Minutes of the Analyst Briefing for the First Half of the Fiscal Year Ending March 31, 2017

Date & Time: November 7, 2016 10:00-11:30

Venue: Room 501AB, STATION CONFERENCE TOKYO

Attendees from the Company:

President and Representative Director (President and CEO): *Juichi Suezawa*

Vice President and Representative Director: *Yoshihide Hata*

Representative Director and Senior Managing Executive Officer,
General Manager of Processed Foods Business Division: *Koji Kawamura*

Director and Senior Managing Executive Officer,
General Manager of Overseas Business Division: *Hiroji Okoso*

Director and Senior Managing Executive Officer,
General Manager of Fresh Meats Business Division: *Katsumi Inoue*

Director and Managing Executive Officer, General Manager of Affiliated Business Division: *Kazunori Shinohara*

Director and Executive Officer, General Manager of Sales & Marketing Division, Processed Foods Business Division: *Tetsuhiro Kito*

Number of attendees: 102

<u>Financial Results Overview for FY2017/3 1st half (Apr.-Sep.)</u>

○Reclassifications of operating income of discontinued operations due to the sale of Texas Farm, LLC, mentioned in the beginning of the briefing

1st half forecasts: (revised in 1Q, including discontinued operations) ¥21.0 billion
(revised in 1Q, excluding discontinued operations) ¥21.8 billion(a)

1st half results (excluding discontinued operations) ¥23.4 billion ((a) + ¥1.6 billion))

2nd half forecasts: ¥27.6 billion (downward revision of ¥1.1 billion against the forecasts)

Full year forecasts: (revised in 1Q, including discontinued operations) ¥49.0 billion
(revised in 1Q, excluding discontinued operations) ¥50.5 billion(b)

Full year forecasts: (excluding discontinued operations) ¥51.0 billion ((b) + ¥0.5 billion)

Impact on operating income from sales of Texas Farm, LLC

Annual improvement of ¥1.5 billion

○Review of FY2017/3 1st half

Decrease in revenue and increase in operating income

Net sales: ¥593.0 billion (decrease of ¥20.6 billion year on year)

Operating income: ¥23.4 billion (increase of ¥1.6 billion against the forecast, increase of ¥0.37 billion year on year)

・Sales volume increased for hams and sausages, processes foods, fresh meats and dairy products.

・The Processed Foods Business Division, Fresh Meats Business Division and Affiliated Business Division reported a total of ¥24.2 billion in operating income (increase of ¥4.7 billion year on year, increase of ¥2.4 billion against the forecast)

・Overseas Business Division: ¥(0.6) billion (decrease of ¥4.1 billion year on year, decrease of ¥0.3 billion against the forecast)

<Business Results of Processed Foods Business Division>

Increases in both revenue and operating income

Net sales: ¥169.1 billion (increase of 1.6% year on year)

Operating income: An increase of ¥2.8 billion year on year

Variation factors in operating income

・In terms of commercial-use products, both hams and sausages, and deli and processed foods recovered in volume.

・As for consumer products, despite the introduction and resulting growth of *SCHAU ESSEN* in hams and sausages, and a total of 16 products (14 in hams and sausages and two in deli and processed foods) sold exclusively by sales companies to meet area demands, there was a delay in recovery of PB products.

・In deli and processed foods, hamburgers and the new category of soups performed strongly.

Operating income: ¥3.2 billion

(Breakdown) Increase of ¥2.8 billion (increase of ¥0.7 billion against the forecast)

・Increase in volume by ¥0.3 billion (decrease of ¥0.1 billion against the forecast)

The volume of hams and sausages was 101% of the previous year (98.5% of the forecast).

The volume of deli and processed foods was 105% of the previous year and in line with the forecast.

・Profit margin improved by ¥2.5 billion.

Positive factor was the ¥2.3 billion cutback in the cost of principal raw materials.

Profit margin improved by ¥0.3 billion particularly centered on chicken.

Cost of other materials was also reduced by ¥0.5 billion.

At the stage of the 1Q plan, product mix (product renewal, exclusive products for sales companies) used ¥2.7 billion in funds, which resulted in a decrease of ¥1.6 billion in 1st half.

Production and sales & marketing divisions improved by ¥1.3 billion.

<Business Results of Fresh Meats Business Division>

Decrease in revenue and increase in operating income

Net sales: ¥370.6 billion, a decrease of 1.7% year on year

Operating income: ¥19.4 billion, an increase of ¥0.8 billion year on year

・Net sales decreased due to a drop in unit prices as a result of weak market prices in the domestic chicken and pork markets.

・While domestic fresh meats sales volume of the whole NH group grew approximately 4.2%, sales fell from that of the previous year due to the effects of market prices.

