

KOKUYO CO., LTD (7984 JP)

THE THIRD MEDIUM-TERM MANAGEMENT PLAN (FY22~24), FIELD EXPANSION 2024, WAS LAUNCHED

THE THIRD MEDIUM-TERM PLAN

After the Board resolution on 29 November 2021, Kokuyo (7984 JP) launched its third medium-term management plan – the *Field Expansion 2024* (hereinafter referred to as the Plan) – that covers the three-year period between 2022 and 2024. This is the firm’s third mid-term plan, which is the first plan in *CCC 2030*, a ten-year strategy that was launched in February 2021 and will continue to 2030.

A long-term vision, CCC 2030

Under *CCC 2030*, Kokuyo redefines its role as a company that provides services to support workstyle and lifestyle of its customers, beyond that of just being a supplier of stationery and office furniture products. The firm aims to achieve total net sales of ¥500bil in 2030 by shifting its business focus from tangibles (such as products) to intangibles (such as services, consulting, and design), as well as to accelerate efforts to create new and better customer experiences. The FY30 forecast of ¥500bil in total net sales comprises ¥300bil from organic growth in its existing; ¥100bil from the expansion of its existing businesses into new fields and ¥50~100bil from new business ideas and services.

REVIEW OF PREVIOUS MEDIUM-TERM PLAN (FY19-FY21)

During the second three-year plan (FY19~FY21), Kokuyo managed to adapt to the changes and challenges that COVID brought. Although the firm missed the initial three-year target due to COVID influences, FY21 earnings should be better than the company guidance provided with the FY20 Q3 results, which saw sales revised down from ¥346bil to ¥305bil and OP from ¥21.5bil to ¥13bil, respectively, thanks to stronger-than-expected office furniture sales in FY21 1H. Consequently, Kokuyo has revised up its FY21 OP forecast to ¥20.2bil on sales of ¥322bil.

Kokuyo (7984 JP): The Second Medium-term Plan			
(¥bil)	FY21 target / forecast		
	Initial F/C	Revised FY20Q3	Revised FY21Q2
Sales	346~	305~	322~
Gross Profit	127.8~	109.3~	116.7~
GPM (%)	37.0~	35.8~	36.2~
Operating Profit	21.5~	13~	20.2~
OPM (%)	6.2~	4.3~	6.3~

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

Kokuyo’s business portfolio was divided into three business domains: Spatial Value, Business Supply, and Global Stationery. Each business domain saw improved business trends in FY21 compared to that of pre-COVID FY19 levels. Along with Covid instigating workstyle reforms, the digitalisation initiatives implemented by the Abe administration have promoted changes in work and education. This especially applies to the office furniture business that is included in the Spatial Value Domain where demand from corporates to reorganise the workplace accelerated during the pandemic.

EXECUTIVE SUMMARY




- Kokuyo (7984 JP) has launched its third medium-term management plan, *Field Expansion 2024 (The Plan)*, that covers the three-year period between 2022~2024.
- The Plan was the first medium-term plan in a ten-year long-term strategy, *CCC 2030* (launched in February 2021 and will continue to 2030).
- The previous medium-term plan was affected by COVID and led to (1) Kokuyo missing its initial three-year targets and (2) a downward revision to the plan’s targets in FY20 Q3. However, the FY21 earnings trend has improved, resulting in the firm revising up its FY21 guidance.
- The new medium-term plan targets gross profit of ¥143.7bil (CAGR 7.8%) and OP of ¥27.5bil (CAGR 11.2%) on sales of ¥360bil (CAGR 7.0%) in FY24. OPM will improve from the FY21 estimate of 6.8% to 7.6% over the three years.
- Kokuyo also reorganise business segments into 1) Workstyle Field that includes Furniture Business and Business Supply Distribution, and 2) Lifestyle Field that includes Stationery Business and Interior Retail Business.
- Kokuyo’s management commits to achieve ROE of 8% over the next three years. As of FY21 Q3, Kokuyo’s shareholder equity was ¥229bil (73.4%) with retained earnings of ¥194bil. During the next three years, the first priority of capital allocation will be given to growth investment while aiming for a stable dividend increase with a dividend pay-out ratio of 40%.
- Non-operating assets such as investment security (¥48.5bil, or approx. 15.6% of total assets) will likely be reinvested in improving business growth before realised gain from those assets being distributed to shareholders.

