

## 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 Q3 RESULTS

Forum Engineering (7088 JP) reported FY21 cumulative Q1~Q3 (Apr~Dec2021) parent results with OP of ¥1,393mil (-31.1% YoY) on sales of ¥20,086mil (-4.6% YoY), which were largely in line with the company's internal forecast.

Forum Engineering (7088): Earnings summary (Cumulative)							
¥mil	FY19	FY20		FY21			
	FY	Q3	FY	Q3	YoY (%)	FYCE	YoY (%)
Sales	32,115	21,060	27,728	20,086	-4.6	27,850	0.4
GP	11,036	6,532	8,523	5,960	-8.8		
GPM (%)	34.4	31.0	30.7	29.7	-1.3pp		
SG&A	6,956	4,511	6,173	4,567	1.2		
SG&A / sales (%)	21.7	21.4	22.3	22.7	+1.3pp		
OP	4,079	2,021	2,349	1,393	-31.1	1,820	-22.6
OPM (%)	12.7	9.6	8.5	6.9	-2.7pp	6.5	2.0pp
Pre-tax Profit	3,097	2,014	1,974	1,377	-31.6	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). Of the 3,840 electrical and mechanical engineers Forum employed as of Q3-end, 3,708 were dispatched to Japanese manufacturing sectors, such as automobile, industrial machinery, and precision machinery.

One of Forum's key KPIs – the number of operating engineers/month – has not yet recovered to the pre-COVID level of 4,500+, however, 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 331 in Q1, fell again to 180 in Q2 and then to 132 in Q3. As a result, the staff utilisation rate improved from 90.6% in Q1 to 94.1% in Q2, and then to 96.7% in Q3, equivalent to the pre-COVID norm.

However, GPM for the nine-month period remained below 30%, coming in at 29.7% (-1.3ppt YoY). Excluding the impact of the Employment Support Subsidy, a government support measure to retain employment during the pandemic which reduced COGS by ¥432mil, FY21 Q3 GPM was 27.5% (+0.5ppt YoY). During the period of weak demand for engineers due to COVID-related closures and low level of inquiries – which had fallen from pre-Covid levels of over 1,000/month to below 500/month – for engineers from manufacturers, Forum did not reduce the staffing rates as management thought that there would be a structural shortage of electrical and mechanical engineers in Japan over the long-term.

