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Highlights of Major Breweries' Financial Results for Fiscal Year Ended December 2018

The following is Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended December 2018 (FY2018) and earnings forecasts for FY2019 of Japan's four major breweries (collectively, the "Companies"): SAPPORO HOLDINGS LIMITED ("SAPPORO"); Asahi Group Holdings, Ltd. ("Asahi"); Kirin Holdings Company, Limited ("Kirin"); and Suntory Holdings Limited ("Suntory").

1. Industry Trend

Domestic alcoholic beverage market has been shrinking partly because of declining alcohol-drinking population and per-capita alcohol consumption in this aging society with low birthrates. Although beer-type beverages account for the largest part in the market quantity-wise, demand for these products has been falling from its peak in 1994.

The taxable shipping volume of beer-type beverages, i.e. beer, happoshu (low-malt beer) and new genre (no malt beer), for five domestic breweries[1] combined dropped for fourteen years straight in 2018, down 2.5% from 2017 to 393.9 million cases, where 1 case equals to 20 × 633 ml bottles, including private brand products. In fact, the year-on-year decline, which was around 1% from 2012 to 2015, has been over 2% since 2016. By category, while the volume dropped 5.2% and 8.8% for beer and happoshu, respectively, it grew 3.7% for new genre. As major negative factors for 2018, prices of beverages in returnable containers (bottles and kegs) were raised in spring, and heat waves and natural disasters hit the whole of Japan in summer, usually the high season. New genre achieved fairly good growth thanks to the inclusion of private brand products, which Kirin started contract manufacturing for a major retail chain operator in 2018. While demand fell for beer-type beverages, it increased for the eleventh straight year for RTD (ready-to-drink) low-alcohol beverages thanks to their affordability as well as to growing demand for these products to be consumed during the meal in place of beer-type beverages.

In terms of the market share by volume for beer-type beverages for 2018, Asahi enjoyed the largest share of 37.4%, followed by Kirin with 34.4%, Suntory 16.0% and SAPPORO 11.4%. These rankings remained the same as 2017 when Asahi topped with a 39.1% share, followed by Kirin's 31.8%, Suntory's 16.0% and SAPPORO's 12.1%. Comparison with 2017 shows that only Kirin saw growth in shipment, up 2.6 points, while Asahi and SAPPORO lost their shares a bit. By category, Asahi and Kirin kept the top share for beer and happoshu, respectively. For new genre, although Asahi gained the largest share for the first time in 2017, Kirin won back the top position in 2018. This change in the ranking is attributable mainly to Honkirin launched in March 2018 becoming another hit product besides the private brand products for Kirin. For RTD products, Suntory, which is number one in this category, as well as all other major breweries, achieved sales growth. At a time when consumers remain deeply cost-conscious, tough competition over the limited demand and shift in consumer preferences to different categories continue.

1: Asahi Breweries, Ltd., Kirin Brewery Company, Limited, Suntory Beer Ltd., Sapporo Breweries Limited and Orion Breweries, Ltd.

2. Financial Results

EBITDA[2] of the Companies combined came to 984.4 billion yen in FY2018. This indictor, which stayed at around 500 billion yen throughout the 00's, has been expanding steadily since topping 600 billion yen in FY2010. It broke the 900 billion yen mark for the first time in FY2017 and grew further in FY2018 (Chart 1).

The FY2018 results varied among the Companies (Chart 2). While Asahi and Kirin achieved greater revenue and profit, Suntory posted greater revenue but lower profit, and SAPPORO saw them drop[3]. Asahi reported a business profit of 221.3 billion yen, up 12.7% from the previous year and the third consecutive growth in the years since FY2015 for which IFRS-based comparison is possible. It became the second company in the industry, after Suntory, to achieve EBITDA of over 300 billion yen.

Although the profit decreased for its alcohol beverages business due to competition in the domestic market for beer-type beverages, full-year contribution from the beer businesses in Central and Eastern Europe that were acquired in 2017 helped boost overall performance. Business profit from these and other overseas operations grew to 99.6 billion yen in FY2018 from 14.0 billion yen in FY2015, coming close to 117.1 billion yen for the alcohol beverages business. For Kirin, profit growth was driven by improved stability in overseas operations and also by strong new genre sales. Suntory, on the other hand, weakened its performance as the drop in profit for the beverage & food business more than offset the profit growth for alcoholic beverages with robust sales of liquors, spirits and RTD products at home and abroad. Major negative factors behind such profit decline include a weaker product mix and greater supply chain costs in Japan and the reporting of impairment losses arising from some ailing overseas operations. SAPPORO, despite such favorable factors as a new RTD beverage becoming a hit and operations in Viet Nam turning profitable, was negatively affected by a rise in raw material prices, drop in sales of new genre and canned coffee, the recording of an impairment loss on the business acquired in the previous year, etc.

