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S-POOL INC. (2471 JP)

CONTRIBUTING TO WORK STYLE REFORM AND UNIVERSAL EMPLOYMENT

NIPPON INVESTMENT BESPOKE RESEARCH UK LTD

LONDON, UK

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Summary

A Universal Employment Solutions Service Provider

S-Pool (2471 JP) provides employment solution services that aim to generate opportunities in the workforce for those who wish to work but have not yet found employment. Under Japan's 'Universal Employment' initiative, the Ministry of Health, Welfare and Labour (MHWL) encourages the employment of people that are not or have not been in employment such as housewives and single parents, young jobseekers that have not been given opportunities due to lack of experiences, retired seniors and those with special educational / physical needs.

The company provides solutions between those cohorts identified as per the Universal Employment and employers through two business segments: 1) Human Resources Solutions and 2) Business Solutions. The former is to dispatch temporary staff members as a group to customers such as call centres and specialist retailers. The latter is further divided into four businesses, of which Special Needs Employment Support is the second pillar of growth. In this business, it supports jobseekers with disabilities to find employment at hydroponic farms created, sold / leased out and operated by S-Pool itself, on behalf of the employers. Both segments are stemmed from S-Pool's vision that businesses that supports social needs and meets social demands are resilient against economic turbulence. The name of the company represents the pool of services it offers, all of which begin with the letter "S", such as solution, system, social, sharing and staff.

In FY18 (year to Nov), both sales and operating profit exceeded the company's original estimates thanks to favourable results in the Temporary Staffing Services (Group Dispatching) business and Special Needs Employment Support segment. For the current fiscal year (to Nov 2019), the company continues to offer high-value added services to its customers with, in particular, Temporary Staffing Services and Special Needs Employment Support leading earnings growth. In the company's medium-term plan ending Nov 2020, it aims to boost OPM from 6.6% in FY18 to 10% by the end of the final year.

S-Pool (2471) : Earnings Snapshot

(JPY million)	FY2014	FY2015	FY2016	FY2017		FY2019
				CE	(Actual)	CE
Sales	7,267	9,236	11,696	13,587	14,797	17,066
Gross Profit	1,836	2,685	3,342	3,811	4,022	4,834
Gross Profit Margin (%)	25.3	29.1	28.6	28.0	27.2	28.3
SG&A	1,777	2,177	2,668	2,977	3,038	3,573
SG&A / Sales (%)	24.5	23.6	22.8	22.8	20.5	20.9
Operating Profit	59	507	674	814	983	1,260
OP Margin (%)	0.8	5.5	5.8	5.8	6.6	7.4
Recurring Profit	49	496	687	802	1,007	1,248
Net Profit	-68	408	423	468	619	811
EPS (JPY, adjusted basis)	-4.57	27.17	27.32	29.66	39.27	51.29
Dividend (JPY, adjusted basis)	2.00	2.00	3.60		5.00	10.00
BPS (JPY, adjusted)	43.75	68.90	92.54		128.27	
ROE (%)	n/a	48.23	29.522		35.54	

Source: S-Pool Inc. CE = Company Estimate

The company is currently listed on Tokyo Stock Exchange Second Section after having been promoted from JASDAQ. Management reckons that it is a stepping stone to be eventually listed on the First Section.



Source: Company

Historical Background

Back to Basics – Reconfirming the Original Vision After a Painful Lesson

- 3 While the Human Resources Solutions segment mainly offers a temporary staffing service, S-Pool's second key segment, Business Solutions, includes special needs employment services. The former generates 70% of its consolidated sales, while more than 50% of OP comes from the latter.

From its beginnings in 1999, the firm's original mandate was to offer a temporary staff dispatching service for short periods of time, say 2~3 months maximum. In those days, that core business generated 90% of its consolidated revenue, up until the Lehman crisis hit.

S-Pool was founded by Mr. Urakami, as a spin-off venture from his employer at that time. He worked at Kateikyoshi Centre, a home-tutor dispatching agent that had 10,000 university students registered on its books. After 1995, university graduates struggled to find full-time employment in the post-bubble recession. It was said circa 2mil graduates reluctantly became freelancers due to the lack of employment opportunities.

Mr. Urakami saw many high-calibre / highly qualified students registered as home-tutors as they were unable to find traditional employment. He persuaded his employer to set up a small division to support university graduates find employment. He first started by matchmaking the graduates with companies for internship mandates. Having proved successful – with many of the interns taken up as full-time employees after a short probation period – Mr Urakami carved out the business from his employer and bought out the business in December 1999.

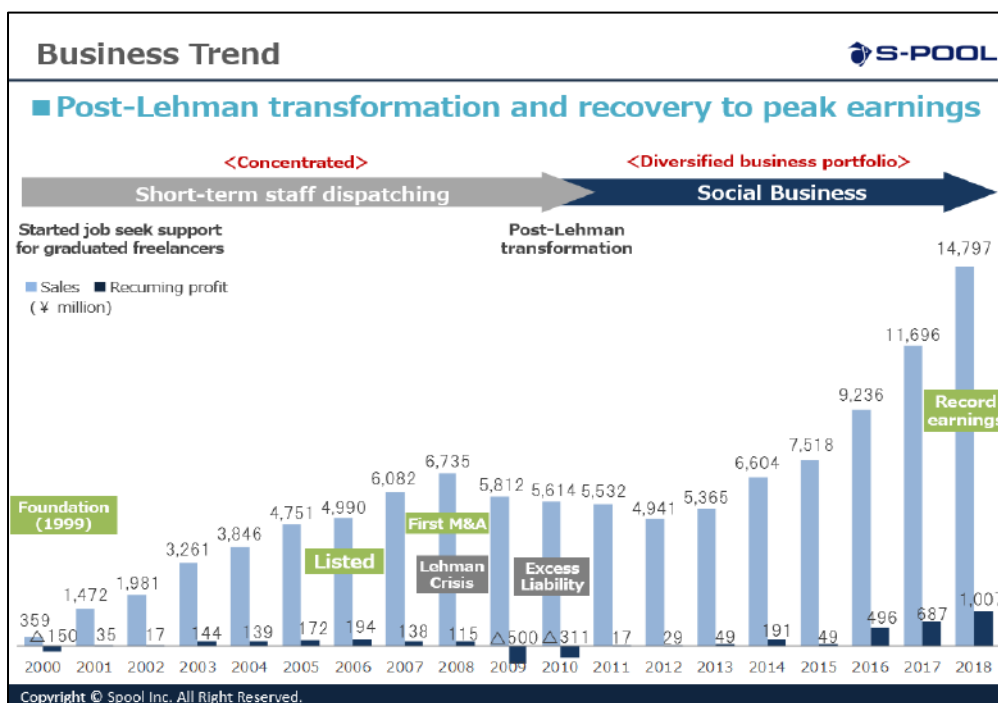
S-Pool first attracted media attention when it started using NTT DoCoMo's i-Mode – a mobile internet service – as an information tool for both graduates and companies wishing to hire interns. The use of i-Mode was simply introduced for operational efficiency, but media attention brought more students and younger people to register. It also attracted attention of venture capitalists (VC) and within 8 months since inception in December 1999, the firm managed to raise JPY600mil from several VCs.

