KOKUYO CO., LTD (7984 JP)

Theme: Work Style Reform, Office Space Creation, Coworking, Global Stationery

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Summary – A Brand that Many Japanese Remember with Their School Days

Kokuyo Co., Ltd (7984 JP) manufacturers and supplies office furniture and stationery. Its first product was a binder for accounting ledgers made of traditional Japanese paper, first sold in 1905. It then expanded its business to office furniture and filing cabinets, first launched in 1960. Over time, Kokuyo has become one of the largest comprehensive office supply companies in Japan. One of its most well-known brands is the *Campus* notebook series – a product that has sold nearly 3bil units since it was launched in 1975. Currently, the firm renders office design and consulting to corporates, government offices, schools and hospitals, in addition to the supply of furniture and stationary products. In both Office Furniture and the Stationary business, its success is more notable in the BtoB area.

Under the leadership of Kokuyo's current management, the 3-year plan's (2016~2018) aim was to shift out of its low level of profitability; prior to current president's tenure, the 5-year average OPM was 1.88% but that has now improved to over 5%. All numerical targets were achieved thanks to an improved gross profit margin in the furniture business and growth in global stationary business. On the other hand, targets for the transformation of the domestic stationary business, the BtoB specific catalogue and online office supply business – *Kaunet* – were not met.

FY2019 (year to Dec) is the start of next 3-year plan: Kokuyo hopes to achieve sustainable growth for all its businesses, as well as looking for new growth areas to further meet customers' demand. Kokuyo plans to announce full details of its long-term (10-yr) vision "Vision 2030", in FY2020, which currently targets revenues of ¥450~500bil (of which ¥150~200bil from new area of business and overseas) and an operating margin (OPM) of 8~9%.

From this year, Kokuyo's four business segments – Stationary, Furniture, Catalogue / Online Retail and Others – will be re-categorised by into three new business domains. The purpose of this is to better identify unrecognised business opportunities by focusing on what customers want to do (actions) rather than what they want (items). The new business domains are as follows:

1. Spatial Value Domain – office space design and consultation, office furniture supply
2. Business Supply Domain (BtoB)– procure and supply office supplies as presented by *Kaunet*
3. Global Stationary Domain (BtoC) – Production, wholesale and sale of stationaries in Japan and overseas

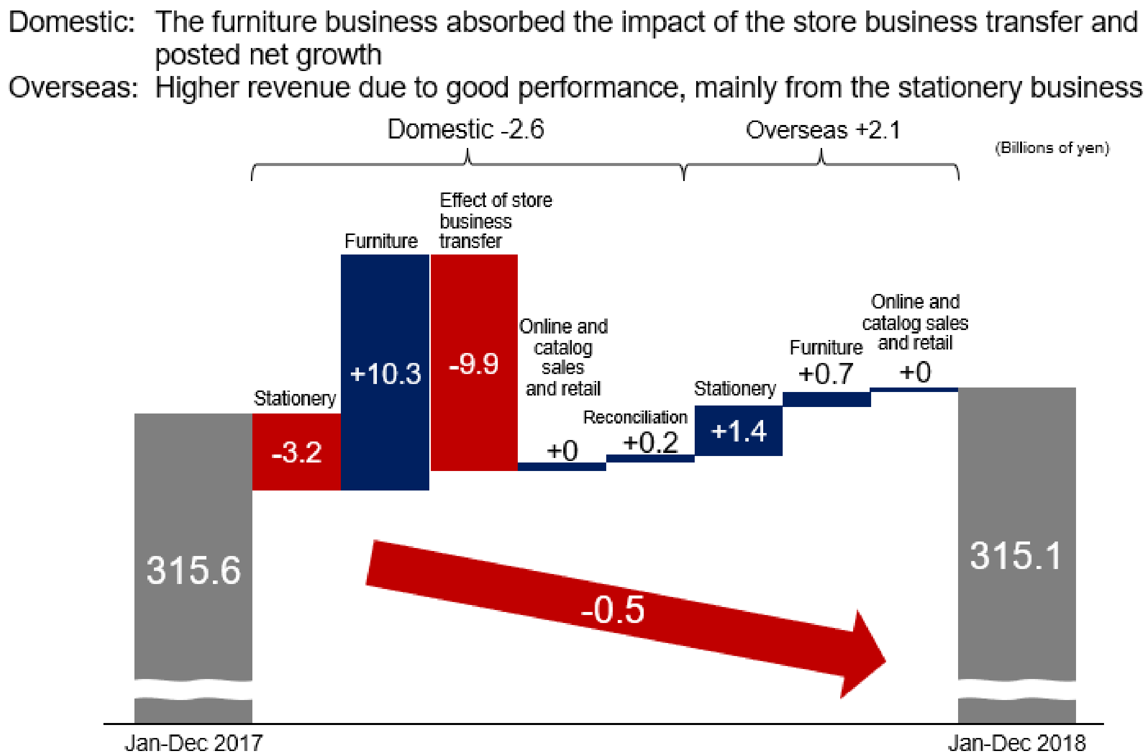
The external business environment, specifically the expansion in large-scale office buildings, has proved to be a tailwind for Kokuyo's furniture business thus far. The risk over the next three years still lies in the *Kaunet* business and whether it can successfully establish its BtoC businesses, i.e. if Kokuyo can expand the appeal of its stationary products to general consumers.

FY12/2018 and Conclusion on the 1st Medium-Term Management Plan

FY2018 Results

Total sales growth was flattish at 0.1%YoY to ¥315.1bil in FY2018. While office furniture sales contributed positively, the Stationary business fell -1.9% YoY. The company transferred its store furniture business – which manufactures and sells store shelfing units – to Sankyo Tateyama Inc (5932 JP) in Jan 2018. The business generated circa ¥10bil sales in FY2017. Like-for-like sales growth excluding the impact of the Store business in FY2018 was +3% YoY.

Waterfall Chart – YoY Change in Sales (FY2018)



The gross profit margin (GPM) has been steadily improving over the past 5 years reflecting management's efforts to focus on cutting COGS as well as to review pricing and optimising the sales mix. In FY2018, the firm recorded an all-time high GPM of 35.7%.