### EXECUTIVE SUMMARY

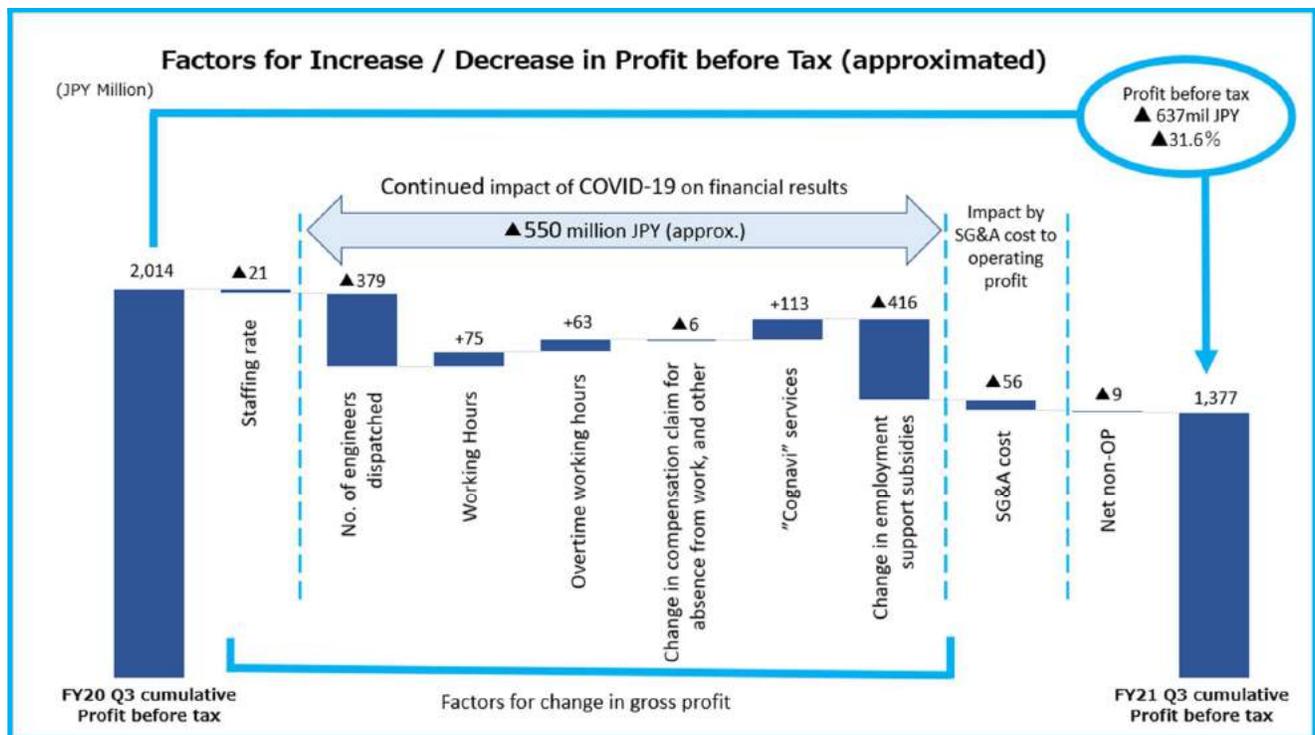
- Forum Engineering's (7088 JP) FY21 Q1~Q3 (Apr~Dec2021) results – OP of ¥1,393mil (-31.1% YoY) on sales of ¥20,086mil (-4.6% YoY) – were largely in line with company guidance.
- The core *Cognavi Staffing* business, comprising 99% of earnings, has achieved (1) the optimal number of staff on stand-by as the number of inquiries is back above 500/month, and (2) the utilisation rates were as high as 96.7%.
- While Q3 GPM remained below the pre-COVID norm of 30%, in Dec alone, it recovered to 34.3% thanks to improved utilisation rates.
- Forum has left its FY21 forecasts remain unchanged with OP of ¥1,820mil (-22.6% YoY), RP of ¥1,790mil on sales of ¥27,850mil (+0.4% YoY).
- To ensure long-term growth, Forum 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 as these services use skill-based data already accumulated in the *Cognavi* platform.
- Forum aims to pay a stable dividend and maintain a higher than 60% payout ratio. The FY21 dividend is set at ¥48/share, which is flat YoY as the management 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.
- Forum aims to start FY22 with approx. 3,800 engineers. The only KPI that has yet to see much of a recovery is the number of inquiries per month (currently back up to over 500/month though the aim is to get back to pre-Covid levels of over 1,000/month).

After the State of Emergency [SoE] restrictions were lifted at the end of September 2021, the number of inquiries went up month by month to currently over 500/month. During Q1~Q3, Forum prioritised the placement of stand-by engineers to jobs rather than hiring new engineers. As a result, in Dec 2021 alone, GPM improved back up to the 34.3% level. The optimal level of staff on stand-by is around 100, which was achieved during Q3. Consequently, the company hired 90 engineers in the Q3 alone compared to just 14 in Q1, 17 in Q2, and 65 in FY20. Forum reckons that it can achieve its FY21 guidance with the existing number of engineers (3,840 as of the end of Q3) and any hiring during Q4 will be ready for deployment in FY22.

<b>Key Variables for Cognavi Staffing Segment vs. GPM (%)</b>							
	FY18	FY19	FY20	FY21			
	Mar-19	Mar-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22*1
Number of Registered Engineers (at the end of each month)	4,279	4,521	4,001	3,961	3,858	3,840	3,950
Number of dispatched engineers (at end of each month)	4,625	4,284	3,616	3,630	3,678	3,708	3,830
Staff utilisation rate (%)	97.8	96.0	89.3	90.6	94.1	96.7	97.0
Average working hours (hours/month/person)	159.3	159.8	157.1	160.4	153.7	163.3	163.3
Average monthly staffing fee (¥/hour)	3,628	3,787	3,795	3,791	3,780	3,776	3,776
Quarterly average GPM (%)	35.8	34.4	30.7	29.5	28.3	29.7	30.0

*Source: Nippon-IBR based on Forum Engineering's Earnings Results Material  
Mar-22\*1 Nippon-IBR estimates*

Forum initially reckoned that the ongoing semiconductor shortage would somewhat affect the demand for engineers given the automobile sector – comprising approx. 28% of the engineer temporary staffing business – has been subject to several production cuts. 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.



