

KOKUYO CO., LTD (7984 JP)

STRONG OFFICE RENEWAL DEMAND IN SPATIAL VALUE DOMAIN LED TO UPWARD REVISION OF THE GUIDANCE

FY21 Q1 RESULTS SUMMARY

Kokuyo (7984 JP) reported FY21 Q1 results with OP of ¥9,982mil (+11.7% YoY) on sales of ¥90,157mil (-0.1% YoY). Gross profit fell 1.0% YoY to ¥34,523mil, however, the firm managed to reduce SG&A by 5.3% YoY to ¥24,541mil by reallocating human resources to areas management deems as an investment priority as well as declines in travel and subsistence costs due to COVID. SG&A/sales improved from 28.7% in FY20 Q1 to 27.2% in FY21 Q1. Recurring profit fell 39.5% YoY to ¥5,383mil due to an impairment cost of ¥5,254mil which includes ¥5,000mil associated with Pentel (unlisted, JP) – an equity method affiliate – as its overseas business underperformed due to COVID.

Kokuyo also announced upward revision of FY21 1H and full-year guidance with the release of its Q1 results, thanks to:

Rising demand for new usage of office spaces due to increasing remote working.

An increase in Kaunet business customer numbers and the likely impact from Kokuyo's "migration strategy" – to merge the traditional mail-order business via wholesalers and Kaunet – will continue to improve earnings in the Business Supply Domain.

Continued strong business momentum in China in the Global Stationary domain.

FY21 Earnings Guidance Revision

(¥mil)	FY20		FY21			
	1H	FY	1HCE (old)	1HCE (new)	FYCE (old)	FYCE (new)
Sales	155,813	300,644	162,000	167,000	311,000	321,000
OP	10,090	14,807	10,300	13,100	15,200	18,600
RP	9,467	14,173	10,700	8,500	16,000	14,200
NP ¹	6,288	8,297	7,400	7,300	11,800	11,800
EPS (¥)	53.15	70.13	62.55	61.7	99.74	99.74

Source: Kokuyo's press release on 10 May 2021

SEGMENTS BY BUSINESS DOMAIN

Kokuyo has three business domains: Spatial Value Domain, Business Supply Domain and Global Stationary Domain.

Spatial Value Domain

As one of the firm's core businesses, the Spatial Value Domain has captured demand that has emerged from the change in the way companies use their office spaces due to COVID. Prior to the pandemic, Kokuyo targeted demand for office furniture and spatial consultation when companies move offices. Since Covid, more workers are doing remote work so this has drastically changed the way that large corporations use their office spaces. Specifically, pre-COVID, open space designs were popular. Now, post-COVID, demand for partitions and cubicles has been stronger than expected.

EXECUTIVE SUMMARY

- Kokuyo's Q1 was better-than-expected thanks mainly to the strong performance in the Spatial Value Domain, which led to an upward revision of both 1H and FY21 guidance.
- COVID-led remote working influenced the way workers use office space. Instead of moving to a larger office space, which conventionally brought in cyclical growth in demand for office furniture, there is active demand for office renewal.
- The Business Supply Domain has been going through – as Kokuyo calls it – a "migration strategy" which centralises distribution channels. Kaunet, a mail-order platform, saw an increase in customer numbers. The Office Supply business was negatively hit by COVID, however, thanks to the migration strategy, the business stayed afloat.
- The Global Stationary Domain saw OP growth of +10.9% YoY / +154.3% QoQ, thanks primarily to strong sales in China. Some 60% of sales in China are from e-commerce channels such as Alibaba and JD.com. On the other hand, business in India was badly hit by the prolonged pandemic and saw sales plummet by nearly 20% YoY in Q1. The largest risk to FY21 earnings will be the stationary business in India.
- The upward revision to the 1H and FY were on the back of the strong Spatial Value Domain performance. While the trend has not been slowed through Q2, the firm's revised guidance only reflects the strong Q1 result.
- Kokuyo plans to announce the next medium-term plan in Nov 21.
- FY21 dividend forecast is ¥40/share, or ca. 40% pay-out ratio. There is still another ca. ¥3,750mil equivalent of shares to be bought back under the ongoing share buy-back programme.

¹ Net profit attributed for the parent company's shareholders.

In the overseas business, Kokuyo is aiming to capture demand from non-Japanese companies. In Q1 alone, the Spatial Value Domain segment saw its OP surge +4.0% YoY / +237.0% QoQ to ¥8,398mil on sales of ¥47,337mil (+0.7% YoY / +34.8% QoQ) – both figures were record quarterly highs.