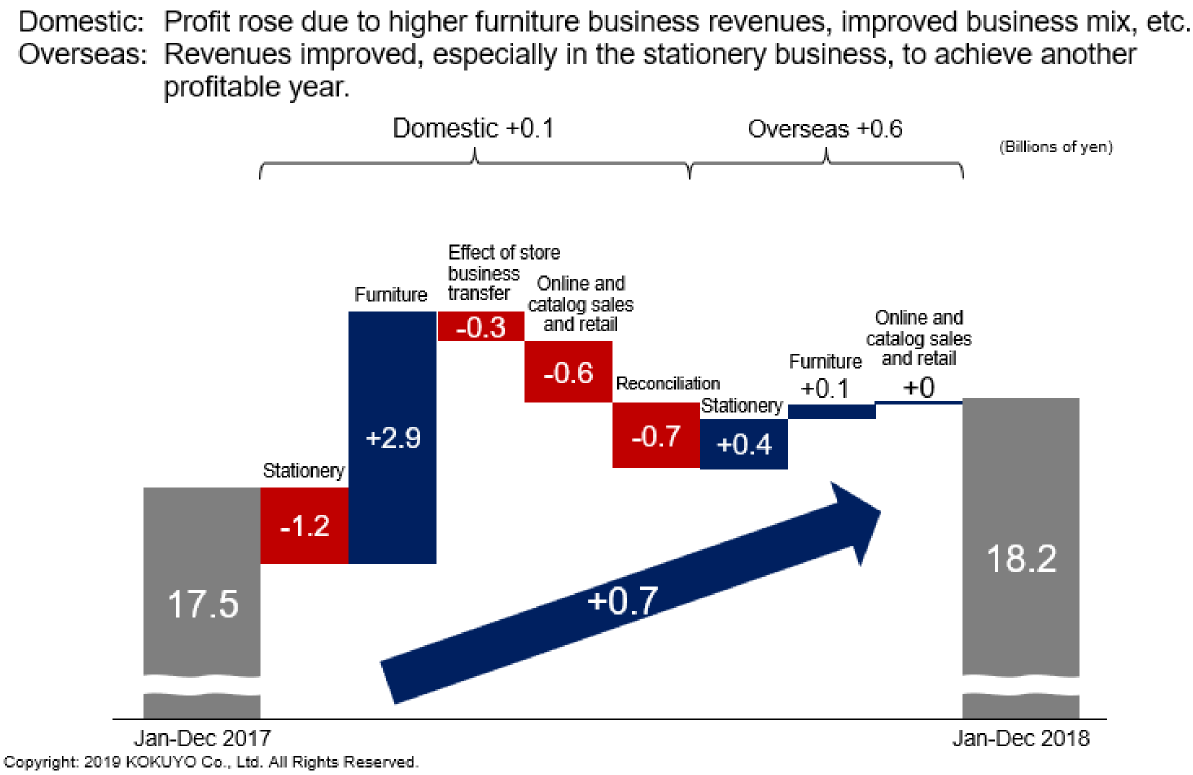
Although the OPM improved in FY2018 thanks to an improved sales mix in the Furniture business, profitability in the Stationary business dragged overall OP down. Some 54% of the Stationary business in Japan comprises the high margin *Kokuyo* brand – the national brand. However, the sales growth of Kokuyo brand items started to slow, leading to a deterioration in the segment's sales mix and a drop in the Domestic Stationary business FY18 OP by ¥3.2bil (ca. -4%YoY).

The *Kokuyo* brand has high market share – it is the dominant brand for accounting ledgers and notebooks (40% in Japan) (*Campus* brand, for example) – and is renowned for its high quality, therefore garners a higher GPM. Kokuyo also sells through specialist retailers such as Itoya, LOFT, Tokyu Hands as well as other retail channels.

Competitors that offer BtoB office supplies and furniture include PLUS (unlisted), for students' notebooks, Showa Note (unlisted), for document files, King Jim (7962 JP) and Lihit Lab (7975 JP). However, apart from PLUS, the size of the aforementioned companies is much smaller.

Another challenge to the *Kokuyo* brand products has been the digitalisation of accounting which has led to more paperless operations. With Kokuyo's traditional Stationary business – geared to the BtoB network in both wholesale and online retail for office supplies and stationery – under pressure and the weakening consumer channel, the company has been keen to cultivate more BtoC products as this area is beginning to expand. However, it has not yet been successful in capturing any critical mass in the BtoC area. At the same time, efforts have been made to the reduce numbers of items in the domestic stationary market while increasing its market share in selected product categories such as *GLOO*, a new type of glue products.

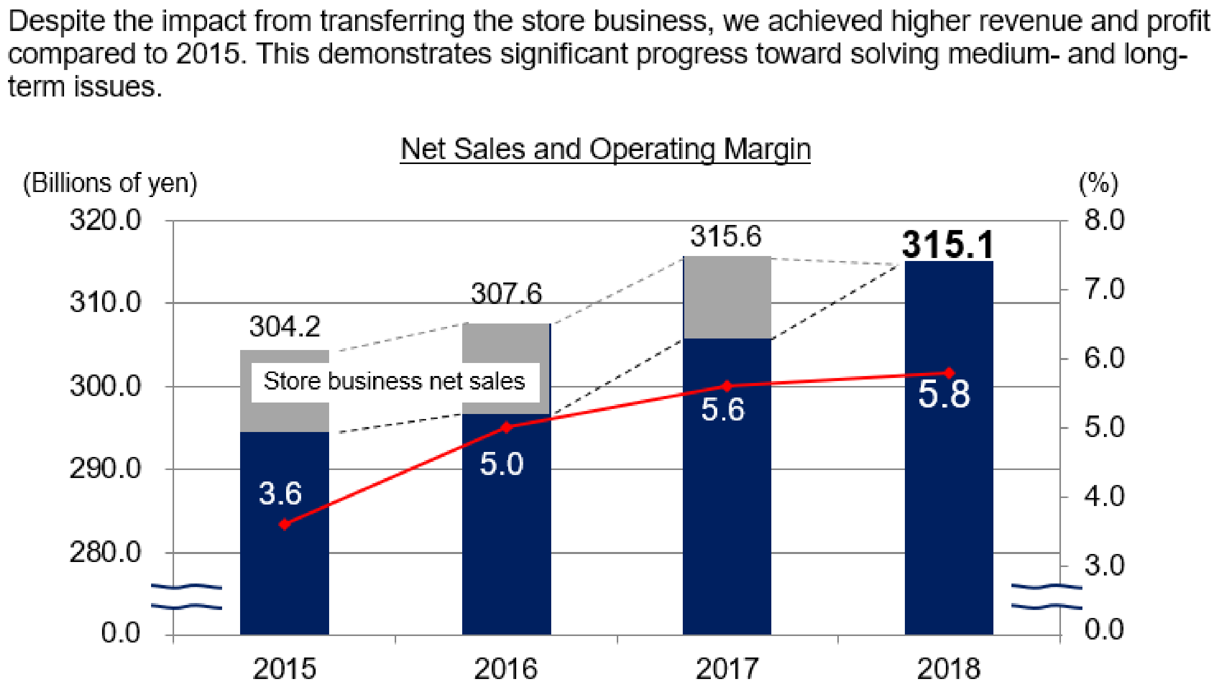
Waterfall Chart – YoY Change in Operating Profit (FY2018)



The Furniture business saw its OPM rise from 9.1% in FY17 to 11.2% in FY18 due to an improved sales mix, with 50% of segment sales generated from value-added, space design consultation-based sales, which typically includes the sale of office furniture and a consultation fee. Consultation-based sales were 1.5x stronger than initially expected. Strong demand for newly created office space, office renovation and renewal that cater for Activity-Based Working (ABW) has been triggered by the Workplace Reform Initiatives led by the Abe Administration. Usually, office furniture demand is cyclical and correlated to the external environment such as an increase in office relocation. However, the current demand appears reflective of a rise in the development of new and modern office space that has enabled corporates to consolidate scattered office locations into one large space, as well as increase in demand for satellite and co-working offices that play vital role in the Work Style Reform.

In the Online & Catalogue Sales and Retail segment, sales were flat YoY in FY2018. Growth in number of SME clients for *Kaunet* – Kokuyo's own online channel – remained sluggish, although the number of large corporate clients has increased. Kokuyo has increased the numbers of items on *Kaunet* by nearly 1.7x in FY2018 compared to FY2017 but the OPM slipped 0.4ppts, chiefly due to higher distribution costs. This is an area which management is striving to reduce further.

