

**FORUM ENGINEERING (7088 JP)****PRIORITY IS GIVEN TO REDUCE STAFF ON STAND-BY DURING FY21 BEFORE MOVING ONTO A MORE DYNAMIC GROWTH FROM FY22****FY21 Q1 RESULTS**

Forum Engineering (7088 JP) reported FY21 1H (Apr~Sept 2021) results with OP of ¥672mil (-27.3% YoY) on sales of ¥13,068mil (-7.5% YoY), which were largely in line with the company's internal forecast.

Forum Engineering (7088JP): Earnings summary (¥mil)							
March yr-end	FY19	FY20		FY21			
	FY	Q2	FY	Q2	YoY (%)	FYCE	YoY (%)
Sales	32,115	14,129	27,728	13,068	-7.5	27,850	0.4
GP	11,036	4,172	8,523	3,692	-11.5		
GPM(%)	34.4	29.5	30.7	28.3	-1.2pp		
SG&A	6,956	3,247	6,173	3,019	-7.0		
SG&A / sales (%)	21.7	23.0	22.3	23.1	+0.1pp		
OP	4,079	925	2,349	672	-27.3	1,820	-22.6
OPM (%)	12.7	6.5	8.5	5.1	-1.4pp	6.5	-2.0pp
Pre-tax Profit	3,097	922	1,974	651	-29.4	1,770	-10.3

Source: Nippon-IBR based on Forum Engineering's presentation materials

Some 99% of Forum's earnings are currently derived from *Cognavi Staffing* – the engineer temporary staffing business. Forum dispatches its engineers, who are generally hired on a full-time basis by the firm, to its clients' companies on a temporary basis for an initial three-month contract (renewable). As of the end of Q2, of the 3,858 electrical and mechanical engineers Forum employed, 3,678 were dispatched to Japanese manufacturing sectors, such as automobile, industrial machinery, and precision machinery. Although one Forum's key KPIs – the number of operating engineers per month – did not recover to the pre-COVID level of over 4,500, it has improved steadily from the beginning of FY21 as the number of staff on stand-by, which is another KPI of the business decreased from 550 to 330 in Q1 and further to 180 in Q2. As a result, the staff utilisation rate improved from 91.6% in Q1 to 95.3% in Q2, equivalent to the pre-COVID norm.

However, GPM for the six-month period remained below 30%, coming in at 28.3% (-1.2ppt YoY), excluding the impact of the Employment Support Subsidy, a government support to retain employment during the pandemic, FY21 1H GPM was 25.8%, -0.2ppt YoY. During the period of weak demand for engineers due to COVID-related closures, Forum did not reduce the staffing rates as the firm considered there would be a structural shortage of electrical and mechanical engineers in Japan over the long-term. During 1H, Forum prioritised the placement of stand-by engineers to jobs rather than hiring new engineers. As a result, in September alone, GPM improved back to the 33% level. The optimal level of staff on stand-by is some one hundred, therefore, by reducing the number of stand-by engineers to this level will likely improve GPM in the latter half of this fiscal year.

**EXECUTIVE SUMMARY**

- FY21 1H results were largely in line with the firm's internal forecast with OP of ¥672mil (-27.3% YoY) on sales of ¥13,068mil (-7.5% YoY).
- The core *Cognavi Staffing* business, which comprises some 99% of the firm's earnings, has started to see signs of recovery in (1) the reduction in the number of staff on stand-by and (2) improved utilisation rates.
- While 1H GPM remained below the pre-COVID norm of 30%, it recovered to 33% in September thanks to improved utilisation rates.
- Despite progress to its full year targets is 46.9% in sales and 37.0% in OP, Forum kept its FY21 OP at ¥1,820mil (-22.6% YoY), with RP of ¥1,790mil on sales of ¥27,850mil (+0.4% YoY).
- To ensure long-term growth, the firm will focus on establishing new income streams through other *Cognavi* services such as *Cognavi Career Change*, *Cognavi Graduate*, and ultimately, *Cognavi Talent Management*. Unlike its staffing service, job referrals garner almost 100% GPM because these services use skill-based data already accumulated in the *Cognavi* platform.
- Forum aims to pay stable dividend and maintain a higher than 60% pay-out ratio. The FY21 dividend is set at ¥48/share, which is flat YoY as the firm assumes COVID-related disruptions are still likely. Should earnings fall short of the guidance, however, Forum will still be able to pay the said dividend given its strong cash position.

