

INITIATION REPORT

MILBON. (4919 JP)

CREATING A UNIQUE ECOSYSTEM OF PROFESSIONAL HAIR PRODUCTS

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NIPPON INVESTMENT BESPOKE RESEARCH UK LTD

London, UK

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Executive Summary

Milbon is in a unique position in Japan's substantial Cosmetics and Toiletry industry as it solely focuses on the development, manufacture and supply of hair care and treatment products specifically aimed at the professional market. The company boasts top market share of 16.9% in Japan's professional hair product market (CY19) which is estimated to be worth ¥178bil on a shipment basis within the total domestic haircare product market of ca. ¥563bil, according to a field research conducted by Fuji Keizai.

Until the late 1980s, the professional hair product market in Japan was dominated by overseas brands. Milbon first entered the market in the 1960s. It took ca. 20 years for the firm to position itself as the top supplier in its home market where it spent time building its current business model which is supported by the following two pillars which we discuss in more detail on pg. 5~6:

1. **Field Person System (FPs):** FPs are Milbon's highly regarded staff members who are trained in-house and then assigned to the firm's top tier customers to promote products, train hairdressers in the specific use of its products and to provide consultation in salon management. The FPs primarily market Milbon's premium brands which are only available at selected salons. FPs are also trained in various hair care techniques as it enables them to better demonstrate to hairdressers the use of the products to suit a myriad of styles.
2. **TAC Product Development System:** Milbon identifies its top hair designers – i.e. stylists – who have outstanding technique and a loyal client list. Milbon's "star" designers are respected and looked up to by many other hairdressers in the industry who are keen to learn from their expertise. Milbon forms a product project team with a "star designer"; together they work on solving issues / problems experienced by him/her with the existing products, as well as the development of new products to specifically address those issues. The FPs promote both the products and the technical expertise of the star hair designers in styling and how best to use the products for each type of style.

This business model was not built overnight. Unlike consumer brands, the professional market does not respond to advertisements and TV commercials. Milbon's success in Japan started by identifying that its hands-on approach worked well, and that has helped build out trust and loyalty toward its products among the hairdressing community over time. However, given the scale of this niche market, such an approach is costly and time-consuming. This factor is one of the main barriers to entry, especially for the larger cosmetic / toiletry makers as the economics provide little return. The Milbon strategy is built on taking the time to develop a strong relationship with its clients; the face-to-face time with the FP's, whose dedicated role is to ensure their clients have access to the best products and are up to date on the latest styles thanks to an opportunity to access to various training and seminars, not only fosters strong customer loyalty, it supports the eco-system Milbon has built out for this niche market. Milbon's challenge in overseas markets is to establish a similar system as in Japan. For a market like Korea, it was relatively easy to copy the domestic model. However, it is proving more difficult in a country like in the US.

FY20 (Dec year-end) has been a tough year for Milbon, without exception. Although Japan's hair salons were not subject to closures due to the State of Emergency due to Covid-19, customer traffic was affected partly because 1) many salons, especially in the urban areas, voluntarily closed and 2) customers consciously refrained from visiting salons for fear of infection. As a result, Milbon's sales in April and May were also affected (-39.6% YoY and -24.0% YoY, respectively). Sales in Korea and China fell 1Q fell -7.9% YoY and -31.5% YoY, respectively, but then rebounded in 2Q alone, Korea +11.7% YoY / +22.3% QoQ and China +5.1% YoY / +20.6% QoQ, as the pandemic became under control. However, sales in the other overseas markets have not yet shown a recovery. US 1Q sales -39.9% YoY / 2Q -58.2% YoY and -32.7% QoQ; Others 1Q -6.8% YoY / 2Q -38.7% YoY and -38.1% QoQ).

FY20 is the second year of the 5-year management plan. The plan was announced in Feb 2019 with FY23 OP guided to reach ¥8,800mil (5-year CAGR of 7.0%) on sales of ¥48,500mil (5-year CAGR of 7.4%). However, due to Covid-19, management has decided to review the earnings trend and business outlook over FY20 2H and FY21 and the plan will be revised after that review period.

Milbon's shareholder return policy, in principle, is to pay out 40% but the firm also pays out a stable cash dividend.

There are currently two external independent directors and two external independent auditors on Milbon's Board. However, the number of the independent directors is still below the one third level guided by the Corporate Governance Code. Moreover, although the main target of its products are women visiting beauty salons, it is yet to appoint a female director.

Historical Background – Making of a Market Dominated by Only Japanese Makers

Milbon is not a household name. It is unique in that it specialises in supplying professional hair products only used and/or sold at beauty salons. Its global peers include Wella Inc. (currently a part of Coty Inc (COTY: NYQ)), Kérastase (part of professional products division of L'Oréal (OR: PAR)) and Schwarzkopf (a part of Henkel AG (HEN3:GER)). What makes Milbon unique compared to its global peers is that Milbon products are not available at retail outlets at all, you can only purchase them from a salon.