With VCs encouraging the company to list, S-Pool’s strategic focus shifted more on boosting revenues. In 2001, the business model changed from matchmaking graduates & corporates to a short-term staff dispatching service using the mobile phone network, i-Mode. In the beginning, the business grew rapidly and almost instantly generated JPY1.5bil in annual revenue as of FY2001 from JPY359mil in FY2000. As a result of rapid growth, supported by job market recovery, the company was able to list on the Tokyo Stock Exchange JASDAQ within 6 years of its inception.

By 2008, S-Pool accumulated a cash position of JPY0.9bil. Under pressure from shareholders to use the cash, the firm acquired the IT staff outsourcing business division of an IT engineering company in September of the same year, and with it gained the 300 engineers registered on its books. Moreover, the head of the acquired division, Mr Tokunaga – a former senior director of Microsoft Japan – came on board. However, the effects of the Lehman Crisis which dramatically hit the labour market, and especially temporary staff mandates, resulted in a JPY1bil loss from this newly acquired business and the S-Pool Group became insolvent on balance sheet.

After such a painful lesson, Mr. Urakami took charge of the acquired business himself and managed to turn it around from operating in the red and moving back into the black within two years. This event gave the company some important lessons: One is that the short-term staff dispatching business is vulnerable to downturns in the economy. Another is that the company’s vision had been diverted away from its original focus – that is to provide support to those in need of job opportunities, such as new graduates who are struggling to find positions in the workplace and help them become financially independent. Mr. Urakami recalls that rapid success over those first 8 years of its operation which led the management to chase earnings success proved to be misguided as it took them away from their originally mission, namely, support those truly in needs of job opportunities. Lessons from the firm’s venture into M&A further led the company to reengineer its business model based on social needs.

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Source: S-Pool Inc.

Business Model

Tapping the Untapped Human Resources

S-Pool’s two core businesses now currently generate more than 80% of consolidated revenue and almost 100% of consolidated operating profit.

Segment Earnings

(\u00a5million)	FY2016			FY2017			FY2018CE		
	Sales	OP	OPM (%)	Sales	OP	OPM (%)	Sales	OP	OPM (%)
Business Solutions	3,998	728	18.2	4,482	874	19.5	4,774	1,170	24.5
Human Resources Solutions	7,722	680	8.8	10,382	1,004	9.7	12,400	1,179	9.5
Adjustment	-25	-	-	-68	-895	-	-108	-1,089	-
Total	11,696	674	5.8	14,797	983	6.6	17,066	1,260	7.4

Source: Company

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Business segment

■ We generate 84% of consolidated net sales from 2 core services

Business Solution (30%)	Human Resources Solution (70%)
<p>■ Special Needs Employment Service </p> <ul style="list-style-type: none"> • Support for companies seeking to employ persons with disabilities • Job training for disabilities <p>■ Logistics Outsourcing Service </p> <ul style="list-style-type: none"> • Outsourcing service for distributing products sold over the Internet • Logistic center operation agency <p>■ Sales Support Service </p> <ul style="list-style-type: none"> • Sales promotion • Support for Marketing Operations <p>■ New Business </p> <ul style="list-style-type: none"> • Job placement services for skilled senior citizens • Answering services for part-time job application 	<p>■ Temporary staffing Service </p> <ul style="list-style-type: none"> • Call Center Operations Supervisor / Phone operator • Office Support Clerk / Dispatch to business centers • Support For Sales Retail personnel / Sales personnel • Specialist Services Nurse / Nursery teacher / carer

* %:Sales Ratio

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Source: S-Pool Inc.

CORE BUSINESS 1: HUMAN RESOURCES SOLUTIONS
Temporary Staffing – higher profit margin than its competitors is driven by multitasking superstars called Field Consultants

The Human Resource Solutions segment generated 70.1% of consolidated revenue as of FY2018. Over the past 3 years, the company has enjoyed rapid sales growth (+35.6% YoY in FY11/16, +32.4% YoY in FY11/17 and +34.4% YoY in FY11/18) in its temporary staffing business. However, the current staff dispatch business model is totally different from the company's original one. There is no revenue from the short-term dispatch of individual employees any longer.

The uniqueness of S-Pool's Temporary Staffing service is to dispatch workers as a team. Unlike other companies' temporary staffing services who dispatch workers with certain level of experience, and often on an individual basis, S-Pool promotes job seekers – typically in their 20s and 30s with little or no work experiences – for call centre and sales support roles, but the key difference is that they are part of a team. The company found that sending individuals out to specific roles can lead to high staff turnover because the dispatched worker often feels isolated at work and suffer from stress because of it. High staff turnover is neither favourable for the employer nor for the agency in terms of cost and efficiency.

Under S-Pool's group dispatch model, staff members work as a team from the beginning. Some 40% of the firm's mandates are currently monitored by an on-site supervisor – referred to as a Field Consultant (FC). The FCs play a vital role for high retention rate of workers, hence profitability of the business.

6 The role of FCs includes not only training and supporting a smooth transition of the team into the work place, but they also directly communicate with the clients onsite, thus eliminating the need for sales and marketing personnel – usually a large part of SG&A-costs for most temporary staffing businesses. In addition, this hands-on relationship often leads to FCs securing renewed business mandates with existing clients. Moreover, with team members able to have access to their FC directly at the work place, when issues / problems arise; the result is that the temp staff rotation is relatively low which, in turn, leads to extremely low – only 2.2% of the segment revenue in FY11/18 – job advertisement costs. We would note that while like-for-like comparisons cannot readily be made, total (not segment) job advertisement costs of peer group companies such as WILL Group (6083 JT) and CRG (7041 JT) –were higher (3.5% of Mar 18 revenue and 3.7% of Sept 18, respectively) than that of S-Pool (JPY229mil in Nov18).

