

MILBON CO., LTD (4919 JP)

CONTINUES THE REST OF THE 18-MONTH TRANSITION BEFORE LAUNCHING THE NEW MEDIUM-TERM BUSINESS STRATEGY IN FY22

FY20 EARNINGS RESULTS

Milbon Co., Ltd (4919 JP) reported FY20 earnings of operating profit [OP] of ¥6,394mil (-5.3% YoY) on sales of ¥35,725mil (-1.5% YoY). The firm saw continuous sales growth every year until FY19 – when it also achieved record profits – as COVID disrupted its operating environment. FY20 OP declined more than sales because Milbon did not hold back on hiring additional Field Persons [FPs] despite the impact from COVID as management views FPs as strategically important for the firm's growth. Consequently, fixed costs increased.

In Q4 alone, sales were strong at ¥10,511mil (+9.3% YoY / +12.5% QoQ). Moreover, even taking into account the easy YoY comparisons from the weakness due to the consumption tax hike of FY19 Q4, the performance was impressive. This was thanks to a better-than-expected rise in December sales which saw customers rush back to salons ahead of the second State of Emergency closures.

Sales by products

While total Haircare product sales fell 0.9% YoY, Premium brands sales rose 5.8% YoY as customers in Japan spent more on salon-bought high-end products such as Aujua, for use at home.

Hair colour sales saw the most negative impact from the pandemic due to the fall in customer traffic and shorter operating hours of hair salons. Net sales fell 3.1% YoY to ¥12,594mil, but sales of fashion hair colour improved 3.0%. Since wearing a mask has become the norm and half of one's face is hidden, customers are choosing to add hair colour as part of their fashion repertoire.

Sales of Imprea, a cosmetics brand sold through hair salons only in Japan, were ¥360mil. The sales were short of the firm's target due to restrictions on marketing due to COVID (the target figure was not disclosed). However, the number of salons selling Imprea more than doubled YoY to 645, surpassing the FY20 target to have the product in 500 salons nationwide.

Sales by country

I. Japan

Milbon earns ca. 84% of its consolidated sales in Japan. FY20 Japan OP fell 3.0% YoY to ¥5,989mil on sales of ¥29,880mil (-1.7% YoY). Beauty salons stayed open during the pandemic, although there were some changes in customers' behaviour – e.g., a shorter stay at salons, lower frequency of visits and staying away from urban locations on the back of remote working and closures of stores in the urban areas. Milbon had been aware of those changes prior to the pandemic, however, the COVID-restrictions further accelerated those changes.

To support salon sales, Milbon offered salons access to its official e-commerce site – *milbon:iD*. For customers to access the site, they must obtain a QR code from their salon. Given Covid has led to

EXECUTIVE SUMMARY

- Milbon saw a YoY drop in FY20 OP after hitting record earnings in FY19. However, despite the impact from COVID, earnings overshot the firm's guidance.
- A new medium-term business plan will be announced with FY21 results.
- While earnings in Japan contracted, there was some resilience thanks to higher product sales at salons and, in particular, a rise in premium brand sales. The OPM fell due to FP-related hiring costs.
- Earnings in the US have been the most affected by COVID, but China and Korea are seeing a rapid recovery.
- Milbon is guiding for FY21 OP of ¥6,420mil (+0.4% YoY) on a 6.9% YoY rise in sales to ¥38,200mil – and should be another record year of earnings. However, the guidance is likely conservative as the firm assumes the impact from COVID will be prolonged.
- The firm identifies 4 strategies and 25 missions to tackle during the review period. That includes encouraging salons to sell merchandise so that they can increase a revenue stream as well as advancing with digitalisation.
- Milbon plans to spend CAPEX of ca. ¥7,488mil. For the time being, the firm's focus is on growth hence an annual cash dividend will stay at ¥56, the same as last year.
- Milbon sold some of its crossholdings and realised a gain of ca. ¥114mil, and it plans to gradually reduce its positions in strategically held shares. It also has treasury shares of ca. ¥2,109mil.

customers not frequenting salons as much due to restrictions, it has become vital that hairdressers encourage sales of salon-bought haircare products in an effort to maintain their business. As a result, the number of salons that registered with *milbon:ID* reached 1,300 vs. 1,000 expected for FY20. Thanks to an increase in product sales at salons, Premium brands sales grew 5.8% YoY. In particular, Aujua – one of Milbon's premium brands – saw sale rise 5.9% YoY to ¥7,960mil.