According to research by Fuji Research Institute, Milbon had ca. 16.9% market share in Japan as of CY2019 and the firm continues to maintain its position as the top professional hair products supplier. The domestic professional hair products market is highly fragmented and dominated with local makers, with Milbon at No.1, followed by Napla (unlisted) at No.2 with a much lower share of 8%. The rest of the market comprises multiple other Japanese makers with ca. 3~6% market share each. However, Japan's professional hair products market was not always made up solely with domestic players. Prior to the foundation of Milbon in 1965, the Japanese professional hair care market was dominated by many of the aforementioned non-Japanese brands.

The founder and the fourth president of Milbon, Ichiro Konoike, worked as a sales rep for a distributor of professional hair products to salons. On his many visits to hairdressing salons, Konoike also realised that product development was important. He noticed that the majority of hairdressers suffered with rough hands – a reaction from the harsh chemicals in professional hair care products – and that the major complaint was how harmful products, particularly those used for permanent solutions, were to their skin. Konoike responded by establishing a professional hair care products distributor, and he partnered up with a chemical manufacturer and a wholesaler specialised in beauty products to form Milbon in 1965.

Since many of the stylists he met during his working day were women, Konoike envisioned an opportunity to set up a business that targeted these women – by providing the stylists with products that are effective and enhance their styling skills yet are less harmful for them to use. He then realised that hairdressers not only were keen to discuss products, but there was also a lot of exchange on new styles, techniques and even operational issues. From this, the basis for the current Field Person (FP) System, which started in 1984, was born. In addition, the shift in Japan whereby more women were entering the workforce, which resulted in them becoming more financially independent so more able to spend their income on premium haircare products, was a revelation and a game changer for Konoike's vision.

Until the 1990s, foreign hair care brands were still mainstay in hair salons in Japan and most of the fashion magazines were full of Western models – even the advertisements for hair products used non-Japanese models. Milbon decided to break from this norm by hiring Japanese models to pose for its advertisements, emphasising that its hair products are specifically created for Japanese women. By 2000, Japanese professional hair products manufacturers dominated the market.

Market Trends in Japan

In Japan, both hairdressers and salons must register with the Ministry of Health, Labour & Welfare (MHLW). According to the MHLW, as of CY2018, there were 251,140 salons in Japan in 2018 (+1.4% YoY), and the number of hairdressers registered with the MHLW was 533,814 (+2.0% YoY). However, the data can be misleading as those who have retired or dormant businesses that have closed often do not report the change to the ministry, so they remain on the MHLW registry.

Milbon reckons that the more realistic market figure for the hair salon industry is shipments by haircare product makers. The shipment data between CY2016 and CY19 by Fuji Keizai indicates that the 3-year CAGR during the period was 3.4%. On the other hand, the data by Statistics Bureau of Japan suggests that number of beauty customers – females between 15~64 years old – are also beginning to wane. In CY2014, the population of females between 15~64 years old was ca. 38.7mil. The number declined to ca. 36.1mil in CY2019. This puts pressure on salon operators to shift their business model from having its sole source of revenue from just technical fees (e.g. a haircut), to establishing another source of income such as selling salon hair care products to its customers.

Hair salons' revenue is mainly generated from 1) a technical fee – the fee paid for hairdressers' skills, and 2) merchandise revenue – sales from products sold at salons e.g. hair care and styling products. While the technical fees income is under pressure given the population of beauty customers is steadily declining, merchandise sales have been gradually growing.

Although still small in scale, there is a growing trend whereby salon customers are purchasing professional hair care products at salons to use at home. According to a Fuji Keizai Research report on Japan's professional cosmetics and toiletry market (2019), 18.1% of the people surveyed purchase their hair care products at beauty salons rather than buying similar salon-quality products from retailers. Milbon believes this trend is largely due to the fact that there more women successfully seeking work, which gives them the income to spend on what they want. With the social status that comes from being gainfully employed, these women also want to show who they are, so a fashionable / smart hairstyle is one of the most effective tools to boost their appearance. Buying premium hair care products at the salon to use at home, so as to maintain their hairstyle, is a luxury that they can now well afford.

Milbon also offers a wide product range for each stage of a customer's life. For example, one of Milbon's premium brands Aujua – specifically designed for characteristics of Japanese women's hair – started gaining popularity among female salon customers, taking the recommendation of their stylist to buy and use at home. In FY20 1H, Milbon's hair care product sales were ¥9,391mil (-5.1% YoY) of which premium brand products sales fell 1.6% YoY to ¥5,403mil. However, sales of 1H the Aujua product range rose 1.2% YoY to ¥3,330mil.

While its competitors are competing over price, Milbon offers specific products with properties based on requirements requested by hairdressers. The added value the FPs brings to the relationship with each salon, by providing management consulting, training and innovation updates, is that they are aware of all aspects of their clients' needs, so are in a better position to improve on what they can offer. This level of support garners huge customer loyalty and management believes is the reason why Milbon has managed to maintain the top market share without having to stoop to price wars. This suggests that market for salon hair care products is not very price sensitive.

