

## FORUM ENGINEERING (7088 JP)

REFOCUSING ON THE CORE COGNAVI STAFFING BUSINESS WHERE THE FIRM SEES THE PROMISING GROWTH.

### FY22 Q1 RESULTS

Forum Engineering (7088 JP) reported FY22 Q1 results with OP of ¥477mil (+7.5% YoY) on sales of ¥7,111mil (+7.8% YoY).

Forum Engineering (7088): Earnings summary (Cumulative)							
¥mil	FY20	FY21		FY22			
	FY	Q1	FY	Q1	YoY (%)	FYCE	YoY (%)
Sales	27,728	6,599	26,914	7,111	7.8	31,410	16.7
GP	8,523	1,944	7,890	2,115	8.8	9,935	25.9
GPM (%)	30.7	29.5	29.3	29.8	+0.2ppt	31.6	+2.3ppt
SG&A	6,173	1,500	6,055	1,638	9.2	6,480	7.0
SG&A / sales (%)	22.3	22.7	22.5	23.0	+0.3ppt	20.6	-1.9ppt
OP	2,349	444	1,834	477	7.5	3,020	64.6
OPM (%)	8.5	6.7	6.8	6.7	+0.0ppt	9.6	+2.8ppt
Pre-tax Profit	1,974	425	1,816	474	11.6	3,000	65.2

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). The number of registered engineers – seen as one of five important KPIs of Forum's performance – reached 3,904 employees, of which 3,834 engineers were contracted out on jobs as of the end of Q1.

The number of engineers on the job, another KPI to measure the utilisation of the engineers, has not yet recovered to the pre-COVID level of 4,500+. However, Forum plans to get that figure back to over 4,000 this fiscal year (FY22).

During FY21, the firm focused on dispatching existing engineers, particularly engineers on stand-by, and held back on hiring so as to reduce costs and improve the utilisation rate. The utilisation of engineers has steadily risen from the beginning of FY21 as the number of staff on stand-by fell from 550 to 331 in Q1, fell again to 180 in Q2, then to 132 in Q3 and finally, to 75 in Q4. In FY22 Q1, the number of staff on stand-by declined to 70, which is below the optimal level of 100. As a result, the staff utilisation rate improved from 98.0% in FY21 Q4 to near a full utilisation rate of 98.2%, and higher than the pre-COVID norm. Gross profit margin [GPM] reached 29.7% in FY22 Q1 vs FY21 full-year GPM of 27.6% without the impact of Employment Support Subsidy which reduced FY21 COGS by ¥464mil.

### EXECUTIVE SUMMARY

- Forum Engineering (7088 JP) reported FY22 Q1 results with OP of ¥477mil (+7.5% YoY) on sales of ¥7,111mil (+7.8% YoY).
- The number of registered engineers, one of Forum's five key KPIs, hit 3,904 employees, of which 3,834 engineers are on the job as of the end of Q1, which led to almost full staff utilisation rate of 98.2%.
- Forum aims to hire approx. 1,200 engineers (250~300/Q) this FY to boost top-line growth in its *Cognavi Staffing* service but Q1 hiring fell just short at 226.
- Forum is guiding for FY22 OP of ¥3,020mil (+64.6% YoY) on sales of ¥31,410mil (+16.7% YoY). The OPM is expected to recover to 9.6%.
- The firm plans to spend ¥600mil on advertising to boost *Cognavi's* services and profile among mechatronics engineers in order to secure future earnings. Without the advertisement 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. For FY22, it is guiding for an annual dividend of ¥55/share (+14.6% YoY), generating a pay-out ratio of 69.4%. Should 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.

