 2019, the company opened the new Mariko Winery in Ueda City, Nagano Prefecture, creating a new venue for fulfilling its key CSV issue of community engagement. The company also expanded the shelf-presence of its brand with the positively received new *Wine Cidre* product featuring no added antioxidants. Sales of the company's core wine brands were generally strong; however, the impact from the Japan-Europe Economic Partnership Agreement and reduced Chile wine sales led to overall wine sales volume contracting 5% from the previous year. Mercian Corporation ultimately posted year-on-year declines of 1.4% in revenue to 63.9 billion yen and 15.5% in normalized operating profit to 2.2 billion yen.

Myanmar Brewery

The beer market in Myanmar is rapidly expanding as the country's economic growth is creating a larger population of alcohol consumers and more frequent consumption. Myanmar Brewery implemented several initiatives focused on advancing CSV, marketing, and management systems. Management's focus on investing to develop the flagship *Myanmar Beer* brand and the economy category *Andaman Gold* brand helped generate a 20% year-on-year rise in sales volume. The company recorded overall year-on-year growth of 24.4% in revenue to 32.6 billion yen and 27.8% in normalized operating profit to 12.9 billion yen.

Coca-Cola Beverages Northeast

After broadening its geographic business domain and completing the factory reorganization begun in 2018, The Coca-Cola Bottling Company of Northern New England rebranded the company as Coca-Cola Beverages Northeast and unified its operations behind a new philosophical framework. Strong sales of carbonated water and other products boosted sales volume. At the same time, restructured business processes and comprehensive structural reform reduced costs and improved profitability. These efforts enabled the company to post overall year-on-year growth of 0.6% in revenue to 132.6 billion yen and 86.0% in normalized operating profit to 5.3 billion yen.

Kyowa Hakko Bio

Kirin Holdings acquired a 95% stake in Kyowa Hakko Bio from Kyowa Kirin in April 2019 with the aim of maximizing the value of Kyowa Hakko Bio and enabling Kyowa Kirin to concentrate its management resources on the Pharmaceuticals business. Kyowa Hakko Bio posted strong sales of amino acids for fish feed in the fine chemicals business and of *Citrulline Zn* in the consumer products business. The company also expanded its product lineup by launching a supplement (foods with function claims) business and adding the new *iMUSE for eye* product featuring KW lactic acid bacteria developed by the Kirin Group.

Kyowa Hakko Bio also acted on the U.S. Food and Drug Administration's notification about an inadequate response to quality management and data integrity issues at the Hofu Plant in 2018 by revising the plant's quality control system. In September 2019, the company voluntarily halted all manufacturing and shipment operations to verify product safety after its investigation discovered that certain manufacturing processes differed from the originally authorized processes. In December 2019, the company received an administrative disposition from Yamaguchi Prefecture to halt operations at the Hofu Plant and a business improvement order. Kyowa Hakko Bio ultimately posted year-on-year declines of 4.2% in revenue to 74.9 billion yen and 71.4% in normalized operating profit to 2.3 billion yen.

The Kirin Group is taking this situation with the utmost seriousness and has assembled an investigation committee

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led by third parties to objectively and independently examine the matter. In January 2020, the committee reported their findings of causes for the situation and recommendations of recurrence prevention measures. Following the report recommendations, the Group is overhauling the quality assurance system and completely reforming the corporate culture with the aim of reestablishing the business growth trajectory and returning Kyowa Hakko Bio to its place as a driver of the Kirin Group growth.

2. Financial Status

General overview

Total assets at the end of the current fiscal year amounted to 2,412.9 billion yen, an increase of 109.2 billion yen from the previous fiscal year end. The increase was largely attributable to increases in equity method investments and property, plant and equipment, which more than offset a reduced book value of fixed assets (such as goodwill and other intangible assets) associated with the sales of the Oceania Integrated Beverages Business's Dairy and Drinks businesses and a decrease in other financial assets (non-current). Other financial assets (non-current) declined by 38.8 billion yen due to a reduced value of equity holdings and the sale of strategically held shares. Equity method investments rose by 144.2 billion yen primarily from the acquisition of FANCL shares and increased equity earnings in affiliates from the strong earnings at San Miguel Brewery. Property, plant and equipment increased by 34.2 billion yen, mainly from a 62.8 billion yen rise in right-of-use assets from the application of the International Financial Reporting Standards (IFRS) 16.

Equity declined by 44.6 billion yen from the end of the previous fiscal year to 1,146.8 billion yen. While retained earnings increased, equity declined from a 23.1 billion yen increase in treasury stock, 44.6 billion yen decline in non-controlling interest, and 25.0 billion yen decrease in reserves. The increase in treasury stock was due to the partial exercise of the program announced in November 2019 to further enhance shareholder returns by repurchasing up to 100 billion yen of company shares. The decline in non-controlling interests mainly owed to Kyowa Kirin's acquisition and cancellation of 15.9 billion yen of its shares. Reserves decreased due largely to reduced income from a net change in equity instruments measured at fair value through other comprehensive income.

Liabilities increased by 153.8 billion yen from the end of the previous fiscal year to 1,266.0 billion yen mainly due to an increase in bonds and borrowings. Bonds and borrowings increased by 115.9 billion yen. The Company seeks to procure and repay funds while maintaining a sound capital structure, and during the year it issued straight bonds worth 70.0 billion yen in September 2019, redeemed bonds valued at approximately 50.0 billion yen in November, and also paid down long-term borrowings, took out new borrowings, and issued commercial paper of a value of 127.0 billion yen. Other financial liabilities increased by 63.9 billion yen, primarily from a 66.4 billion yen increase in lease liabilities from the application of IFRS 16.

As a result of the above, the ratio of consolidated profit attributable to owners of the Company was 37.6% and the gross debt-to-equity ratio was 0.59.

Financial status of each reportable segment

• Japan Beer and Spirits Business

Segment assets amounted to 437.5 billion yen at the end of fiscal 2019, a decrease of 4.4 billion yen from the end of the previous fiscal year. The decrease was due to a decline in deferred tax assets, mainly owing to a decrease in deductible temporary differences.

• Japan Non-alcoholic Beverages

Segment assets amounted to 174.5 billion yen at the end of fiscal 2019, an increase of 0.2 billion yen from the end of the previous fiscal year. The increase was primarily due to a rise in property, plant and equipment from the application of IFRS 16.

• Oceania Integrated Beverages Business

Segment assets amounted to 491.0 billion yen at the end of fiscal 2019, an increase of 1.3 billion yen from the end of the previous fiscal year. The increase was primarily due to a rise in cash and cash equivalents from intersegment borrowing.

• Pharmaceuticals

Segment assets amounted to 725.1 billion yen at the end of fiscal 2019, an increase of 100.5 billion yen from the end of the previous fiscal year. The increase was mainly due to a rise in other financial assets (current) resulting from booking the increase in cash and cash equivalents from Kyowa Kirin's transfer of Kyowa Hakko Bio shares as an intersegment loan.

3. Cash Flow

Cash flow and liquidity status

The balance of cash and cash equivalents (hereinafter "net cash") at the end of the current consolidated fiscal year was 165.7 billion yen, a decrease of 7.4 billion yen from the end of the previous consolidated fiscal year. Consolidated cash flows were as follows.