The company has 196 FCs, which it wants to increase to 240 in FY19. Currently only 40% of the total dispatched teams are accompanied by FCs. Management wants to increase the FC coverage ratio to 60% by the end of this fiscal year. However, one of the potential earnings risks in this segment is that the company may not secure enough numbers of FCs.

Group dispatch business has been growing circa 30%+ CAGR for the past 2 fiscal years and the company still has order backlog as of the end of FY11/18 which will cover this year's 1H segment revenue. Given Japan's structural labour shortage, it has become increasingly difficult for companies to secure experienced staff. Demand for team of staff with little or no experience has been strong as the management of the team by the FCs – despite the lack of experience – has proved successful. Its competitors – WILL Group and CRG Holdings – have also entered the team dispatch market but have struggled to achieve growth rates and OP margins as high as that of the S-Pool's, as the table below demonstrates.

Human Resources Service - Peer Comparison in Revenue

S-Pool (2471)	Nov-17	Nov-18	yy(%)	OPM(%)
<Temporary staffing>	7,722	10,382	34.4	9.7
WILL Group (6089)	Mar-17	Mar-18	yy(%)	OPM(%)
<Subsidiary Saint Media>	32,423	38,447	18.6	7.0
CRG (7041)	Sep-17	Sep-18	yy(%)	OPM(%)
<Subsidiary Casting Road>	12,814	13,227	3.2	n/a

Source: Nippon Investment Bespoke Research UK Ltd based on publicly available information

Main clients include Bell System 24 (6183 JT), Relia Communications (4708 JT), a company affiliated to NTT Group and Trans Cosmos (9715 JT) for call centre mandates, and Conexio (9422 JT), T-Gaia (3738 JT), and electricals retailers for mobile phone and electrical goods sales support. It has sizeable business with each of those clients. S-Pool is the largest supplier of call centre staff at Bell System 24. Its sales to Bell System have been steadily increasing: FY16 JPY950mil, FY17 JPY1,350mil, FY18 JPY2,500mil. It also appears that the company has been taking competitors' business at Bell System for its call centre revenue.

To counter, S-Pool's competitors are now trying to establish their own group dispatch business model, actively seeking new graduates to register as potential workers for the service. Management commented that its competitors are not enjoying the same level of earnings growth in this field as they suffer from high staff turnover, a symptom of not successfully recruiting personnel equivalent to the likes of its Field Consultants. S-Pool's client value how well the FCs are able to train inexperienced workers, bringing them up to workable standards as well as improve the job-retention rate of the workers. In fact, the success of the training has seen some 90% of those workers leave the temp job within 2 years to become full-time employees. Every year, circa 600~800 those workers dispatched through S-Pool become full-time employees of other companies, including its clients.

The average hourly fee/worker that clients pay to S-pool is currently between JPY1,500~1,800. Under the tight job market, the hourly fee per worker is on a rising trend. However, for S-Pool, the associated social security costs are also rising, leaving gross profit margin unchanged. Attracting new registration of staff has not been affected by the labour shortage. Currently, there are 4,000 new registrations every month, of which 15-20% are dispatched.



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CORE BUSINESS 2: SPECIAL NEEDS EMPLOYMENT SOLUTION

Being a coordinator between workers with disabilities and employers who wish to enhance special needs employment programmes as a part of CSR programmes

Business Solutions segment generates circa 30% of consolidated revenue but earns 50% of consolidated operating profit. The main driver for the segment’s high margin is the Special Needs Employment Support business, namely employment support for those with intellectual and mental disabilities and for corporates that would like to hire them.

Special Needs Employment service has been growing amid change in the Act on Employment Promotion etc. of Persons with Disabilities, reviewed in April 2013, 2015 and 2018. Under the reviewed Act 2018, companies who hires more than 45.5 employees need to satisfy statutory employment quota for people with disabilities, which is now 2.2% of total employment.

The main reason behind the change in the Act is due to employment rate among workers with disabilities in Japan is much lower than that of the US and in European countries, although not all nations share the same definition of “being disabled” hence an apple-to-apple comparison is somewhat inaccurate. According to Ministry of Health, Labour, & Welfare (MHLF), there are circa 91,000 companies that are required to meet the quota in Japan, however only half currently meet the requirements.

There are circa 9.4mil people with disabilities registered with MHLF. Of which, circa 3.61mil are between 18 and 64, i.e. those who can work. Currently, only 500,000 are employed, of which around 70% are physically disabled people but do not have any intellectual and mental handicaps. Workers with physical disorders are beginning to be more

fully engaged in employment. In order for companies to meet the employment quota specified under the Act, they need solutions to hire people with disabilities.

Core Businesses② Special Needs Employment Service

[Employer] (Company)

「Act on Employment Promotion of Persons with Disabilities」

Regulates that a company must employ persons with disabilities in a number equivalent to **2.2%** of the total employees.
 ※From 2021 a number equivalent increase from 2.2% to 2.3%

91,000 companies nationwide have the obligation to employ persons with disabilities, but only 50% have fulfilled their obligations.

Large Employment Mismatch

[Job Seekers] (Persons with Disabilities)

No. of persons with disabilities in Japan : Approx. 9.37 million

18~64 years old : 3.61 million

Physical disabilities : Approx. 1.01 mil.
 Mental disabilities : Approx. 2.02 mil.
 Intellectual disabilities : Approx. 0.58 mil.

➔

[No. of persons with disabilities employed by private companies]

Only 500,000 persons
 (14% of the 18~64 years old)
70% of which have physical disabilities.

Persons with physical disabilities are more likely to be employed than those with mental or intellectual disabilities. The latter seem to have little chance.

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Businesses that support disabled workers to seek employment are often heavily subsidised by the government, which can often lead to earnings volatility. S-Pool runs this business without receiving any subsidies by the Government yet is generating a steady earnings stream. Companies that do not comply with the Act are penalised and the fine is on their record permanently. So, companies that have exposure to public orders may end up losing out on the chance to participate in a tender for public work projects. The penalty charge is circa JPY600,000/person times the number of people with disabilities that they could have hired if they had complied with the Act.