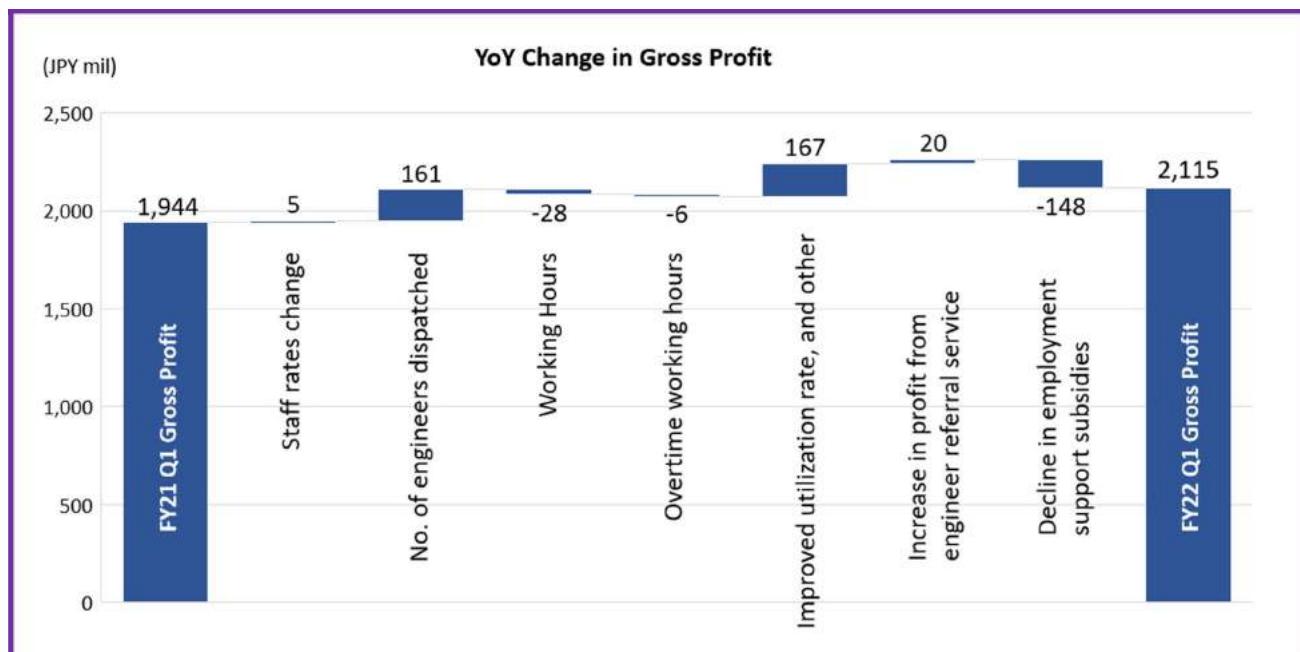
Although the high staff utilisation improved the GPM, higher than optimal levels of staff utilisation will limit the potential for the top-line growth going forward. Therefore, it was a priority for the firm to hire approx. 1,200 engineers in FY22 – with the churn of engineers, net increase will likely be 700-800 – to stockpile engineers that can be dispatched. However, in Q1, the firm only hired 226 staff, falling short of 250~300 hirings per quarter indicated from annual target to hire approx. 1,200 new engineers.

Forum reckons that manufacturing companies, the firm's customers, started accelerating direct hiring of full-time engineers during FY22 Q1 with expectations that the influences of COVID will fade out over the fiscal year. Consequently, with manufacturers now looking to hire full-time engineers, the dynamics of the job market for engineers has changed.

Job seeking engineers are going for full-time positions directly with manufacturers rather than being hired by staffing service providers. Forum reckons this was a major reason why it could not meet its own hiring target for engineers in Q1. Moreover, with the structural changes brought about with the shrinking of Japan's labour force, which peaked out in 2019 as the population ages, the hiring of engineers with desired skills will continue to be difficult.

Key Variables for Cognavi Staffing Segment vs. GPM (%)						
	FY20	FY21				FY22
	Q4	Q1	Q2	Q3	Q4	Q1
Number of Registered Engineers (at the end of each quarter)	4,001	3,961	3,858	3,840	3,808	3,904
Number of dispatched engineers (at end of each quarter)	3,616	3,630	3,678	3,708	3,733	3,834
Staff utilisation rate (%)	89.4	90.6	94.1	96.7	98.0	97.9
Average working hours (hours/month/person)	159.7	160.4	153.7	163.3	157.3	157.7
Average monthly staffing fee (¥/hour)	3,783	3,791	3,780	3,776	3,777	3,805
Quarterly average GPM (%)	30.7	29.5	28.3	29.7	29.3	29.8

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



Source: Nippon-IBR based on Forum Engineering FY22 Q1 Earnings Presentation Material

## FY22 OUTLOOK AND BEYOND

Forum maintained its FY22 guidance with 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%.

