

FORUM ENGINEERING (7088 JP)

MOVING ONTO A MORE DYNAMIC GROWTH FROM FY22 WITH NEWLY INVESTING ON COGNAVI PROMOTION

FY21 RESULTS

Forum Engineering (7088 JP) reported FY21 (March year-end) results with OP of ¥1,834mil (-21.9% YoY) on sales of ¥26,914mil (-2.9% YoY). Sales fell in short of the company estimate of ¥27,850mil but OP was in line with the firm's forecast, thanks to steady recovery in number of dispatched engineers.

Forum Engineering (7088): Earnings summary (Cumulative)				
¥mil / March Year-End	FY19		FY21	
	FY	FY	FY	YoY (%)
Sales	32,115	27,728	26,914	-2.9
GP	11,036	8,523	7,890	-7.4
GPM (%)	34.4	30.7	29.3	-1.4pp
SG&A	6,956	6,173	6,055	-1.9
SG&A / sales (%)	21.7	22.3	22.5	+0.2pp
OP	4,079	2,349	1,834	-21.9
OPM (%)	12.7	8.5	6.8	-1.7pp
Pre-tax Profit	3,097	1,974	1,816	-8.0

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 3,808 electrical and mechanical engineers Forum employed as of FY21-end, 3,733 were dispatched to Japanese manufacturing sectors, such as automobile, industrial machinery, and precision machinery.

One of Forum's KPIs – the number of operating engineers/month – has not yet recovered to the pre-COVID level of 4,500+, however, the company reckons that the bottom of the trend was seen in FY20 Q3~Q4, when the utilisation rate of engineers hit 87.5% and 89.4%, respectively. During FY21, the firm focused on dispatching existing engineers, particularly engineers on stand-by, and reduced hiring so as to reduce costs and improve the utilisation rate. The utilisation of engineers has risen steadily from the beginning of FY21 as the number of staff on stand-by – another KPI for the business – decreased from 550 to 331 in Q1, fell again to 180 in Q2, then to 132 in Q3 and finally, to 75 in Q4. As a result, the staff utilisation rate improved from 90.6% in Q1 to 94.1% in Q2, then to 96.7% in Q3, and finally to 98.0% in Q4, higher than the pre-COVID norm.

However, FY21 GPM remained below 30%, coming in at 29.3% (-1.4ppt YoY). Excluding the impact of the Employment Support Subsidy, a government support measure to retain employment during the pandemic which reduced FY21 COGS by ¥464mil, FY21 GPM was 27.6% (+0.6ppt YoY) – FY20 GPM without the subsidy (total of ¥1,033mil deducted from COGS) was 27.0%.

During the period of weak demand for engineers due to COVID-related closures and low level of inquiries for engineers from manufacturers – which had fallen from pre-COVID levels of over 1,000/month to below 500/month – Forum did

EXECUTIVE SUMMARY

- Forum Engineering's (7088 JP) FY21 results – OP of ¥1,834mil (-21.9% YoY) on sales of ¥26,914mil (-2.9% 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 to ~1,000/month, and (2) the utilisation rates were as high as 98.0%.
- The number of staff on stand-by declined to below the optimal level of 100 engineers, which signifies that the firm will restart hiring
- Forum is guiding for FY22 OP of ¥3,020mil (+64.6% YoY) on sales of ¥31,410mil (+16.7% YoY). The OPM will recover to 9.6%
- Forum plans to spend ~¥600mil to boost *Cognavi's* services / profile among mechatronics engineers. Forum reckons that it is important to invest on promotion to stockpile engineers so as to secure earnings potential. Without the promotion cost, the firm will likely earn FY22 OP of approx. ¥3,600mil.
- Forum aims to pay a stable dividend and maintain a 60%+ pay-out ratio. It is guiding for an annual dividend of ¥55/share (+14.6% YoY), in FY22 which will make the pay-out ratio 69.4%. Should the earnings fall short of company guidance, Forum will still be able to pay the said dividend as it has abundant cash (¥13bil, over 50% of market cap), steady cashflow and little capex planned.

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.