(¥mil)		FY2019		FY20	
		IH	FY	IH	YoY (%)
Aujua	Gross Sales	3,290	7,485	3,330	1.2
	No. of salons	3,698	3,698	3,897	5.4
Global Milbon	Gross Sales	1,235	2,551	1,188	3.6
	No. of salons (Japan)		4,370		
	No. of salons (Overseas)		3,304		
	No. of salons (Total)	7,674	7,674	8,892	15.9
Villa Lodola	Gross Sales	563	1,187	500	-2.5
	No. of salons	9,015	9,015	9,351	3.7
Premium Brand Sales	Gross Sales	5,088	11,223	5,018	-1.4

Source: Milbon's FY19 and FY20 IH presentation materials

Milbon's Hair Care Brand Positioning Map



Source: Milbon's FY19 presentation material

¹ Sales by the different brands illustrated are on a gross basis while total consolidated sales are on a net basis.

Business Model and Differentiation

At ¥180bil, Japan's professional hair product market is not that big. This provides some barrier to entry for the larger players as there is not enough scale for the larger cosmetics, toiletry companies to allocate resources and get a return. In addition, the market requires the ability to launch multiple brands, tailored to the demands of the stylists. Furthermore, the sales promotion and marketing of professional products are different from that of consumer products. TV marketing, which is a common method in consumer products, usually has no impact on sales of professional products as the professional market uses a more hands-on approach – showcasing products in store or at industry conventions, providing product seminars etc.

Milbon's business model comprises two systems: 1) Field Persons System and 2) TAC (Target Authority Customer) Product Development System. These two components are intertwined and coexist with one another.

Field Persons (FPs) – Milbon's "Treasured" Children

Milbon sells its products through distribution partners, hence the relationship with major distributors is important. For example, ca. 30% of FY19 consolidated sales were from three main distributors. However, the strategically important salons are covered by FPs.

Milbon first introduced the Field Person system in 1984 – a time when hair products from non-Japanese makers were dominating the professional hair products market in Japan. Milbon successfully drove out these players to take the top market share in the industry thanks to its FPs.

The FPs have the following roles:

- 1) **Promoting products based on their unique properties:** While Milbon sells its products through distribution partners, they cannot fully rely on distributors because some of the larger distributors also handle various brands by other makers. FPs, separately or jointly, promote Milbon's brands based on product properties that meet the requirements and demand from hairdressers who understand the specific hair care need of their clients.
- 2) **Educating hairdressers with technical demonstrations:** The FPs educate the hairdressers on the properties and use of each of Milbon's products so they can maximise the benefits. Milbon takes the education of its FPs seriously and each FP is trained to demonstrate the top-notch beauty techniques on how to best use its products. Having such expertise to hand fosters greater traction with the hairdressers than just sampling a few free marketing products. As described in the TAC section below, Milbon develops products under projects with star hairdressers / hair designers who have technical expertise that other hairdressers desire to know. The FPs then provide product education to hairdressers by demonstrating the techniques learnt directly from the star hair designers.
- 3) **Customer relations:** FPs are very aware of their clients' (salon owners') concerns and issues regarding the running of a beauty salon. They provide support in salon management, planning and creating treatment menus – so, not just haircuts but also offering additional high margin services colouring and conditioning treatments – which can lead to commercial growth of the salon.

With 279 FPs in Japan, Milbon reckons that its FP system is the key differentiating factor compared to the mainstay salon-use product suppliers. Having FPs raises the barrier to entry given the investment needed is high for such a small market. Specifically, hiring new graduates and training them until they can start demonstrating beauty techniques and their product knowledge, as well as giving them time to build solid relationships with their customers is costly as it requires much time and dedication. Milbon's policy is to hire 40~50 new graduates every year as trainee FPs.

As testament to Milbon's successful use of FPs, it holds the No.1 share in Japan's professional hair products market of 16.9%, nearly threefold more than the next three companies that have 8.0%, 6.3% and 5.2%, respectively, which is

then followed by a further six companies with 3~4% each. The rest of the market (40~45%) of the market is highly fragmented and made up of multiple small players.

Milbon's FPs offer a package of solutions, such as training programme for new hairdressers, creating salon's menu and miscellaneous support for the operational problems, and products. Napla, the No.2 player, has similar products to Milbon but competes on price alone as it does not have the expertise of an FP to offer a holistic suite of products and services. Milbon reckons that it is not easy for others to achieve the same crafted approach in gaining trust and loyalty from hairdressers – and they are the ones in a position to decide which products to use and what to recommend to their valued customers at the end of the day.

Milbon continues to hire new graduates as FP trainees. Although its nationwide market share is 16.9%, some regions have higher market share than the others. There is a tendency whereby regions with more FPs, for example Osaka and Tokyo, have a higher market share. The firm has 30% market share in Osaka and more than 25~26% in Tokyo.

Milbon reviews the list of salons that it allocates FPs to every year. In the past, each professional hair products brand has their own affiliated salons Milbon has now moved to a system under which the firm chooses ca. 10,000 growing salons for its list of strategic customers of which 7,000~8,000 use Milbon's premium brands – Global Milbon, Aujua and Villa Lodola – and are followed up by FPs. The remaining salons on the list are mainly covered by distributors and use Milbon's products in its Professional Brands range such as Jemile Fran, Cronna, Plarmia and Elujuda.

