

**KOKUYO CO., LTD (7984 JP)**

Q1 RESULTS WERE IN LINE. RISK TO FY22 GUIDANCE IS THE STATIONARY BUSINESS IN CHINA.

**FY22 Q1 RESULTS SUMMARY**

Kokuyo's (7984 JP) reported FY22 Q1 (Dec yr-end) earnings with gross profit [GP] of ¥34,947mil (+2.9% YoY) and operating profit [OP] of ¥10,043mil (+0.9% YoY) on sales of ¥86,437mil (+3.3% YoY), based on the new revenue recognition method. The results were largely in line with the company guidance and the YoY comparison is based on adjusted FY21 Q1 numbers. Despite a rapid surge in raw material prices, such as steel materials and paper, the impact to GPM (40.4%) was limited to just a 0.2ppt YoY gain as prices have been raised. On the other hand, OP growth was only +0.9% YoY due to an increase in SG&A (+3.7% YoY) on the back of proactive spending to expand existing businesses. RP and NP growth came in at 98.6% YoY and 253.6% YoY, respectively, because there was an impairment cost of approx. ¥5,000mil associated with equity method holdings on Pentel (unlisted, Japan) in FY21 Q1.

FY21 Q1 office furniture sales were strong, thanks to healthy order backlog from new office buildings and strong office renewal demand. However, despite tough comps, the FY22 Q1 performance managed to see further YoY growth on the back of an increase in office renewal projects.

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, the FY22 Q1 Furniture Business operating profit margin [OPM] improved 0.2ppt YoY to 19.4%, primarily due to an improved sales mix with solid growth in office renewal projects. Office refurbishment demand to accommodate various COVID safety measures continues to remain strong.

The Stationary Business, which is included in Lifestyle Segment, continued to enjoy strong demand among high school students in China. Despite ongoing rigid lockdown in some regions, the business remained unaffected until the end of FY22 Q1. Meanwhile, the Stationary business in India saw a steady recovery despite higher material costs such as paper, thanks to price hikes and the reopening of schools.

Earnings Summary (Adjusted Basis)							
(¥mil)	FY21		FY22				
	Q1	Q1	YoY (%)	1HCE	YoY (%)	FYCE	YoY (%)
Sales	83,692	86,437	3.3	160,700	3.5	307,000	4.9
OP	9,956	10,043	0.9	14,100	-3.8	20,800	4.5
RP	5,383	10,688	98.6	14,700	40.5	22,200	35.2
NP <sup>1</sup>	2,172	7,681	253.6	10,500	26.0	15,900	16.0

Source: Kokuyo's FY21 & FY22 Q1 earnings results materials

**EXECUTIVE SUMMARY**

- Kokuyo's FY22 Q1 results were largely in line with expectation with gross profit [GP] of ¥34,947mil (+2.9% YoY) and operating profit [OP] of ¥10,043mil (+0.9% YoY) on sales of ¥86,437mil (+3.3% YoY).
- Workstyle Field reported FY22 Q1 segment OP of ¥9,461mil (+4.7% YoY) on sales of ¥69,575mil (+1.2% YoY). Kokuyo's core Furniture Business managed to capture office renewal demand, newly created through hybrid working conditions, and led to an improved sales mix.
- Lifestyle Field reported FY22 Q1 segment OP of ¥2,624mil (+5.2% YoY) on sales of ¥25,193mil (+4.1% YoY). The Stationary Business saw a solid growth in Q1, thanks to the continued popularity of its products among Chinese high school girls. As of Q1, Kokuyo has not suffered any impact on its business despite the strict lockdown measures implemented in some cities in China.
- Kokuyo is guiding for FY22 1H OP of ¥14,10mil (-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 ¥307,000mil (+4.9% YoY). A possible earnings risk is its Stationary business in China, which has not yet seen any slowdown but the continued lockdowns in some cities in China might have a negative impact going forward.
- Kokuyo still has non-operating assets, such as investment securities, of approx. ¥30,900mil (approx. 13.3% of total assets). With the Q1 results, Kokuyo announced that it aims to reduce the investment securities holdings to below 10.0% of total assets by FY24, which is the final year of the current medium-term management plan. The proceed is most likely be invested on future growth.

<sup>1</sup> NP attributed to the parent's shareholders

## **FY22 Q1 PERFORMANCE BY BUSINESS SEGMENTS**

Kokuyo introduced new business segments with the launch of the new medium-term management plan (FY22~FY24), categorising its operations into two business fields: 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, when the focus was on addressing the challenges in each area. However, given Kokuyo has identified and aims 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)**

Workstyle Field reported FY22 Q1 segment OP of ¥9,461mil (+4.7% YoY) on sales of ¥69,575mil (+1.2% YoY). The firm focuses on capturing newly created demand through the increased adoption of hybrid working which has become under COVID.

- The Furniture Business, Kokuyo's core business, earned FY22 Q1 OP of ¥8,386mil (+2.7% YoY) on sales of ¥43,201mil (+1.7% YoY). Although there will be new office buildings completion expected in FY23 onwards in Tokyo, for this year (FY22), furniture demand associated with office renewal will lead the firm's earnings higher.
- For the Business Supply and Distribution business, FY22 Q1 OP came in at ¥1,075mil (+23.6% YoY) on sales of ¥26,373mil (+0.3% YoY), thanks to recovery in office supply procurement by large corporates as workers started going back to the office.

### **Lifestyle Field (Stationary Business and Interior Retail)**

Lifestyle Field reported FY22 Q1 OP of ¥2,624mil (+5.2% YoY) on sales of ¥25,193mil (+4.1% YoY).

