

S-POOL INC. (2471 JP)**LITTLE IMPACT FROM COVID. 1H RESULTS OVERSHOT INITIAL GUIDANCE BUT NO CHANGE IN FY20 FORECAST****FY20 (NOV-20) 2Q EARNINGS RESULT**

S-Pool Inc. (2471 JP) reported FY20 2Q operating profit (OP) of ¥991mil (+29.9% YoY) on sales of ¥9,759mil (+17.6% YoY). Both sales and profits renewed a record result on a semi-annual basis.

The impact of COVID was small and in some businesses positive. Prior to the 2Q results, S-Pool revised its 1H guidance. Sales overshot the company's original estimate by 1.3% and OP beat it by 25.8% thanks to:

- Higher than expected growth in the Call Centre Staff Dispatch Service business, which is included in the Human Resources Solution segment. Out of the ¥1,462mil YoY increase in total sales, ¥1,253 was incurred by the Human Resources Solution segment.
- Lower recruiting costs in the Human resources solution segment.
- Reductions in hydroponic farm construction cost.

Earnings Revision (FY20 1H)

(Nov~Apr / ¥mil)	Sales	OP	OPM (%)	RP	NP for parent's s/h	EPS (¥)
Previous guidance	9,633	788	782	782	509	6.45
Revised guidance	9,759	991	989	989	688	8.71
Change (%)	1.3	25.7	26.4	26.4	35.0	35.0
FY19 2H results	8,296	763	778	778	496	6.30

Source: S-Pool Inc.

The Call Centre Staff Dispatch Service – one of the company's core businesses – saw FY20 1H sales improve +27.2% YoY to ¥5,624mil thanks to a steady rise in demand for group dispatches (sending a group of staff) with S-Pool's Field Person (onsite supervisor). COVID has led to staff utilisation rates at some call centres being affected due to social distancing and staggered work hours. However, demand for customer services that many companies outsource to call centre operators remained solid due to store closures.

Another core business, Special Needs Employment Support, which is in the Business Solutions segment, earned sales of ¥1,503mil (+19.3% YoY). In 4Q alone, the business saw sales of ¥848mil (+3.4% YoY / +29.7% QoQ). Due to COVID, job training for special need jobseekers was delayed, affecting sales of hydroponic farming facilities. Although the sales of hydroponic plots fell short of forecast (408 plots vs guidance of 450 plots), recurring revenue from managing those plots steadily increased (+55.3% YoY / +7.5 QoQ).

There was a change to delivery cost charges to customers in the Logistics business. Segment sales fell 4.9% YoY to ¥562mil, however, without that change, sales would have risen 50.5% YoY.

EXECUTIVE SUMMARY

- S-Pool Inc. (2471 JP) reported FY20 2Q results with operating profit (OP) of ¥991mil (+29.9% YoY) on sales of ¥9,759mil (+17.6% YoY). Both sales and profits renewed a record result on a semi-annual basis. Prior to the results, 2Q earnings forecast was revised up.
- The COVID impact has been mostly positive. One of the core businesses, Special Needs Employment Support, was somewhat negatively affected in sales of facilities because job training for special needs jobseekers was delayed due to COVID.
- The Call Centre Staff Dispatch business saw a surge in demand for S-Pool's signature group dispatch (sending a group of staff to one call centre). Despite lower staff utilisation rates amid social distancing and staggered working hours at urban centres, the call centre staff dispatch business saw a 27.2% rise in sales in 1H. The pace is expected to continue as the Government's emergency support measures require call centre support.
- Full-year earnings risks remain for specialty need employment support as the facility sales order backlog is only 192 plots vs the 2H sales target of 600 plots. However, demand for special needs employment services remains strong especially since the regulatory change in special needs employment quota has will be raised from 2.2% of the workforce to 2.3% in April 2021.
- Despite a better than expected 1H, the firm kept its FY20 earnings guidance due to the uncertainty surrounding its businesses from COVID. However, it reckons the current guidance is well within reach unless sales of hydroponic facilities does not fall short by more than 200 plots.

The Employment Support Service, OMUSUBI, was considered to be one of the areas which could be impacted by COVID, given the client base includes restaurant and amusement (e.g. karaoke) companies. However, the drop in demand from those clients was well offset by urgent employment demand by supermarkets and delivery services.