S-Pool offers companies the opportunity to meet the requirements via its hydroponic farms. The company builds PVC greenhouses with plots equipped with hydroculture systems which are designed specifically for workers with disabilities. Each worker gets two plots to grow variety of vegetables. In hydroponic culture, one plot can harvest up to 10 times a year and growing vegetables is found to be very stimulating and highly rewarding for disabled workers. While the greenhouses remain an asset of S-Pool, client companies can either 1) purchase the hydroculture systems as their own asset or 2) lease them.

S-Pool also introduces people with disabilities to be employed by client companies that have acquired these facilities for a fee of JPY500,000/worker. Each worker will oversee 2 sections, each with 90cm x 3000cm. Clients pay JPY1.5mil/section for the hydroculture facilities. In addition, it charges clients JPY40,000/section as an operational fee and allocates its staff members as supervisors.

Special Needs Employment Business : sales breakdown

(¥ million)	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018CE
Sale of facilities (flow revenue)	213	336	521	737	1,053	1,204
Farm management fee (stock revenue)	56	89	208	390	730	1,077
Others (Recruitment Fee)	97	143	156	178	202	227
Special Needs Employment Support Service	366	568	885	1,305	1,985	2,508

Source: S-Pool Inc.

The business initially started as its own special needs employment solution. It began offering excess spaces in greenhouse to other employers. Many of the client companies had already complied with the Act but took up the company’s suggestion as one of their CSR programmes.

Operating margins on the sale of hydroponic facilities is 70% and brings in upfront revenue that the company identifies as flow-based sales. Staff introduction fees depends on the level of disabilities of each job seeker but on average, the fee is circa JPY500,000/person with a 90% OP margin. The smallest team unit comprises 3 workers plus a supervisor. S-Pool currently has 13 greenhouse farms. The OPM of S-Pool’s greenhouse management business overall is circa 15%. As the number of years in operation rise, the depreciation burden and other costs associated with the greenhouse business begin to ease and in the 3rd year, OPM can reach as high as 30%. The greenhouses are depreciated over 14 years. The firm also builds Trailer houses – according to the Agricultural Land Law, depending on the classification of the land, solid buildings cannot be built on some plots. In these cases, S-Pool uses Trailer house (as staffrooms) – which are depreciated over 4 years. Both assets are depreciated under declining balance method, which makes the first year of depreciation the heaviest burden.

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Core Businesses② Special Needs Employment Service

We operate 13 rental farms specifically designed for persons with intellectual disabilities that are offered to companies.

Management of the farm

Support for the retention

Work Happiness Farm

Persons with intellectual disabilities

Staff A, Staff B, Staff C

[Client]

Corp. A

Corp. B

Corp. C

Renting farms

Direct Employment

Total amount since our establishment

No. of client enterprises: Approx.186 (only received three termination)

No. of persons with disabilities employed: Approx.1020 (retention rate of over 92%)

Farm with plastic greenhouses for hydroponic cultivation systems

Company A's Farm
Company B's Farm
Company C's Farm
Used as small rental lots

This service is exclusively provided by us in Japan!

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Source: S-Pool Inc.

Harvest from the farms is usually consumed / sold in-house at each employer. Under this business model, employers do not need to change their business articles (e.g. If a car maker starts selling vegetables to outside the company, it needs to change its business article), nor are they required to increase level of assets on the BS.

CAPEX per farm is circa JPY200mil. Asset turnover is high and the return on invested capital is recouped after just 1 year. With a typical farm size of 3,000tsubo (2.2sq m) / 120 sections, around JPY180mil of JPY200mil CAPEX is spent on the greenhouse, trailer houses for staff offices and facilities and shuttle bus from/to nearest stations to the farms.

Of the 1,000 people with disabilities hired by companies through S-Pool, only 8% have left the job which is more to do with changes in their living locations or medical recommendations. On average, workers with disabilities are paid circa JPY100,000/month and receive disability benefit, making them financially independent. S-Pool recruits jobseekers through special needs schools, special needs job training centres run by local government and private entities and also from support organisations for families with people with disabilities in Chiba and Aichi prefectures where it has its hydroponic facilities. Due to the firm’s good reputation from various employers and its high job retention ratio, more prefectures are trying to get S-Pool to open new facilities.

In addition to the successful track record, the fact that the business is fully sustainable without any public subsidies appears to be an attractive proposition to many local governments. S-Pool receives mounting invitations to build its farms from various local authorities. All existing farms are located within 1-hour commuting distance from the employing companies’ headquarters, so the HR manager responsible for those in special needs employment programmes are able to readily and regularly visit them. From this year, the company will open facilities and plans to recruit jobseekers in Saitama.

As of FY18, 1,020 workers were employed in 13 greenhouses and 186 employers have signed up to the scheme. Examples of companies hiring workers through this scheme is shown below:

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Core Businesses② Special Needs Employment Service **S-POOL**

■ Main Client

小売・アパレル	メーカー	飲食	ホテル
<p>近畿日本ツーリスト (東証一部) CREATHE LIFE STORE TOKYU HANDS Cartier リシュモンジャパン Triumph トリップ・スタッフ・サービス (上場子会社) HIBIYA KADAN TOYO TIRES (東証一部) sojitz 双日インフィニティ (双日グループ)</p>	<p>NISSAN (東証一部) NOK (東証一部) CAT キャタピラー・ジャパン 今治造船株式会社</p>	<p>DOUTOR (東証一部) 銀座ルノアール (東証JASDAQ) UKAI (JASDAQ)</p>	<p>東京ドームホテル (上場子会社) 山の上ホテル HOTEL WING INTERNATIONAL フォーブス</p>
IT・ソフトウェア	商社、食品、金融、出版、製薬ほか	人材サービス	
<p>PCA (東証一部) FUJI XEROX 富士ゼロックスシステムサービス (上場子会社) IMJ GROUP CTC CTCシステムマネジメント (伊藤忠グループ) WiMAX CTC VOYAGE (東証一部) アイネス (東証一部)</p>	<p>SMBC日興証券 日興みらん(特例子会社) 岡谷鋼機株式会社 (東証一部) ソニーライフ・エイゴン生命 チューリッヒ生命 KADOKAWA 純日本品質 東海漬物 河合塾 HASEKO 長谷工システムズ (特例子会社) 日通トランスポート ネクスティ エレクトロニクス 豊田通商グループ バイエル薬品</p>	<p>JAC Recruitment (東証一部) リンクスタッフィング (上場子会社)</p>	

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Source: S-Pool Inc.