While farming operations struggled as a result of declining market prices, sales of imported beef by the Nippon food companies were strong; sales of branded fresh meats grew (*Sakurahime*: 118% of the previous year); and volume retail channels grew 107%, which made up for any declines and resulted in an increase in operating income overall.

Factors for changes in operating income

・Increase of ¥0.8 billion (increase of ¥1.6 billion against the forecast)

(Breakdown)

・Imported fresh meat market: ¥0.3 billion (increase of ¥0.5 billion against the forecast: Imported beef covered the decrease in income for imported chicken as a whole)

・Domestic fresh meat market: ¥(0.3) billion (increase of ¥0.4 billion against the forecast: Domestic pork prices stabilized and the sales environment improved from 2Q)

・Changes in farming operations in Japan: ¥(0.7) billion (decreased by ¥0.2 billion against the forecast) overall due to the effects of market prices.

・Growth in Nippon Food Group: ¥1.1 billion (increase of ¥0.3 billion against the forecast)

Sales volume increased by 104% year on year mainly in imported beef in addition to increased sales volume of branded fresh meats.

The good results are analyzed to have come from capitalizing on the strengths of stable supply and branded fresh meats.

Foreign exchange losses of ¥1.0 billion from 1Q have been recovered in 2Q.

<Business Results of Affiliated Business Division>

Increases in both revenue and operating income

Net sales: ¥77.7 billion, an increase of 0.8% year on year

Operating income: ¥1.6 billion, an increase of ¥1.2 billion year on year (an increase of ¥0.1 billion against the forecast)

・Operating income increased both in marine products and dairy products.

・In marine products, operating income increased through the growth of in-house manufactured products and progress in price revisions.

・In dairy products, sales of yogurt and lactic acid bacteria beverages mainly for volume retail channels increased. Sales of cheeses for mainstay bread production channels and restaurant channels increased. Operating income increased also as a result of stabilized raw material prices.

<Business Results of Overseas Business Division>

Decrease in both revenue and operating income: Extremely harsh conditions

Net sales: ¥109.2 billion (a decrease of 15.7%) (the 25% decrease for the Company in sales volume in Australia affected the result)

Operating income: ¥(0.6) billion, a decrease of ¥(4.1) billion year on year

Factors for changes in operating income

・Operating income for Australia decreased by ¥4.7 billion.
  Foreign exchange cross rates were about the same level year on year. Due to difficulties in collecting livestock, number of heads processed decreased by 31% year on year. Procurement prices rose as well. Sales for U.S. struggled and came to 33% year on year.

・Operating income for Americas was ¥0.38 billion. (an increase of ¥0.3 billion year on year: Day-Lee Foods and processed foods business were strong. Underperformed forecast by ¥0.3 billion: Struggled slightly in South America.)

・Operating income for Asia & Europe increased ¥0.4 billion (Roughly the same as forecasted: Strong exports from Europe and some improvement in Ege-Tav.)

<u>Operating income forecasts for FY2017/3</u>

2nd half: ¥27.6 billion (downward revision of approximately ¥1.0 billion)

Full year: ¥51.0 billion

Breakdown details

(Processed Foods Business Division)

2nd half: ¥5.5 billion (an increase of ¥2.0 billion: roughly the same as forecasted.)

(Fresh Meats Business Division)

2nd half: ¥19.6 billion (a decrease of ¥0.7 billion: upward revision of ¥1.1 billion)

Full year: ¥39.0 billion

(Affiliated Business Division)

In The Marine Foods, increase the ratio of in-house products and develop new products that utilize ultra-high pressure processing machines.

In Hoko, expansion of products for normal temperature, structure for increased production in Hachinohe factory, and expansion of consumer cheese products are planned.

(Overseas Business Division)

☆Australia

For 2nd half, operating income decreased by ¥0.7 billion year on year. (Underperforming forecast by ¥2.8 billion)

For the full year, operating loss of ¥1.9 billion is forecasted.

・Sales volume is expected to decrease year on year.

FY2017/3 full year forecast

Operating income: ¥51.0 billion, income before income taxes: ¥47.0 billion, net income: ¥32.5 billion.

Statutory tax rate for 1st half was 33.1% (an increase of 8 points year on year: mainly due to the deficit in Australia), and for the full year, approximately 31% is expected.

○Q&A

Q1. With regard to the Australia Operations, how will you cope with the continuing high prices for feeder cattle in the next fiscal year?

A1.

We are taking a defensive approach in the Australia Operations to keep our losses as small as possible. The U.S. market influences our Australia Operations, and we can't be optimistic about exports to the U.S. for the time being. We will therefore modify sales structure to other regions so as to generate profit, and reduce unprofitable items, in order to strike a balance in operating rates at plants. We will increase the sales composition ratio of branded beef, mainly grain fed, and will increase the ratio of grass fed beef that has value and that can maintain a high price to some extent. We will promote a switch to profitable items that will sell.