S-Pool Inc. (2471 JP) : Results & Forecasts								
Year to November (¥mil)	FY19		FY20					
	2Q	FY	2QCE	2Q	vs. CE (%)	YoY (%)	FYCE	YoY (%)
Sales	8,296	17,522	9,633	9,759	1.3	17.6	20,636	17.8
GP	2,426	5,214	2,777	2,874	3.5	18.5	6,122	17.4
GPM (%)	29.2	29.8	28.8	29.5	+0.7pp	+0.3pp	29.7	-0.1pp
SG&A	1,663	3,610	1,988	1,883	-5.3	13.2	4,121	14.2
SG&A/Sales (%)	20.0	20.6	20.6	19.3	-1.3pp	-0.7pp	20.0	-0.6pp
OP	763	1,604	788	991	25.8	29.9	2,000	24.7
OPM (%)	9.2	9.2	8.2	10.2	+2.0pp	+1.0pp	9.7	+0.5pp
RP	778	1,626	782	989	26.5	27.1	1,988	22.3
NP	496	1,082	509	688	35.2	38.7	1,288	19.0
EPS (¥)	6.30	13.7	6.47	8.71	34.6	38.3	16.3	18.9
Dividend (¥)	0.0	2.0	0.0	0.0	n/a	n/a	3.3	n/a
Dividend P/O (%)	n/a	14.6	n/a	n/a	n/a	n/a	20.2	n/a

Source: Nippon Investment Bespoke Research UK Ltd based on S-Pool Inc.'s presentation

SEGMENT RESULTS AND OUTLOOK

Human Resources Solution

The Human Resources Solution segment earned the segment OP of ¥786mil (27.2% YoY) on sales of ¥7,142mil (+21.3% YoY). In 2Q alone, OP was ¥434mil (+35.6% YoY / +23.3% QoQ) on sales of ¥3,680mil (+20.8% YoY / +6.3% QoQ). Although the sales support service – where S-Pool dispatches sales support staff to retailers – saw over a 10% YoY fall in sales to ¥1,132mil due to closure of shops and shorter operating hours, the core Call Centre Staff Dispatch Service business more than offset the negative impact. Since the call centre staff dispatching business earns almost 100% of the segment profit, a rise in the business revenue improves the sales mix. As a result, segment OPM improved by 1.0ppt YoY to 11.0% in 2Q.

Call Centre Staff Dispatch Service

Nearly 80% of the segment sales and almost 85% of segment profit are generated by the Call Centre Staff Dispatch Service. 1H segment sales hit ¥5,624mil (+27.2% YoY). In 2Q alone, the business earned sales of ¥2,916mil (+27.4% YoY / +7.7% QoQ). March is usually the high season for the Call Centre business, but this year, staff utilisation in March was higher than recent years. As a result, March renewed a record month of earnings for this business. However, the April-May period is seasonally lower due to the Golden Week and it is expected to be even lower this year under the COVID-related restrictions. However, utilisation rates of the already dispatched staff was affected in the urban call centres but not in regional centres. Some 40% of S-Pool's call centre mandates are in the urban areas while the remaining 60% are regional.

In 1H, staff under operation increased by 18% YoY to 5,600 staff/month. The number of staff registered also rose by 23% YoY to 4,460 staff/month. The number of job applications has been on the rise. S-Pool's clients, call centre operators, are also seeing a steady flow of business even under the COVID-related closures. Customer service is considered as an important role by manufacturers such as a high-end smartphone maker. There has been a surge in demand for food delivery services, so have complaints about those services. Thanks to solid demand for customer service tasks, the utilisation rate of currently dispatched staff was least affected by the various restrictive measures in place under COVID. From 3Q, it is expected that call centre-related work will rise further as customer services related to the COVID relief benefits / support measures from the government.

S-Pool is guiding for the FY20 segment OP of ¥1,410mil (+19.3% YoY) on sales of ¥14,500mil (+15.9% YoY). For the Call Centre Dispatch business, the firm is guiding for sales of ¥10,875mil (+14.3% YoY). These forecasts seem achievable given S-Pool has achieved ca. 50% of both its full-year sales and profit in the first half of the year.