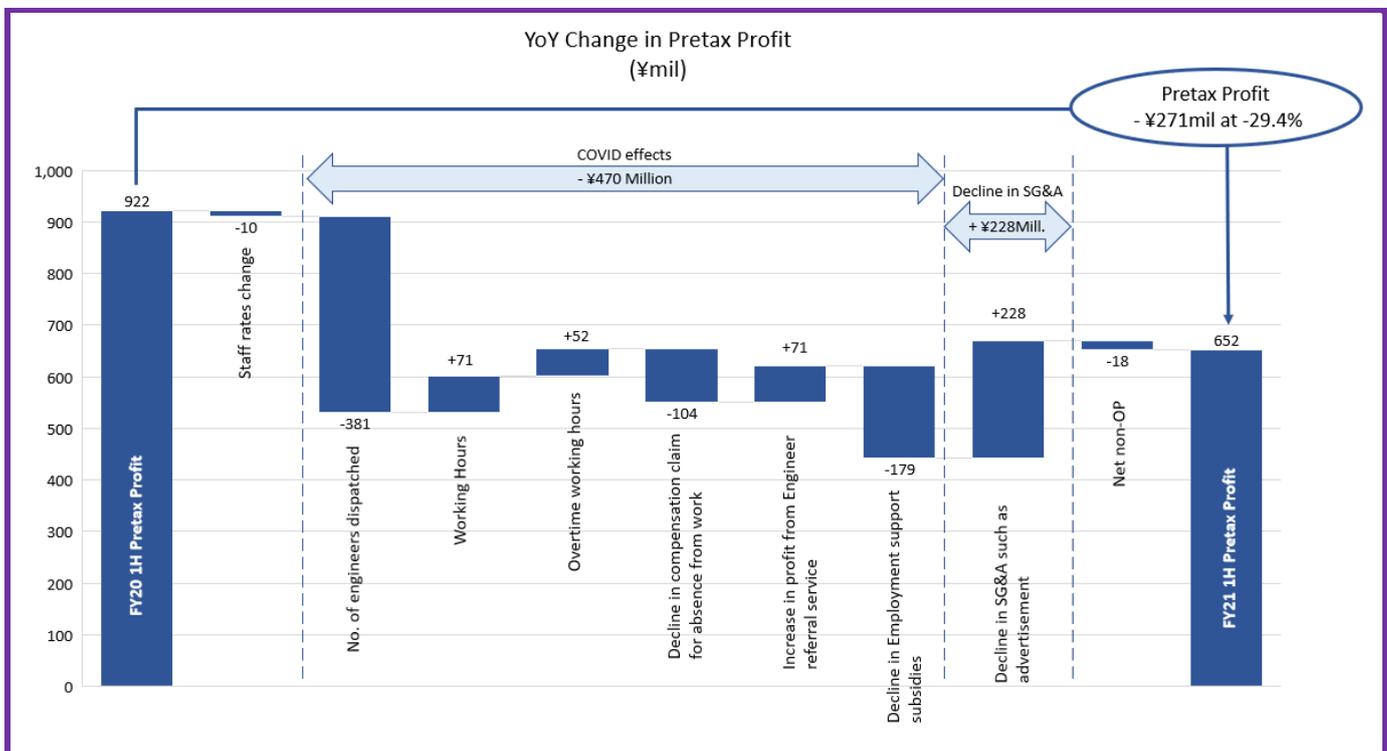
**Key Variables for Cognavi Staffing Segment (Engineer Dispatch Business) vs. GPM (%)**

	FY18	FY19	FY20	FY21	
	FY	FY	FY	1H	FYCE
Number of dispatched engineers (at end of each month)	4,625	4,284	3,616	3,678	3,710
Staff utilisation rate (%)	98.1	96.0	89.3	95.3	92.7
Average working hours (hours/month/person) as at the end of each period	159.3	159.8	159.7	153.7	159.8
Average monthly staffing fee (¥/hour) as at the end of each period	3,628	3,787	3,783	3,779	3,740
GPM (%)	35.8	34.4	30.7	28.3	

Source: Nippon-IBR based on Forum Engineering's Earnings Results Material

As of 1H, although Forum has achieved 46.9% and 37.0% of FY21 sales and OP target respectively, the firm has not revised its FY21 earnings guidance.