Review of the 1st Management Medium-Term Plan



Source: Kokuyo Co., Ltd FY2018 Presentation Material

Over the company's first 3-year Medium-Term Management Plan (to FY12/18), management aimed to reform the business model and build foundations to support medium to long-term growth. Kokuyo's efforts bore fruit: with the firm focusing on market share and gross profit margin, it was able to identify profitable customers and allocated more resources to such customers.

All numerical targets were achieved; however, management was also able to identify areas that require improvement for the 2nd medium-term management plan that started from this year. For example, the growth in *Kaunet* ("kau" means to buy in Japanese), Kokuyo's BtoB Online and Catalogue Office Supply service, has slowed. At the same time, cost competitiveness of *Kaunet* services was influenced by higher logistics cost.

The BtoB Online and Catalogue Office Supply business is dominated by three companies in Japan; Askul's (2678 JP) service, *Tanomail* by Otsuka Shokai (4768 JP) and *Kaunet*. Of those, Kokuyo's *Kaunet* holds the No. 3 position, hence the impact of the cost increase hit the hardest.

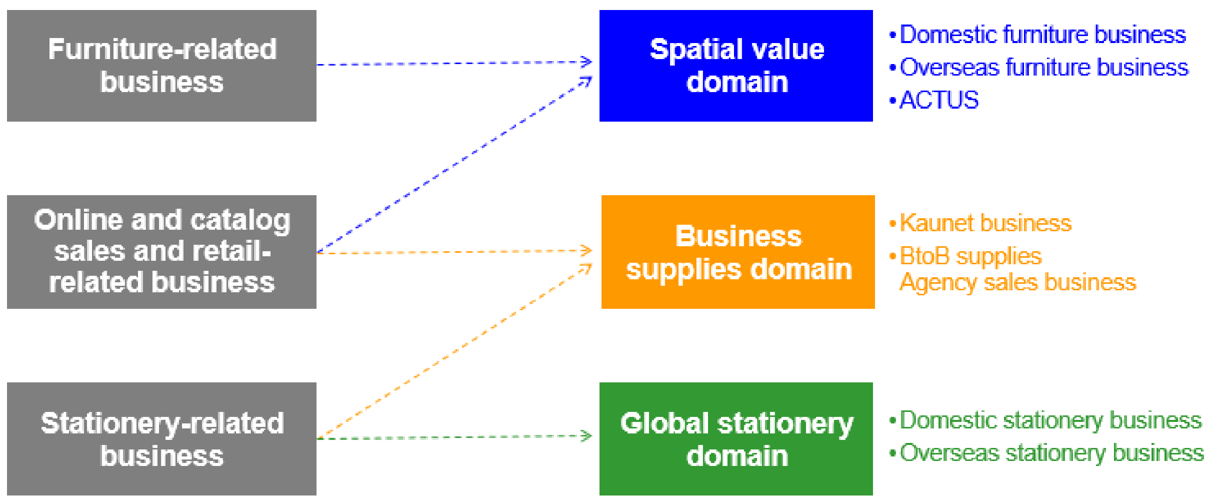
During the FY16~18 period, its ROE improved from below 4% prior to the 1st Medium-Term Management Plan to on average above 7% on the back of the rise in OPM and ROA. However, management reckons that the largest contribution came from significant improvement in GPM in the Furniture business.

The 2nd Part of Long-Term Management Plan – From Paper to Steel, then to Space

Transforming Business Model by Introducing Domain-based Approach

In the first year of the 2nd medium-term plan, Kokuyo introduced domain-based segmentation of its businesses so that management can better identify which business to grow and how. Domain-based segmentation should help clarify changes in client's needs so the firm can better respond to supply a wider range of services, rather than just focusing on the sale of its own products. This strategy should provide Kokuyo the flexibility to allocate its resources more effectively.

Changing business category lines through the setting of domains



Source: Kokuyo Co., Ltd. FY2018 Presentation Material

Sales and OP by domains

	FY12/18	FY12/19 (F/C)						FY12/21 (Target)
(JPY million)	FY	1Q	YoY (%)	1H (Revised)	YoY (%)	FY (Revised)	YoY (%)	FY
Total revenue	315,155	89,269	1.3	167,400	0.2	326,000	3.4	346,000
Spatial Value Domain	148,759	44,938	2.9	81,400	1.2	156,000	4.9	162,000
Business Supply Domain	115,773	30,890	1.8	58,900	-0.4	116,500	0.6	124,000
Global Stationary Domain	82,336	22,725	-1.3	44,300	-0.2	84,900	3.1	94,000
Others	2,263	623	18.2	1,300	17.9	2,400	6.1	
Adjustment	-33,978	-9,908		-18,500		-33,800		
Total Operation Profit	18,296	8,239	-8.4	11,400	-16.7	18,800	2.8	21,500
OP Margin (%)	5.8	9.2		6.8		5.8		6.2
Spatial Value Domain	15,056	6,877	1.1	9,800	-3.6	15,800	4.9	
OP Margin (%)	10.1	15.3		12.0		10.1		11.7
Business Supply Domain	3,273	506	-50.2	1,300	-40.8	2,800	-14.5	
OP Margin (%)	2.8	1.6		2.2		2.4		2.9
Global Stationary Domain	6,644	2,464	-14.7	3,500	-22.7	7,100	6.9	
OP Margin (%)	8.1	10.8		7.9		8.4		9.6
Others	80	32	0.0	50	4.2	100	25.0	
OP Margin (%)	3.5	5.1		3.85		4.2		
Adjustment	-6,759	-1,642		-3,250		-7,000		

Source: Kokuyo Co., Ltd

In the 2nd medium-term plan ending FY2021, Kokuyo is targeting ¥21.5bil in OP on revenues of ¥346bil. By identifying areas where efficiencies can be made in COGS, such as reorganising the Office Supply business in Business Supply Domain, the firm is looking for the GPM to improve from 35.7% as of FY2018 to 37.0% in FY2021. CAGR of the plan – sales +3.2% / OP +5.9% – may look rather conservative but with the reorganisation of its business segments to a domain-based strategy, management is taking a cautious view, testing the waters first to gauge what works.

While management is confident that the Domestic Furniture business and the Overseas Stationary operations will drive growth, risk still lies with how the firm's restructuring efforts in the Domestic Stationary and *Kaunet* business progress.

Spatial Value Domain: We Work Where and When We Want

Conditions for the Spatial Value Domain, which covers both domestic and overseas Office Furniture business, remains favourable thanks to the rise in new office space.

The Domestic Furniture business is primarily influenced by demand for relocation, renovation, and the need for larger space – especially in Tokyo – hence increases in the office space supply and contract ratio for new offices in Central Tokyo are considered to be leading indicators for the future earnings. According to the Office Market View published by CBRE Japan Office, demand for office space in Tokyo is expected to remain strong until 2020.

Market research by MORI Building also comments that the supply of large-scale office buildings in Tokyo's 23 wards is expected to have twin peaks in 2018 (1.46mil sqm) and 2020 (1.68mil sqm), having a dip in 2019 (990,000sqm)i. Although the market is expected to see a temporarily plunge in 2021 and 2022, it is viewed that the market will remain steady, rather than weaken, thereafter despite the increased supply as there are several developments already announced in prime areas such as Yaesu, Toranomon, Shibuya and Hamamatsucho starting from 2023 onwards.

The CBRE statistics show that not only were all buildings completed in Q4 2018 almost fully occupied as of the opening, contracts at existing buildings also saw an increase[ii]. Moreover, the vacancy rate across the board – for any grade of building – was below 1% in that period. Among the office buildings to be completed in 2019, some 80% is already under contract for lease. Demand for space is driven by corporates consolidating offices that were scattered over multiple locations and companies looking to expand the workspace.

