

KOKUYO CO., LTD (7984 JP)

OFFICE RENEWAL DEMAND IN SPATIAL VALUE DOMAIN SUPPORTED STRONG EARNINGS MOMENTUM WHICH WILL LIKELY CONTINUE

FY21 Q3 RESULTS SUMMARY

Kokuyo (7984 JP) reported FY21 Q1~Q3 (cumulative 9 months) results with OP of ¥18,423mil (+51.0% YoY) on sales of ¥241,861mil (+8.1% YoY). Compared to the pre-COVID earnings in FY19 Q3, the cumulative OP went up by 24.9% over the two-year period, although sales were basically flat. In Q3 alone, earnings were in line with the firm's expectation with OP of ¥3,713mil (+76.1% YoY / -21.5% QoQ) on sales of ¥73,721mil (+8.7% YoY / -5.5% QoQ). Spatial Value Domain earnings have high seasonality in Q1 (Jan~Mar) and low seasonality in 2H.

Gross profit margin (GPM) for the 9-month period improved 0.7ppt YoY to 37.0%, thanks primarily to an improved sales mix with strong earnings growth in Spatial Value Domain. Office refurbishment demand to accommodate various COVID safety measures remained strong throughout Q1~Q3. Refurbishment and renewal projects tend to generate higher margins compared to office removal projects because Kokuyo negotiates directly with the customers rather than via tender bids.

FY21 Earnings Summary (Cumulative)						
(¥mil)	FY20			FY21		
	1H	Q3	FY	1H	Q3	FYCE
Sales	155,813	223,664	300,644	168,140	241,861	322,000
OP	10,090	12,198	14,807	14,710	18,423	20,200
RP	9,467	11,787	14,173	10,464	14,540	16,100
NP	6,288	8,330	8,297	8,332	11,505	12,300
EPS (¥)	53.15	70.42	70.13	70.64	97.77	99.74

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

SEGMENTS BY BUSINESS DOMAIN

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

Spatial Value Domain

Spatial Value Domain achieved record earnings over the 9-month period with the segment OP of ¥16,243mil (+42.9% YoY) on sales of ¥121,195mil (+10.6% YoY). Given FY20 was largely affected by COVID, comparisons to FY19 appears more meaningful. On that basis, compared to the same period in FY19, segment sales and OP improved +3.7% and +23.1% respectively, thanks mainly to (1) a rise in consultations regarding how to renovate existing office spaces to meet the new normal standards, which led to (2) more direct business with customers, and (3) less low margin new office-related orders. In Q3 alone, the segment generated OP of ¥3,886mil (+99.3% YoY / -1.8% QoQ) on sales of ¥36,320mil (+15.2% YoY / -3.2% QoQ).

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, there are an increasing number of employees who are working remotely. This

EXECUTIVE SUMMARY

- Kokuyo reported cumulative 9-month earnings with OP of ¥18,423mil (+51.0% YoY) on sales of ¥241,861mil (+8.1% YoY). Compared to the pre-COVID earnings in FY19 Q3, the cumulative OP went up by 24.9% over the two-year period, although sales were basically flat.

- Improved sales mix (thanks to increase in direct business with customers) and solid YoY growth in Spatial Value Domain led to GPM rising 0.7ppt YoY to 37.0%.

- Spatial Value Domain achieved record earnings in both cumulative nine-month period and Q3 alone. Segment OPM improved to 13.4% in Q3, thanks to an increase in direct business and consultation with customers.

- In the Business Supply Domain segment, Kokuyo's office supply mail-order platform Kaunet was negatively affected by remote working as many firms refrained from purchasing office supplies while their employees working from home.

- Sales growth in China continued to offset weak earnings in India in the Global Stationary Domain. The segment saw OP growth improve 5.3% YoY, even compared to FY19 Q1~Q3.

- Kokuyo maintained its previously revised FY21 earnings guidance as the guidance only reflects orders that were recognised as of the Q3-end.

- This year is the last of the second medium-term (three-year) management plan. Kokuyo plans to announce the next part of the long-term vision with another 3-year plan in November.

has drastically changed the way that large corporations use their office space. Specifically, pre-COVID, open-plan designs were popular. Now, post-COVID, demand for partitions and cubicles has been stronger-than-expected. In the overseas business, Kokuyo is aiming to capture demand from non-Japanese companies by offering consultation on workspace styles, especially in China.