However, there are two possible risks to segment earnings:

1. There were no new mandates during the April~May period. This suggests there will be idle staff, which is pure cost to the company. The impact to the segment OP is likely to become apparent during 3Q.
2. Competition in call centre staffing mandates become tougher. Temp staff dispatch companies that do not usually dispatch staff to call centre works are now trying to enter the market because their usual staffing service is struggling under COVID.

S-Pool reckons that those risks can be mitigated by emphasising the efficiency and effectiveness of its group dispatch system and it will continue to target the top market share at each of the major call centre operators.

Business Solutions Segment

The Business Solutions segment earned IH OP of ¥740mil (+10.0% YoY) on sales of ¥2,644mil (+9.4% YoY). There are three main businesses in this segment, special needs employment service, logistics and employment support (OMUSUBI).

I. Special Needs Employment Support

Special Needs Employment Support earned IH sales of ¥1,503mil (+19.3% YoY). The business is largely divided into the sale of hydroponic farm plots (flow-based revenue) and a management fee for those plots (recurring revenue). On top of those two, there is a fee-based revenue for recruiting special need jobseekers to work in those hydroponic farms.

S-Pool sold 408 plots of hydroponic facilities, short of the planned 450 plots. After the State of Emergency announcement by the Japanese government, training of special needs jobseekers was delayed, thus affecting the sales of plots which will likely be delayed to 3Q. Still, the firm sold 252 plots in 2Q alone, compared to 156 plots in 1Q. Hydroponic facilities sales during IH fell 5.3% YoY ¥611mil; in 2Q alone, sales were ¥369mil (-20.6% YoY / +52.5% QoQ).

The second part of the business' revenue is a farm management fee. Thanks to the steady increase in facilities sold, there are currently 3,313 plots under management. It is a recurring revenue with ca. ¥40,000/month per plot. From 1Q, the proportion of recurring revenue exceeded that of facilities sales.

The temporary suspension of marketing activities during 2Q due to COVID saw the order backlog of facilities sales fall to 192 slots at the end of May compared to 384 plots as in the end of 1Q. Although there is demand for special needs employment due to mandatory quota of hiring special needs jobseekers, final decision has not been reached by client companies under the current situation with lack of marketing activities and restriction on physically visiting farms to see if it is the right option to meet the mandatory requirement. S-Pool acknowledges the relatively low level of order backlog as a potential risk to earnings, however, demand for special needs employment solution is on the rise especially because the quota will be revised up from 2.2% of work force to 2.3% in April 2021. Therefore, it has not revised the annual facilities sales target of 1,026 plots. S-pool reckons that another 600 plots can be sold in 2H.

Four of the six farms S-Pool plans to open in FY20, are now operational. Of the two remaining farms, one will likely be an indoor farm which is expected to be launched in 4Q. The firm is guiding for FY20 Special Needs Employment Support sales of ¥3,530mil (+27.6% YoY) – sale of facilities ¥1,576 (+13.6% YoY) and farm management fee ¥1,654mil (+59.3% YoY).

Special Needs Employment Business : sales breakdown (Quarterly)											
(¥ million)	FY19					FY20					
	1Q	2Q	3Q	4Q	FY	1Q	2Q	YoY (%)	QoQ (%)	FYCE	YoY (%)
Sale of facilities (flow revenue)	180	465	306	436	1,387	242	369	-20.6	52.5	1,576	13.6
Farm management fee (stock revenue)	219	239	276	304	1,038	345	371	55.2	7.5	1,654	59.3
Others (Recruitment Fee)	42	115	66	119	342	66	107	-7.0	62.1	299	-12.6
Special Needs Employment Support Service	441	820	647	859	2,766	654	848	3.4	29.7	3,530	27.6

Source: S-Pool Inc. FY20 2Q Results Material

2. Logistics Outsourcing

The Logistics business saw 1H sales of ¥562mil (-4.9% YoY). In 2Q alone, the business earned sales of ¥310mil (+14.4% YoY / +23.0% QoQ). The drop in sales is due to a change in the way delivery costs are charged to customers. Thanks to the surge in demand for online shopping under COVID, Dispatch Outsourcing enjoyed a significant rise in sales. Excluding the impact of the aforementioned change in delivery cost charges, sales of Dispatch Outsourcing surged 68.7% to ca. ¥837mil. Two physical distribution centres, one in Shinagawa and another in Tsukuba, were operating at the full capacity during the months of April and May. In June, however, the utilisation rate fell to 90%.