Forum initially reckoned that the ongoing semiconductor shortage would somewhat affect the demand for engineers because its largest customer is the automobile sector (approx. 28% of the firm's total sales), which has had to suspend production on several occasions. However, Forum did not experience much of a negative impact on demand for its engineers, thanks to 1) its diverse client base, therefore it does not rely on a smaller number of large customers, and 2) broader job type coverage, from the upper end of the engineering process, such as R&D to the lower end, which is closer to the actual manufacturing process, such as production technology / quality control.



## FY21 OUTLOOK

Forum kept its full-year FY21 guidance unchanged, eyeing OP of ¥1,820mil (-22.6% YoY) and RP of ¥1,790mil on sales of ¥27,850mil (+0.4% YoY), primarily based on the following assumptions:

- Demand for engineers: Although demand for temporary staffing of engineers seemed to have bottomed in Q4 FY20, management does not expect a full recovery until the end of FY21 due to the prolonged impact from the State of Emergency closures which has several manufacturers still somewhat reluctant to hire aggressively.
- Hiring of engineers to restart in 2H: Forum has been prioritising the placement of engineers on stand-by rather than hiring new staff during 1H. Therefore, as those on stand-by are put to work, profitability can increase. The firm reckons that the demand for engineers will recover from Q3 onwards. Manufacturers in Japan continue to struggle to find skilled engineers, which remains a long-term structural problem. Forum currently plans to meet the

potential demand for engineers by 1) proactively hiring new graduate engineers through its network of STEM universities, and 2) by dispatching staff wherever and whenever there is a demand for the engineer's skills. Unlike its competitors that dispatch a team of engineers under a contractor to certain projects, Forum dispatches from one engineer if a client needs certain skillset. Forum uses its proprietary AI-based skill matching technology to connect an engineer with specific skills required by a manufacturer and proactively promotes the engineer to them. This way, the firm manages to capture niche demand.

- Engineer dispatch contracts renewal: despite the pandemic, the structural shortage of engineers has seen demand for renewing ongoing contracts remain strong.
- Hiring by corporates: although many companies still remain reluctant to undertake any hiring, the rapid digital shift by corporates has created demand for workers with specific, advanced skills.

The risk is whether the firm can hire the optimal numbers of engineers. The minimum level to remain profitable calls for approx.4,000 engineers on its register with more than 90% utilisation rate. The Staff Dispatching business is cash-generative. Despite the temporary slowdown of this core business, Forum managed to generate free cash flow of ¥2,322mil in FY20. FCF will likely improve as the engineers on stand-by are dispatched and number of operating engineers return to pre-COVID levels (hence the normalised utilisation rate). Ideally, it should hire 5,000~6,000 engineers when the job market recovers. This is where Forum's network with STEM universities become an advantage. Younger engineers are less expensive for the firm to employ, hence more profitable for the firm.

Through one of its recruitment referral businesses, *Cognavi New Graduates*, Forum has been gaining an increasing number of new graduates who are registering their information – such as the subjects they studied – on the *Cognavi* platform. The number of students who graduated in March 2021 and registered with the *Cognavi* platform was just 440. That figure has significantly improved as there are now 1,941 STEM students who are about to graduate university in March 2022 registered on the platform, of which thirty-four students have already been offered positions as mechatronics engineers. There are also a further 1,934 students who will graduate in March 2023 registered with *Cognavi*.

For the longer-term growth, however, of pressing importance is for Forum to establish a new income stream through its *Cognavi* services such as *Cognavi Career Change*, *Cognavi Graduate*, and ultimately, *Cognavi Talent Management*. Unlike its staffing service, those job referrals services garner almost 100% GPM because these services use data in the *Cognavi* platform, on which the candidates' skills and the needs of the employer are both registered. A job referral is then made through an AI matching process via the skill tree.

As of Q2, Forum has two customers using the *Cognavi Talent Management*. The key concept of the *Cognavi* proprietary technology is to (1) automatically optimise the number of staff needed, and (2) to match them with the most appropriate department, based on both the engineering skills a department requires and the level of skill needed for the job. It also supports manufacturers to manage their in-house engineers' skills and helps them work towards achieving positions and careers that they deserve. As of FY20, Forum marketed *Cognavi Talent Management* to manufacturers and secured just one new customer. From FY21, the firm has changed its marketing focus from offering its services on a company-wide basis to target individual divisional heads – of which there are approx. 3,200 with whom Forum already does business. While the firm continues its efforts to gain more customers for the *Cognavi Talent Management*, for this fiscal year, the firm's primary aim is to find placements for engineers on stand-by in its Staffing business and to start hiring both new graduates and more experienced engineers during 2H for them to start working in April.