Vacancies in existing buildings have also tightened: Demand for office consolidation and expansion should remain strong as companies finding it hard to find suitable size and locations in existing buildings have apparently already started looking at new office spaces in developments that are to be launched over the next two years. [iii]

There are several notable reasons behind the high level of demand for new office spaces.

- Approximately 60% of companies that intend to lease new office space are doing so to expand current floor space, so that they can "expand their business" and "accommodate an increase in employees". Interestingly, companies wanting to move to a "low rent / lower-priced building" was the lowest rank as a reason for relocation since the survey began in 2003.[iv]
- In addition to corporates wanting to relocate to larger office spaces, the demand for co-working offices (i.e. facilities that allow for both hot desking and dedicated remote office space – like an office away

from the office. The facilities offer communal use of typical office infrastructure – including reception, internet access, board rooms – which has played an active role in boosting demand for such workspace over the last couple of years. According to the results of an occupier survey conducted by CBRE[v], 23% of companies with an office in the Tokyo 23 wards said that they were either already adopting a flexible workplace practice, such as a co-working office, or have indicated that they intend to do so within the next year.

Work-Life Balance: Surge in need for co-working space as satellite office

Due to increasing recognition of maintaining a healthier work-life balance for Japanese companies and workers, there is also increasing demand for satellite working space as a mean of improving productivity and providing employees flexibility and convenience in their work schedule. Demand for co-working operators is coming from both traditional corporates as well as entrepreneurs. The space taken up for co-working space as a percentage of the total take-up in the Tokyo 23 wards has grown steadily in recent years, reaching 7.9% in 2018[vi]. According to Jones Lang LaSalle (JLL) Japan, co-working space doubled during the first half of CY 2018 from a year earlier. Furthermore, JLL estimates that the flexible office market in the major five wards of Tokyo should grow +20% YoY in square meters in CY2019, and a further +30% YoY in CY2020.

Another reason for large corporations becoming interested in taking up co-working space is the change in accounting standards. Effective from 2019, the International Financial Reporting Standard (IFRS) 16 will change the accounting practice for occupiers of real estate, requiring them to capitalise most leases on the balance sheet. However, co-working offices are expected to be allowed to continue being expensed. This could encourage occupiers seek more flexible or short-term office space to manage the impact to their balance sheet.

Kokuyo also has a branch of co-working office, Creative Lounge MOV (picture below), in prestigious Hikarie Shibuya. Shibuya is a hub for many IT ventures and the location typically caters for Japanese entrepreneurs. In response to the Activity Based Working (ABW) initiative, Kokuyo opened its co-working office to showcase its state-of-art designed furniture and offers clientele free use of *Campus* brand stationary. Management is also encouraged by the Work Style Reform Initiative, as they anticipate demand for satellite offices and co-working spaces – catering for workers' demand to work wherever and whenever they can / want to work –will grow, therefore providing its Spatial business tremendous business opportunities.

In Spatial Domain, competitors include not only office furniture makers such as Okamura (7994 JP) and Itoki (7972 JP) but also architectural design creators such as Nomura Co., Ltd (9716 JP) and Tanseisha (9743 JP). However, Kokuyo often works in partnership with these firms on large projects.

Shared Offices / Co-working Spaces Market in Japan

	Origin	Company	Services	Branches in Japan
Non-Japanese Capital	Shared Office	**WeWork**	Operates over 200 branches in 57 cities over 22 countries in the world. Tenants/users include not only start-up companies but multinational companies such as IBM. Uniqueness lies in the fact that it offers its own SNS apps and provides supports through community managers. In Japan, it has 6 branches as of June 2018 and plans to expand in cities such as Yokohama, Osaka and Fukuoka.	6
Non-Japanese Capital	Office Leasing	**ServeCorp Japan**	Has over 160+ branches in 53 cities over 22 countries, mainly in A-class buildings. Pricing is relatively higher. Members are mostly SMEs. In Japan, it started offering co-working spaces in existing leased offices.	24
Non-Japanese Capital	Office Leasing	**Regus Japan**	The largest office lease provider in the world with more than 3000 branches in 1000 cities over 110 countries. In Japan, its users were individuals but in 2016, it started a co-working space in Nagoya, focusing on networking among users. Plans to open spaces in Haneda Airport and Tokyo Station.	125
Target At Large Companies	Offsite Office Providers	**Work Styling (by Mitsui Fudosan:8801 JP)**	Shared-office facilities for large corporations that need offsite satellite offices. Members can use any of 30 branches. There are so-called Business Stylists that can support communications between members.	30
Target At Large Companies	Offsite Office Providers	**NewWork (by Tokyu Railway: 9005 JP)**	Membership-bases satellite offices for corporates. Branches are located along the Tokyu Railway Line. Aim is to moderate rush-hour travel.	11
Target At Large Companies	Offsite Office Providers	**Choku (by Xymax: 3488 JP)**	Satellite offices for corporates, operating Monday to Friday but not weekends. Aims to increase satellite offices with nurseries / childcare facilities.	32
Target Start-ups and Freelancers	Shared offices / co-working	**Business-Airport (by Tokyu Fudosan : 3289 JP)**	One of the leaders of shared offices in Japan. Users are mainly start-up ventures, although it promotes use by large corporations. Offers welfare packages (insurance products, gym access etc) of Tokyu Group to start-up members.	7
Target Start-ups and Freelancers	Shared offices / co-working	**FINO LAB**	Specific to fintech start-ups. It also provides non-Japanese ventures bases in premium Tokyo locations. Has JV with Mitsubishi Estate (8802 JP), Dentsu (4324 JP), International Information Services - Dentsu (4812 JP).	1
Target Start-ups and Freelancers	Shared offices / co-working	**Creative Lounge MOV (by KOKUYO)**	A leader in co-working space operation in Japan. Originally targeted at freelancers. Offers networking events for members.	1
Target Start-ups and Freelancers	Shared offices / co-working	**Think Lab (JINS: 3046 JP)**	Aims to offer "the environment that workers can concentrate the most in the world".	1
Target Start-ups and Freelancers	Shared offices / co-working	**Park 6 (Mori Trust)**	Offer shared offices for freelancers and people working at home. Plans to open support centre for entrepreneurs.	1
Target Start-ups and Freelancers	Shared offices / co-working	**APAMAN (fabbit)**	Membership-based shared offices for freelancers and start-ups. Hourly usage by non-members is also available. Expanding networks overseas.	18

Source: Nippon Investment Bespoke Research UK based on Industry Map 2019 by Toyo Keizai

Kokuyo managed to improve the GPM of the Domestic Furniture business as it offered both office design suggestions as well as furniture advice. Recently renovated corporate offices have very a similar look as those of co-working offices such as WeWork, for example. There are communal spaces for employees with fashionable furniture, big windows and an airy atmosphere unlike traditional corporate offices.

The overseas office furniture market is quite different from that of Japan. In Europe, the market is fragmented with various players – thus it may not be a scalable market for Kokuyo – while in the US, the market is fairly concentrated, so the entry barrier for a Japanese manufacturer may be too high. In Asian countries, markets have not yet been established by any particular brand, therefore Kokuyo aims to target Japanese companies expanding in Asian countries.