Business Supply Domain

In the Business Supply Domain, the firm has been working on its “migration strategy” which aims to consolidate multiple distribution channels into one and create an optimal sales network for customers. Kokuyo has been working on the migration strategy for the past 3 years and finally started seeing an effect on efficiency in both sales and distribution. Customers’ shift to e-commerce accelerated during State of Emergency closures. To capture such demand, Kokuyo increased web-based merchandises. The firm earned Q1 segment OP of ¥785mil (+16.5% YoY / -7.2% QoQ) on sales of ¥31,262mil (+0.6% YoY / +1.1% QoQ). The lower growth was due to Covid affecting the mail-order office supply service Kaunet. However, segment OP improved 16.5% YoY thanks to more efficient distribution.

Global Stationary Domain

The Global Stationary Domain earned Q1 OP of ¥2,340mil (+10.9% YoY / +154.3% QoQ) on sales of ¥20,072mil (-3.8% YoY / +12.8% QoQ), on the back of growth in China. Kokuyo’s stationary products are well received by China’s trendsetters – local high school students – whose activities are monitored by a team of local staff. The firm has built up a relationship with a wholesaler that has a strong relationship with e-commerce operators such as Alibaba and JD.com. As a result, ca. 60% of sales in China – which increased 1,000mil YoY, or approximately 2x YoY to ca. ¥2,300 – came from e-commerce and helped boost Q1 overseas sales 19.0% YoY (+¥700mil) to ¥4,300mil. On the other hand, Q1 sales in India remained a negative trend, ca. -20% YoY to ¥1,900mil after having seen FY20 sales slump 40% YoY to ¥6,000mil from a pre-COVID sales level of ca. ¥10,000mil p.a. However, the firm anticipates recovery in demand for edu-stationary products among the emerging middle class once the schools reopen.

Quarterly Sales and OP by Domain											
(JPY million)		FY20				FY21					
		Q1	Q2	Q3	Q4	Q1	QoQ (%)	YoY (%)	Q2CE	QoQ (%)	YoY (%)
Spatial Value Domain	Sales	47,019	31,055	31,517	35,109	47,337	34.8	0.7	36,263	-23.4	16.8
	OP	8,075	1,342	1,950	2,492	8,398	237.0	4.0	3,102	-63.1	131.1
	OPM (%)	17.2	4.3	6.2	7.1	17.7	+10.6pp	+0.5pp	8.6	-9.1pp	+4.3pp
Business Supply Domain	Sales	31,066	24,902	26,185	30,912	31,262	1.1	0.6	28,638	-8.4	15.0
	OP	674	513	469	846	785	-7.2	16.5	685	-12.7	33.5
	OPM (%)	2.2	2.1	1.8	2.7	2.5	-0.2pp	+0.3pp	2.4	-0.1pp	+0.3pp
Global Stationary Domain	Sales	20,866	16,107	16,770	17,793	20,072	12.8	-3.8	19,028	-5.2	18.1
	OP	2,110	530	1,250	920	2,340	154.3	10.9	1,160	-50.4	118.9
	OPM (%)	10.1	3.3	7.5	5.2	11.7	+6.5pp	+1.6pp	6.1	-5.6pp	+2.8pp
Others	Sales	645	607	605	665	677	1.8	5.0	693	2.4	14.2
	OP	35	26	-6	-1	31	n/a	-11.4	39	25.8	50.0
	OPM (%)	5.4	4.3	n/a	n/a	4.6	n/a	-0.8pp	5.6	+1.0pp	+1.3pp
Adjustment	Sales	-9,315	-7,140	-7,226	-7,498	-9,192	n/a	n/a	-7,778	n/a	n/a
	OP	-1,959	-1,256	-1,556	-1,648	-1,575	n/a	n/a	-1,865	n/a	n/a
Total as in PL	Sales	90,283	65,530	67,851	76,980	90,157	17.1	-0.1	76,843	-14.8	17.3
	OP	8,936	1,154	2,108	2,609	9,982	282.6	11.7	3,118	-68.8	170.2
	OPM (%)	9.9	1.8	3.1	3.4	11.1	+7.7pp	+1.2pp	4.1	-7.0pp	+2.3pp