No major changes were observed in the Companies' financial directions toward the end of FY2018. Although the financial structure varies among the Companies due to differences in stages of growth investments and business portfolios, it is controlled appropriately by individual companies to maintain and even improve soundness. As regards the two companies that carried out large-scale M&A deals recently, for Suntory, net DER increased to 1.5x in FY2014 (under J-GAAP) following the acquisition of Beam Inc. but dropped to as low as 0.7x at the end of FY2018[4]; for Asahi, too, it rose to around 1.5x immediately after the acquisition of beer businesses in Central and Eastern Europe but fell to 0.8x at the end of FY2018. Both companies are steadily decreasing the interest-bearing debt by disposing of non-core businesses and increasing cash flows with contribution from the businesses acquired. For Kirin, the ratio grew to over 1x at the end of FY2015 (under J-GAAP) due in part to the impairment loss incurred by a subsidiary in Brazil but kept improving thereafter, falling to as low as 0.3x by the end of FY2018. For SAPPORO, it has been staying below 1.5x since the mid-10's despite large interest-bearing debt arising from real estate leasing.

2: EBITDA = Gross margin - SG&A expenses + Depreciation expenses, where depreciation expenses are based on the cash flow statement.

3: "Revenue" includes liquor tax for all of the Companies. "Profit" refers to business profit (gross margin - SG&A expenses) for Asahi, Kirin and SAPPORO and adjusted operating profit (operating profit less profits/losses on non-recurring items) for Suntory. IFRS-based data are used for year-on-year comparison for FY2018, and data partly adjusted for IFRS for FY2017.

4: In consideration of equity content of hybrid securities

3. Highlights for Rating

While all of the Companies forecast higher revenue for FY2019, Suntory, Asahi and SAPPORO expects a higher profit but Kirin projects a bit smaller profit. Thanks to M&A deals, sales growth for major brands, etc., overall performance has been improving consistently for the industry as a whole in recent years. That said, positive effects of M&As will cease in FY2019, and cost increases will stagnate overall growth. Therefore, when based on the initial forecasts of the Companies, the combined EBITDA will likely grow only slightly, falling just short of 1 trillion yen.

According to the 2019 sales plan for beer-type beverages, while Asahi, Suntory and Kirin expect a year-on-year growth of 2% to 3%, only SAPPORO expects a drop, though marginal, of 0.3%. Whether they can achieve the sales in line with the initial plans is one of the key elements to be watched, but aggregate demand for beer-type beverages is most likely to keep shrinking even in 2019 due to structural factors. With an eye to the upcoming consumption tax hike in October, consumers will probably be even more budget-minded to protect their livelihoods. Given these moves and actual sales trends in 2018, Asahi, Suntory and SAPPORO intend to follow Kirin to focus on new genre. JCR considers how much they can capture demand for these and RTD products and how efficiently they can implement marketing efforts to that end amid such intensifying competition will affect the results of their alcoholic beverage business. At the same time, however, it is also vital that they maintain and even enhance the appeal of their beer brands in anticipation of the unification of liquor tax rates. Meanwhile, in the soft drinks business, rising costs of raw materials and logistics are weighing on heavily in recent years. For this reason, companies in the industry are planning to raise the prices of large-size bottled beverages in April or later. How smoothly they can have such changes accepted by the consumers will probably be the key to improving the profitability of this business.

When looking at the Companies individually, for Suntory, whether it can keep achieving greater synergies through the integration of Beam Suntory Inc. and enhance the earnings structure of food and soft drink businesses in and outside Japan will be closely watched. For Asahi, attention will be paid to whether it can steadily increase sales for its beer businesses in Western, Central and Eastern Europe. For SAPPORO, as it is pushing ahead with structural reforms recently, especially for overseas operations, whether it can realize positive effects at an early stage will be watched.