- The Stationary Business saw a solid growth of 3.4% YoY in sales and 5.1% YoY in OP, respectively, in Q1, thanks to continued popularity of its products among Chinese high school girls. Moreover, as of Q1 end, Kokuyo did not see much impact on its business despite the strict lockdown measures implemented in some regions. Another growing market for Kokuyo, India, has gradually recovered, in line with management's expectations. The Stationary Business overall reported FY22 Q1 OP of 2,352mil (+5.1% YoY) on sales of ¥20,559mil (+3.4% YoY).
- Interior Retail, which 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, earned FY22 Q1 OP of ¥271mil (+5.8% YoY) on sales of ¥4,633mil (+7.0% YoY). The firm's Online Merges with Offline [OMO], which integrates e-commerce and real stores, aims to capture demand from consumers' new needs for living spaces.

## **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 ¥307,000mil (+4.9% YoY). There was no change to the full year earnings guidance at the Q1 results. Note that YoY figures are based on adjusted FY21 results to reflect the new revenue recognition method. 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. The uptrend in the office renovation demand has been so far in line with Kokuyo's forecast for FY22. Although the firm has not yet seen any significant impact from strict lockdowns in some cities in China, the FY22 guidance assumes that the Stationary Business will continue to see solid growth in FY22. The Stationary Business in China, therefore, remains an earnings risk in FY22, should the current restrictive situation continue in China.

### 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 ¥139,900mil (+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.

Kokuyo is guiding for FY22 Business Supply OPM of 3.2% (+0.5ppt YoY) on sales of ¥95,500mil (+2.2% YoY). Here, Kokuyo's main growth strategies include improving existing businesses, such as upgrading business supply interface solutions 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 ¥79,900mil (+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. Of the ¥7,200mil (+9.9%) YoY increase in segment sales estimated for FY22, the firm expects approx. 40%+ will come from China. If the lockdown in some cities continues, Kokuyo's stationary sales in China might be affected. On the other hand, the business in India will likely see a steady recovery despite the rising paper prices, thanks to price hikes and the reopening of schools boosting demand for education.

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 ¥19,700mil (+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 ¥211,500mil (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 cross-held securities of approx. ¥30,900mil (approx. 13.3% of consolidated net assets). With the FY22 Q1 results, the firm announced that it aims to reduce them to below 10.0% of consolidated net assets by FY24 – the final year of the current medium-term management plan. Kokuyo has been gradually unwinding its positions and reckons that the proceeds should gradually be reinvested to improve growth before any such realised gains are distributed to shareholders. Currently, Kokuyo holds shares in 30 companies.

## SEGMENT DATA

Kokuyo (7984 JP): Segment Sales and OPM medium-term target									
(¥bil)		FY21		FY22				FY24	
		Q1 (Adj)	FY (Adj)	Q1	YoY (%)	FYCE (Adj)	YoY (%)	Target	CAGR (%)
Workstyle Field	Net sales	68.8	229.5	69.6	1.2	235.4	2.6	275.0	6.2
	OP	9.0	20.3	9.5	4.7	22.1	8.9	27.2	10.2
	OPM (%)	13.1	8.8	13.6	+0.5pp	9.4	+0.6pp	9.9	n/a
Furniture Business	Net sales	42.5	136.1	43.2	1.7	139.9	2.9	170.0	7.7
	OP	8.2	17.7	8.4	2.7	19.1	7.9	23.4	7.9
	OPM (%)	19.2	13.0	19.4	+0.2pp	13.7	+0.7pp	13.8	n/a
Business supply distribution	Net sales	26.3	93.4	26.4	0.3	95.5	2.2	105.0	4.0
	OP	0.9	2.6	1.1	23.6	3.00	20.0	3.8	3.2
	OPM (%)	3.3	2.7	4.1	+0.9pp	3.2	+0.5pp	3.6	n/a
Lifestyle Field	Net sales	24.2	90.7	25.2	4.1	99.6	9.8	116.0	8.5
	OP	2.5	7.0	2.6	5.2	8.2	17.1	10.2	13.3
	OPM (%)	10.3	7.7	10.4	+0.1pp	8.2	+0.5pp	8.8	n/a
Stationary business	Net sales	19.9	72.7	20.6	3.4	79.9	9.9	95.0	9.3
	OP	2.2	6.1	2.4	5.1	7.2	20.0	8.8	8.0
	OPM (%)	11.3	8.3	11.4	+0.1pp	9.0	+0.7pp	9.3	n/a
Interior retail business	Net sales	4.3	18.0	4.6	7.0	19.7	9.4	21.0	5.2
	OP	0.3	0.9	0.3	5.8	1.0	11.1	1.4	5.9
	OPM (%)	5.9	5.2	5.8	-0.1pp	5.1	-0.1pp	6.7	n/a
Other	Net sales	0.1	0.4	0.1	-6.1	0.4	0.0	0.6	14.5
	OP	0.0	0.0	0.0	n/a	-0.1	n/a	0	n/a
	OPM (%)	2.4	2.3	n/a	n/a	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-9.4	-28.0	-8.5	n/a	-28.4	n/a	-31.6	n/a
	OP	-1.6	-7.4	-2.0	n/a	-9.4	n/a	-9.8	n/a
Total	Net sales	83.7	292.6	86.4	3.3	307.0	4.9	360.0	7.0
	OP	10.0	19.9	10.0	0.9	20.8	4.5	27.5	11.4
	OPM (%)	11.9	6.8	11.6	-0.3pp	6.8	+0.0pp	7.6	n/a

Source: Nippon-IBR based on Kokuyo's Field Expansion 24, FY21 & FY22 Q1 earnings results presentation

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