Business Supply Domain

Business Supply Domain Q1~Q3 OP rose 14.6% YoY to ¥1,897mil on sales of ¥85,384mil (+3.9% YoY). Compared to the same period in FY19, the segment sales and OP were -3.5% and +10.0% respectively, thanks to the “migration strategy” which aims to consolidate multiple distribution channels into one and create an optimal sales network for customers. During the period of COVID closures, Kaunet, Kokuyo’s office supply mail-order platform, was negatively affected by remote working as many companies did not buy office supplies while their employees worked from home. In the Q3 alone, the segment reported sales of ¥25,784mil (-1.53% YoY / -9.0% QoQ), of which Kaunet sales were approx. ¥7,050mil (-6.3% YoY or -¥450mil), which explains almost half of the YoY sales decline. Kokuyo has been working on the migration strategy for the past three years and has finally started to see an effect on efficiency in both sales and distribution. Segment OP for the cumulative 9 months improved 14.6% YoY thanks to more efficient distribution.

Global Stationary Domain

The Global Stationary Domain earned Q1~Q3 OP of ¥5,087mil (+30.8% YoY) on sales of ¥55,291mil (+2.9%), on the back of growth in China. Kokuyo’s stationary products continue to be popular among 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. Q1~Q3 sales in China were approx. ¥7,500mil, almost equivalent to the annual sales in China in FY20. Compared to FY19 Q1~Q3, segment sales and OP were -11.5% and +5.3% respectively.

FY21 OUTLOOK

FY21 earnings guidance was revised up at the time of 1H results to OP of ¥20,200mil (+36.4% YoY) on sales of ¥322,000mil (+7.1% YoY), however, there was no change with the Q3 announcement. This suggests the implied Q4 of OP ¥1,777mil (-31.9% YoY / -52.1% QoQ) on sales of ¥80,139mil (+4.1% YoY / +8.7% QoQ) will see a much greater seasonal decline. There are primarily two reasons for the unchanged full year and rather weak Q4 forecast:

1. Kokuyo explains that ongoing strong demand for office renewal and refurbishment will likely continue during this year. However, the guidance for FY21 only reflects orders that are recognised as of the end of Q3 but does not reflect any potential business that might be realised during Q4, therefore there is some wiggle room on the upside. Kokuyo has been receiving enquiries for office refurbishment and renewal from companies that need to prepare their office spaces to meet COVID safety measures requirements before their employees return to the office. Management reckons that the uptrend in the office renovation demand will likely continue until FY22 1H.
2. During Q4, the firm will need to absorb the higher raw material prices, which is estimated to increase COGS by approx. ¥300mil.

The FY21 dividend forecast of ¥40/share, generates a pay-out ratio of approx. 40%. Kokuyo announced a share buy-back programme to repurchase a total of 3% of shares outstanding (maximum of 3.5 million shares or ¥5,000mil) on 22 February 2021. As of 30 September 2021, the firm has bought back total of 1,466,900 shares (approx. ¥2,618mil).

This year is the last of the second medium-term (three-year) management plan. Kokuyo plans to announce the next part of the long-term vision with another 3-year plan in November. Thanks to focusing on higher value-added designs for new working style demands and cost management to improve profitability, FY21 OPM will likely surpass the plan’s target of 6.2%.