Trend in number of Field Persons (FPs)						
(people)		CY2016	CY2017	CY2018	CY2019	CY2020
(¥mil)						
Japan	No of FP	249	258	269	279	297
	Sales per FP	102	105	111	108	TBC
US	No of FP	9	12	13	13	17
	Sales per FP	63	48	48	50	TBC
China	No of FP	18	19	22	21	30
	Sales per FP	40	50	62	70	TBC
Korea	No of FP	20	23	25	30	32
	Sales per FP	80	84	82	77	TBC
Other areas	No of FP	25	33	33	35	38
	Sales per FP	37	31	37	39	TBC

Source: Milbon's FY19 & FY20 IH earnings presentations

TAC (Target Authority Customer) Product Development System – Another Wheel of Business Model

In addition to the aforementioned FP system, Milbon operates a unique system in its product development. Under the TAC Product Development System, the firm initiates product development projects jointly with star hairdressers who are considered as “authority” in the hair salon industry.

TAC Product Development System (TAC System in short) was based on an inspiration from Asics's founder Kihachiro Onitsuka. One of Milbon's founders, Ichiro Konoike was deeply impressed by Onitsuka's product development philosophy that Asics works solely with top athletes to develop shoes rather than using market research. Following this line of thought, Milbon aims to develop hair products based on what the top ranked hair designers need to enhance their technique. So, similar to novel runners wanting to buy shoes designed for the gold medallists, hairdressers are also keen to learn techniques from highly skilled stylists and follow their lead by also using the products they use.

The product development journey starts with Milbon identifying a “star” hair designer – they may have been featured in a magazine / feedback from celebrities / the FPs are hearing that a specific stylist is getting rave reviews from customers etc – many of whom are often not fully satisfied with the existing products they use and are looking for

new ones that can both compliment and improve their technique. Milbon, sets up a contract to form a team partnership with the stylist to develop a hair product. The star hairdressers – who are brands themselves – seem to prefer working with Milbon over major cosmetics and toiletry brands because they know that Milbon only supplies the professional markets – so its products are seen as a cut above the others. Moreover, working with makers who mainly supply the general consumer markets can possibly dilute the added value of the professional market.

After the product development, the FPs visit the target list of salons to train the hairdressers in the techniques they acquired from the star designers using Milbon's products – the hairdressers are not just interested in the products developed by the star hair designer, but the techniques developed and taught by the designers themselves. In addition to the FPs' demonstration at the salon, Milbon also holds seminars at Milbon Studios by inviting star hair designers to showcase new techniques while using the Milbon product range.

Expanding Overseas – Overseas Subsidiaries

It is estimated that the size of the global professional hair products market is ca. ¥1trn, in which L'Oréal, through its professional products brands, has ca. 20% market share. Milbon first ventured into the overseas business in New York in 2004. Currently, the firm operates in 13 countries. Milbon's overseas business model is principally the same as in Japan, although it needs to apply flexibility to meet requirements in each country. Currently, R&D activities are solely conducted in Japan with research branches to be opened in China and US.

In FY20 IH, overseas revenues were 15.7% of total sales. There are three notable overseas subsidiaries: US, China, Korea, and the rest is consolidated as Others and includes Thailand, Vietnam, Malaysia, Taiwan, Hong Kong, Turkey, Indonesia, Philippines, Singapore and Germany. In the Asia, Milbon has the top market share in the professional hair product market.

- **Milbon Korea**

The largest overseas base is Korea, where Milbon Korea generated ca. 7.3% of FY20 IH consolidated sales. The subsidiary reported FY20 IH OP of ¥275mil (-21.3% YoY) on sales of ¥1,165mil (+1.9% YoY). The market in Korea is somewhat similar to that of Japan, hence the strategy to expand the business using the FP system (currently there are 30 FPs in Korea) in collaboration with local distributors. Data from 2017 shows that Milbon had ca. 5.6% market share in Korea's professional hair product market. However, the data is outdated, and the firm reckons that its current market share is higher as its sales in Korea has steadily been growing since FY17: sales by Milbon Korea was KW20,357mil in FY17, KW20,630mil in FY18 and KW24,927mil in FY19 (Milbon Korea's 3-year sales CAGR of 7% vs the industry growth of ca. 3%, according to data from Statistia.com). The top player in the professional hair product in Korea is Amorepacific (090430 KS) with a 22.7% share, followed by L'Oréal at 12.0% (both are the figures in CY17). The market share difference between the top maker and the second is wide and Milbon has its sights on taking over L'Oréal's No.2 slot in the near future.

