

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

1H EARNINGS FELL SHORT OF THE FORECAST BUT NO CHANGE IN FY22 SALES AND OP WITH ANOTHER PRICE RISE.

**FY22 1H RESULTS SUMMARY**

Kokuyo (7984 JP) reported FY22 (Dec yr-end) 1H earnings with gross profit [GP] of ¥61,219mil (-3.0% YoY) and operating profit [OP] of ¥12,731mil (-13.1% YoY) on sales of ¥156,424mil (+0.7% YoY). While Q1 earnings were largely in line with expectations, Q2 earnings fell short of the firm's guidance due to 1) slower than expected office furniture sales to new office buildings, 2) faster-than-expected surge in raw material costs and 3) the negative impact on its stationery business in China due to the prolonged lockdown in Shanghai. Due to the sharp rise in raw material prices, such as steel materials and paper, Q2 (Apr~Jun) GPM fell to 37.5% from 40.4% in Q1 (1H GPM was 39.1%). Kokuyo initially budgeted for 1H raw material costs of ¥1,440mil but the reported cost came in 66% higher at ¥2,386mil – the Domestic Furniture business was ¥400mil above budget while the Stationery business in India was ¥406mil above the original forecast. Despite the firm implementing price hikes for its products that are affected by surge in raw materials prices, the impact only managed to offset some 50% of the raw material cost hike as of Q2.

1H OP fell 13.1% YoY due to 1) the larger-than-expected surge in raw materials cost impacting GP, and 2) the continued proactive spending to expand existing businesses.

RP and NP growth came in at +39.7% YoY and +30.2% YoY, respectively, because there was an impairment cost of ¥5,429mil associated with equity method holdings on Pentel (unlisted, Japan) in FY21 1H.

Earnings Summary (Adjusted Basis)						
(¥mil)	FY21		FY22			
	1H*	1HCE	1H	YoY (%)	FYCE	YoY (%)
Sales	155,281	160,700	156,424	0.7	307,000	4.9
OP	14,655	14,100	12,731	-13.1	20,800	4.5
RP	10,464	14,700	14,614	39.7	23,200	41.3
NP attributed to the parent's shareholders	8,332	10,500	10,845	30.2	16,400	19.7

Source: Kokuyo's FY21 & FY22 Q2 earnings results materials  
\* FY21 1H figures are adjusted to the new revenue recognition method.

**FY22 1H 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:

Workstyle Field - which includes the Office Furniture Business and Business Supply Distribution, and

Lifestyle Field – which includes the Stationery Business and the Interior Retail Business (via a subsidiary ACTUS).

This is a move away from the business domain-based segmentation when the focus was on addressing the challenges in each area. Having identified and initiated strategies to solve issues presented in each domain in the previous medium-term plan, the new plan will now focus on expanding its customer base and to cultivate new customer demands in those existing businesses, as well as expanding business fields through M&A, for example.

**EXECUTIVE SUMMARY**

- Kokuyo (7984 JP) reported FY22 1H (Dec yr-end) results with gross profit [GP] of ¥61,219mil (-3.0% YoY) and operating profit [OP] of ¥12,731mil (-13.1% YoY) on sales of ¥156,424mil (+0.7% YoY).
- In Q2 alone, earnings fell short of guidance due to 1) slower-than-expected office furniture sales to new office buildings, 2) the rapid surge in raw material costs being much higher than expected, and 3) the prolonged lockdown in Shanghai led to weak stationary sales in China.
- FY22 guidance calls for OP of ¥20,800mil (+4.5% YoY) on sales of ¥307,000mil (+4.9% YoY). Although 1H sales and OP fell short of expectations by 2.7% and 9.7%, respectively, Kokuyo did not revise the full-year guidance. The firm is anticipating (1) the impact of its decision to hike prices will offset the impact of raw material price hike, and (2) some office renewal projects will finally be realised in 2H. A possible earnings risk is if the firm cannot cover the higher raw material costs with a second price increase.
- Kokuyo still has non-operating assets, e.g., investment securities, of approx. ¥30,000mil (approx. 12.6% of total assets). During Q2, Kokuyo sold one of its major holdings which generated an extraordinary gain of ¥840mil. The firm aims to reduce its investment securities holdings to below 10.0% of total assets by FY24 – the final year of the current medium-term management plan. The proceeds are most likely to be invested on future growth.