OP growth fell more than sales in Japan because of higher fixed costs on the back of the increase in FPs. The number of active FPs rose from 279 in FY19 to 297 in FY20 in Japan. In addition, the firm took on 50 new hires who underwent training but are yet to start contributing to revenue, which also added to the increase in fixed costs.

2. US

The COVID impact was the most apparent in Milbon's US operations. Despite the fact that economic activity had slowly started to pick up at the end of June, another lockdown commenced during Q4 (Oct~Dec). Consequently, Milbon USA made an operating loss of ¥302mil. Global Milbon – the firm's key product in the US – is also sold at salons for customers' home use. In FY20, 83% of Global Milbon brand sales came from product sales vs. 17% sold to salons for be used at salons. This compares to 73% from product sales and 27% for salon use in FY19. Milbon launched 301 online training sessions to hairdressers in the US in FY20 to reinforce corporate communication and to raise customer loyalty.

3. China

Sales in China saw the deepest YoY decline in February 2020 but started recovering sharply after the first wave of pandemic. As a result, FY20 sales reached ¥1,528mil (+2.7% YoY on a yen-denominated base / +5.2% in local currency). However, OP fell 14.6% YoY to ¥292mil, as the 2H recovery could not be offset by the 51.8% YoY slump in 1H OP from salon closures nationwide.

4. Korea

Milbon Korea is the largest part of Milbon's overseas operation, generating ca. 7.1% of total consolidated sales. The subsidiary earned FY20 OP of ¥645mil (-4.9% YoY) on sales of ¥2,543mil (+9.0% YoY on a yen-denominated base / +13.2% YoY in local currency). 70% of sales in Korea is earned from hair colour products, which rose 13.7% YoY (local currency).

Sales and OP Breakdown by Country (Cumulative: JPY basis)

(¥mil)		FY18	FY19		FY20				
		FY	1H	FY	1H	FY CE	FY Actual	vs. CE	YoY (%)
Japan	Sales	28,569	14,383	30,409	13,373	29,600	29,880	0.9	-1.7
	OP	5,642	2,723	6,177	2,360	n/a	5,989	n/a	-3.0
	OPM(%)	19.7	18.9	20.3	17.7	n/a	20.0	n/a	-0.3pp
Overseas	Sales	5,312	2,859	5,857	2,495	5,300	5,844	10.3	-0.2
	OP	617	365	574	27	n/a	405	n/a	-29.4
	OPM(%)	11.6	12.8	9.8	1.1	n/a	6.9	n/a	-2.9pp
Total	Sales	33,882	17,242	36,266	15,869	34,900	35,725	2.4	-1.5
	OP	6,260	3,089	6,751	2,388	5,930	6,394	7.8	-5.3
	OPM(%)	18.5	17.9	18.6	15.1	17.0	17.9	+0.9pp	-0.7pp

Source: Milbon's FY19 and FY20 earnings results materials

Overseas Sales and OP Breakdown by Country

(¥mil)	Sales / OP / OPM (%)	FY19	FY20	YoY (%) ¥based	YoY (%) LCY based
US	Sales	657	464	-29.3	-27.8
	OP	-252	-302	n/a	n/a
	OPM (%)	n/a	n/a	n/a	n/a
China	Sales	1,488	1,528	2.7	5.2
	OP	343	292	-14.6	n/a
	OPM (%)	23.0	19.2	-3.8pp	n/a
Korea	Sales	2,334	2,543	9.0	13.2
	OP	678	645	-4.9	n/a
	OPM (%)	29.1	25.4	-3.7pp	n/a
Others	Sales	1,377	1,307	-5.1	-4.7
	OP	-195	-230	n/a	n/a
	OPM (%)	n/a	n/a	n/a	n/a
Total	Sales	5,857	5,844	-0.2	2.4
	OP	574	405	-29.4	n/a
	OPM (%)	9.8	6.9	-2.9pp	n/a

Source: Nippon-IBR based on Milbon's FY20 earnings results material

FY21 OUTLOOK

Milbon is guiding for FY21 OP of ¥6,420mil (+0.4% YoY) on sales of ¥38,200mil (+6.9% YoY). The guidance is likely conservative as it is based on the assumption that the impact of COVID will be prolonged. Furthermore, Milbon plans to strategically invest for the future growth which will be explained later in this report.