At the beginning of the plan, Kokuyo assumed that the furniture demand would be more correlated to new office building trends and the corresponding demand for office removal services. Under COVID, however, Kokuyo saw a boost in demand for workplace renovation amid the need for more diverse working patterns. As a result, the performance of the Spatial Value Domain business came in ahead of the firm's revised forecast as shown in the table below.

In the Business Supply Domain, Kokuyo worked on its migration strategy which aims to consolidate multiple wholesale distribution channels into one and to create an optimal sales network for its customers. As a result, the segment's OPM improved from 2.0% in FY19 to approx. 2.5% so far in FY21. However, Kaunet, Kokuyo's mail-order office supply business, was negatively affected by the increase in remote working with many employees of its customers shifting to e-commerce for supplies while working from home.

The business landscape of the Global Stationery Domain also went through COVID-driven changes. While the market in Japan had matured, the pandemic has accelerated the shift to digitalisation and further shrunk the B2B market. Weakness in the domestic market, however, was more than offset by growth in the overseas market, especially in China. The firm did not suffer any negative effects from COVID in China and managed to capture a new audience – high school girls – for its stationary products. In India, Kokuyo acquired a local edu-stationery specialist in 2016 and since then, sales nearly doubled during the pre-COVID period. However, due to a shift to distant online learning during the peak of the pandemic in India, demand for edu-stationery – whose main customers are schools – fell sharply. Despite the rapid decline in sales during the peak of the pandemic, the Indian subsidiary remained profitable and has built a solid balance sheet.

Despite the impact of the business environment,
each domain performed fairly consistently with initial expectations.

	(Billion yen)	2021			Evaluation
		Initial target	Revised target	Full-year forecast	
Spatial Value Domain	Net sales	> 162.0	> 139.0	157.0	 <ul style="list-style-type: none"> Riding the business tailwinds, the domain increased its competitiveness and achieved business growth.
	Operating income	> 19.0	> 12.5	18.2	
	(%)	> 11.7%	> 9.0%	11.6%	
Business Supplies Domain	Net sales	> 124.0	> 117.0	117.9	 <ul style="list-style-type: none"> The domain made headway in its migration strategy, boosting efficiency and enhancing business sustainability.
	Operating income	> 3.5	> 2.6	2.9	
	(%)	> 2.9%	> 2.2%	2.5%	
Global Stationery Domain	Net sales	> 94.0	> 75.0	74.6	 <ul style="list-style-type: none"> In Japan: The domain improved its profitability, but not enough to offset the Covid-driven changes in the business landscape. Overseas: The domain grew a new audience for stationery (schoolgirls in China). Progress surpassed expectations.
	Operating income	> 9.0	> 5.3	6.1	
	(%)	> 9.6%	> 7.1%	8.2%	

Source: Kokuyo Co., Ltd, P23 of Field Expansion 2024 presentation material released on 29 November 2021

FIELD EXPANSION 2024 – THE NEW THREE-YEAR STRATEGY

The third medium-term plan, *Field Expansion 2024*, will cover the three years starting FY22 until FY24. As the plan's name suggests, Kokuyo aims to expand its coverage within the existing businesses as well as into new fields. The numerical targets call for gross profit of ¥143.7bil (CAGR 7.8%) and OP of ¥27.5bil (CAGR 11.2%) on sales of ¥360bil (CAGR 7.0%) in FY24, to generate a FY24 OPM of 7.6%, vs the company guidance of 6.8% FY21. Note the aforementioned CAGR figures are based on FY21 guidance adjusted for a change in revenue recognition method.