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

#### Workstyle Field (Furniture Business and Business Supply Distribution Business)

The Workstyle Field Segment reported FY22 1H OP of ¥12,820mil (-5.2% YoY) on sales of ¥122,309mil (-1.3% YoY). In Q2 alone, segment OP was ¥3,359mil (-25.2% YoY / -64.5% QoQ) on sales of ¥52,734 (-4.4% YoY / -24.2% QoQ).

**The Furniture Business:** Kokuyo's core business, recorded FY22 1H OP of ¥10,927mil (-8.3% YoY) on sales of ¥72,371mil (-2.6% YoY). Although several new office buildings due to be completed in Tokyo from FY23, for this current fiscal year (FY22), the firm had expected furniture demand associated with office renewal would lead segment earnings growth.

FY21 Q1 office furniture sales were strong, thanks to a healthy order backlog from new office buildings and strong office renewal demand. 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. However, in addition to the usual low seasonality in Q2, orders concluded in Q2 were below the firm's expectation, despite a solid number of enquires for office furniture related to office renewals.

Kokuyo promotes workstyle consultation to non-Japanese customers in China. This was impacted by the prolonged lockdowns. As a result, in Q2 alone, OP was ¥2,541mil (-32.3% YoY / -69.7% QoQ) on sales of ¥29,170mil (-8.4% YoY / -32.5% QoQ).

**The Business Supply and Distribution Business:** FY22 1H OP came in at ¥1,892mil (+17.7% YoY) on sales of ¥49,938mil (+0.6% YoY) (+0.3% YoY). Thanks to a recovery in office supply procurement by large corporates as workers started going back to the office, spending per customer improved by customer. The number of companies that use Kaunet, Kokuyo's own office supply sales platform, increased from 5,000 companies in FY21 1H, to 5,212 companies in FY21, and to 5,271 in FY22 1H. Kokuyo's strategy to cross-sell business supply services to large customers of the Furniture Business proved successful. In Q2 alone, the Business Supply Distribution earned OP of ¥817mil (+10.9% YoY / -24.0% QoQ) on sales of ¥23,565mil (+1.0% YoY / -10.6% QoQ).

For **the Workstyle Field Segment** going forward, management's aim is to capture newly created demand through the increased adoption of hybrid working which has become more of a common practice under COVID, both at home and abroad.

#### Lifestyle Field (Stationery Business and Interior Retail)

Lifestyle Field reported FY22 1H OP of ¥3,947mil (-6.5% YoY) on sales of ¥48,043mil (+2.5% YoY). In Q2 alone, the segment earned OP of ¥1,323mil (-23.5% YoY / -49.6% QoQ) on sales of ¥22,850mil (+0.9% YoY / -9.3% QoQ). The segment comprises of two businesses – Stationery and Interior Retail.

**The Stationery Business:** 1H OP fell -9.3% YoY to ¥3,397mil on sales of ¥38,497mil (+1.5% YoY) Although Kokuyo enjoyed continued popularity of its products among Chinese high school girls during Q1, several lockdowns in urban areas like Shanghai finally took its toll in Q2 due to impact from supply chain disruptions, resulting in shortage of the supply of stationery in China in April.

Kokuyo initially assumed FY22 sales of Stationery Business in China to grow +30.0% YoY to approx. ¥14,000mil, up from FY21 sales of ¥11,000mil. Q2 sales resulted in approx. ¥4,000mil, some ¥1,000mil short of the firm's expectation. The short fall in sales is primarily due to supply problems rather than demand. Given inherent demand for Kokuyo's stationery among Chinese high school girls remains firm, Kokuyo anticipates a recovery in demand once the lockdowns in China are lifted.

Another growing market for Kokuyo is India. There has been a gradual recovery, in line with management's expectations, and while higher raw material costs affected Q2 earnings, Kokuyo looks for a further recovery thanks to (1) the reopening of schools and (2) the introduction of new prices. In 1H, the Stationery Business overall reported FY22 1H OP of 1,045mil (-30.7% YoY / -55.6% QoQ) on sales of ¥17,938mil (-0.5% YoY / -12.7% QoQ).