- **Milbon Shanghai**

The market in China is completely different due to the size of the country and the differences in the socioeconomic background from region to region. There are many beauty salons in China, however, the market that Milbon would target, i.e. the premium market, is not so large. Milbon reckons it can target 30% of the beauty salons in China. In value terms, the size of the premium market is currently smaller than that of Japan but will likely grow larger going forward. Moreover, given China's size, it is impossible and inefficient to place FPs to cover the entire country. Therefore, Milbon has allocated FPs in Beijing, Shanghai, and Chengdu, while the other regions are covered by a sole distributor for each province. Milbon Shanghai's FY20 IH OP slumped 51.8% YoY to ¥95mil on sales of ¥642mil (-10.7% YoY on a local currency basis / -15.5% YoY in Japanese yen) as the Chinese government instructed 90% of the nation's hair salons to close from February. Milbon Shanghai saw ca. 80% YoY drop in February sales. However, in 2Q alone, sales grew by 10.6% YoY on in a local currency terms.

• Milbon US

In the US, Milbon rapidly shifted to a distributor-based approach during FY19. Currently, it works with seven distributors and its FPs are mainly in Manhattan where Milbon opened a studio. Here, Milbon solely sells Global Milbon, one of the three premium product ranges that has reinvigorated the market. In addition, the firm launched Sophistone, a hair colour series specifically developed for US and European customers, in June 2020. Having highly sought-after hair colouring products is one of the main ways to cultivate new customers. Moreover, once the product is in-store, those customers usually are loathe to change to a new product – there is a lot of training involved on how to use the product as well as costs associated with inventory control – so a product like Sophistone is expected to help boost sales. Milbon US made an operating loss of ¥164mil (-13.3% YoY in Japanese yen) on sales of ¥189mil (-39.9% YoY on the Japanese yen converted basis) in FY20 1H.

Sales and OP Breakdown by Country (Cumulative: JPY basis)										
(¥mil)		FY18	FY19			FY20				
		FY	IQ	IH	FY	IQ	IH	YoY (%)	FY CE	YoY (%)
Japan	Sales	28,569	6,428	14,383	30,409	6,590	13,373	-7.0	29,600	-2.7
	OP	5,642	1,073	2,723	6,177	1,061	2,360	-13.3	n/a	n/a
	OPM(%)	19.7	16.7	18.9	20.3	16.1	17.7	-2.2pp	n/a	n/a
Overseas	Sales	5,312	1,458	2,859	5,857	1,235	2,495	-12.7	5,300	-9.5
	OP	617	191	365	574	-30	27	-92.5	n/a	n/a
	OPM(%)	11.6	13.1	12.8	9.8	n/a	1.1	-11.7pp	n/a	n/a
Total	Sales	33,882	7,886	17,242	36,266	7,825	15,869	-8.0	34,900	-3.8
	OP	6,260	1,265	3,089	6,715	1,031	2,388	-22.7	5,930	-12.2
	OPM(%)	18.5	16.0	17.9	18.6	13.2	15.1	-2.8pp	17.0	-1.6pp

Source: Milbon's FY19 and FY20 1H presentation materials

Financial Results

FY20 1H Results

Milbon reported FY20 1H OP of ¥2,388mil (-22.7% YoY) on sales of ¥15,869mil (-8.0% YoY). Despite hair salons being allowed to operate during the State of Emergency in April and May, domestic sales were affected by reduced operations and voluntary closures of hair salons and led to FY20 1H OP of ¥2,360mil (-13.3% YoY) on sales of ¥13,373mil (-7.0% YoY). In April and May, sales in Japan fell 40% YoY and 25% YoY, respectively. In June, as customers rapidly went back salons to have their hair treated, monthly sales rose by 18% YoY and uptrend, although smaller, continued in July.

Milbon also reported overseas FY20 1H OP of ¥27mil (-92.5% YoY – in Japanese yen) on sales of ¥2,495mil (-8.2% YoY). After a dip in IQ earnings, Milbon Korea and Milbon Shanghai were back on a recovery track in 2Q. However, while Milbon US has started to show a recovery trend since May on a YoY basis, the situation remains unstable because of the widespread impact from COVID-19.

Monthly Sales Trend (YoY change)						
(%)	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20
Consolidated	0.4	0.2	-2.4	-36.5	-23.1	15.9
Japan	-0.3	5.4	2.4	-39.7	-24.0	18.0
Korea	5.5	3.9	-9.5	4.6	14.9	39.7
China	-1.3	-83.9	-44.2	0.4	4.7	29.9
USA	38.4	13.9	-49.1	-83.3	-67.7	-33.4

Source: FY20 1H results presentation

In the Hair Care division, premium brand sales have been relatively resilient thanks to many users willing to continue using the products. One in particular, Aujua, enjoyed an increase in both the numbers of accounts (i.e. the number of salons using the brand) by +5.4% to 3,897 salons in FY20 IH, and saw sales increase 1.2% YoY to ¥3,330mil despite the effects of Covid-19. Another premium brand, Global Milbon, enjoyed a 15.9% rise in the number of accounts to 8,892mil, however, sales fell 3.8% YoY to ¥1,188mil due to weak overseas sales, in especially in the US, under lockdown. Meanwhile, Professional Brands sales were down -9.3% YoY (on a gross sales basis) due to salon closures. New products launched in early April also struggled due to a lack of marketing under the State of Emergency measures. IH Hair Care division sales fell 5.1% YoY to ¥9,391mil.