Source: Nippon-IBR based on Kokuyo's earnings presentation materials

Sales and OP by domains (Cumulative)											
(JPY million)		FY18		FY19		FY20		FY21CE			
		1H	FY	1H	FY	1H	FY	1H	YoY (%)	FY	YoY (%)
Spatial Value Domain	Sales	80,429	148,759	81,608	152,066	78,074	144,700	83,600	7.1	155,000	7.1
	OP	10,166	15,056	10,140	15,361	9,417	13,859	11,500	22.1	17,300	24.8
	OPM(%)	12.6	10.1	12.4	10.1	12.1	9.6	13.8	+1.7pp	11.2	+1.6pp
Business Supply Domain	Sales	59,113	115,773	59,534	118,081	55,968	113,065	59,900	7.0	118,000	4.4
	OP	2,194	3,273	1,270	2,318	1,187	2,502	1,470	23.8	2,900	15.9
	OPM(%)	3.7	2.8	2.1	2.0	2.1	2.2	2.5	+0.4pp	2.5	+0.3pp
Global Stationary Domain	Sales	44,398	82,336	43,526	81,845	36,973	71,536	39,100	5.8	76,300	6.7
	OP	4,529	6,644	3,592	6,017	2,640	4,810	3,500	32.6	5,950	23.7
	OPM(%)	10.2	8.1	8.3	7.4	7.1	6.7	9.0	+1.9pp	7.8	+1.1pp
Others	Sales	1,103	2,263	1,297	2,642	1,252	2,522	1,370	9.4	2,800	11.0
	OP	47	80	69	139	61	54	70	14.8	100	85.2
	OPM(%)	4.4	3.5	5.3	5.3	4.9	2.1	5.1	+0.2pp	3.6	+1.5pp
Adjustment	Sales	-17,965	-33,978	-18,314	-34,435	-16,455	-31,179	-16,970	n/a	-31,100	n/a
	OP	-3,259	-6,759	-3,453	-7,092	-3,215	-6,419	-3,440	n/a	-7,650	n/a
Total as in PL	Sales	167,081	315,155	167,652	320,200	155,813	300,644	167,000	7.2	321,000	6.8
	OP	13,680	18,296	11,619	16,743	10,090	14,807	13,100	29.8	18,600	25.6
	OPM(%)	8.2	5.8	6.9	5.2	6.5	4.9	7.8	+1.3pp	5.8	+0.9pp

Source: Nippon-IBR based on Kokuyo's earnings presentation materials

FY21 OUTLOOK

Kokuyo is guiding for 1H OP of ¥13,100mil (+29.8% YoY) on sales of ¥167,000mil (+7.2% YoY), and full year FY21 OP of ¥18,600mil (+25.6% YoY) on sales of ¥321,000mil (+6.8% YoY). The 1H guidance was revised up from the original forecast by ¥5,000mil in sales and ¥2,800mil in OP, respectively, mainly thanks to the performance of the Spatial Value Domain, where segment 1H sales and OP were revised up by ¥5,600mil and 2,050mil, respectively. This segment is seasonally strong in Q1 as many corporates in Japan have an accounting year-end in March – a time when the completion of office renewal and refurbishment projects are usually undertaken.

Both FY21 sales and OP guidance have also been revised up by ¥10,000mil and ¥3,400mil respectively, of which earnings from the Spatial Value Domain are expected to be the main contributor (+¥9,000mil in sales and +¥2,750mil in OP). Kokuyo reckons that Spatial Value Domain earnings in the Q1 were particularly strong- almost too good – hence the upward revision simply reflects the higher than pre-COVID level orders that the firm has received so far.

The recurring profit [RP] guidance, however, was revised down for both 1H and the full-year, due a ¥5,254mil impairment charge reported in Q1 for equity method affiliate Pentel's underperformance in overseas markets. The 1H RP was originally guided for ¥10,700mil (+13.0% YoY) but is now forecast at ¥8,500mil (-10.2% YoY). For FY21, RP guidance was revised from ¥16,000mil (+12.9% YoY) down to ¥14,200mil (+0.2% YoY).

FY21 dividend forecast is ¥40/share, ca. 40% pay-out ratio. Kokuyo announced a share buy-back programme to repurchase total of 3% of shares outstanding (maximum of 3.5 million shares or ¥5,000mil) on 22 February 2021. As of 31 May 2021, the firm bought back total of 727,800 shares (ca. ¥1,250mil).

FY21 Earnings Guidance Revision by Segment							
(¥mil)		FY20		FY21			
		1H	FY	1HCE (old)	1HCE (new)	FYCE (old)	FYCE (new)
Spatial Value	Sales	78,074	144,700	78,000	83,600	146,000	155,000
	OP	9,417	13,859	9,450	11,500	14,550	17,300
	OPM (%)	12.1	9.6	12.1	13.8	10.0	11.2
Business Supply	Sales	55,968	113,065	60,000	59,900	118,000	118,000
	OP	1,187	2,502	1,450	1,470	2,850	2,900
	OPM (%)	2.1	2.2	2.4	2.5	2.4	2.5
Global Stationary	Sales	36,973	71,536	39,100	39,100	75,600	76,300
	OP	2,640	4,810	3,200	3,500	5,500	5,950
	OPM (%)	7.1	6.7	8.2	9.0	7.3	7.8