**The Interior Retail Business**, 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 1H OP of ¥549mil (+14.8% YoY) on sales of ¥9,545mil (+6.8% 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. In Q2 alone, the business reported OP of ¥278mil (+25.2% YoY / +2.6% QoQ) on sales of ¥4,912mil (+6.6% YoY / +6.0% QoQ).

Kokuyo (7984 JP): Segment Sales and OPM medium-term target												
(¥bil)		FY21			FY22							
		Q1 (Adj)	1H	FY	Q1	1HCE	1H	YoY (%)	vs. CE (%)	2HCE	FYCE	YoY (%)
Workstyle Field	Net sales	68.8	123.9	229.4	69.6	126.3	122.3	-1.3	-3.2	113.0	235.4	2.6
	OP	9.0	13.5	20.3	9.5	14.3	12.8	-5.2	-10.3	9.2	22.1	8.9
	OPM (%)	13.1	10.9	8.8	13.6	11.3	10.5	-0.4pp	-0.8pp	8.2	9.4	+0.6pp
Furniture Business	Net sales	42.5	74.3	136.0	43.2	76.1	72.3	-2.6	-4.9	67.5	139.9	2.9
	OP	8.2	11.9	17.7	8.4	12.5	10.9	-8.3	-12.9	8.1	19.1	7.9
	OPM (%)	19.2	16.0	13.0	19.4	16.5	15.1	-0.9pp	-1.4pp	12.1	13.7	+0.7pp
Business supply distribution	Net sales	26.3	49.6	93.4	26.4	50.2	49.9	0.6	-0.5	45.5	95.5	2.2
	OP	0.9	1.6	2.5	1.1	1.7	1.8	17.7	8.1	1.1	3.0	20.0
	OPM (%)	3.3	3.2	2.7	4.1	3.5	3.8	+0.6pp	+0.3pp	2.4	3.2	+0.5pp
Lifestyle Field	Net sales	24.2	46.8	90.7	25.2	50.6	48.0	2.5	-5.1	51.5	99.6	9.8
	OP	2.5	4.2	7.0	2.6	4.5	3.9	-6.5	-13.2	4.2	8.2	17.1
	OPM (%)	10.3	9.0	7.7	10.4	9.0	8.2	-0.8pp	-0.8pp	8.2	8.2	+0.5pp
Stationery business	Net sales	19.9	37.9	72.7	20.6	41.3	38.4	1.5	-6.8	41.4	79.9	9.9
	OP	2.2	3.7	6.0	2.4	4.1	3.3	-9.3	-17.1	3.8	7.2	20.0
	OPM (%)	11.3	9.9	8.3	11.4	9.9	8.8	-1.1pp	-1.1pp	9.2	9.0	+0.7pp
Interior retail business	Net sales	4.3	8.9	18.0	4.6	9.3	9.5	6.8	2.6	10.1	19.7	9.4
	OP	0.3	0.4	0.9	0.3	0.4	0.5	14.8	22.2	0.4	1.0	11.1
	OPM (%)	5.9	5.4	5.2	5.8	4.8	5.8	+0.4pp	+1.0pp	4.4	5.1	-0.1pp
Other	Net sales	0.1	0.2	0.4	0.1	0.2	0.2	-7.4	2.4	0.1	0.4	0.0
	OP	0.0	0.0	0.0	0.0	0.0	-0.1	n/a	n/a	-0.1	-0.1	n/a
	OPM (%)	2.4	6.8	2.3	n/a	0.0	n/a	n/a	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-9.4	-15.7	-28.0	-8.5	-16.4	-14.1	n/a	n/a	-14.3	-28.4	n/a
	OP	-1.6	-3.1	-7.4	-2.0	-4.7	-3.9	n/a	n/a	-5.5	-9.4	n/a
Total	Net sales	83.7	155.2	292.6	86.4	160.7	156.4	0.7	-2.7	150.5	307.0	4.9
	OP	10.0	14.6	19.9	10.0	14.1	12.7	-13.1	-9.7	8.0	20.8	4.5
	OPM (%)	11.9	9.4	6.8	11.6	8.8	8.1	-1.3pp	-0.7pp	5.4	6.8	+0.0pp

Source: Nippon-IBR based on Kokuyo's Field Expansion FY22 1H earnings results presentation

## **FY22 OUTLOOK**

Kokuyo is guiding for FY22 OP of ¥20,800mil (+4.5% YoY) on sales of ¥307,000mil (+4.9% YoY). FY22 recurring profit [RP] and net profit attributed to the parent's shareholders [NP] were revised by ¥1,000mil to ¥23,200mil (+41.3% YoY) and by ¥500mil to ¥16,400mil (+19.7% YoY), respectively, primarily due to FOREX.