SEGMENT DATA

Sales and OP by Domain (Cumulative)												
(JPY million)		FY19			FY20			FY21				
		1H	3Q	FY	1H	Q3	FY	1H	Q3	YoY (%)	FY CE	YoY (%)
Spatial Value Domain	Sales	81,608	116,897	152,066	78,074	109,591	144,700	84,875	121,195	10.6	157,000	8.5
	OP	10,140	13,186	15,361	9,417	11,367	13,859	12,357	16,243	42.9	18,200	31.3
	OPM(%)	12.4	11.3	10.1	12.1	10.4	9.6	14.6	13.4	+3.0pp	11.6	+2.0pp
Business Supply Domain	Sales	59,534	88,445	118,081	55,968	82,153	113,065	59,600	85,384	3.9	117,900	4.3
	OP	1,270	1,725	2,318	1,187	1,656	2,502	1,547	1,897	14.6	2,900	15.9
	OPM(%)	2.1	2.0	2.0	2.1	2.0	2.2	2.6	2.2	+0.2pp	2.5	+0.3pp
Global Stationary Domain	Sales	43,526	62,532	81,845	36,973	53,743	71,536	38,297	55,291	2.9	74,600	4.3
	OP	3,592	4,829	6,017	2,640	3,890	4,810	3,845	5,087	30.8	6,100	26.8
	OPM(%)	8.3	7.7	7.4	7.1	7.2	6.7	10.0	9.2	+2.0pp	8.2	+1.5pp
Others	Sales	1,297	1,956	2,642	1,252	1,857	2,522	1,358	2,041	9.9	2,700	7.1
	OP	69	104	139	61	55	54	66	76	38.2	100	85.2
	OPM(%)	5.3	5.3	5.3	4.9	3.0	2.1	4.9	3.7	+0.7pp	3.7	+1.6pp
Adjustment	Sales	-18,314	-26,362	-34,435	-16,455	-23,681	-31,179	-15,990	-22,050	n/a	-30,200	n/a
	OP	-3,453	-5,096	-7,092	-3,215	-4,771	-6,419	-3,105	-4,881	n/a	-7,100	n/a
Total as in PL	Sales	167,652	243,469	320,200	155,813	223,664	300,644	168,140	241,861	8.1	322,000	7.1
	OP	11,619	14,749	16,743	10,090	12,198	14,807	14,710	18,423	51.0	20,200	36.4
	OPM(%)	6.9	6.1	5.2	6.5	5.5	4.9	8.7	7.6	+2.1pp	6.3	+1.4pp

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

Sales and OP by Domain (Quarterly)													
(JPY million)		FY20				FY21							
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	YoY (%)	QoQ (%)	Q4 CE	YoY (%)	QoQ (%)
Spatial Value Domain	Sales	47,019	31,055	31,517	35,109	47,337	37,538	36,320	15.2	-3.2	35,805	2.0	-1.4
	OP	8,075	1,342	1,950	2,492	8,398	3,959	3,886	99.3	-1.8	1,957	-21.5	-49.6
	OPM (%)	17.2	4.3	6.2	7.1	17.7	10.5	10.7	+4.5pp	+0.2pp	5.5	-1.6pp	-5.2pp
Business Supply Domain	Sales	31,066	24,902	26,185	30,912	31,262	28,338	25,784	-1.53	-9.0	32,516	5.2	26.1
	OP	674	513	469	846	785	762	350	-25.4	-54.1	1,003	18.6	186.6
	OPM (%)	2.2	2.1	1.8	2.7	2.5	2.7	1.4	-0.4pp	-1.3pp	3.1	+0.4pp	+1.7pp
Global Stationary Domain	Sales	20,866	16,107	16,770	17,793	20,072	18,225	16,994	1.3	-6.8	19,309	8.5	13.6
	OP	2,110	530	1,250	920	2,340	1,505	1,242	-0.6	-17.5	1,013	10.1	-18.4
	OPM (%)	10.1	3.3	7.5	5.2	11.7	8.3	7.3	-0.2pp	-1.0pp	5.2	+0.0pp	-2.1pp
Others	Sales	645	607	605	665	677	681	683	12.9	0.3	659	-0.9	-3.5
	OP	35	26	-6	-1	31	35	10	n/a	-71.4	24	n/a	140.0
	OPM (%)	5.4	4.3	n/a	n/a	4.6	5.1	1.5	n/a	-3.6pp	3.6	n/a	+2.1pp
Adjustment	Sales	-9,315	-7,140	-7,226	-7,498	-9,192	-6,798	-6,060	n/a	n/a	-8,150	n/a	n/a
	OP	-1,959	-1,256	-1,556	-1,648	-1,575	-1,530	-1,776	n/a	n/a	-2,219	n/a	n/a
Total as in PL	Sales	90,283	65,530	67,851	76,980	90,157	77,983	73,721	8.7	-5.5	80,139	4.1	8.7
	OP	8,936	1,154	2,108	2,609	9,982	4,728	3,713	76.1	-21.5	1,777	-31.9	-52.1
	OPM (%)	9.9	1.8	3.1	3.4	11.1	6.1	5.0	+1.9pp	-1.1pp	2.2	-1.2pp	-2.8pp

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

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