Source: Kokuyo's press release on 10 May 2021

REVISION IN THE LONG-TERM GROWTH FOCUS

FY21 is the last year of the ongoing 3-year second medium-term plan. The plan is part of a long-term vision towards FY2030. In Oct 2020, Kokuyo revised down the final year (FY21) earnings target because of unclarity surrounding the business environment due to COVID. At the beginning of the 3-year plan, the firm assumed a more favourable outlook for all three business domains. In the six months since downward revision, the plan's targets have been adjusted again to reflect the demand that has emerged under the new norm.

In the Spatial Value Domain, changes in the way offices are used will likely continue. As remote working is now more readily accepted, demand for office renewal is proving more popular than moving to a larger office, especially in the urban areas. However, the increase in remote working presents both opportunities and risks for Kokuyo. For example, there are several competitors in home office furniture market that are well-known brands and favoured for their affordability, such as Nitori (9843 JP) and Iris Ohyama (unlisted, Japan). Though Kokuyo is a rather late entrant to the home office furniture market, its focus will remain in the office furniture market. The office renewal market presents more opportunity for the firm and is likely more profitable than office moves and upsizing mandates. Office renewal orders come directly from user companies, rather than through general contractors and wholesalers.

Profitability in the Business Supply Domain remains low since the implementation of the migration strategy. The majority of office supply merchandise handled in this segment are non-Kokuyo brands – essentially, Kokuyo acts as a distributor. In FY20, Kaunet earned sales of ¥100,720mil out of ¥113,065mil segment sales. Ca. 5% of Kaunet sales was sanitary products while 20% of office supplies distributed through the segment is stationary. With the migration strategy, which is expected to reduce costs by ¥1,100mil (¥380mil from reinforcing operation efficiency including Kaunet, ¥450mil from distribution efficiency and ¥260mil from increasing Kaunet private brand products and centralising procurement networks) over three years to FY21, the segment eventually becomes sustainable. Going forward, the firm aims to establish a distribution business and is looking to expand the customer base not just to offices but also to nursing homes and beauty industries.

The Global Stationary Domain has been seeing surprisingly strong sales in China since FY20 Q2 and a year later, to FY21 Q2, the trend has not slowed down. The largest risk in the division is India given the prolonged lockdown affecting earnings recovery. In FY21, Kokuyo expects sales in India will recover to ca. -20% of the pre-COVID annual sales level of ca. ¥10,000mil. The firm reckons that there is potential demand for edu-stationary among the emerging middle class which will likely provide support for the recovery after schools reopen in India .

Kokuyo plans to announce the next part of the long-term vision with another 3-year plan in November.

FINANCIAL SUMMARY

P&L Summary										
(¥mil / Dec year-end)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21CE
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Sales	275,821	288,083	293,054	304,276	307,625	315,622	315,155	320,200	300,644	321,000
YoY (%)	6.0	4.4	1.7	3.8	1.1	2.5	-0.2	1.6	-6.2	6.7
COGS	186,602	194,674	196,603	203,267	202,159	205,495	202,524	206,265	193,257	
Gross Profit (GP)	89,219	93,408	96,450	101,009	105,465	110,126	112,630	113,934	107,386	
GPM (%)	32.3	32.4	32.9	33.2	34.3	34.9	35.7	35.6	35.7	
SG&A	84,366	86,981	88,851	89,906	90,026	92,535	94,334	97,190	92,579	
Operating Profit (OP)	4,852	6,426	7,598	11,102	15,438	17,591	18,296	16,743	14,807	18,600
YoY (%)	19.1	32.4	18.2	46.1	39.0	13.9	4.0	-8.5	-11.6	25.6
OPM (%)	1.7	2.2	2.5	3.6	5.0	5.5	5.8	5.2	4.9	5.7
Interest & dividend received	786	935	1,249	1,056	1,077	997	918	1,460	762	
Interest payment	625	472	471	406	374	308	257	249	213	
Investment gains & losses	42	45	28	47	47	85	71	66	-1,604	
Recurring Profit (RP)	6,142	8,276	9,643	11,880	15,690	19,130	19,178	18,198	14,173	14,200
YoY (%)	49.8	34.7	16.5	23.1	32.0	21.9	0.2	-5.2	-22.2	0.1
RPM (%)	2.2	2.9	3.3	3.9	5.1	6.1	6.1	5.7	4.7	4.4
Pre-tax Profit	5,262	7,821	7,628	10,812	17,219	18,702	20,214	21,623	12,342	
Tax costs	2,780	3,034	2,528	4,455	5,030	3,625	5,913	6,235	4,109	
Minority shareholder interest	-53	17	-35	-43	-5	-77	-69	-83	64	
Net Profit (NP)	2,428	4,804	5,065	6,312	12,182	15,000	14,231	15,303	8,297	11,800
YoY (%)	n/a	97.8	5.4	24.6	92.9	23.1	-5.2	7.5	-45.8	42.2
Comprehensive Profit	5,585	14,871	7,515	13,032	9,320	19,962	8,194	16,359	9,744	