THIRD PILLAR: LOGISTICS OUTSOURCING, SALES SUPPORT AND NEW BUSINESSES

Under Business Solutions, there are three other businesses for which S-Pool is able to outsource workers with little or no experience.

S-Pool operates logistics centres that are open to client companies, typically so-called repeat ECs, i.e. e-commercial companies that sell merchandise such as cosmetics and supplements. Since its fee is generated by the frequency of distribution, it specifically targets small to medium-size e-commerce ventures whose customers tend to purchase goods regularly, e.g. on a monthly basis. Distribution centres are shared by multiple e-commerce ventures typically at the start-up phase. With the aid of a wearable device, workers with little or no experience can readily identify items for dispatch.

In the Sales Support business, it provides merchandising and sales promotion services with part-time workers. Client companies are producers of daily consumables that need to secure shelf space at supermarkets / drug stores. Typically, housewives who wish to work in hours that fit to their daily routines are the target work force.

It also has new businesses, one of which is Omusubi, sharing call centre service. S-Pool plans to open a new call centre to further increase locally hired staff members from 86 to 150 in fiscal year November 2019. Call centres are deliberately located in rural and remote areas to enhance employment opportunities in those towns.

Financials and Medium-Term Plan

Ongoing growth is stronger than expected but OP margin 10% medium-term plan may be missed due to sales mix

S-Pool Inc. (2471): Segment Sales and Operating Profit

(\$million)			FY2013	FY2014	FY2015	FY2016	FY2017	FY2018CE	YoY (%)
Human Resources Solution	Call Centres	Sales	1,830	2,757	4,285	5,607	7,663	9,411	22.8
	Sales Support		1,375	1,041	1,273	1,756	2,245	2,686	19.6
	Others		775	504	274	359	474	303	-36.1
	Segment Total	OP	3,980	4,302	5,832	7,722	10,382	12,400	19.4
		OPM (%)	310	360	529	680	1,004	1,179	17.4
			7.8	8.4	9.1	8.8	9.7	9.5	-0.2ppt
Business Solutions	Special Needs Employment Support Service	Sales	366	568	885	1,305	1,985	2,508	26.3
	Logistics Outsourcing Service		1,748	1,712	1,047	1,185	1,467	1,040	-29.1
	Sales Support		94	356	418	559	536	538	0.4
	New Business		496	469	1,203	1,022	516	686	32.9
	Segment Total	OP	2,704	3,000	3,440	3,998	4,482	4,772	6.5
		OPM (%)	280	163	583	728	874	1,170	33.9
		10.4	5.4	16.9	18.2	19.5	24.5	+5.0ppt	
Total		Sales	6,685	7,303	9,273	11,721	14,865	17,172	15.5
		OP	590	523	1,112	1,408	1,878	2,349	25.1
Adjustment		Sales	-80	-35	-37	-25	-68	-108	58.8
		OP	-383	-465	-605	-734	-895	-1,089	21.7
Value as in P&L		Sales	6,604	7,267	9,236	11,696	14,797	17,066	15.3
		OP	207	58	507	674	983	1,260	28.2
		OPM (%)	3.13	0.80	5.49	5.76	6.64	7.38	+0.74ppt

Source: Nippon Investment Bespoke Research UK Ltd based on publicly available information on S-Pool Inc.

FY18 RESULTS

The two core businesses reported better than expected earnings in FY18. However, the firm's attempt to establish a third pillar of growth – in logistics outsourcing and Omusubi (an employment support service through sharing-type call centres) – has failed to enjoy a similar success, falling short of S-Pool's targets set for FY17 and FY18. Omusubi is a support system for shops and restaurants looking to hire staff and acts as an outsourcing service to help organise interviews, contact candidates, process CVs and contracts etc.

Temporary staffing service enjoyed 30%+ CAGR over the past 3 years and generates an OPM of 9.7%. Continuously high level of revenue growth is mainly due to the increase in the numbers of FCs. It hired 32 additional FCs in FY11/18 to 196. The OPM is close to the gross profit margin because some of the HQ overheads are not included. However, even with HQ-related overheads for the staff dispatching business typically including personnel cost, job advertisement cost and rent, S-Pool still enjoys a higher profit than its competitors. (as explained on page 6). It only spent circa JPY0.2-0.3bil in job advertisement cost in FY18, 2~3% of the segment sales. Low job advertisement costs result from a high job retention ratio.

New registrations/month hit 3,670 (+21% YoY), with 4,142 workers/month dispatched (+35.8% YoY). The number of dispatched workers per month tends to correlate with the segment sales, i.e. it is an earnings indicator.

Some 70% of FY18 the Temporary Staffing Service segment's sales come from call centres. Sales from call centres were up 36% YoY. Circa 20% of segment sales came from group sales support, which rose 28% YoY. While there has been no change in S-Pool's client base in call centre outsourcing, the group sales support roles entail providing support for smartphone shops and counters in electrical retailers such as Yamada Denki to mandates for cleaning robots and Nespresso machine from non-Japanese electrical goods manufacturers.