Japan

Milbon is guiding for FY21 sales in Japan of ¥31,318mil (4.8% YoY), renewing the record level of revenues of ¥30,409mil achieved in FY19.

The firm was running a 5-year medium-term business strategy which started in FY19. However, management decided to scrap the plan at the release of FY20 results due to the disruption from COVID. Instead, Milbon has initiated an 18-month review period (*Change the Stage 18-month Missions*) that will last until the end of this fiscal year. Management has identified four stages and 25 missions to work on during that period, based on the ultimate question: How can Milbon support the beauty industry's survival post COVID.

The environment surrounding the Japan's beauty industry had entered a period of transition before the pandemic. COVID has accelerated the transition. Changes include the following factors:

1. Peak out of Japan's population – population is shrinking by 1,400 people per month on average.
2. Change in the demography – more than 35% of the population will be over 65 years old in 2040, increase from 28.9% as of 2020.
3. Change in the labour market – 71% of working age women work outside the household.
4. Rapid shift to digitalisation, which will likely change the competition environment.

Milbon recognises that the aforementioned changes in the market are having an impact on the operations of beauty salons. Covid has also dramatically changed the customers' behaviour. Findings from a survey conducted by Milbon on 2 October 2020, showed 65% of the sample population (2,031 females in their 20s~60s) said that the frequency of their visits to the salon would not change under COVID, with the remaining 35% answering that they went to the beauty salon less because of COVID. However, 63.1% of those 35% who went to the beauty salon less also answered that they would postpone their next salon visit by more than one month. Customers delaying their visit to the salon has, therefore, had an impact on salon's sales.

Since before the pandemic, it had been said that 1) increase in the elderly population, and 2) increase in working women will impact the consumption behaviour. For example, older people tend to complete their daily tasks within close proximity to their home rather than going to a major fashion district. Working women who are always pressed

for time tend to visit salons nearby their home instead of visiting ones in the urban areas. These change in consumption behaviours became more apparent under COVID. For example, the number of visitors to the Ginza district, a premium high street in Tokyo, were down 15~20% YoY during Oct~Dec 20, while number of visitors in Kichijoji, a West Tokyo residential area, saw a recovery back to normal levels in the same quarter.

Equally, shopping behaviours appeared to have changed. Another survey that Milbon conducted with 1,794 females in their 20s~60s answered that they prefer completing their shopping in one go; they are spending less time shopping and prefer to shop one place rather than hopping around various stores.

Based on these findings, Milbon came up with strategies on how it can help beauty salons adapt to these changes and which transforms the existing eco-system of professional hair care market.

1. Offering more digital platforms to support hair salons' revenue and education.

By having haircare products to sell also supports the revenue stream of the salons, even if customers are to the salon less frequently. Hairdressers are, in general, not trained to sell merchandise. Even prior to COVID, Milbon was supporting hairdressers to become multi-skilled, selling not just their hairdressing skills to customers but also product knowledge and information. The launch of *milbon:iD*, an e-commerce platform for Milbon's home-use products, gave salons opportunities to further boost revenues and also to keep customers coming back. In FY21, Milbon hopes to get 3,000 salons registered with *milbon:iD* – more than double the 1,300 salons signed up in FY20. In addition, the firm is encouraging salons to sell Imprea, a cosmetic brand co-developed with Kose (4922 JP) but sold solely at hair salons. In FY20, 654 salons were selling Imprea; Milbon aims to increase this number to 1,800 salons in FY21.