The Hair Colour Products segment was the worst hit by the fall in customer traffic under temporary closures and the shorter operating hours of hair salons. Although hair salons were not requested to close in Japan, many voluntarily closed. Moreover, customers refrained from going to the salons that remained open due to the fear of contracting the virus. Those that did visit the salons had their hair cut but did not stay for additional services, such as hair colour and treatments, as they require more time. IH sales of Hair Colour Products dropped 12.9% YoY to ¥5,594mil.

Despite total sales falling 8.0% YoY, gross profit margin (GPM) was only marginally affected, down 0.3ppt YoY. On the other hand, OP margin (OPM) worsened by 2.8ppt YoY as the firm has a high proportion of fixed costs in SG&A such as personnel cost. Milbon hired 40 new graduate FPs in April as planned. Usually, new FPs are placed under training for the first six months then they are allocated to work with senior FPs. However, due to COVID restrictions, most of the training was conducted remotely in April and May, focusing mainly on knowledge, while technical training could not be given as it is difficult to do virtually. Training period has been extended by one month. The second round of FPs (usually around 10) due to come onboard in October, has been cancelled.

Milbon (4919 JP): Earnings Summary (Quarterly Cumulative)

(¥mil)	FY18	FY19			FY20					
	FY	IH	FY	YoY (%)	IH	YoY (%)	Previous FYCE	New FYCE	Chg (%)	YoY (%)
Sales	33,882	17,242	36,266	7.0	15,869	-8.0	39,000	34,900	-10.5	-3.8
COGS	11,693	5,746	12,554	7.4	5,329	-7.3				
GP	22,189	11,496	23,711	6.9	10,540	-8.3				
GPM (%)	65.5	66.7	65.4	-0.1pp	66.4	-0.3pp				
SG&A	15,928	8,406	16,959	6.5	8,151	-3.0				
SG&A / Sales (%)	47.0	48.8	46.8	-0.2pp	51.4	+2.6pp				
OP	6,260	3,089	6,751	7.8	2,388	-22.7	7,300	5,930	-18.8	-12.2
OPM (%)	18.5	17.9	18.6	+0.1pp	15.1	-2.8pp	18.7	17.0	-1.7pp	-1.6pp
RP	5,811	2,824	6,231	7.2	2,102	-25.6	6,670	5,280	-20.8	-15.3
RPM (%)	17.2	16.4	17.2	0.0pp	13.3	-3.1pp	17.1	15.1	-2.0pp	-2.2pp
NP for the parent's s/holders	4,495	1,999	4,517	0.5	1,451	-27.4	4,730	3,840	-18.8	-15.0

Source: Milbon's FY19 and FY20 IH presentation materials

Sales Breakdown by Products (Cumulative)

(¥mil)	FY18	FY19			FY20			YoY (%)
	FY	IQ	IH	FY	IQ	IH		
Hair care products	20,222	4,323	9,897	21,328	4,424	9,391	-5.1	
Hair colouring products	11,857	3,175	6,423	12,994	2,995	5,594	-12.9	
Permanent wave products	1,544	337	770	1,515	291	660	-14.3	
Cosmetic products	0	0	47	165	71	136	186.1	
Others	257	50	103	263	42	85	-17.6	

Source: Milbon's FY19 and FY20 IQ, & IH presentation materials

FY20 Guidance

Milbon is guiding for FY20 OP of ¥5,930mil (-12.2% YoY) on sales of ¥34,900mil (-3.8% YoY) based on assumptions that the pandemic situation remains under control and economic activity gradually return to normal. Milbon expects 2H earnings will likely be flat YoY if the sales recovery trend continues with slight YoY growth as seen in July. FY20 domestic sales is guided to dip 2.7% YoY to ¥29,600mil, while overseas sales forecast to fall 9.5% YoY to ¥5,300mil.

While the restrictions and rapid changes experienced under Covid-19 had a negative influence on the business and the hair salon industry overall, opportunities for Milbon also emerged. One of the examples is the earlier than expected test phase of *milbon:iD* – the firm’s first e-commerce channel.

Milbon’s premium hair care products can only be bought when customers visit a salon, so in order to enhance salon revenue opportunities, Milbon launched its own e-commerce site *milbon:iD* on 1 June, through which customers can buy Milbon products only if they receive a QR code from their salon. Sales made on the site will then be booked directly to the salon. However, because of the temporary closure and customers unwillingness to go out due to Covid-19, Milbon offered to ship the products directly to the salons’ customers in response to requests from salons from late April, rather than customers having to go back to the store to them pick up – usually on their next appointment. Such a prompt response resulted in an increase in the number of salons registering with *milbon:iD*. The firm was hoping for 1,000 salons to register with *milbon:iD* by December, however, as at the end of July, 900 salons had already registered. Although Milbon does not expect *milbon:iD* to be fully operational until the end of FY20 – contracts with the salon signed / credit checks made etc – and, therefore, will have little impact to earnings this year, it has made a clear step towards a BtoBtoC model.