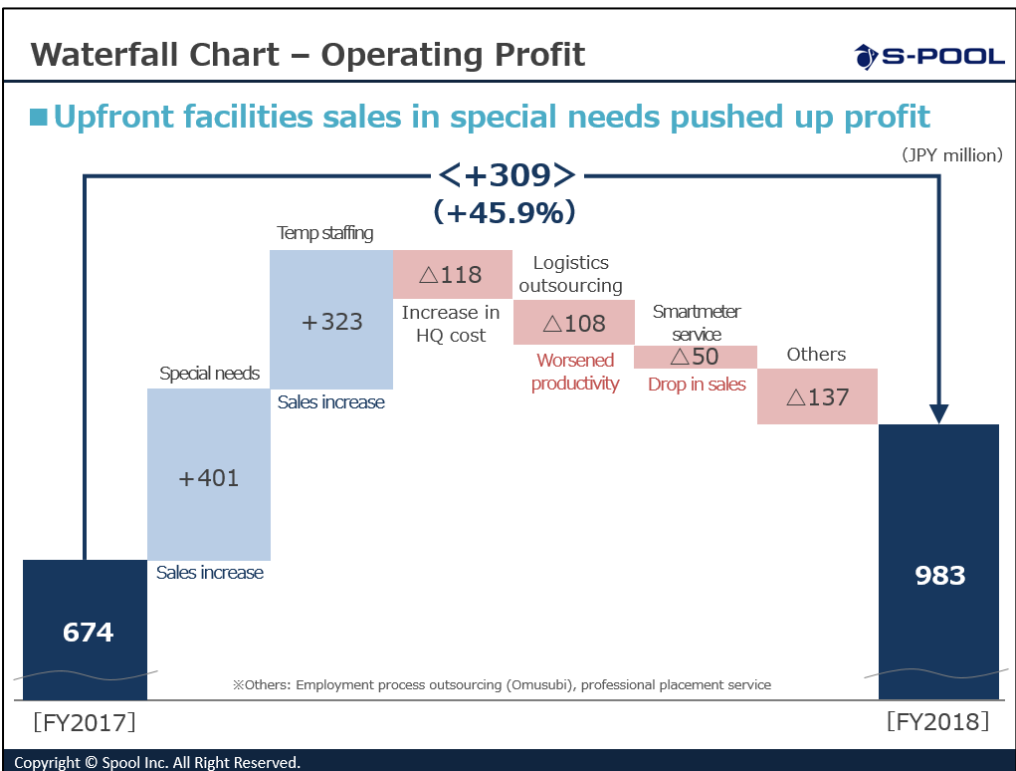
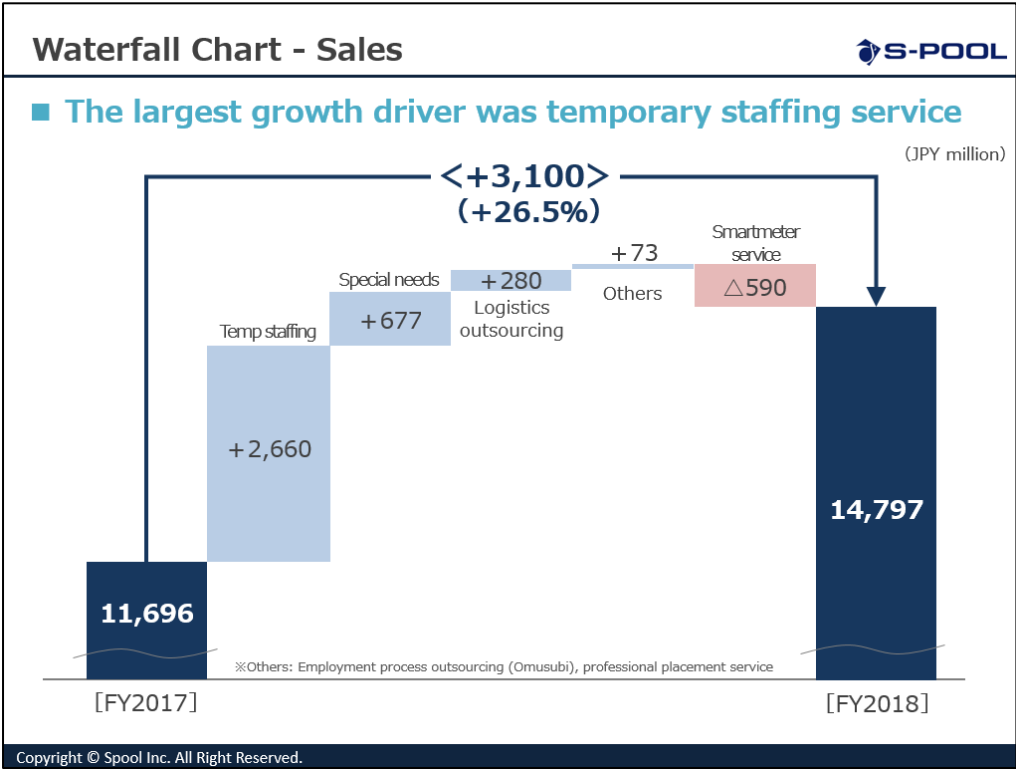
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Special needs employment support business enjoyed a 1.5x YoY increase in FY18 sales thanks to better than expected upfront sales. The company initially planned for the sale of 500 plots of its hydroponic facilities but managed to surpass that goal and recorded sales of 702 plots. As a result, the number of plots under management, which forms its stock-based revenue, hit 2,039 and generated JPY40,000 in management fees per plot. The company opened five new locations in FY18, making total number of greenhouse farms 13 as of FY18.

Staff turnover of the business remained low – less than 8% over the past 8 years. This compares to the typical 50% turnover in the staff of special needs employment. The business has been attracting more orders and had an order backlog of 438 plots as of FY18.

Although securing locations for new farms were in line with its plans, it seems the pool of special needs workers is becoming tapped out. It recruited 350 workers in Chiba and Aichi in FY18, up from 290 in FY17. This year S-Pool plans to hire 310 in those two areas and 90 in Saitama. Having Saitama as a new recruitment location gives an extra room to hire more workers.

The Logistic outsourcing business sales grew 23% YoY but remained in the red to the tune of JPY92mil. Sales growth were driven by a rise in shipping volumes from e-commerce companies. However, reasons for the losses are twofold: 1) start-up cost of the new Shinagawa distribution centre, and 2) inefficiencies caused by operating three different distribution logistics systems.



Source: S-Pool Inc.

FY19 OUTLOOK

In FY19, S-Pool's two core businesses will likely continue to lead earnings growth.

Sales for the Temporary Staffing service is forecast to reach JPY12.4bil (+19.4% YoY), comprising JPY9.4bil (+22.8% YoY) from call centres and JPY2.7bil (+19.6% YoY) from in-store sales support. Growth rates appear to be slowing compared to that of the past 3 years. However, management remains confident it can achieve these targets as the trend in the first two months of this new fiscal year are in line with that of the year before. Moreover, they expect the OPM of the Temporary Staffing service will also largely follow the same trend and dip slightly (-0.2ppt YoY) as the firm intends to increase the numbers of Field Consultants as they are the profit driver of the business. [NB: FC-related costs are included in the segment COGS, not SG&A.] By hiring an additional 44 FCs in FY19, the FC coverage ratio (number of teams with FCs / all dispatched teams) is expected to reach 60%, an impressive improvement from last year's 40%. There is a direct relationship with the level of profit and the number of FCs, given having more FCs leads to lower staff turnover. As of now, the company does not observe any risks to its plan to hire 44 new FCs (22 from new graduates and 22 from people with experience in call centres and in-store sales).