Although 1H sales and OP fell short of Kokuyo's initial guidance by 2.7% and 9.7%, respectively, the firm did not revise its full-year guidance as it expects the July price hikes will offset the impact of higher raw material costs, and some office renewal projects will finally be realised in 2H.

Kokuyo has been receiving enquiries for office refurbishment and renewal from companies that need to prepare their office spaces to meet post-COVID safety measures requirements. The uptrend in the office renovation demand has been so far in line with Kokuyo's forecast which calls for top-line growth in all businesses but specifically in the domestic office furniture and overseas stationery businesses. Domestic Furniture and Overseas Stationery together will explain approx. 60% of the FY22 YoY sales growth of ¥14,400mil (+4.9% YoY).

Kokuyo plans to implement a second price hike to offset the surge in raw material costs. Initially, the firm estimated a cost increase of ¥2,258mil in FY22, but is more likely to come in at ¥5,870 (+¥3,612mil over budget) of which ¥1,429mil of the increase comes from the domestic furniture business, as it is affected by the price of steel products, and ¥901mil for the stationery business in India.

### **Workstyle Field (Furniture Business and Business Supply Distribution Business)**

The FY22 forecast for the Furniture Business in the Workstyle Field segment remains unchanged at OP of ¥19,111mil (+7.6% YoY) on sales of ¥139,900mil (+2.8% YoY), generating an OPM of 13.7% (+0.7ppt YoY). Kokuyo will focus on:

Improving its existing businesses, such as capturing office renewal demand,

Expanding into new fields in its existing businesses, such as increasing office space merchandise, and

Introducing new sustainable merchandise to add value and expand segment earnings.

Kokuyo revised the increase in raw material costs by ¥1,029mil in 2H. Management assumes that office renewal demand will continue to lead segment growth and with the price revisions, the higher raw material costs will likely be offset. The firm is guiding for 2H Furniture Business OP of ¥8,100mil (39.7% YoY) on sales of ¥67,500mil (+9.4% YoY).

In the Business Supply Distribution, Kokuyo is guiding for FY22 OP of ¥3,000mil (+19.3% YoY) on sales of ¥95,500mil (+2.2% YoY), and an OPM of 3.2% (+0.5ppt YoY). Here, Kokuyo's main growth strategies include:

Improving existing businesses, such as upgrading business supply customer interface solutions for large corporate customers, and

Cultivating business supply needs at non-office customers such as hospitals, nursing homes, schools, etc., which will also extend to include a sustainable strategy such as testing recycling of paper-based packages.

The firm estimates an additional raw material cost increase of ¥552mil in 2H, which will largely be offset by a revision of its product prices. The 2H guidance for the Business Domain Distribution is for OP of ¥1,100mil (+22.2% YoY) on sales of ¥45,500mil (+4.1% YoY), and an OPM of 2.4%.

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

Kokuyo is guiding for Stationery Business FY22 OP of ¥7,200mil (+18.6% YoY) on sales of ¥79,900mil (+9.9% YoY) and plans to establish a differentiated value chain, such as offering more locally-sourced 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 stationery business in China and offer more value-added merchandise. Moreover, 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 expected approx. 20% will come from China. However, in Q2, the negative impact from the prolonged lockdown in Shanghai and other urban cities, which caused supply problems, became apparent. Kokuyo assumes that the supply chain problem will be resolved in China in the 2H and as a result, FY22 sales in China will be some 30% YoY at ¥14,000mil. On the other hand, the business in India will continue to see a steady recovery despite the rising paper prices, thanks to price hikes and the reopening

of schools boosting demand for edu-stationery. In 2H alone, the Stationery business is guided for OP of ¥3,800mil (+65.2% YoY) on sales of ¥41,400mil (19.3% YoY).