Kokuyo has also reorganised its business segments into 1) Workstyle Field that includes Furniture Business and Business Supply Distribution, and 2) Lifestyle Field that includes Stationery Business and Interior Retail Business, moving away from the business domain-based segmentation. During the previous medium-term plan, management divided Kokuyo's business into three business domains so as to clarify business challenges in each domain. Given Kokuyo has identified and aimed to solve issues presented in each domain, the focus of each segment in the new plan will be on expanding its customer base and to cultivate new customer demands in those existing businesses, as well as expanding to new businesses through M&A, for example.

To capture business field expansion opportunities, over FY22~24, Kokuyo plans to further expand earnings through:

1) Dynamic Investment:

Kokuyo pledges to invest total of ¥30bil for the expansion of business fields from its existing businesses, ¥20bil of which will be spent on Workstyle Field, such as expanding the office space and furniture product line-up, and the overseas businesses. The remaining ¥10bil will be invested in Lifestyle Field such as enhancing the line-up of value-added products, overseas stationery businesses, and reinforcing e-commerce. These investments are in addition to the regular CAPEX (¥20bil) that has been budgeted over the three year period. The firm also plans to increase R&D from 0.6% of sales to 1.0% to nurture business ideas for new, emerging needs in its existing businesses.

2) Empowering Talent:

Kokuyo aims to increase employee mobility to create career opportunities, for example, by encouraging them to actively engage in "internal moonlighting" so that they can experience other fields and gain knowledge inside the company. The firm also plans to promote 30 employees to leadership positions to develop future leaders.

3) Active Innovation:

Kokuyo recently opened The Campus at its Tokyo HQ as a space for open innovation so as to accelerate internal business incubations.

4) Social Value and Business Value:

Kokuyo aims to encourage company-wide engagement in the creation of social value through employees' experience in social and environmental issues first-hand, which can subsequently lead to ideas for products and services that resonate. The firm provides 1% of recurring profit, approx. ¥200bil, in funds for building social value and ESG initiatives.

Two Segments

• Workstyle Field:

Kokuyo's target for the segment earnings in FY24 is for OP of ¥27.2bil (CAGR 9.7%) on sales of ¥275bil (CAGR 6.0%). Changes in the working environment driven by the pandemic, such as remote working and working patterns, will likely continue. Japan Electronics and Information Technology (JEITA) estimates that growth in the remote working market between 2020~2030 to be 13.5% pa. Another estimate by Xymax Corporation shows CAGR in shared office space between 2011~2021 was 25.5%. Kokuyo reckons those changes to the work environment present growth opportunities.

The segment is further divided by 1) Furniture Business, which aims to achieve FY24 OP of ¥23.4bil (CAGR 10.2%) on sales of ¥170bil (CAGR 7.9%), and 2) Business supply distribution, whose FY24 OP target is ¥3.8bil (CAGR 7.0%) on sales of ¥105bil (CAGR 3.2%). The firm's core business, Office Furniture, correlates with new office supply and office relocation demand. The pre-COVID growth scenario was to win office relocation orders through a highly

competitive bidding war. Moreover, with the office furniture market at a mature stage, growth strategies were somewhat limited. The aforementioned changes in office space and working patterns cast a light on the emerging demand for office renovation for corporates to prepare for the post-COVID landscape. Business Supply Distribution will see growth opportunities in e-commerce and mail-order markets whose demand is driven by hybrid working (combination of onsite and remote working). Kokuyo estimates the market growth of e-commerce and mail-order business supplies to be 3.2% pa. The rise in offsite procurement of office supplies will boost demand for new purchasing solutions so corporates can better monitor and control procurement. Furthermore, changes in working patterns will trigger new demand for products and services.

- Lifestyle Field

Kokuyo is targeting FY24 segment OP of ¥10.2bil (CAGR 14.5%) on sales of ¥116bil (CAGR 7.6%), supported by identifying growth opportunities in diversifying lifestyles and values that will create new needs and demand. For example, a survey by Lancers, Japan's largest cloud sourcing site for freelancers, indicates that Japan's freelancer population between 2015~2021 was growing at a rate 9.1% pa. Another survey by HolonIQ shows the global EduTech market will likely growth at a pace of 16.3% p.a. between 2019~2025. Kokuyo aims to achieve growth in this segment by offering lifestyle products and services for consumers to realise the lifestyle they desire.