S-Pool is guiding for FY20 sales of ¥1,200mil (+9.6% YoY) in Logistics Outsourcing. Management considered opening a new distribution centre, however, they decided to postpone it and instead aims to increase the sales_{tsubo} (3.3m²) through optimising the productivity of the existing two centres.

3. Employment Process Support Service – OMUSUBI

The Employment Process Support Service business, OMUSUBI, supports branches of restaurants, retailers, and amusement /entertainment facilities in employing part-time staff by processing applications, setting up the initial interviews and promptly communicating with candidates. This business was thought to be a risk to earnings under COVID, given the customer base was predominantly restaurant chains, karaoke stores etc. However, the business saw a record number of job applications of 52,154 cases on average per month during 2Q, compared to 34,885 cases in 1Q. In April alone, applications hit 58,593 cases thanks to the rapid surge in recruitment by supermarkets and delivery services, which more than offset the drop in restaurants and amusement facilities. As a result, S-Pool opened a new centre (its 5th centre) for this business in Aomori. 1H sales reached ¥277mil (+39.9% YoY). In 2Q alone, the business earned sales of ¥154mil (+38.7% YoY / +25.2% QoQ).

S-Pool is guiding for FY20 sales of ¥60mil (+37.4% YoY) in Employment Process Support Services. The firm is aiming to introduce a subscription model in this business by offering a menu of services, such as online interviews, aptitude diagnostics, so that in addition to an increase in sales by raising the number of new customers, sales can also grow through increasing ARPU of existing customers.

S-Pool Inc. (2471): Segment Sales and Operating Profit (Cumulative)											
(#million)		FY19					FY20				
		1Q	2Q	3Q	FY	YoY (%)	1Q	2Q	YoY (%)	FYCE	YoY (%)
Human Resources Solution	Call Centres	2,134	4,422	6,869	9,518	24.2	2,708	5,624	27.2	10,875	14.3
	Sales Support	615	1,265	1,916	2,492	11.0	576	1,132	-10.5	3,000	20.4
	Others	93	202	347	505	6.5	178	386	91.1	625	23.8
	Segment Total	2,842	5,889	9,131	12,516	20.6	3,462	7,142	21.3	14,500	15.9
	Segment OP	271	591	934	1,182	17.7	307	786	29.8	1,410	19.3
	Segment OPM (%)	9.5	10.0	10.2	9.4	-0.3pp	8.9	11.0	-1.0pp	9.7	+0.3pp
Business Solutions	Special Needs Employment Support Service	441	1,260	1,907	2,766	39.3	654	1,503	19.3	3,530	27.6
	Logistics Outsourcing Service	321	592	832	1,095	-25.4	252	562	-5.1	1,200	9.6
	Sales Support	147	266	381	517	-3.5	140	197	-25.9	600	16.1
	Employment process support (OMUSUBI)	87	198	311	437	43.8	123	277	39.9	600	37.3
	Professional HR Bank	60	114	171	235	20.5	53	93	-18.4	282	20.0
	Total Segment Sales	1,054	2,425	3,596	5,043	12.5	1,222	2,644	9.0	6,214	23.2
	Segment OP	162	673	1,042	1,514	76.5	352	740	10.0	1,808	19.4
	Segment OPM (%)	15.4	27.8	29.0	30.0	+10.5pp	28.8	28.0	+0.2pp	29.1	-0.9pp
Total	Sales	3,896	8,314	12,727	17,559	18.1	4,684	9,787	20.2	20,714	18.0
	OP	433	1,264	1,976	2,696	44.8	659	1,527	52.2	3,218	19.4
Adjustment	Sales	-8	-18	-27	-37	n/a	-8	-27	n/a	-78	n/a
	OP	-222	-502	-773	-1,093	n/a	-272	-536	n/a	-1,217	n/a
Value as in P&L	Sales	3,888	8,296	12,699	17,522	18.4	4,675	9,756	20.2	20,636	17.8
	OP	211	763	1,203	1,604	65.9	386	991	82.9	2,000	24.7
	OPM (%)	5.4	9.2	9.5	9.2	+2.6pp	8.3	10.2	+2.9pp	9.7	+0.5pp