With no specific plans for large-scale M&As at this point, JCR assumes that there will be no major changes in the Companies' financial trends in a short run. That said, the probability of large-scale M&As in the future to achieve medium- to long-term group growth is high. JCR will pay utmost attention to, as a factor concerning the entire industry, whether the Companies can steadily improve and strengthen their financial bases.

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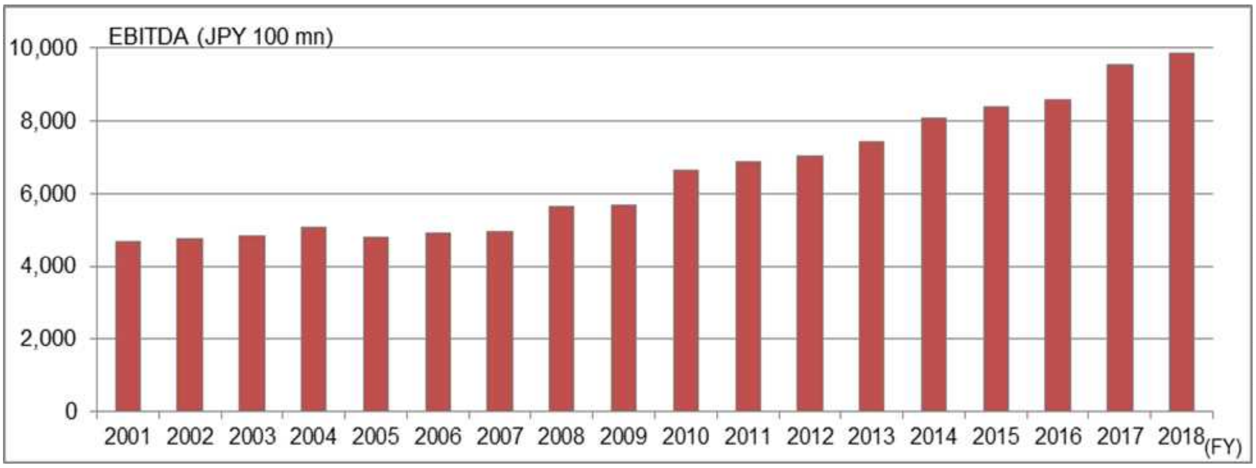
(Chart 1) EBITDA of Four Major Breweries Combined



EBITDA under J-GAAP = Operating profit + Depreciation expenses + Amortization of goodwill;
EBITDA under IFRS = Gross margin - SG&A expenses + Depreciation and amortization

(Chart 2) Consolidated Results of Four Major Breweries

(JPY 100 mn)

		Revenue*1	Business Profit*2	Adjusted Operating Profit*3	Operating Profit	Profit Attributable to Owners of Parent
SAPPORO HD (2501)	FY2017	5,365	174	—	128	71
	FY2018	5,218	144	—	108	85
	FY2019F	5,488	158	—	126	87
Asahi GHD (2502)	FY2017	20,848	1,963	—	1,831	1,410
	FY2018	21,202	2,213	—	2,117	1,510
	FY2019F	21,530	2,300	—	2,170	1,520
Kirin HD (2503)	FY2017	18,637	1,946	—	2,110	2,419
	FY2018	19,305	1,993	—	1,983	1,642
	FY2019F	20,000	1,900	—	—	1,200
Suntory HD (—)	FY2017	24,202	2,523	2,554	2,536	2,114
	FY2018	25,172	2,451	2,509	2,508	1,401
	FY2019F	25,700	—	2,540	2,510	1,230

*1: Revenue including liquor tax
*2: Published values for SAPPORO HD, Asahi GHD and Kirin HD (Gross margin - SG&A expenses), and values adjusted for the same standard adopted by these three companies for Suntory HD
*3: Operating profit less profits/losses on non-recurring items (for Suntory HD only)
(Source: Prepared by JCR based on financial materials of above companies for both Charts 1 & 2)

<Reference>
Issuer: SAPPORO HOLDINGS LIMITED
Long-term Issuer Rating: A- Outlook: Stable
Issuer: Asahi Group Holdings, Ltd.
Long-term Issuer Rating: AA- Outlook: Stable
Issuer: Suntory Holdings Limited
Long-term Issuer Rating: AA- Outlook: Stable

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