At the same time, Milbon plans to launch a digital education platform, *education:iD*, to support hairdressers gain multiple skills. The platform was introduced to enhance Milbon's education system for hairdressers in a digital format with structured certification programmes. They will be able to gain certification in four different categories such as Haircare, Cosmetics, Hair Colour and Design Logic. Ultimately, high achievers will be granted *Milbon Beauty Sommelier Certificate* by obtaining 3 certificates of the 4, mastered Milbon Counselling Method and revenue track record such as customer repeat ratio and knowledge-based sales.

2. Offering a digital platform to exhibit creativity.

One of the main investments that Milbon plans to make in FY21 is in Milbon Digital Arena. Every year, the firm holds Asia's largest Design Abilities (DA) event where hairdressers compete over their skills, learn from more experienced hairdressers and exchange information on skills. The event attracts ca. 10,000 audience every year. Under COVID restrictions, such an event might not take place any time soon, therefore, Milbon plans to launch a digital version of the event – creating a virtual space where training sessions, exhibitions, shows, photo galleries etc can be held – with a chat system, so participants can freely exchange their ideas, views, and ask any questions they might have. Details of Milbon Digital Arena are yet to be disclosed.

3. Offering a digital marketing support by utilising dynamic data in addition to static data

One of the important functions of the FPs is to consult on the day-to-day management issues for the salons. Under the existing support system, marketing data – such as the residential population of an area, commuter populations etc – was based on often outdated data from publicly available sources. However, with the use of a new digitalised marketing tool, anonymised dynamic data can be captured from a smartphones' GPS – albeit only from consumers who have agreed to data sharing with their mobile phone carriers. This data enables the FPs to better assess strategies for a salon's operations – opening hours / staffing / promotions – thanks to the more live information regarding the foot flow of customers in the area – where they are and at what times they are in the vicinity etc.

4. Direct approach to users via digital advertisement

With the launch of *milbon:iD*, customers can now buy haircare products from their salons online, without having to physically go to the salon, which boosts product sales at salons. Milbon plans to launch a campaign to boost the awareness of *milbon:iD* and the products that can be bought via the platform by launching advertisements on SNS, YouTube and other media. At the same time, the firm plans to launch Milbon Brand Movie to encourage viewers to go to hair salons.

Towards the end of the 18-month transition period, Milbon has several investment plans in Japan and overseas. The firm is guiding for CAPEX of ¥7,488mil, a big jump from FY20's ¥1,917mil. Ca. ¥5,300mil will be spent on land for the R&D Innovation Centre in Japan (ca. ¥3,000mil), and factory premises in China (¥1,800mil), and an expansion of production facilities in Thailand (¥500mil). Furthermore, ca. ¥240mil will be spent on a new Studio in Aoyama.

Overseas

Milbon is guiding for FY21 overseas sales of ¥6,882mil (17.8% YoY). Overseas sales are also likely to renew record sales, exceeding the current record, FY19 sales of ¥5,857mil. FY21 growth will focus on the following areas:

1. Increase sales reps at distribution partners

The overseas business model is principally the same as in Japan, where FPs and sales reps of distributors work closely together. In the US and China, roles played by FPs are carried out by trusted distributors. While the number of sales reps at Milbon's distribution partners fell from 754 in FY19 to 700 in FY20, the firm is guiding for a sharp rise to 840 in FY21. Thanks to an increase in distribution partners in the US, Milbon will reduce the physical distribution centres in US from two to one. At the same time, in Europe, the firm plans to have a logistics base in Holland that can cover the entire EU region. Together with two additional studios, one in Korea and another in Vietnam, the firm's overseas marketing bases will increase to 20.

2. Global diversification of R&D and production

Milbon's main R&D Centre is in Japan, which develops scientifically based new products with star hairdressers. The company is planning to open an R&D branch in the US (April 21), followed by branches in China and Thailand, next to each factory to be completed in 2022. These overseas R&D branches will help the firm develop brands for the local markets. Expansion of the existing capacity in the factory in Thailand will be completed in Dec 21 and a second overseas factory in China will likely be completed in Nov 21.

