

KOKUYO CO., LTD (7984 JP)

OFFICE FURNITURE AND OVERSEAS STATIONARY BUSINESS WILL CONTINUE TO LEAD GROWTH IN FY22

FY21 RESULTS SUMMARY

Kokuyo's (7984 JP) FY21 (Dec yr-end) earnings – OP of ¥20,004mil (+35.1% YoY) on sales of ¥320,170mil (+6.5% YoY) – were largely in line with the revised company guidance released with the Q2 results. Compared to FY19 pre-COVID OP of ¥16,743mil, FY21 OP is up by 19.4% over the two-year period, although sales were basically flat. In Q4 alone, earnings slightly fell short of both sales and OP estimates as remote working affected the performance of the Business Supply business.

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. Consequently, FY21 gross profit margin [GPM] improved 0.4ppt YoY to 36.1%, primarily due 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 FY21.

During the second three-year plan (FY19~FY21), Kokuyo managed to adapt to the changes and challenges that COVID brought. The Office Furniture business particularly performed well, thanks to COVID instigating workstyle reforms as well as the digitalisation initiatives originally implemented by the Abe administration.

Over this period, Kokuyo worked on:

1. Identifying its areas of strength in the Domestic Office Furniture business, such as design and consultation,
2. Its migration strategy in Business Supply Domain which aims to consolidate multiple wholesale distribution channels into one and to create an optimal supply chain network for its customers, and
3. Overseas (China and India) business growth opportunities in Global Stationary.

As a result, the company's GPM has improved from 35.6% in FY19 to 36.1% in FY21, and operating profit margin [OPM] from 5.2% in FY19 to 6.2% in FY21.

FY21 Earnings Summary (Cumulative)								
(¥mil)	FY20		FY21				YoY (%)	VS. CE (%)
	1H	FY	1H	FYCE	FY			
Sales	155,813	300,644	168,140	322,000	320,170	6.5	-0.6	
OP	10,090	14,807	14,710	20,200	20,004	35.1	-1.0	
RP	9,467	14,173	10,464	16,100	16,415	15.8	2.0	
NP	6,288	8,297	8,332	12,300	13,703	65.2	11.4	
EPS (¥)	53.15	70.13	70.64	103.97	116.76	66.5	12.3	

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

EXECUTIVE SUMMARY

- Kokuyo (7984 JP) reported FY21 (Dec yr-end) results largely in line with the revised company estimate announced with Q2 results, with OP of ¥20,004mil (+35.1% YoY) on sales of ¥320,170mil (+6.5% YoY). FY21 Gross profit margin [GPM] improved 0.4ppt YoY to 36.1%, primarily due to an improved sales mix with strong earnings growth in Spatial Value Domain.
- Since the introduction of business domain segmentation in FY19, the Spatial Value Domain segment achieved record earnings in FY21, on the back of strong demand for office renovations to ensure COVID safety. Segment OPM also rose thanks to a rise in direct business and consultations with customers.
- The “migration strategy” which aims to consolidate multiple distribution channels into one and create an optimal supply chain network for customers, has helped the Business Supply Domain segment improve efficiency in sales and distribution, adding approx. ¥1,000mil in FY21 segment OP.
- In the Global Stationary Domain, FY21 sales in China hit the ¥10,000mil level. However, the stationary business in India saw revenue fall 30~40% over FY20~FY21, from FY19's sales level of approx. ¥10,000mil.
- Kokuyo is guiding for FY22 1H OP of ¥14,10mil (-3.8% YoY) on sales of ¥160,700mil (+3.5% YoY), and FY22 OP of ¥20,800mil (+4.5% YoY) on sales of ¥307,000 (+4.9% YoY).
- Kokuyo's management is aiming for ROE of 8% over the next three years. 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%.

SEGMENTS BY BUSINESS DOMAIN

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

Spatial Value Domain

The Spatial Value Domain segment achieved record earnings in FY21 since the introduction of the business domain segmentation in FY19, with OP coming in at ¥18,606mil (+34.2% YoY) on sales of ¥157,033mil (+8.5% YoY). However, given FY20 was largely affected by COVID, comparisons to FY19 are perhaps more meaningful. On that basis, compared to FY19, segment sales and OP improved +3.3% and +21.1% 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) fewer low margin new office-related orders. The segment OPM improved from 10.1% in FY19 and 9.6% in FY20 to 11.8% in FY21.