After the State of Emergency [SoE] restrictions were lifted at the end of September 2021, the number of inquiries went up month by month and recovered closer to the pre-COVID level of 1,000/month. During FY21 1H, Forum prioritised the placement of stand-by engineers to jobs rather than hiring new engineers. However, finally, in 2H, it gradually resumed hiring (with 90 engineers hired in Q3 and 94 in Q4 compared to just 14 in Q1, 17 in Q2, and 65 in FY20).

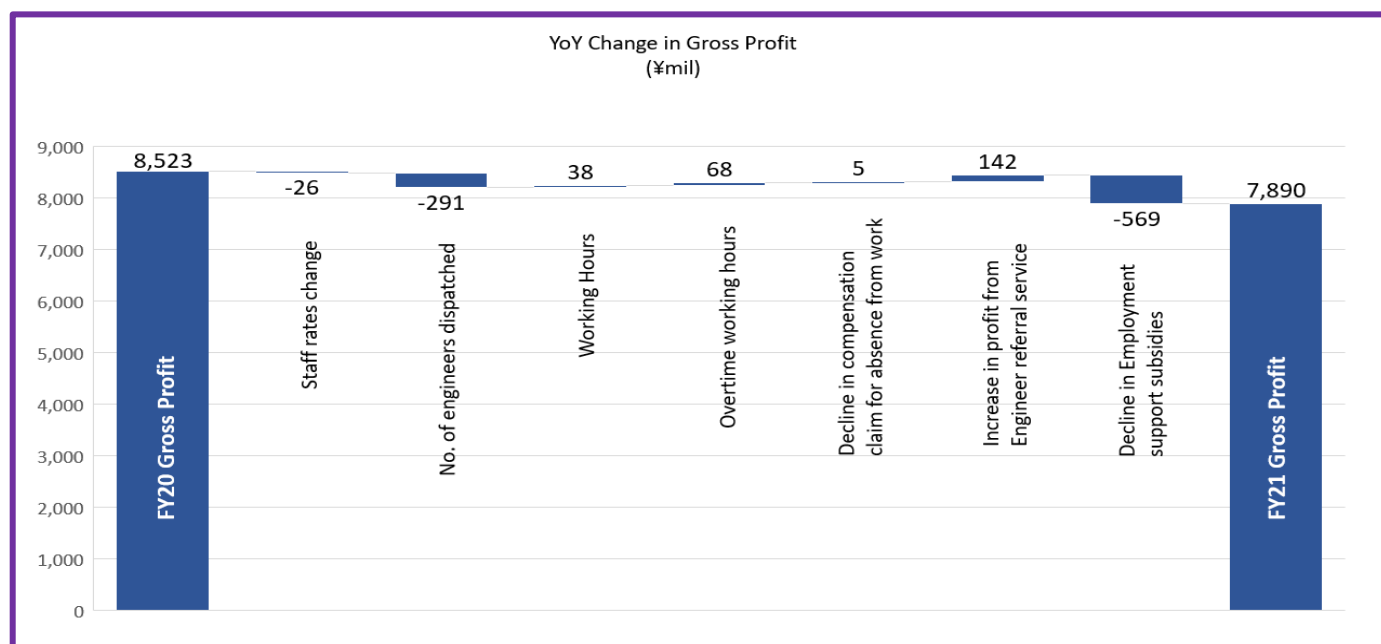
Although Forum only received a ¥32mil Employment Support Subsidy in Q4, the GPM in the quarter improved to 28.2%. Excluding the Employment Support Subsidy, the GPM would have come in at 27.8% in FY21Q4, up from 27.1% a year ago, and an improvement on the Q1~Q3 levels of 27.5%.

Key Variables for Cognavi Staffing Segment vs. GPM (%)							
	FY18	FY19	FY20	FY21			
	Mar-19	Mar-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Number of Registered Engineers (at the end of each month)	4,729	4,521	4,001	3,961	3,858	3,840	3,808
Number of dispatched engineers (at end of each month)	4,625	4,284	3,616	3,630	3,678	3,708	3,733
Staff utilisation rate (%)	98.1	96.0	89.3	90.6	94.1	96.7	98.0
Average working hours (hours/month/person)	163.6	160.7	156.9	160.4	153.7	163.3	157.3
Average monthly staffing fee (¥/hour)	3,583	3,637	3,795	3,791	3,780	3,776	3,777
Quarterly average GPM (%)	35.8	34.4	30.7	29.5	27.0	32.3	28.3