Sales of the Special Needs Employment Support business will continue to show strong growth and is expected to rise 26.3% YoY in FY19. It aims to open 800 new hydroponic plots this year, of which 438 are already in backlog. Of the 800 new plots, 180 will be opened in the new facilities in Saitama. S-Pool has already started cultivating jobseekers with intellectual and mental disabilities in Saitama – through the local training centres, special needs schools etc – and plans to find 90 workers for the region. The company expects to hire 400 new recruits in total this fiscal year.

S-Pool is looking to improve the construction of the farms, making them more efficient and reducing the construction time. It aims to open 292 plots in 1H and 508 in 2H. Given opening greenhouse hydroponic facilities will be a first for Saitama, it will take six months to obtain consent from the local government to convert available land to an agricultural site. In Chiba and Aichi, the lands on which it plans to build greenhouses must also be prepared – and that can take time. Since profitability of this business can swing depending on how much upfront revenue is generated, the new facilities and prep time will likely lead to a stronger 2H in FY19. Depending on how quickly the company manages to build farms in all three locations, the level of segment OP can have upside potential.

In order to achieve its goal to construct 1,000 plots by FY20, it needs to successfully expand in Saitama. Any delay in construction can be an earnings risk given the hefty order backlog, equivalent to circa 50% of planned plot sales volume for the year.

The company aims to turn around the two loss-making sub-divisions – Logistics Outsourcing business and the employment support business Omusubi.

Logistics Outsourcing sales is expected to fall 29.1% YoY in FY19, but this decline is linked to inefficiencies in how payments were taken. It used to charge customers inclusive of shipping, however, since shipping companies have raised their delivery charge on multiple occasions recently, S-Pool had to take on those costs and that led to a rise in the number of loss-making customers. From this year, shipping cost will be negotiated directly between customers and the transportation companies. S-Pool will charge its own commission separate to the shipping charge. This change in charging method reduces level of revenue but improves profitability.

It also will be terminating business with agencies and unprofitable customers. S-Pool now has two distribution centres, in Shinagawa and Tsukuba – having closed down its Kasai centre in 4Q last year for which the associated closure costs will be reflected in this year's P&L. Efforts to improve their efficiency are making progress as the facilities turned profitable on single monthly basis in November and December 2018. Key to achieving breakeven in this business is to fill the vacant space at the Shinagawa centre. Tsukuba is currently fully occupied but Shinagawa is still 40% vacant. There are new customers signing up every month.

The employment support service Omusubi supports employers such as restaurants and retailers to hire staff. It offers support with the interview process, such as contacting shortlisted candidates and make interview appointments through S-Pool's call centres, which are shared by multiple clients. The President himself oversees the business and 60 employers have taken up the service. Last year, sales of this business grew by 1.7x to JPY300mil but generated a JPY45mil operating loss. The forecast for this year is JPY450mil in sales and breakeven at the operating level.

Under the current medium-term plan ending in FY20, the company aims to achieve OPM of 10%. Despite earnings exceeding guidance over the past two years, management reckons the OPM target may be difficult to achieve due to the sales mix; The Temporary Staffing Services segment has been growing faster than expected, thanks to success of the group dispatch business model and low staff rotation, but the segment OPM is lower than that of special needs employment service.

Shareholders Return

Time to think of paying out more dividend?

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The company uses DOE (dividend on equity) as a medium- to long-term benchmark for shareholders' return. Since S-Pool had fallen into balance sheet insolvency in the past, a historical comparison of ROE will appear misleading as the contributing factors to shareholders' equity is now very different. It aims to provide more of a balance between improving enterprise value and making sustainable and stable dividend payments. Currently, it hopes to achieve a 5% DOE and it plans to pay out JPY10/share in FY19, double that of the year earlier thanks to an extra JPY3/share commemorative dividend for the firm's 20th anniversary.

As of FY18, the shareholders' equity ratio had recovered to 35%, therefore, management believes that it is time to reconsider its shareholders' return policy. Retained earnings increased from JPY875mil in FY17 to JPY1,438mil in FY18 (JPY482mil in FY16). We suspect a change in the dividend policy is likely to come in FY20. Share buybacks, however, appear less likely due to liquidity and the firm's intention to become a TSE main market listed stock. Given management learned some tough lessons regarding the use of excess cash on its balance sheet for M&A, we think they will be more willing to reinvest on its own growth and in-house developed new businesses as well as enhancing shareholders' return.

Corporate Governance Summary

Concise Board of Directors with 50% of it being external directors

S-Pool currently has 6 Board members of which 3 are external directors. Management reckons that if it increased Board members, s/he would be an external director. The 3 external directors include a chartered accountant, a lawyer and a venture capitalist. The maximum number of the Board of Directors is 9, according to the company's Business Articles. It has not yet moved to a committee-based Board; however, its Board of Auditors are formed only with external members such as certified social insurance and labour consultant, management consultant and a foreigner.

At the AGM held on 27 February 2018, a vote was made to limit on directors' pay (in total is JPY200mil/year, of which JPY30mil/year is spared for external directors' base pay). In addition, the company introduced performance-linked directors' bonus schemes for full-time executive internal directors. In FY17, directors' remuneration in total was JPY91.86 million, including directors' bonuses JPY18mil. There is no change in directors' base pay in fiscal year November 2019.

Directors' Pay - S-Pool Inc. (2471 JP)

(JPY million)	FY2016	FY2017
Bonus	18	25
Total	92	120
Max limit	100	200

Source: S-Pool Inc.

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The company appoints Grant Hornton Taiyo LLC as its financial audit company. It initially appointed Chuo Aoyama but after it was dissolved, due to a window-dressing fraud, S-Pool split from Chuo Aoyama and newly formed a partnership with Grant Thornton. Management now sees no need to make further changes to its auditor.