As one of the firm's core businesses, the Spatial Value Domain segment 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 has drastically changed the way that large corporations use their office space. Specifically, pre-COVID, open-plan designs were popular. Post-COVID, demand for partitions and cubicles has been stronger-than-expected.

Business Supply Domain

The Business Supply Domain segment is mainly a wholesale business, and also includes Kaunet, Kokuyo's mail-order platform and catalogue-based business supplies. FY21 OP fell 0.3% YoY to ¥2,494mil on sales of ¥115,579mil (+2.2% YoY). While the growth the wholesale business is down, the firm's mail order business supply is estimated to expand in line with the market growth of 3%.

Compared to FY19, while FY21 segment sales are down 2.1%, OP is up 7.6% thanks to the firm's "migration strategy" which aims to consolidate multiple distribution channels into one, creating optimal supply chain network for customers. Kokuyo has finally started to see the effects of this strategy in terms of sales and distribution efficiency as approx. ¥1,000mil contributed to FY21 segment OP. During COVID closures, while Kaunet showed resilience in business with large corporations, it was negatively affected by the shift to remote working as many SMEs did not buy office supplies while their employees worked from home. In Q4 alone, the segment reported sales of ¥30,195mil (-2.3% YoY / +17.1% QoQ).

Global Stationary Domain

The Global Stationary Domain segment reported FY21 OP of ¥6,205mil (+29.0% YoY) on sales of ¥73,378mil (+2.6%) and saw OPM improve from 6.7% in FY20 to 8.5% thanks primarily to 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 in China that has strong links with e-commerce operators such as Alibaba and JD.com. FY21 China sales hit the ¥10,000mil level. On the other hand, stationary business in India was negatively affected by COVID and revenues are down around 30%~40% over FY20 and FY21, from FY19's sales level of approx. ¥10,000mil.

FY22 OUTLOOK

Kokuyo is guiding for FY22 1H OP of ¥14,100mil (-3.8% YoY) on sales of ¥160,700mil (+3.5% YoY), and full year FY22 OP of ¥20,800mil (+4.5% YoY) on sales of ¥307,000 (+4.9% YoY). Note that YoY figures are based on adjusted FY21 results to the new revenue recognition method. Prior to FY21 results, the firm released a new medium-term plan that covers FY22~FY24. 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 during FY21.

Kokuyo has also reorganised its business segments into 1) Workstyle Field which includes the Office Furniture Business and Business Supply Distribution, and 2) Lifestyle Field which includes the Stationery Business and the Interior Retail Business (via a subsidiary ACTUS), moving away from the business domain-based segmentation. During the previous medium-term plan, management divided Kokuyo's segments into three business domains so as to clarify business challenges in each domain. However, given Kokuyo has identified and aimed to solve issues presented in each domain during the previous medium-term plan, 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.

Workstyle Field (Furniture Business and Business Supply Distribution Business)

The FY22 forecast for the Furniture Business in the Workstyle Field segment is for sales of ¥139.9bil (+2.8% YoY) and an OPM of 13.7% (+0.6ppt YoY). The firm will focus on 1) improving its existing businesses such as capturing office renewal demand, 2) expanding into new fields in its existing businesses such as increasing office space merchandises, and 3) introducing sustainable merchandise to add value and expand segment earnings.

Another business in the Workstyle Field segment is the Business Supply and Distribution business. Kokuyo is guiding for FY22 OPM of 3.2% (+0.5ppt YoY) on sales of ¥99.5bil (+2.2% YoY). Here, Kokuyo's main growth strategies also include improving existing businesses such as upgrading business supply interface solution and cultivating business supply needs at non-office customers such as hospitals, nursing homes, schools, etc., and will also extend to include a sustainable strategy – for example, testing recycling of paper-based packages.

Lifestyle Field (Stationary Business and Interior Retail)

Kokuyo is guiding for Stationary Business FY22 OPM of 9.0% (+0.7pp YoY) on sales of ¥79.9bil (+9.9% YoY) and plans to establish a differentiated value chain, such as offering more locally-source merchandise and raising product awareness via social media, to support segment growth. In the existing businesses, the firm plans to expand the regional coverage of the stationary business in China and offer more value-added merchandise. As part of Kokuyo's sustainable strategy, the firm will establish a new procurement policy.