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

S-Pool Inc. (2471): Segment Sales and Operating Profit (Quarterly)										
(#million)		FY19				FY20				
		1Q	2Q	3Q	4Q	1Q	2Q	YoY (%)	QoQ (%)	
Human Resources Solution	Call Centres	2,134	2,288	2,447	2,649	2,708	2,916	27.4	7.7	
	Sales Support	615	651	651	576	576	556	-14.6	-3.5	
	Others	93	109	145	159	178	208	90.8	16.9	
	Total segment sales	2,842	3,047	3,242	3,384	3,462	3,680	20.8	6.3	
	Segment OP	271	320	343	249	352	434	35.6	23.3	
	Segment OPM (%)	9.5	10.5	10.6	7.4	10.2	11.8	1.3pp	1.6pp	
Business Solutions	Special Needs Employment Support Service	441	820	647	859	654	848	3.4	29.7	
	Logistics Outsourcing Service	321	271	240	265	252	310	14.4	23.0	
	Sales Promotion Support	147	119	115	136	140	57	-52.1	-59.3	
	Employment process support (OMUSUBI)	87	111	113	125	123	154	38.7	25.2	
	Professional HR Bank	60	54	57	64	53	40	-25.9	-24.5	
	Total segment sales	1,054	1,371	1,170	1,448	1,222	1,422	3.7	16.4	
	Segment OP	162	511	369	472	307	433	-15.3	41.0	
	Segment OPM (%)	15.4	37.3	31.5	32.6	25.1	30.5	-6.8pp	+5.4pp	
Total	Sales	3,896	4,418	4,412	4,832	4,684	5,102	15.5	8.9	
	OP	433	831	712	722	659	867	4.3	31.6	
Adjustment	Sales	-8	-10	-9	-10	-8	-19	n/a	n/a	
	OP	-222	-280	-271	-320	-272	-264	n/a	n/a	
Value as in P&L	Sales	3,888	4,408	4,403	4,822	4,675	5,085	15.4	8.8	
	OP	211	551	440	400	386	605	9.8	56.7	
	OPM (%)	5.4	12.5	10.0	8.3	8.3	11.9	-0.6pp	+3.6pp	

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

FY20 OUTLOOK SUMMARY

S-Pool is guiding for FY20 OP of ¥2,000mil (+24.7% YoY) on sales of ¥20,636mil (+17.8% YoY). Despite better than expected 1H earnings, S-Pool did not change the full-year earnings guidance

Although 1H OP overshoot the original forecast by 25.8%, the firm did not revise the full-year guidance due to lack of visibility under COVID. There are currently three possible risks for the earnings. Those are:

1. There were no new mandates for call centre staff dispatches during April and May, which will likely affect 3Q sales.
2. More competition in the call centre staff dispatch market because temp staff dispatching agencies are trying to gain mandates while their main business remain weak.
3. A low order backlog of hydroponic farm sales mainly due to slower a decision-making process by customers under COVID. During the 2H, the firm needs to sell 600 plots to reach the annual target. Currently, there are 192 order backlogs. Facilities sales is the most profitable business; therefore, any shortfall can affect profit.

Of the aforementioned three risks, No. 1 and No.2 are unlikely to affect earnings on the downside. Since June, S-Pool has been seeing new mandates from call centres and idle staff have been reallocated to new roles. S-Pool's market share in the call centre dispatch industry has been unaffected by temp staff agencies. Therefore, the shortfall in facilities sales in the Special Needs Employment Support business appears to be the largest possible risk. S-Pool reckons that if the sales of facilities were to fall short by 200 plots in 2H, it can still achieve its targets, with the likely impact of a ¥200mil hit to OP, thus wiping out the OP overshoot achieved in 1H.

S-Pool aims to pay out 20% of net profit as a dividend. In the past, the firm prioritised solidifying the BS to avoid another BS insolvency. The firm used DoE of 5% as a measure for shareholder return, but that has now changed to a dividend pay-out of 20%. While retaining earnings for the future growth, S-Pool aims to sustainably pay dividends. For example, in case of a YoY drop in earnings, it will likely pay out a dividend pay-out ratio of up to 60%. In FY20, the dividend/share is estimated at ¥3.30, up from last year's ¥1.40 annual dividend plus a ¥0.6 commemorative dividend.

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