Milbon also quickly responded to the physical restrictions on its seminars and training sessions – held at its training centres – by swiftly switching to online streaming. Seminars to hairdressers are important as it supports product promotion and provides technical support to hairdressers. Milbon has a higher than average market share in big cities, such as Tokyo and Osaka, where the impact from Covid-19 on hair salons was more damaging than in suburban areas. Online seminars are also more convenient to those salon workers who may not readily be able to get to Milbon Studio and are a perfect solution during closures. Although online training is not the best alternative to physical face-to-face training, Milbon has made the decision to support the use of online seminars and has allocated a part of its CAPEX budget to facilitate a streaming capability at training centres from FY21 onwards.

Of the ¥1,958mil planned for FY20 CAPEX, ca. ¥ 1,700mil, though CAPEX for facilities needed for the online remote seminars is not yet known. Some of the less urgent items, such as the Aoyama Studio whose original opening was the Autumn 2020 and the new FP training centre, will be postponed to FY21 and the Milbon’s existing facilities will be used until then.

Medium-term Management Plan

In Feb 2019, Milbon announced its 5-year management plan that covers FY19 until FY23. The firm’s hopes to become the global top professional hair products producer by committing to develop the global beauty industry through field activities such as education and training professional hairdressers. As a steppingstone to this ultimate vision, Milbon aims to become one of the 5 best global makers during the current medium-term plan, one step forward from its current position as a top professional hair products maker in Asia.

While Covid-19 has interrupted the progress of the plan this year, the second year of the 5-year plan, Milbon has initiated an 18-month review period (Change the Stage 18-month Missions) starting from FY20 3Q until the end of FY21. Management has identified four stages and 25 missions to work on during the 18 months, based on an ultimate question: How can Milbon support the beauty industry’s survival during the post-COVID transition?

So far, the firm has not announced any change in its medium-term management plan although the review will likely be necessary once the 18-month review is completed.

Medium-term management plan (FY19~23)			
(¥mil)	FY18	FY23	5-yr CAGR (%)
Sales	33,882	48,500	7.4
Japan	28,570	40,000	7
OV	5,312	8,500	9.9
OP	6,260	8,800	7
OPM (%)	18.5	18.1	
NP attributed to the parent	4,495	5,960	5.8
NPM (%)	13.3	12.2	

Source: FY19~23 New medium-term plan press release

The original medium-term growth strategies in each of domestic and overseas markets are as follows:

❖ Domestic market

Milbon is targeting a market share of 25% in Japan, with sales of ¥40,000mil (5-year CAGR 7.0%). In addition to the organic growth of professional hair products through the FP system, the firm is looking for growth potential in the following two areas:

I. Building out its cosmetics (skin care) brand, Imprea – co-developed with Kose (4922 JP)

Of the 7,000~8,000 salons that use Milbon's premium hair care brands, 200 salons primarily sell the Aujua or Global Milbon brand at their salons as well as Imprea brand cosmetics. Skin care and make-up products sold through hair salon channels was ¥13,250mil (-4.0% YoY) in CY19. It is still a tiny fraction of the total domestic skin care market of ca. ¥1.7trn (+1.0% YoY – this figure includes purchase by inbound tourists), according to Yano Research Institute.

The Cosmetic Business dates back to June 2017 when the firm and Kose (4922 JP) formed a joint venture named Kose Milbon Cosmetics. Kose's role is to provide R&D and manufacturing capabilities as well as training FPs with skin care technique. In FY20, Milbon prepared 28 FPs specifically to promote the Imprea brand by instructing skin care expertise to 128 Imprea ambassadors at its distributors.

With the addition of a skin care product line-up, it also gives salons the potential for:

- I. Hairdressers to increase merchandise sales on top of their technical fee and hair care sales,
- II. Salons to offer a more holistic approach to customers' beauty demand by offering skin care products as well as hair care,
- III. Skin care products sales leading to greater customer retention – in general, brand switching is not common in skin care.
- IV. And finally, while customers can only buy those products by coming to salon, moving to an online option as *milbon:iD* is rolled out will likely be the next step.

2. Shifting from BtoB to BtoBtoC

Milbon has been expanding sales of products from professional salon-use only to salon and customers' home-use. In June 2020, Milbon opened its official e-commerce site, *milbon:iD*. The site can be accessed to shoppers only if they have QR codes issued by their salon. By having the convenience of online shopping, customers can repeat buying the products which will likely lead to brand loyalty.

There are two main reasons why Milbon does not have a more open e-commerce site – i.e. without the need of a QR code. 1) With salons issuing QR codes, sales can be directly booked to the salon not Milbon. Most importantly, Milbon wishes to avoid any conflict of interest by selling directly to users instead of going through salons. 2) With e-commerce sites, there is always the risk of resale, thus potentially damage the brand.