The Interior Retail Business is operated by Kokuyo's subsidiary ACTUS (previously a part of the Office Furniture Business in Spatial Value Domain), which runs real (i.e. bricks and mortar) and online stores. The firm is guiding for FY22 OPM of 5.1% (-0.2ppt YoY) on sales of ¥19.7bil (+9.2% YoY). Kokuyo will continue to invest on IT and strengthening links between real and online stores (OMO, Online Merges Offline) to encourage growth in its existing businesses and as part of its sustainable strategy, the firm will reduce the amount of disposal of furniture.

Shareholder Return

Management is aiming for ROE of 8% over the next three years. As of FY21, Kokuyo's shareholder equity was ¥230bil (70.9%) with retained earnings of approx. ¥195.7bil. 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. Management will likely continue to engage with M&A going forward. However, in addition to taking a stake in a firm as it has done in the past, Kokuyo will also consider investing to gain resources that it does not have and/or will 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 will assess whether those investments complement its growth strategy and enhance enterprise value.

Kokuyo still has non-operating assets, such as investment securities, of ¥45.0bil (approx. 13.8% 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.

SEGMENT DATA

Sales and OP by domains (Cumulative)										
(JPY million)		FY19		FY20		FY21				
		1H	FY	1H	FY	1H	FYCE	FY	YoY (%)	VS. CE (%)
Spatial Value Domain	Sales	81,608	152,066	78,074	144,700	84,875	157,000	157,033	8.5	0.0
	OP	10,140	15,361	9,417	13,859	12,357	18,200	18,606	34.2	2.2
	OPM (%)	12.4	10.1	12.1	9.6	14.6	11.6	11.8	+2.2ppt	+0.2pp
Business Supply Domain	Sales	59,534	118,081	55,968	113,065	59,600	117,900	115,579	2.3	-2.0
	OP	1,270	2,318	1,187	2,502	1,547	2,900	2,494	-0.3	-14.0
	OPM (%)	2.1	2.0	2.1	2.2	2.6	2.5	2.2	+0.0ppt	-0.3pp
Global Stationary Domain	Sales	43,526	81,845	36,973	71,536	38,297	74,600	73,378	2.6	-1.6
	OP	3,592	6,017	2,640	4,810	3,845	6,100	6,205	29.0	1.7
	OPM (%)	8.3	7.4	7.1	6.7	10.0	8.2	8.5	+1.8pp	+0.3pp
Others	Sales	1,297	2,642	1,252	2,522	1,358	2,700	2,799	11.0	3.7
	OP	69	139	61	54	66	100	117	116.1	17.0
	OPM (%)	5.3	5.3	4.9	2.1	4.9	3.7	4.2	+2.1ppt	+0.5pp
Adjustment	Sales	-18,314	-34,435	-16,455	-31,179	-15,990	-30,200	-28,619	n/a	n/a
	OP	-3,453	-7,092	-3,215	-6,419	-3,105	-7,100	-7,418	n/a	n/a
Total as in PL	Sales	167,652	320,200	155,813	300,644	168,140	322,000	320,170	6.5	-0.6
	OP	11,619	16,743	10,090	14,807	14,710	20,200	20,004	35.1	-1.0
	OPM (%)	6.9	5.2	6.5	4.9	8.7	6.3	6.2	+1.3ppt	-0.1pp