Business Supply Domain: At Turning Point

The Business Supply Domain is mainly a BtoB businesses, supported by *Kaunet* and BtoB wholesale. For the next three years, Kokuyo expects only market-level sales growth in this business.

Kokuyo has historically been strong in the BtoB office supply business, especially for paper-based stationary such as account books / ledgers and filing items. The BtoB stationary market has become extremely competitive over pricing as there has been a shift from customers to buy lower-priced generic, no-brand items. This has led to a deterioration in the sales mix. Furthermore, the sale of accounting ledgers and document files – products for which Kokuyo has a high market share in Japan (notebooks is circa 40% / document files is estimated between 20~30% / accounting ledgers unknown but the company reckons it is a dominant player) – has also started to slow as the shift to digital software and storage of documents becomes the norm among corporates.

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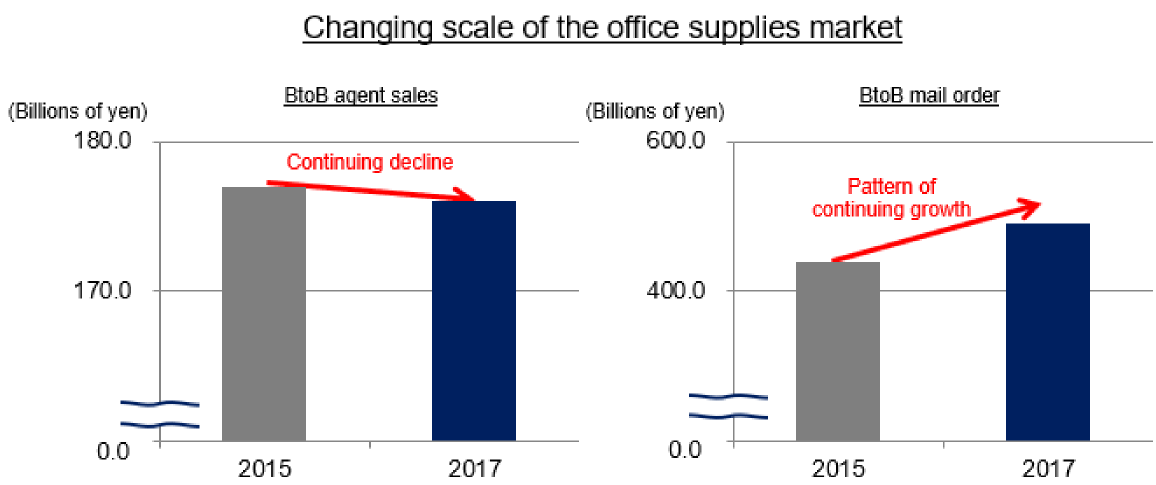
Under the old categorisation, the BtoB wholesale business was trending down but *Kaunet*, BtoB online and catalogue commerce had been on an uptrend. Management reckons that by consolidating the BtoB businesses into the one domain, it should be able to strengthen its customer base, become more efficient – especially in distribution cost that significantly rose during the past 3 years – and enhance its bargaining power.



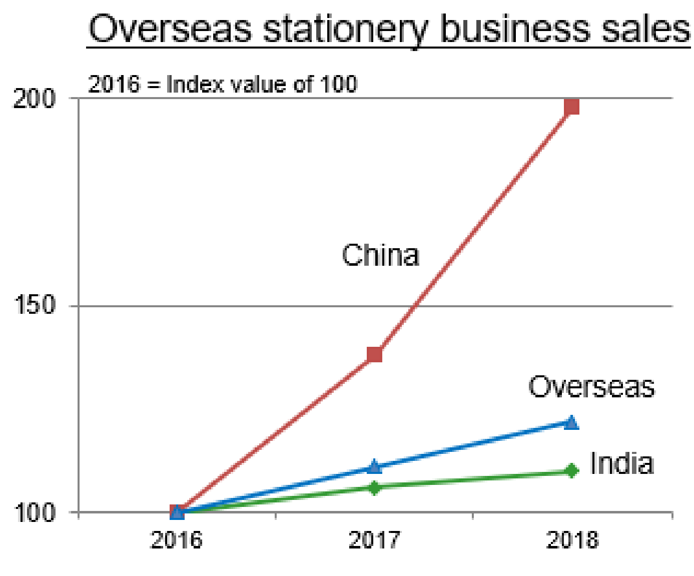
Source: Kokuyo FY2018 Presentation Material

Global Stationary Domain: Aiming to Launch Fun-to-Use Products

The Global Stationary Domain covers both the BtoC and BtoB Stationary businesses in Japan as well as overseas. Kokuyo largely focused on growing its BtoC businesses in stationary. Consumer stationary has been enjoying rapid growth overseas, especially in China – where revenue has doubled between FY2016 and FY2018 – and India.

Over the past 10 years, Kokuyo has successfully established its brand in Asian countries. Two years ago, all its local subsidiaries, in countries such as China, India and Vietnam, turned profitable. Since the beginning of the firm's move to Asia, management has focused on a cross-border business strategy. Kokuyo acquired a notebook maker in China and took over its factory to access the China market. In India, it acquired a 51% stake of a local art supply and crayon maker to gain access to its network and launched products to capture the local demand.

Kokuyo's products developed locally are well received both in China and India. For example, Kokuyo identified that there was a strong desire among female junior school students in China to have unique stationary as it carried a "cool" status. Since they must wear plain uniforms that lack individuality, girls find stationary a convenient tool to differentiate themselves from others. In India, demand for a good education for the children of middle-class parents is emerging. Stationary such as highlighters and mechanical pencils are popular items. Kokuyo sells those goods using networks it acquired from M&A. Now it is building a strategy to capture local demand in Vietnam.



Source: Kokuyo Co., Ltd. FY2018 Presentation Material

The BtoC products range has been under review to capture consumer demand in Japan. Because of its roots, Kokuyo has the top market share and strong brand presence in paper-based products, e.g. notebooks. Anybody brought up in Japan would have used Kokuyo's notebook rage (*Campus* brand) during their school years. Stationary other than paper-based products have been less of a strength for the firm.

Operational efficiency can be achieved by reducing the numbers of items and concentrating on the more unique, high value-added products. Moreover, there are customers' needs yet to be met. In FY18, Kokuyo developed and launched several new products by investing ¥899million on R&D. Those products are:

- *GLOO*, a new adhesive brand. There are 4 main product lines and 31 items under the GLOO brand such as:
  - stick glue that can be spread easily to the corners of paper
  - Tape glue that can be held in various angles
  - Instant glue whose colour disappears when glued safely
  - Sticky tape with a lightweight cutter that cab ne handled in one hand".
- *Softring® Note*, a notebook bound by soft resin rings. Binding ring is so soft that it does not disturb writing to the edge. So far 7mil *Softring® Notes* were sold.
- "*Choitas*" by *Campus*, a sticker that can be used to stick handouts to notebooks to help organise notetaking.
- Campus Study Planner, daily or weekly study planner.
- *Bizrack Up*, a bag-in-bag organiser in A4, A5, A6 sizes.

New Adhesive Series, "GLOO"

Glue stick that's easy to apply to corners

Quick-drying glue with fading color

Multi-grip tape runner

Easy-cut one-handed tape cutter

Source: Kokuyo Co., Ltd. FY2018 Presentation Material

To further enhance its BtoC business, the company plans to introduce non-paper, universal stationary products, such as the glue stick, globally. In stationary products, except for notebooks and document files, Kokuyo's role is to design and choose materials, but manufacturing would be done by OEM contractors. It continues to seek M&A opportunities globally to expand product range and/or distribution routes.