Forum Engineering (7088): Earnings summary (Cumulative)								
(¥mil)	FY19		FY20		FY21		FY22CE	
	FY	FY	FY	FY	YoY (%)	FY	YoY (%)	
Sales	32,115	27,728	26,914	26,914	-2.9	31,410	16.7	
GP	11,036	8,523	7,890	7,890	-7.4	9,935	25.9	
GPM (%)	34.4	30.7	29.3	29.3	-1.4ppt	31.6	+2.3ppt	
SG&A	6,956	6,173	6,055	6,055	-1.9	6,480	7.0	
SG&A / sales (%)	21.7	22.3	22.5	22.5	+0.2ppt	20.6	-1.9ppt	
OP	4,079	2,349	1,834	1,834	-21.9	3,020	64.6	
OPM (%)	12.7	8.5	6.8	6.8	-1.7ppt	9.6	+2.8ppt	
Pre-tax Profit	3,097	1,974	1,816	1,816	-8.0	3,000	65.2	

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. However, the supply of mechatronics engineers remains in a structural shortage. Although manufacturers have started hiring full-time engineers directly, any structural shortage will likely exhibit an opportunity for the temporary staffing demand.
- **Hiring of Engineers to Restart:** Forum had prioritised the placement of engineers on stand-by rather than hiring new staff during FY21. As noted above, given the number of staff on stand-by is currently at the minimal level; this represents a risk for Forum to potentially be unable to secure enough number of engineers and lose growth opportunities while demand for engineers remains solid. Consequently, with the utilisation rate over 90%, management is aware that the firm needs to increase its own hiring of engineers to capture the surging demand from manufacturers, if it is to further expand its earnings potential

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 *Cognavi* 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 by relaunching advertisement campaign:** Having halted its successful TV advertising campaign to promote the *Cognavi* brand, primarily to job seeking engineers, management now believes it is important to initiate a new advertisement campaign to (1) gain traction not only with job seeking engineers but also with companies looking to hire them, and to (2) build up a pool of talent so as to secure future earnings potential. Forum plans to launch a month-long multimedia advertisement campaign from the end of August. Without the advertisement cost, FY22 OP would likely reach ¥3,600mil, generating an OPM of 11.5%.

Previously, Forum aimed to achieve growth through cross selling of 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* 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.

While management remains confident in the potential for those *Cognavi* services, and will continue to promote cross-selling opportunities, the increase in number of users remained sluggish hence revenue growth of those services proved slower than expected even after the first TV media advertisement campaign. Management has reviewed where the current growth potential lies and has identified that the opportunities primarily exist in the core *Cognavi Staffing* service. Therefore, the firm will focus on ensuring the *Cognavi Staffing* business remains stable. The aforementioned advertisement campaign to re-promote the *Cognavi* brand will be funded by profit raised from *Cognavi* referral services and will lead to profit growth of all *Cognavi* services.

### **Earnings Risks**

The main earnings risk for Forum is whether it can hire enough engineers. The minimum level to remain profitable requires approx. 4,000 engineers to be registered 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 hit 98.2% in FY22 Q1, means that the firm cannot grow the top-line unless it gets more engineers. Apart from the aforementioned ¥600mil cost for the advertisement campaign, Forum is preparing to spend another ¥500mil for hiring.

FY22 OPM is expected to reach 9.6%, an improvement of 2.8ppts 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 compared to the current level of approx. 800/month, (2) an additional 1,200 staff to be hired during the year, with the resignation rate of around 11%, which should lead to (3) the number of engineers dispatched to increase to 4,500.

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## **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 (outside of the advertising and hiring spent) planned.

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For further enquiry, please contact:

Yumi Yamamoto-Tyrrell

Nippon Investment Bespoke Research UK Ltd

118 Pall Mall

London SW1Y 5EA

TEL: +44 (0)20 7993 2583

Email : [enquiries@nippton-ibr.com](mailto:enquiries@nippton-ibr.com)



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