S-Pool Inc. (2471) Business Model Summary

Human Resources Solutions Segment					
Business	Services	Target workforce	Clients	Business environment	Competitors
Temporary Staffing service	Dispatch workers in a group with the company's Field Consultants (group supervisors)	Workers with no previous experience of the job such as housewives, workers who used to do different jobs, people in their 20s-30s with no notable job experiences	Call centre operators, manufacturers of smartphones and electrical goods who need sales staff at retailers' stores	Demand from call centres remain solid. Sales from its top client Bell System 24 (6183) doubled on the year-on-year basis in FY11/18. Demand for smartphone sales staff has already peaked. On the other hands, demand for onsite sales staff team from non-Japanese manufacturers of electrical goods are rapidly surging.	WILL Group (6089 JP), CRG (7041 JP), Like (2462 JP), Hito Comm (3654 JP)
Business Solutions Segment					
Business	Services	Target workforce	Clients	Business environment	Competitors
Special needs employment service	Bridging between employers and jobseekers with intellectual and mental disabilities through providing work placement solutions (hydroponic farms)	Workers with disabilities, especially intellectual and mental disabilities	Companies with more than 45.5 employees - it is said there are 91,000 employs applicable for employment quota specified by the Act	People with Disabilities Employment Promotion Act increased employment quota for applicable companies to hire more workers with disabilities. Applicable companies shall be penalised with permanent penalty record if not complied	Startline (unlisted)
Logistics Outsourcing	E-commerce merchandise dispatch outsourcing services	Workers with no previous experience of the job such as students and housewives	Small-to-medium e-commerce companies, especially so-called "repeat ECs"	In order to turn around the business, the company cancelled contract with agencies which used to find tenants for the company and cut off unprofitable tenants in FY11/18. With trucking companies having raised their fees, it also changed the fee structure to customers, therefore, sales will look smaller in FY11/19 compared to FY11/18 but profit improves.	Misc. Similar one is Scroll (8005)
Sales support	Provide part-time workers in merchandising and promotion, i.e. cultivating and securing shelf spaces at supermarkets and drug stores	Workers with no previous experience of the job, especially housewives who cannot have fixed date and time to work but prefer working in jobs that fits their day-to-day routines	Daily consumables makers	Supermarket and drug stores see daily merchandises as baits to draw more customers to their stores. Therefore, they are eager to spare shelf spaces with competitive and attractive merchandises	Mediaflag (6067 JP)

Source: Nippon Investment Bespoke Research UK Ltd based on publicly available materials

Financial Summary

S-Pool Inc (2471 JP)

(JPY million)	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19 (Est)
Sales	6,604	7,267	9,236	11,696	14,797	17,066
Operating Profit	207	59	507	674	983	1,260
Recurring Profit	191	49	496	687	1,007	1,248
Net Profit	165	-68	408	423	619	811
EPS (JPY)	58.89	-22.86	135.85	136.60	39.27	51.39
Adjusted EPS (JPY)	-	-	130.24	134.14	39.20	51.00
Cash flow from operation (CFO)	291	-253	725	801	724	-
Cash flow from investment (CFI)	-188	-388	-480	-577	-878	-
Cash flow from finance (CFF)	229	513	138	-58	1	-
Cash and cash equivalent	819	691	1,074	1,240	1,087	-
Free cash flow (FCF)	103	-641	245	224	-154	-
CFO per share (JPY)		-84.24	241.40	258.43	45.88	-
FCF per share (JPY)	36.67	-213.43	81.58	72.27	-9.76	-
Total asset	2,155	2,664	3,717	4,493	5,801	-
Liabilities	1,399	2,000	2,675	3,019	3,769	-
Net asset	756	663	1,041	1,473	2,032	-
Capital	351	351	351	366	368	-
Shareholders' equity	756	657	1,035	1,459	2,024	-
BPS (JPY)	251.66	218.74	344.52	462.71	128.27	-
OPM (%)	3.13	0.81	5.49	5.76	6.64	7.38
ROE (%)	34.96	-9.62	48.23	33.92	35.54	32.00
ROA (%)	10.59	2.08	15.61	16.27	19.00	11.40
Shareholders' equity ratio (%)	35.08	24.66	27.85	32.47	34.89	-
D/E ratio (%)	185.05	304.41	258.45	206.92	186.22	-
Total asset turnover (X)	3.61	3.02	2.89	2.85	2.87	-
Interest coverage (x)	15.92	6.56	56.33	112.33	164.00	-
Current ratio (%)	138.46	126.14	111.64	110.17	100.51	-
Interest-bearing debt	494	1,037	1,204	1,144	1,203	-
EBITDA	253	144	673	913	1,286	-
EBITDA margin (%)	3.83	1.98	7.29	7.81	8.69	-
Number of full-time employees	243	341	411	546	623	700
Annual dividend (JPY / share)	10.00	10.00	10.00	18.00	5.00	10.00
Normal dividend	10.00	10.00	10.00	18.00	5.00	7.00
Commemorative dividend	-	-	-	-	-	3.00
Dividend pay-out ratio (%)	17.00	-	7.40	13.20	12.70	-
DoE (%)	6.20	4.30	3.60	4.50	4.50	-
Shares outstanding as of the end of fiscal year (shares)	3,003,400	3,003,400	3,003,400	3,153,400	15,780,500	15,780,500
Interim average shares outstanding (shares)	2,809,089	3,003,338	3,003,338	3,099,494	15,776,586	15,776,586
Treasury shares (shares)	62	62	62	129	692	692
Potential dilution (shares)	-	-	129,407	56,886	30,393	-

Source: Nippon Investment Bespoke Research UK based on information available on Nikkei Value Search

Major Shareholders

Name of shareholder	No. of shares held (shares)	Ownership (%)	Position in the company
Sohei Urakami	2,727,100	17.3	Founder, Representative Director
Nippon Trustee Service	2,300,800	14.6	
Northern Trust Co. (AVFC) RE IEDU UCITS CLIENTS NON LENDING 15 PCT TREATY ACCOUNT	1,100,300	7	
Nippon Trustee Service (Trust Account 9)	750,200	4.8	
Hideaki Sato	634,700	4	Board director
Toru Akaura	581,200	3.7	External Director, VC
Asset Management Service Trust Bank (trust acc)	449,100	2.8	
Employees' shareholding scheme	430,700	2.7	
Somitsu Takehara	378,200	2.4	External director, CPA
Japan Master Trust (trust account)	328,900	2.1	
Total held by institutional investors		45.7	
of which % owned by foreign investors		20.5	
Free float		8.4	

Source: Company and Toyo Keizai

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