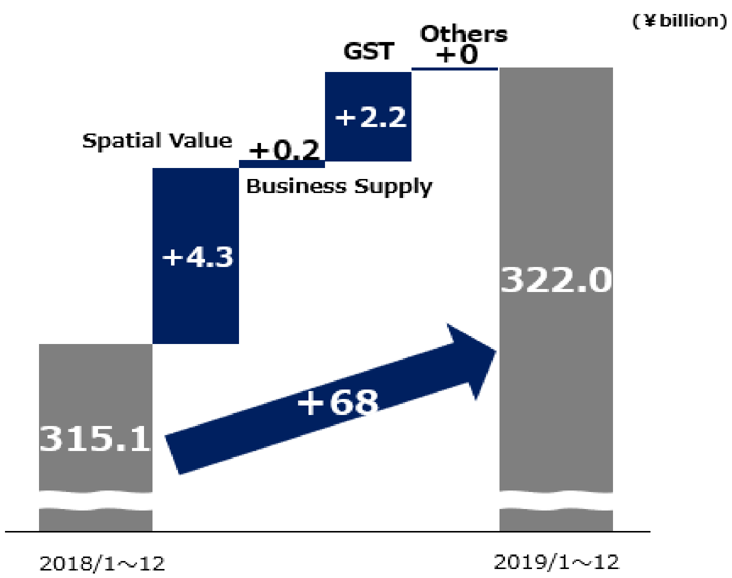
On 10 May 2019, Kokuyo announced its investment on Pentel, an unlisted Japanese pen maker. Pentel's largest shareholder is a fund managed by Mercuria Investment (7190 JP). Kokuyo becomes the largest investor of the fund and will effectively own 40% of Pentel.

Currently, overseas exposure of Kokuyo's stationery business is only 20%. On the contrary, Pentel has 20 marketing bases overseas that generate 60% of its sales. While Kokuyo is strong in paper-based stationery items, Pentel's speciality is in writing devices, hence there is little overlap in product line-ups.

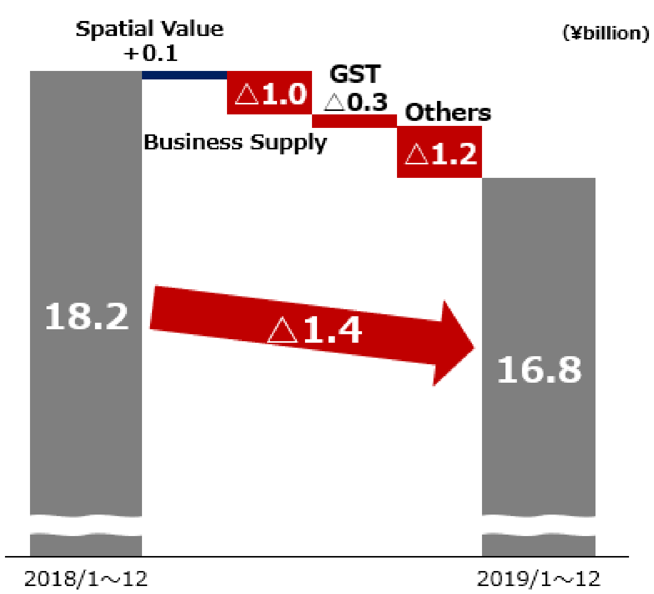
Kokuyo has not yet analysed if there is any impact to its earnings and Medium-Term Management Plan. If there were any change in guidance, the firm shall make official disclosure promptly.

BtoC stationary presents a higher growth potential compared to that of the BtoB range. However, growth of the consumer business has not been sufficient to cover the slowdown in the BtoB business. Kokuyo's BtoB original stationary range was paper-based products – such as duplicate receipt books and accounting-use ledgers, whose market has been shrinking due to shift to digitalisation. Therefore, the firm reckons it is important to turn on its focus to the growing consumer stationary market.

Waterfall Chart – YoY Change in Sales (FY2019 forecast)



Waterfall Chart – YoY Change in Operating Profit (FY2019 Forecast)



Financials

Q1 FY2019 Results – Plunge in the Gap Year

Kokuyo reported FY19 1Q (Jan - Mar) total revenue of ¥89.3bil (+1.3% YoY) and OP ¥8.2bil (-8.4% YoY). The firm has revised down both 1H and full-year guidance.

Revision on Domain Sales and OP - 1H and FY2019

(JPY million)	FY12/2019 (F/C)							
	1H (Old)	1H (New)	YoY (%)	chg in F/C (%)	FY (Old)	FY (New)	YoY (%)	chg in F/C (%)
Total revenue	170,400	167,400	0.2	-1.8	326,000	322,000	2.2	-1.2
Spatial Value Domain	83,500	81,400	1.2	-2.5	156,000	153,100	2.9	-1.9
Business Supply Domain	58,400	58,900	-0.4	0.9	116,500	116,000	0.2	-0.4
Global Stationary Domain	45,200	44,300	-0.2	-2.0	84,900	84,600	2.7	-0.4
Others	1,200	1,300	17.9	8.3	2,400	2,500	10.5	4.2
Adjustment	-17,900	-18,500			-33,800	-34,200		1.2
Total Operation Profit	13,100	11,400	-16.7	-13.0	18,800	16,800	-8.2	-10.6
OP Margin (%)	7.7	6.8			5.8	5.2		
Spatial Value Domain	10,400	9,800	-3.6	-5.8	15,800	15,100	0.3	-4.4
OP Margin (%)	12.5	12.0			10.1	9.9		
Business Supply Domain	1,800	1,300	-40.8	-27.8	2,800	2,200	-32.8	-21.4
OP Margin (%)	3.1	2.2			2.4	1.9		
Global Stationary Domain	4,200	3,500	-22.7	-16.7	7,100	6,300	-5.2	-11.3
OP Margin (%)	9.3	7.9			8.4	7.4		
Others	50	50	4.2	0.0	100	100	25.0	0.0
OP Margin (%)	4.2	3.85			4.2	4.00		
Adjustment	-3,350	-3,250			-7,000	-6,900		

Source: Kokuyo Co., Ltd

Although the Spatial Value Domain business is expected to grow over the medium-term, relocation activities within small-medium size offices was slower than expected in Q1. Kokuyo reckons that economic sentiment in Jan-Feb period was rather weak, affecting demand for relocation temporarily. Furthermore, relocation to the small-to-medium size office buildings was limited due to a lack of supply. On the other hand, demand from office relocation in the large-scale building segment remains strong. Demand for office consolidation and workplace improvement is also firm, however, some corporate tenants are finding it harder to secure new locations to move to, given low vacancy rates and high level of leasing contracts made off-plan. Overall, the company has cut its guidance both for the 1H and full year.