Milbon is guiding for FY21 total consolidated OP of ¥6,420mil (+0.4% YoY). Despite forecasting sales growth of 6.9% YoY, the smaller rise in OP is due to costs associated with the aforementioned growth investment plans. In addition to the ¥300mil budgeted for the firm's digitalisation investment at the Japan HQ, there will likely be a ¥200mil rise in overseas costs, which includes ¥100mil for the China factory and ¥100mil in R&D in the US.

SHAREHOLDER RETURN AND OTHER USAGE OF CASH

Milbon plans to pay an annual cash dividend of ¥56/share in FY21, generating a pay-out ratio of 45%. Although the firm budgets ¥7,488mil for CAPEX this year, it can be reviewed depending on how the COVID situation develops ahead. The firm had cash / cash equivalents of ¥12,345mil on the BS (as of FY20) and free cash flow of ¥6,387mil in FY20, which will likely sufficiently finance the future investment. Also, there are investment securities worth ¥2,935mil (as of FY20) on the BS. Milbon sold some of its crossholdings and realised a gain of ca.¥114mil, and it plans to gradually reduce its positions in strategically held shares. It also has treasury shares of ca. ¥2,109mil. In the past, the firm used some of the treasury shares as a reward to directors and executives with a form of shares with restriction on transfer.

Milbon (4919 JP): Earnings Summary (Cumulative)

(¥mil)	FY18	FY19			FY20				FY21		
	FY	IH	FY	YoY (%)	IH	New FYCE	FY	vs. CE (%)	YoY (%)	FYCE	YoY (%)
Sales	33,882	17,242	36,266	7.0	15,869	34,900	35,725	2.4	-1.5	38,200	6.9
COGS	11,693	5,746	12,554	7.4	5,329	11,940	12,339	3.3	-1.7	12,890	4.5
GP	22,189	11,496	23,711	6.9	10,540	22,960	23,385	1.9	-1.4	25,310	8.2
GPM (%)	65.5	66.7	65.4	-0.1pp	66.4	65.8	65.5	-0.3pp	+0.1pp	66.3	+0.8pp
SG&A	15,928	8,406	16,959	6.5	8,151	17,030	16,990	-0.2	0.2	18,890	11.2
SG&A / Sales (%)	47.0	48.8	46.8	-0.2pp	51.4	48.8	47.6	-1.2pp	+0.8pp	49.5	+1.9pp
OP	6,260	3,089	6,751	7.8	2,388	5,930	6,394	7.8	-5.3	6,420	0.4
OPM (%)	18.5	17.9	18.6	+0.1pp	15.1	17.0	17.9	+0.9pp	-0.7pp	16.8	-1.1pp
RP	5,811	2,824	6,231	7.2	2,102	5,280	5,791	9.7	-7.1	5,710	-1.4
RPM (%)	17.2	16.4	17.2	0.0pp	13.3	15.1	16.2	-1.1pp	-1.0pp	14.9	-1.3pp
NP for the parent's s/holders	4,495	1,999	4,517	0.5	1,451	3,840	4,204	9.5	-6.9	4,050	-3.7

Source: Milbon's FY19 and FY20 presentation materials

Net Sales Breakdown by Products (Cumulative)

(¥mil)	FY18	FY19			FY20			FY21CE	
	FY	IH	FY	YoY (%)	IH	FY	YoY (%)	FYCE	YoY (%)
Hair care products	20,222	9,897	21,328	9.3	9,391	21,135	-0.9	22,768	7.7
Hair colouring products	11,857	6,423	12,994	5.5	5,594	12,594	-3.1	13,112	4.1
Permanent wave products	1,544	770	1,515	6.6	660	1,372	-9.4	1,416	3.2
Cosmetic products	0	47	165	136	136	360	118.2	640	77.8
Others	257	103	263	85	85	262	-0.4	264	0.7

Source: Milbon's earnings results materials

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	100
US	No of FP	9	12	13	13	17
	Sales per FP	63	48	48	50	27
China	No of FP	18	19	22	21	30
	Sales per FP	40	50	62	70	50
Korea	No of FP	20	23	25	30	32
	Sales per FP	80	84	82	77	79
Other areas	No of FP	25	33	33	35	38
	Sales per FP	37	31	37	39	34

Source: Milbon's FY19 & FY20 earnings results materials

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