Source: Nippon-IBR based on Kokuyo's presentation materials, YUHOs and Toyo Keizai estimate

Balance Sheet Summary										
(¥mil / Dec year-end)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Current Asset	124,283	130,398	141,447	149,477	166,615	174,177	185,504	187,640	189,182	
Fixed Asset	134,178	140,339	132,324	136,836	127,356	130,969	119,283	130,776	131,114	
Tangible	67,834	65,557	63,992	62,881	61,646	61,691	61,014	59,927	58,547	
Intangible	11,494	10,512	10,084	9,500	9,535	8,258	7,489	7,544	7,402	
Investment and others	54,849	64,269	58,247	64,454	56,174	61,019	50,779	63,303	65,164	
Total Asset	258,461	270,738	273,772	286,313	293,971	305,147	304,788	318,416	320,296	
Current Liability	67,496	73,784	67,655	72,758	82,449	77,494	74,345	77,004	76,291	
Fixed Liability	37,895	31,296	35,764	32,762	23,481	23,159	21,481	20,132	17,668	
Net Asset	153,069	165,656	170,352	180,793	188,040	204,493	208,962	221,279	226,335	
Capital	15,847	15,847	15,847	15,847	15,847	15,847	15,847	15,847	15,847	
Capital Surplus	19,068	19,068	19,068	18,245	18,245	18,099	18,099	18,105	18,109	
Retained Earnings	128,643	131,728	135,019	139,790	149,903	161,582	172,090	183,313	186,877	
Treasury Shares	-14,334	-14,337	-14,339	-14,342	-14,345	-14,350	-14,355	-14,322	-14,282	
Minority Interest	2,436	2,040	2,078	1,821	1,767	1,891	1,800	1,865	1,719	
Shareholders' Equity	150,633	163,616	168,273	178,972	186,272	202,602	207,161	219,414	224,616	
Shareholders' Equity Ratio (%)	58.3	60.4	61.5	62.8	63.6	66.7	68.2	68.9	70.1	
Interest-bearing Debt	36,599	31,911	25,898	24,299	23,687	13,759	13,893	13,201	12,965	

Source: Nippon-IBR based on Kokuyo's presentation materials, YUHOs and Toyo Keizai estimate

Cash Flow Summary

(¥mil / Dec year-end)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Operating Cash Flow	10,788	10,921	15,882	12,054	23,725	17,500	20,880	16,723	19,217
Depreciation	6,663	6,917	7,138	7,167	6,480	6,483	6,335	6,075	6,119
Goodwill Amortisation	97	204	0	35	30	32	30	29	27
Change in Sales Receivables	-310	178	-3,902	-3,810	94	-4,683	1,882	-889	1,958
Change in inventories	-1,205	-2,715	813	-1,097	1,266	-1,211	-1,208	-2,512	2,494
Change in Accounts Payable	949	909	3,944	685	1,354	4,054	-790	2,285	-2,232
Investment Cash Flow	796	-2,190	-702	-3,186	784	1,660	-2,427	-9,693	-6,111
Free Cash Flow	11,584	8,731	15,180	8,868	24,509	15,840	18,453	7,030	13,106
Finance Cash Flow	-2,837	-7,560	-9,106	-5,616	-3,919	-14,636	-4,585	-5,829	-5,946
Cash and Cash Equivalent	35,629	37,411	43,949	46,953	67,328	68,620	82,324	83,456	90,577

Source: Nippon-IBR based on Kokuyo's presentation materials, YUHOs and Toyo Keizai estimate

Per-share indicators

(¥mil / March year-end)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21CE
EPS	20.53	40.62	42.83	53.37	103.01	126.83	120.34	129.39	70.13	91.70
BPS	1,273.53	1,383.34	1,422.75	1,513.23	1,574.99	1,713.11	1,751.69	1,854.91	1,898.42	
Dividend	15.00	15.00	15.00	17.50	22.00	29.00	32.00	39.00	39.00	40.00

Source: Nippon-IBR based on Kokuyo's presentation materials, YUHOs and Toyo Keizai estimate

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