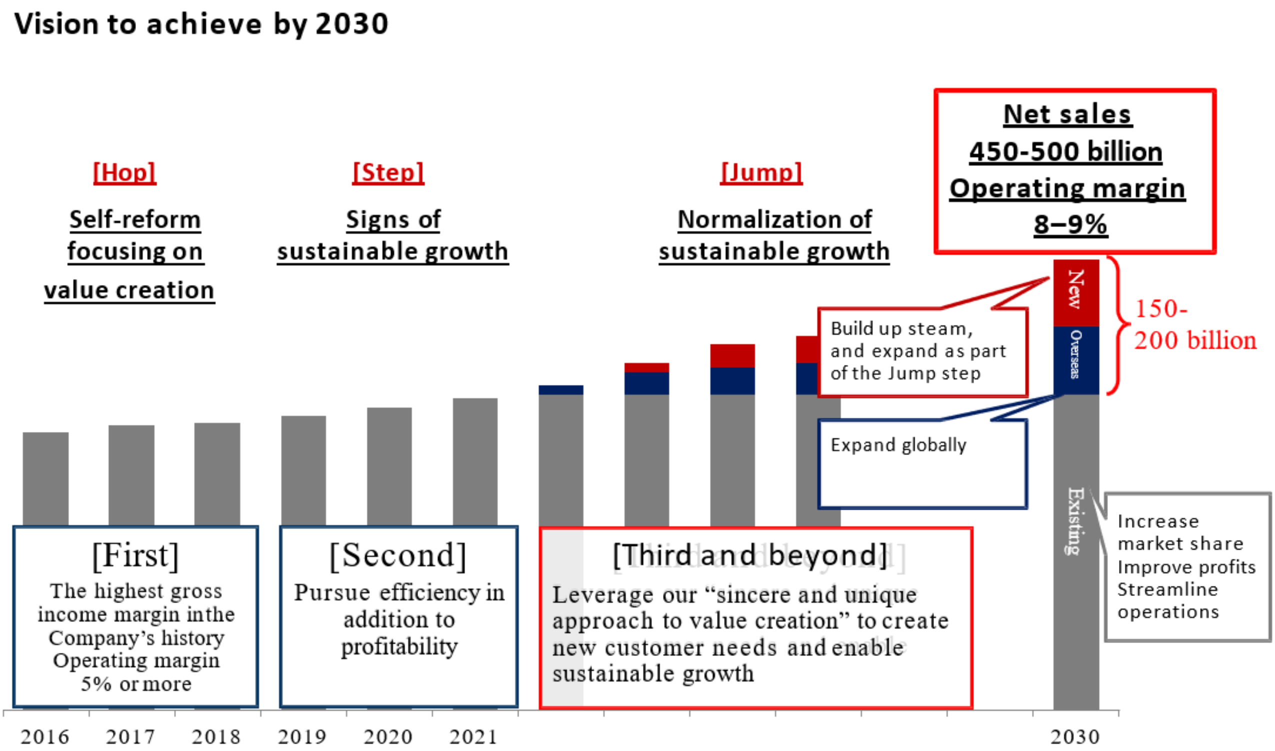
The Business Supply Domain is still struggling due to *Kaunet* failing to capture new clients. In 1Q, additional sales and marketing costs were incurred to test the waters but did not lead to any meaningful success in winning more customers. Management has indicated they are not willing to spend on additional sales promotion cost from 2Q onwards. For the full year, the company is modelling for a ¥1bil increase in logistics costs, which explains the circa ¥1bil YoY drop in the revised full-year OP guidance.

The Global Stationary domain has a successful overseas business, yet the company revised down full-year OP by ¥0.8bil, ¥0.7bil of which will be frontloaded into the 1H to reflect the rapid rise in raw material cost such as paper and resins in 1H. Management is planning to review its pricing policy in 2H as well as introduce cost control measures in the Domestic Stationary business. The Overseas Stationary business, however, has been performing better than expected in 1H.

The cut to company guidance was taken as negative by the market. However, the expected increase in large-scale office buildings to come on stream in 2020 will likely lead to a rise in relocation demand. Moreover, price revisions and cost reductions in the Domestic Stationary business should also contribute to overall earnings growth from FY2020.

Long-term Target beyond FY2021

Management's 2030 targets call for sales of ¥450~500bil and an OPM of 8~9%. Although nothing is concrete at this stage, the company is considering venturing into new areas of business and expanding its overseas business. These initiatives are expected to generate ¥150~200bil in revenue. For the next three years, the firm will prioritise solidifying the growth in the Furniture and Overseas Stationary businesses and will restructure the underperforming the BtoB Office Supply and the Domestic BtoC stationary businesses. In FY2020, management is planning to announce a long-term plan reflecting how the current prioritised initiatives are developing.



Source: Kokuyo Co., Ltd FY2018 Earnings Presentation

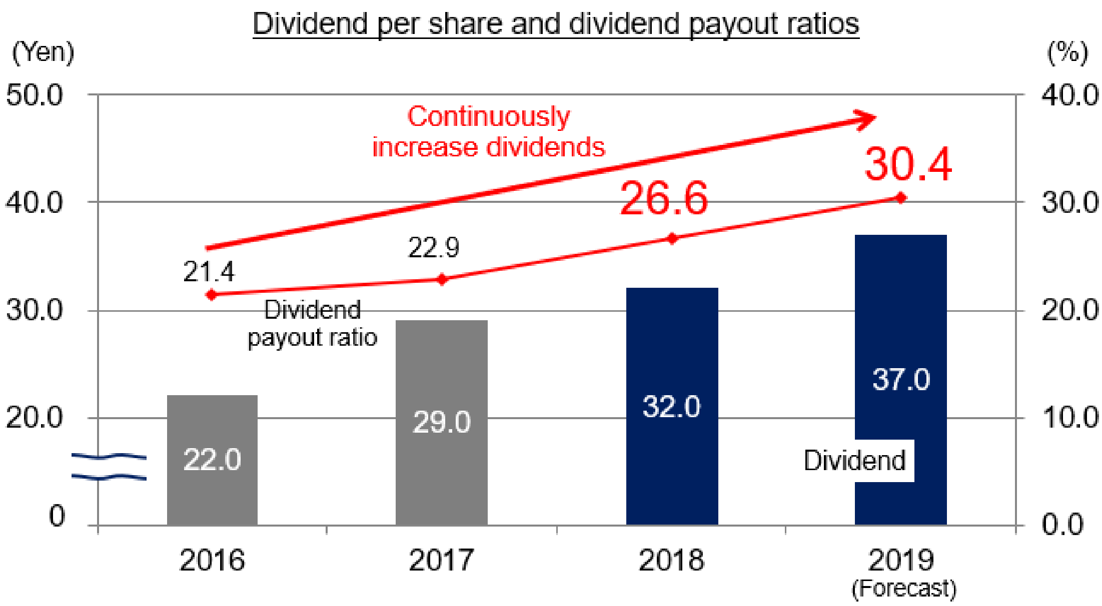
Shareholder Return and Corporate Governance