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	Q4	YoY (%)	QoQ (%)
Spatial Value Domain	Sales	47,019	31,055	31,517	35,109	47,337	37,538	36,320	35,838	2.1	-1.3
	OP	8,075	1,342	1,950	2,492	8,398	3,959	3,886	2,363	-5.2	-39.2
	OPM (%)	17.2	4.3	6.2	7.1	17.7	10.5	10.7	6.6	-0.5ppt	-4.1pp
Business Supply Domain	Sales	31,066	24,902	26,185	30,912	31,262	28,338	25,784	30,195	-2.3	17.1
	OP	674	513	469	846	785	762	350	597	-29.4	70.6
	OPM (%)	2.2	2.1	1.8	2.7	2.5	2.7	1.4	2.0	-0.7ppt	+0.6pp
Global Stationary Domain	Sales	20,866	16,107	16,770	17,793	20,072	18,225	16,994	18,087	1.7	6.4
	OP	2,110	530	1,250	920	2,340	1,505	1,242	1,118	21.5	-10.0
	OPM (%)	10.1	3.3	7.5	5.2	11.7	8.3	7.3	6.2	+1.0ppt	-1.1pp
Others	Sales	645	607	605	665	677	681	683	758	14.0	11.0
	OP	35	26	-6	-1	31	35	10	41	n/a	310.0
	OPM (%)	5.4	4.3	n/a	n/a	4.6	5.1	1.5	5.4	n/a	+3.9pp
Adjustment	Sales	-9,315	-7,140	-7,226	-7,498	-9,192	-6,798	-6,060	-6,569	n/a	n/a
	OP	-1,959	-1,256	-1,556	-1,648	-1,575	-1,530	-1,776	-2,537	n/a	n/a
Total as in PL	Sales	90,283	65,530	67,851	76,980	90,157	77,983	73,721	78,309	1.7	6.2
	OP	8,936	1,154	2,108	2,609	9,982	4,728	3,713	1,581	-39.4	-57.4
	OPM (%)	9.9	1.8	3.1	3.4	11.1	6.1	5.0	2.0	-1.4ppt	-3.0pp

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

Kokuyo (7984 JP) : Segment Sales and OPM medium-term target							
(¥bil)		FY21		FY22CE		FY24	
		Non-adjusted	Adjusted	Adjusted	YoY (%)	Target	CAGR (%)
Workstyle Field	Net sales	258.5	229.4	235.4	2.6	275.0	6.0
	OP	20.3	20.3	22.1	9.1	27.2	9.7
	OPM (%)	7.9	8.8	9.4	+0.6ppt	9.9	n/a
Furniture Business	Net sales	139.1	136.0	139.9	2.8	170.0	7.9
	OP	17.7	17.7	19.1	7.6	23.4	10.2
	OPM (%)	12.8	13.0	13.7	+0.7ppt	13.8	n/a
Business supply distribution	Net sales	119.3	93.4	95.5	2.2	105.0	3.2
	OP	2.5	2.5	3.0	19.3	3.8	7.0
	OPM (%)	2.2	2.7	3.2	+0.5ppt	3.6	n/a
Lifestyle Field	Net sales	91.7	90.7	99.6	9.8	116.0	7.6
	OP	7.0	7.0	8.2	16.9	10.2	14.5
	OPM (%)	7.7	7.7	8.2	+0.5ppt	8.8	n/a
Stationary business	Net sales	73.3	72.7	79.9	9.9	95.0	7.9
	OP	6.1	6.0	7.2	18.6	8.8	13.6
	OPM (%)	8.4	8.3	9.0	+0.7ppt	9.3	n/a
Interior retail business	Net sales	18.4	18.0	19.7	9.2	21.0	5.9
	OP	0.9	0.9	1.0	5.9	1.4	26.0
	OPM (%)	5.1	5.2	5.1	-0.1ppt	6.7	n/a
Other	Net sales	0.4	0.4	0.4	-9.3	0.6	14.5
	OP	0	0	-0.1	n/a	0	n/a
	OPM (%)	2.3	2.3	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-30.5	-28.0	-28.4	n/a	-31.6	n/a
	OP	-7.4	-7.4	-9.4	n/a	-9.8	n/a
	OPM (%)	n/a	n/a	n/a	n/a	n/a	n/a
Total	Net sales	320.1	292.6	307.0	4.9	360.0	7.0
	OP	20.0	19.9	20.8	4.5	27.5	11.0
	OPM (%)	6.2	6.8	6.8	+0.0ppt	7.6	n/a

Source: Nippon-IBR based on Kokuyo's Field Expansion 24 and FY21 earnings results presentation

GENERAL DISCLAIMER AND COPYRIGHT

This report has been commissioned by Kokuyo Co., Ltd (the Sponsor) and prepared and issued by Nippon Investment Bespoke Research UK Ltd (Nippon-IBR), in consideration of a fee payable by Kokuyo Co., Ltd. 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:

Nippon Investment Bespoke Research UK Ltd
118 Pall Mall
London SW1Y 5EA
TEL: +44 (0)20 7993 2583
Email: 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).