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

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. Demand for mechatronics engineers, who engage in designing and R&D, was strong for manufacturers who are preparing for the post-COVID competition,
2. Its diverse client base, therefore, it does not rely on a smaller number of large customers, and
3. 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: Nippon-IBR based on Forum Engineering FY21 Earnings Presentation Material

FY22 OUTLOOK AND BEYOND

Forum is guiding for FY22 GPM of 30.2%, OP of ¥3,020mil (+64.6% YoY) on sales of ¥31,410mil (+16.7% YoY), based on the following assumptions:

1. The monthly average number of operating staff is 4,132 engineers (+13.9% YoY),
2. An average of 160.5 hours per month per person (+1.2% YoY), and
3. An average staffing fee of ¥3,802.
4. To hire some 1,200 engineers in the *Cognavi Staffing* business in FY22.
5. Staff utilisation rate of 97~98% and resignation rate of approx. 11%.

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

Reasons for solid earnings growth are as follows:

- **Demand for Engineers:** Management reckons that demand for the temporary staffing of engineers likely bottomed in FY20 Q4 and has now finally entered a full recovery phase. Manufacturers are back to hiring mechatronics engineers for product design and R&D so as to remain competitive to face the post-COVID recovery. The supply of mechatronics engineers remains in a structural shortage.
- **Hiring of Engineers to Restart:** Forum prioritised the placement of engineers on stand-by rather than hiring new staff during FY21. Therefore, as those on stand-by are put back to work, COGS can be reduced which will subsequently improve GP. Forum reckons that after a successful placement of stand-by engineers, it needs to start hiring again so as to capture the surging demand for engineers. With the utilisation rate at around 90%, hiring almost directly leads to dispatching, hence generating earnings.

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. The company 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.

- **Relaunching promotion of Cognavi services:** Having halted its successful TV advertising campaign to promote the *Cognavi* brand primarily to job seeking engineers, management now believe it is important to initiate a new promotion campaign, to gain traction not only with job seeking engineers but also with companies looking to hire them, and to build up a pool of talent so as to secure future earnings potential. Without the promotion cost, the firm will likely earn FY22 OP of approx. ¥3,600mil which will generate an OPM of 11.5%.

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. 4,500 engineers on its books by the end of FY22. The high utilisation rate, which almost hit 98% in FY21 Q4, means that the firm cannot grow the top-line unless it gets more engineers on its books. Apart from the aforementioned ¥600mil promotion cost, Forum is preparing to spend another ¥500mil for hiring.

Other Cognavi Services

Through one of its recruitment referral businesses – *Cognavi Graduates*— the number of new graduates registering their information on the *Cognavi* has been rising. The number of STEM students who graduated in March 2022 and registered on the *Cognavi* website was 2,057 – a significant improvement from the 440 graduates who registered in March 2021. There are also a further 5,156 STEM students who will graduate in March 2023 already 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* job referral services such as *Cognavi Career Change/Career Change IT*, *Cognavi Graduate*, as well as its HR technology services, namely *Cognavi College*, and ultimately, *Cognavi Talent Management*. Unlike its staffing service, these job referrals and HR technology services garner almost 100% GPM because they use data accumulated through the registrations on the *Cognavi* website, 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.

Since FY20, Forum has been promoting the *Cognavi Talent Management* service to the manufacturing departments of major manufacturing companies. 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. From FY22, Forum sees *Cognavi Talent Management* as an added-value service, with firm-wide cross-selling opportunities.

FY22 OPM will be 9.6%, an improvement of 2.8ppt YoY. However, for Forum to return to the pre-COVID OPM of 12.7%, it would require 1) the number of inquiries to steadily recover to over 1,000/month, and 2) an additional 1,200+ staff hires during the year, with the churn rate of around 11%, which should lead to 3) the average number of operable engineers at 4,500.

SHAREHOLDER RETURN

Forum aims to pay a stable dividend and maintain a pay-out ratio of 60%+. The firm is guiding for an annual dividend of ¥55/share (+14.6% YoY) in FY22, which generates a pay-out ratio 69.4%. 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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