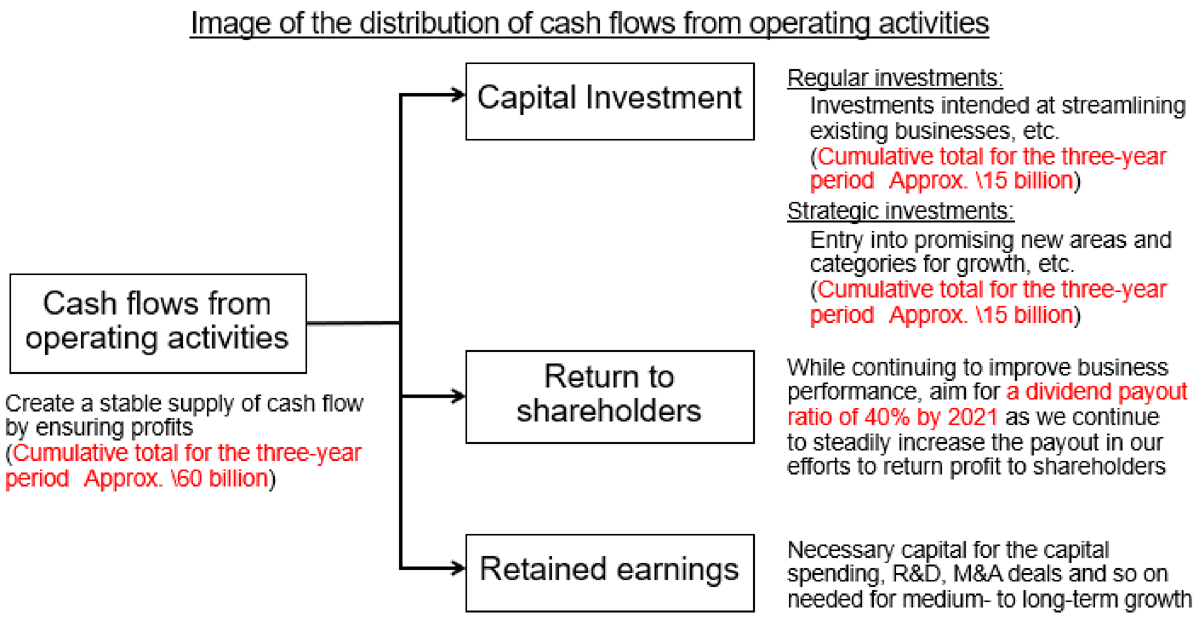
Shareholder Return

Kokuyo has a strong balance sheet that may be attractive to many value investors. It has 62% shareholders' equity ratio, of which nearly 90% is in retained earnings (as of FY2018). Kokuyo targets to pay out 40% of net profits by FY2021. Although some investors may expect an increase in dividend payments, management reckons the current 40% target remains a challenge as the firm is embarking on a new growth strategy. While aiming to continue a stable dividend, cash is also allocated to CAPEX, R&D and M&A to achieve medium and long-term growth. In FY2018, the ¥32/share dividend resulted in a 26.6% pay-out. The company plans to pay out ¥37/share, paying out 30.4% of forecast EPS in FY2019.

Under the ongoing medium-term plan, the priority of cash allocation will be given to investment for growth. Kokuyo is looking to generate ¥60bil in operating cash flow over the next three years. It plans to spend half of on CAPEX and growth investment, of which 50% is maintenance CAPEX (for improving efficiency of business etc) and another 50% is strategic growth investment including investment on new business categories and areas.

Assuming Kokuyo pays out 30~40% of net profit for the three years and spends ¥30bil on investment, retained cash over that period is estimated at circa ¥10bil. The firm has not ruled out the possibility of share buyback. It currently owns circa 8% of shares outstanding in treasury which can be used for M&A.





Source: Kokuyo's Medium-Term Management Plan Presentation

Corporate Governance – Young President Armoured with Solid Governance Structure

The current corporate governance structure was introduced in 2009, right after the Lehman Crisis, by the now Chairman Mr. Akihiro Kuroda, when he was still President of the company.

Kokuyo was not immune to the rapid downturn of earnings given the financial crisis led to a sharp decline in corporate activity. What worried Mr. Kuroda the most was that since Kokuyo had high brand recognition in Japan and plenty of cash on balance sheet, there was no sense of crisis among management and employees. He considered that it was his duty as a founding family member to armour the company with solid corporate governance policy – without that armour, Kokuyo would likely not have survived while the world was changing.

Mr Kuroda invited two external independent directors with management expertise in notable listed companies in Japan to play an active role in supervising executive decisions. To date, the external independent directors have successfully advised the firm.

The current president – Mr. Hidekuni Kuroda – having assumed the position in March 2015, has worked in two of Kokuyo's unlisted subsidiaries, mainly focusing on office systems and furniture. He has led the transformation of Kokuyo, taking the firm from being a company with sluggish growth to one with improving profitability thanks to the new strategies discussed above. These new strategic decisions have also been in response to guidance from external directors. From April this year, an additional external independent director (female) has been added to the Board, making the total of four external independent directors and the proportion of external independent directors to four to nine.

Internally, the company has a leadership programme of which 20~30% are female staff members. It actively seeks to employ staff with experience at other companies and female staff that were out of the job market. At the next AGM, the company plans to propose the introduction of stock options as part of the remuneration to directors, which might lead to the hire of non-Japanese Board members.

Financial Summary Table

(¥million)	2014/12	2015/12	2016/12	2017/12	2018/12	2019/12 (Guidance)
Sales	293,054	304,276	307,625	315,622	315,155	322,000
Operating Profit	7,598	11,102	15,438	17,591	18,296	16,800
Recurring Profit	9,643	11,880	15,690	19,130	19,178	18,400
Net Profit	5,065	6,312	12,182	15,000	14,231	14,400
EPS (JPY)	42.83	53.37	103.01	126.83	120.34	111.85
Adjusted EPS (JPY)	-	-	-	-	-	-
Cash flow from operation (CFO)	15,882	12,054	23,725	17,500	20,880	-
Cash flow from investment (CFI)	-702	-3,186	784	-1,660	-2,427	-
Cash flow from finance (CFF)	-9,106	-5,616	-3,919	-14,636	-4,585	-
Cash and cash equivalent	43,949	46,953	67,328	68,620	82,324	-
Free cash flow (FCF)	15,180	8,868	24,509	15,840	18,453	-
CFO per share (JPY)	134.28	101.92	200.60	147.97	176.55	-
FCF per share (JPY)	128.34	74.98	207.23	133.93	156.03	-
Total asset	273,772	286,313	293,971	305,147	304,788	-
Liabilities	103,419	105,520	105,931	100,653	95,826	-
Net asset	170,352	180,793	188,040	204,493	208,962	-
Capital	15,847	15,847	15,847	15,847	15,847	-
Shareholders' equity	168,274	178,972	186,273	202,602	207,162	-
BPS (JPY)	1,422.75	1,513.23	1,574.99	1,713.11	1,751.69	-
OPM (%)	2.59	3.65	5.02	5.57	5.81	-
ROE (%)	3.05	3.64	6.67	7.71	6.95	-
ROA (%)	3.01	4.13	5.50	6.04	6.17	-
Shareholder equity ratio (%)	61.47	62.51	63.36	66.39	67.97	-
D/E ratio (%)	61.46	58.96	56.87	49.68	46.26	-
Total asset turnover (X)	1.08	1.09	1.06	1.05	1.03	-
Interest coverage (x)	12.22	19.09	27.34	36.33	45.32	-
Current ratio (%)	209.07	205.44	202.08	224.76	249.52	-
Interest-bearing debt	25,898	24,299	23,687	13,759	13,893	-
EBIT	10,297	12,474	16,260	19,617	19,584	-
EBIT Margin (%)	3.51	4.10	5.29	6.22	6.21	-
EBITDA	17,435	19,641	22,740	26,100	25,919	-
EBITDA margin (%)	5.95	6.45	7.39	8.27	8.22	-
Dividend (JPY)	15.00	17.50	22.00	29.00	32.00	37.00
Dividend pay-out ratio (%)	35.00	32.80	21.40	22.90	26.60	-
Shares outstanding (shares)	128,742,463	128,742,463	128,742,463	128,742,463	128,742,463	-
Treasury (shares)	10,468,374	10,470,864	10,473,301	10,476,272	10,478,700	-

Source: Nikkei Value Search

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