<b><i>Cognavi Services</i></b>			
	<b>Service</b>	<b>Fee</b>	<b>Market size</b>
<i>Cognavi Staffing</i>	Engineer temporary staffing. Electrical and mechanical engineers as well as IT engineers	Average fee/engineer per year: ¥7.33mil	Domestic engineer staffing market : ca. ¥920,000mil
<i>Cognavi Career Change</i>	Job referral service for mechanical and electrical engineers.	Success fee of ¥1mil / engineer charged to employers. Periodical subscription fee is under consideration.	640,000 electrical & mechanical engineers
<i>Cognavi Career Change IT</i>	Job referral service for IT engineers.	Success fee of ¥0.5mil / engineer charged to employers + annual subscription fee of ¥0.5nil/business site	940,000 IT engineers
<i>Cognavi Graduate</i>	Job referral service for STEM graduates.	Success fee of ¥1mil / engineer charged to employers. Periodical subscription fee is under consideration.	39,000 new graduates from STEM universities
<i>Cognavi Talent Management</i>	Internal engineer talent management for corporates	Monthly subscription: Companies with 500 or fewer engineers: ¥300K/mo., 501~1,000 engineers ¥400K/mo., 1,000 or more engineers ¥500K/mo.	Existing clients who use other <i>Cognavi</i> services. Specialises in electrical & mechanical engineers
<i>Source: Nippon-IBR based Forum Engineering FY20 earnings results presentation</i>			

## ESG POLICY

The proposal to restructure the Board passed at the AGM in June. However, management reckons that the firm has to quickly access and establish its own ESG policy. Forum plans to build its sustainability policy with the aim of supporting the lifelong career of engineers. Furthermore, the firm aims to attain female executives. The issue remains with 'E' as seen in many non-manufacturing companies. Forum plans to announce more detailed plan of its ESG policy in the next medium-term plan, which will likely be next year.

## SHAREHOLDER RETURN

Forum aims to pay stable dividend and maintain higher than 60% pay-out ratio. FY21 dividend will be ¥48/share. Taking on board that there still might be some negative impact from COVID ahead, the dividend payment is unchanged from FY20. Should the earnings fall short of the guidance, Forum will still be able to pay the said dividend given abundant cash (¥13bil, over 50% of market cap), steady cashflow and little capex planned.

## GENERAL DISCLAIMER AND COPYRIGHT

*This report has been commissioned by Forum Engineering Inc. (the Sponsor) and prepared and issued by Nippon Investment Bespoke Research UK Ltd (Nippon-IBR), in consideration of a fee payable by Forum Engineering. Fees are paid on delivery of the report in cash without recourse. Nippon-IBR may seek additional fees for the provision of follow-up research reports and associated IR services for the Sponsor but does not get remunerated for any investment banking services. We never take payment in stock, options, or warrants for any of our services.*

**Accuracy of content:** *All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however Nippon-IBR does not guarantee the accuracy or completeness of this report and has not sought for this information to be independently verified. Opinions contained in this report represent those of the Nippon-IBR analyst at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of their subject matter to be materially different from current expectations.*

**Exclusion of Liability:** *To the fullest extent allowed by law, Nippon-IBR shall not be liable for any direct, indirect, or consequential losses, loss of profits, damages, costs, or expenses incurred or suffered by you arising out or in connection with the access to, use of or reliance on any information contained on this note.*

**No personalised advice:** *The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Nippon-IBR's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.*

**Investment in securities mentioned:** *Nippon-IBR has a restrictive policy relating to personal dealing and conflicts of interest. It does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees, and contractors of Nippon-IBR may have a position in any or related securities mentioned in this report, subject to its policies on personal dealing and conflicts of interest.*

**Copyright:** *Copyright 2021 Nippon Investment Bespoke Research UK Ltd.*

For further enquiry, please contact:

Yumi Yamamoto-Tyrrell

Nippon Investment Bespoke Research UK Ltd

118 Pall Mall

London SW1Y 5EA

TEL: +44 (0)20 7993 2583

Email : [enquiries@nippon-ibr.com](mailto:enquiries@nippon-ibr.com)



Research Beyond Horizons  
Japanese Equity Specialist

*Nippon Investment Bespoke Research UK Ltd (formerly known as NIB Research UK Ltd.) is registered in England and Wales (9100028) and is authorised and regulated by the Financial Conduct Authority (FRN: : 928332).*