❖ Overseas market

Milbon aims to earn ¥8,500mil (5-year CAGR 9.9%) in overseas sales. The estimated total market size in the Asian region is \$3,200mil in CY17. Strategies to achieve this goal are as follows:

a. Increase sales reps at distribution partners

The number of sales reps at distributors increased to 754 (+54.2% YoY) in FY19 thanks to successfully adding distribution partners in the US. The overseas business model is principally the same as in Japan, where FPs and distributors work closely together. In countries like China and US, the role played by FPs in Japan and Korea is carried out by trusted distributors. The firm aims to increase sales reps to 1,000 by FY23 (5-year CAGR 15.4%).

b. Localised management

In a rapidly changing professional hair products market, accurate communication with styling experts in each region is paramount, each of which also has their own “jargon”. Having localised management (i.e. a native of the region – usually a stylist with a developed client list or someone with industry experience) will likely avoid losing business opportunities due to miscommunication. Milbon also aims to set up a factory in China in addition to a capacity expansion plan in Thailand.

Shareholder return policy and corporate governance

Milbon’s shareholder return, in principle, is to pay out 40%. A share buyback is least likely because of the share’s liquidity (below US\$3mil/day on 52-week average).

There are currently two external independent directors and two external independent auditors on Milbon’s Board. The management is currently seeking one more independent board member to meet the Corporate Governance Code guidelines to have 1/3 of the board with independent members. Since Milbon serves to women’s beauty products, the management wishes to have a female member on the Board going forward.

In the current medium-term plan, Milbon also committed itself to SDGs and signed the UN Global Compact. The firm plans to announce the SDGs matrix and publish the first Integrated Report at the end of August.

Key Financial Data

Milbon. (4919 JP): Key Financial Numbers						
(¥mil/ Dec year-end)	FY15	FY16	FY17	FY18	FY19	FY20CE
Sales	27,377	29,134	33,456	33,882	36,266	34,900
Operating Profit	4,727	5,113	5,345	6,260	6,751	5,930
Recurring Profit	4,427	4,733	4,997	5,811	6,231	5,280
Net Profit	2,950	3,069	3,817	4,495	4,517	3,840
EPS (JPY)	180.20	187.47	-	137.31	137.99	117.95
Adjusted EPS (JPY)	-	-	-	-	-	-
Cash flow from operation (CFO)	3,895	3,355	4,346	6,487	4,486	-
Cash flow from investment (CFI)	-2,834	-4,366	-1,919	-1,202	-2,777	-
Cash flow from finance (CFF)	-1,135	-1,262	-1,317	-1,639	-1,869	-
Cash and cash equivalent	7,086	4,737	5,928	9,541	9,376	-
Free cash flow (FCF)	1,061	-1,011	2,427	5,285	1,709	-
CFO per share (JPY)	237.89	204.92	262.46	198.14	137.02	-
FCF per share (JPY)	64.80	-61.75	146.57	161.42	52.20	-
Total asset	30,799	32,444	37,642	39,634	41,912	-
Liabilities	4,586	4,737	6,539	6,483	6,029	-
Net asset	26,212	27,706	31,103	33,151	35,882	-
Capital	2,000	2,000	2,000	2,000	2,000	-
Shareholders' equity	26,212	27,706	31,103	33,151	35,882	-
BPS (JPY)	1,601.02	1,692.33	-	1,012.58	1,096.02	-
OPM (%)	17.27	17.55	15.98	18.48	18.62	17.0
ROE (%)	11.73	11.38	12.98	13.99	13.09	-
ROA (%)	14.71	14.86	14.00	14.80	15.18	-
Shareholder equity ratio (%)	85.11	85.40	82.63	83.64	85.61	-
D/E ratio (%)	17.50	17.10	21.02	19.56	16.80	-
Total asset turnover (X)	0.93	0.92	0.95	0.88	0.89	-
Interest coverage (x)	10.59	10.84	10.45	10.31	10.52	-
Current ratio (%)	335.72	292.12	268.66	296.78	375.99	-
Interest-bearing debt	0	0	0	0	0	-
EBIT	4,874	5,205	5,509	6,419	6,874	-
EBIT Margin (%)	17.80	17.87	16.47	18.95	18.95	-
EBITDA	5,912	6,288	6,787	7,799	8,367	-
EBITDA margin (%)	21.59	21.58	20.29	23.02	23.07	-
Dividend (JPY)	74.00	78.00	92.00	54.00	56.00	56.00
Dividend pay-out ratio (%)	41.10	41.60	39.50	39.30	40.60	47.40
DOE (%)	4.80	4.70	5.10	5.50	5.30	-
Shares outstanding (shares)	16,558,617	16,558,617	16,558,617	33,117,234	33,117,234	33,117,234
Treasury (shares)	186,242	186,816	188,286	377,460	378,250	614,657

Source: Nikkei Value Search

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For further enquiry, please contact:

Yumi Yamamoto-Tyrrell

Nippon Investment Bespoke Research UK Ltd

First Floor,

35 Little Russell Street

London WC1A 2HH

TEL: +44 (0)20 7993 2583

Email: y.yamamoto@nippon-ibr.com



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Japanese Equity Specialist

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