As for forecasts for livestock and sale prices, although there will be some differences between grass fed, grain fed, and branded beef, depending on the handling cycle, we expect to see the gap improve in the latter half of next fiscal year in August and September. We believe that the situation will take a positive turn in the second half of next year onwards.

Q2. To what extent will capacity be increased by the new Takasaki Plant of Nippon Luna?

What are your dairy product strategies going forward with the increased operating capacity at the new Takasaki Plant?

A2.

We do not intend to lower the unit price of Nippon Luna yogurt, but rather to increase our market share. As for production capacity, the Kanto Plant is currently at 10,000 tons per year. The new Takasaki Plant is scheduled to begin operating in January 2019. At that time, its production capacity is expected to be 24,000 tons. Capacity will more than double from the Kanto Plant to the new Takasaki Plant. The Kyoto Plant is now manufacturing at full capacity, and we began construction of the new Takasaki Plant in order to resolve that issue.

Q3. How do you view production cost reductions in the processed foods business from the next fiscal year on?

A3.

The new Hyogo Plant began full-fledged operations in November, and we expect to see the results of that next year.

We will reduce costs by bringing mainstay products such as *SCHAU ESSEN* to the Ibaraki Plant and new Hyogo Plant, where high-speed lines have been introduced. Through these measures, we also aim to deal with labor shortages and to reduce costs.

Other challenges are capturing sales for *SCHAU ESSEN* and increasing sales volume for products other than *SCHAU ESSEN*. We have reduced the number of production bases from 15 to 13 by combining the Hyogo Plant and Ono Plant into the new Hyogo Plant, and closing one other Group company plant in the previous fiscal year. Through these measures, we can achieve a relative reduction in logistics costs and administration costs.

Q4: What is the basis for your confident outlook regarding sales of hams and sausages in the second half?

A4.

The forecast for hams and sausages in the second half is 110%, and these figures are not very high.

We will also launch TV commercials in November. As for gift products, we expect a double-digit increase from the substantial losses of last year. The second-half forecast for commercial-use products is 120%, but we have reached about 110% in 2Q, as a result of putting together teams in each category and making steady efforts including united development of production and sales for snack counter items, bakeries, and delicatessen products for CVS channels. We believe we can move toward our targets by making differentiated, high-unit-price menu proposals using branded fresh meats.

Q5. Can you increase the ratio of Australian grain fed and branded beef in a situation of cattle shortages?

A5.

The number of calves is small due to the decrease in breeding stock. We believe that the number will increase according to the cattle cycle, but there is also the possibility of farmers not selling cattle. Going forward, we will control production, taking into account the situation of breeding stock and the number of cattle for sale. We will also undertake consignment processing to secure the minimum plant operating rates.

In addition, we are starting to secure highly-evaluated branded grass fed beef, and will expand our feedlots in order to ensure the conversion to beef whose sale prices can be stabilized. The key for cattle to have recognized value as branded beef is how much we can differentiate by added value through feed, etc., while they are raised in the feedlot.

Q6. Although the Australian market deteriorated through 2Q, losses did not change from 1Q. What kind of measures did you take? And what will you do if this situation continues?

A6.

Our measures were to reduce operations at plants that did not show a profit even when we raised the production operating rates. We made a speedy decision regarding how to stop production in areas where procurement prices were outstripping sales prices. As a result, although sales have decreased, the local decision to stop unprofitable production was on the mark.

Q7. What is the outlook for the time being with regard to raw materials prices in the Processed Foods Business Division?

A7.

Raw materials prices improved this fiscal year. We do not have preliminary calculations in terms of amounts for next fiscal year yet. U.S. hog prices are expected to fall through 4Q due to an increase in the number of heads processed in the U.S. Although there is some uncertainty due to the impact of foreign exchange, lower prices are expected for pork preparation products, etc., that are raw materials for sausages, and for local hogs.

Prices for hamburger raw materials are increasing, and we are studying the outlook for raw materials prices for the next fiscal year.

Q8. What are your thoughts about Nippon food companies in the second half?

A8.

Although we worked toward initial sales targets of 105% in both the first and second half for Nippon food companies, sales struggled and it was difficult to profit in an environment of violent market fluctuations during the first half. With regard to market conditions as well, there are concerns over intensifying price competition in domestic sales in response to an increase in the number of hogs, strong condition for chickens, and stable import volume.

Q9. What is the outlook for ROIC for this fiscal year and the next, in light of the forecast reduction in capital expenditures?

A9.

For the current period, ROIC is expected to be 6.7%, based on forecast operating income of ¥51.0 billion for this fiscal year, which exceeds the forecast of 6.4%. It is caused by the increase in operating income ratio from 3.9% to 4.3%.