For the Interior Retail Business, Kokuyo is guiding for FY22 OP of ¥1,000mil (+5.9% YoY) on sales of ¥19,700mil (+9.2% YoY), which generates an OPM of 5.1% (-0.2ppt 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. In 2H alone, the business is guided to earn 2H OP of ¥400mil (n/a) on sales of ¥10,100mil (+11.0% YoY)

### Shareholder Return

Management is aiming for an ROE of 8% in FY24, the final year of the ongoing medium-term management plan. As of FY22 1H, Kokuyo's shareholder equity was ¥218,376mil (67.3%) with retained earnings of approx. ¥203,615mil. 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. ¥30,000mil (approx. 12.6% of consolidated net assets). The firm's aim is to reduce that figure to below 10.0% of consolidated net assets by FY24 – the final year of the current medium-term management plan. During Q2, Kokuyo sold one of its major holdings to generate an extraordinary gain of ¥840mil. The firm has been gradually unwinding its positions and reckons that the proceeds should be reinvested to improve growth as a priority while still proactively improving shareholder return.

## SEGMENT DATA

Kokuyo (7984 JP) : Segment Sales and OPM medium-term target									
(¥bil / December year-end)		FY21				FY22			FY24
		1H	FY	1H	YoY (%)	FYCE (Adj)	YoY (%)	Target	CAGR (%)
Workstyle Field	Net sales	123.9	229.4	122.3	-1.3	235.4	2.6	275.0	6.0
	OP	13.5	20.3	12.8	-5.2	22.1	9.1	27.2	9.7
	OPM (%)	10.9	8.8	10.5	-0.4pp	9.4	+0.6pp	9.9	n/a
Furniture Business	Net sales	74.3	136.0	72.3	-2.6	139.9	2.8	170.0	7.9
	OP	11.9	17.7	10.9	-8.3	19.1	7.6	23.4	10.2
	OPM (%)	16.0	13.0	15.1	-0.9pp	13.7	+0.7pp	13.8	n/a
Business supply distribution	Net sales	49.6	93.4	49.9	0.6	95.5	2.2	105.0	3.2
	OP	1.6	2.5	1.8	17.7	3.0	19.3	3.8	7.0
	OPM (%)	3.2	2.7	3.8	+0.6pp	3.2	+0.5pp	3.6	n/a
Lifestyle Field	Net sales	46.8	90.7	48.0	2.5	99.6	9.8	116.0	7.6
	OP	4.2	7.0	3.9	-6.5	8.2	16.9	10.2	14.5
	OPM (%)	9.0	7.7	8.2	-0.8pp	8.2	+0.5pp	8.8	n/a
Stationery business	Net sales	37.9	72.7	38.4	1.5	79.9	9.9	95.0	7.9
	OP	3.7	6.0	3.3	-9.3	7.2	18.6	8.8	13.6
	OPM (%)	9.9	8.3	8.8	-1.1pp	9.0	+0.7pp	9.3	n/a
Interior retail business	Net sales	8.9	18.0	9.5	6.8	19.7	9.2	21.0	5.9
	OP	0.4	0.9	0.5	14.8	1.0	5.9	1.4	26.0
	OPM (%)	5.4	5.2	5.8	+0.4pp	5.1	-0.1pp	6.7	n/a
Other	Net sales	0.2	0.4	0.2	-7.4	0.4	-9.3	0.6	14.5
	OP	0.0	0.0	-0.1	n/a	-0.1	n/a	0	n/a
	OPM (%)	6.8	2.3	n/a	n/a	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-15.7	-28.0	-14.1	n/a	-28.4	n/a	-31.6	n/a
	OP	-3.1	-7.4	-3.9	n/a	-9.4	n/a	-9.8	n/a
Total	Net sales	155.2	292.6	156.4	0.7	307.0	4.9	360.0	7.0
	OP	14.6	19.9	12.7	-13.1	20.8	4.5	27.5	11.0
	OPM (%)	9.4	6.8	8.1	-1.3pp	6.8	+0.0pp	7.6	n/a

Source: Nippon-IBR based on Kokuyo's Field Expansion 24, FY21 & FY22 1H earnings results presentation

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