Source: Forum Engineering FY21 Q3 Earnings Presentation Material

## FY21 OUTLOOK AND BEYOND

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 SoE closures which has several manufacturers still somewhat reluctant to hire aggressively. However, there has been a recovery in the number of inquiries received since the lifting of the SoE restrictions at the end of September 2022, thanks mainly to a return to face-to-face marketing with manufacturing companies.
- **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 back to work, profitability can improve. Although Manufacturers in Japan remain conservative in their hiring plans, they continue to struggle to find skilled engineers – a long-term structural problem for the nation. Forum currently plans to meet the likely rise in 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, who dispatch a team of engineers to a job, Forum dispatches from as few as just one engineer if a client needs a certain skillset. Forum uses its proprietary AI-based skill matching technology to connect an engineer with the 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, demand for renewing ongoing contracts has remained strong due to the structural shortage of engineers.
- **Hiring by Corporates:** Although many companies remain reluctant to consider new hires, the rapid digital shift by corporates has created demand for workers with specific skills related to digital transformation.

### Earnings Risks

The earnings risk for Forum is whether it can hire the optimal numbers of engineers. The minimum level to remain profitable calls for approx. 4,000 engineers on its register with a 90% utilisation rate. Forum aims to have approx. 3,800 engineers on its books by the end of FY21. The high utilisation rate, which almost hit the full utilisation at 97% in Q3, means that the firm cannot grow the topline unless it gets more engineers on its books. Therefore, the hiring during Q4 will be important to prepare for the next fiscal year. Furthermore, the downside risk to FY21 earnings due to the spread of the Omicron variant, could potentially impact working hours. In Japan, those in close contact with a COVID infectant are still required to quarantine for seven days. Therefore, if, for example, 50 engineers are unable to work for seven days, it will give a negative impact to the firm's net sales by approx. ¥10mil.

### Other Cognavi Services

Through one of its recruitment referral businesses – *Cognavi New Graduates* – the number of new graduates who are registering their information on the *Cognavi* platform has been rising. The number of STEM students who graduated in March 2021 and registered with the *Cognavi* platform was just 440. That figure has significantly improved as there are now 2,026 STEM students who are about to graduate university in March 2022 now registered on the platform, of which 34 students have already been offered positions as mechatronics engineers. There are also a further 4,605 STEM students who will graduate in March 2023 registered with *Cognavi*.

To achieve growth over the long term, however, of pressing importance is for Forum to establish a new income stream. The company aims to achieve this through its *Cognavi* services such as *Cognavi Career Change*, *Cognavi Graduate*, and ultimately, *Cognavi Talent Management*. Unlike its staffing service, these job referrals and HR technology services

garner almost 100% GPM because they use data in the *Cognavi* platform, where both the candidates' skills and the needs of the employer are registered. A job referral is then made through an AI matching process via the skill based tree diagrams.

As of Q3, Forum has six customers, an increase from only two in Q2, 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. The service 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 targeting individual divisional heads – of which there are approx. 3,200 with whom Forum already does business. As a result, four additional customers – of which all are manufacturing divisions of large manufacturers – were added in Q3 and there 10 customers who have signed up on a trial basis.

Some KPIs, namely, the utilisation rate and number of staff on stand-by, have recovered to pre-COVID norms. However, for Forum to return to the pre-COVID peak OPM of 12.7% – based on company guided sales of ¥32,000+mil – it would require 1) the number of inquiries to recover to from the current 500/month to over 1,000/month, and 2) an additional 1,000 or more staff hires during the year, with the churn rate of staff at around 11%, which should lead to 3) the average number of operable engineers at 4,500.

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## 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.

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## SHAREHOLDER RETURN

Forum aims to pay a stable dividend and maintain a pay-out ratio of 60%+. 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 company guidance, Forum will still be able to pay the said dividend given it has abundant cash (¥13bil, over 50% of market cap), steady cashflow and little capex planned.

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