The segment is further divided into two: 1) Stationary businesses, with FY24 OP target of ¥8.8bil (CAGR 13.6%) on sales of ¥95.0bil (CAGR 7.9%), and 2) Interior retail business with FY OP target of ¥1.4bil (CAGR 26.0%) on sales of ¥21.0bil (CAGR 5.9%). In the Stationary businesses, Kokuyo estimates the market in Japan will continue to shrink at a rate of 1.8% over the three years, however that decline will be offset by growth in India and China, at 5.8% and 5.5%, respectively. In India, the market is expected to recover from the COVID impact in the mid-2022. Growth in China will continue to be led by value added stationary, currently popular among Chinese high-school girls. Kokuyo estimates the stationery market in targeted countries to grow at 4.2% pa and Kokuyo's own growth will outperform that of the market.

Kokuyo (7984 JP): Segment Sales and OPM medium-term target					
(¥bil)		FY21CE		FY24	
		Non-adjusted	Adjusted	Target	CAGR (%)
Workstyle Field	Net sales	260.5	230.9	275.0	6.0
	OP	20.7	20.6	27.2	9.7
	OPM (%)	8.0	9.0	9.9	n/a
Furniture Business	Net sales	138.8	135.3	170.0	7.9
	OP	17.5	17.5	23.4	10.2
	OPM (%)	12.7	13.0	13.8	n/a
Business supply distribution	Net sales	121.6	95.5	105.0	3.2
	OP	3.1	3.1	3.8	7.0
	OPM (%)	2.6	3.3	3.6	n/a
Lifestyle Field	Net sales	94.2	93.2	116.0	7.6
	OP	6.9	6.8	10.2	14.5
	OPM (%)	7.4	7.4	8.8	n/a
Stationary business	Net sales	76.1	75.5	95.0	7.9
	OP	6.1	6.0	8.8	13.6
	OPM (%)	8.1	8.0	9.3	n/a
Interior retail business	Net sales	18.0	17.7	21.0	5.9
	OP	0.7	0.7	1.4	26.0
	OPM (%)	4.4	4.5	6.7	n/a
Other	Net sales	0.4	0.4	0.6	14.5
	OP	0	0	0	n/a
	OPM (%)	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-33.1	-30.3	-31.6	n/a
	OP	-7.3	-7.3	-9.8	n/a
	OPM (%)	n/a	n/a	n/a	n/a
Total	Net sales	322.0	294.2	360.0	7.0
	OP	20.2	20.1	27.5	11.0
	OPM (%)	6.3	6.8	7.6	n/a

Source: Nippon-IBR based on Kokuyo's Field Expansion 24 presentation

CAPITAL ALLOCATION POLICY

Kokuyo's management is aiming for ROE of 8% over the next three years. As of FY21 Q3, Kokuyo's shareholder equity was ¥229bil (73.4%) with retained earnings of ¥194bil. During FY22~FY24, the first priority of capital allocation will be given to growth investment while aiming for a stable dividend increase and a dividend pay-out ratio of 40%. Kokuyo assesses prospective investments and evaluates each existing investment by gauging each project's ROIC. While management has not ruled out the possibility of M&A, rather than acquiring a stake in a firm as it has done in the past, the focus will be on investing to gain resources that Kokuyo does not have and/or take too long to establish in-house. For new demand-related investments, Kokuyo will make decisions based on each project's NPV and IRR and judge if those investments complement its growth strategy and enhance enterprise value.

Kokuyo still has non-operating assets, such as investment securities, of ¥48.5bil (approx. 15.6% of total assets). The firm has been gradually unwinding those positions and reckons that the non-operating assets should gradually be reinvested to improve growth before any realised gains from those assets are distributed to shareholders.

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