

KOKUYO CO., LTD (7984 JP)

FY22 GUIDANCE WAS REVISED DOWN AMID SHORTFALL IN SALES IN THE OFFICE RENEWAL PROJECTS

FY22 Q3 RESULTS

Kokuyo (7984 JP) reported FY22 (Dec yr-end) Q3 earnings with 9-month gross profit [GP] of ¥87,246mil (-0.8% YoY) and operating profit [OP] of ¥14,963mil (-18.4% YoY) on sales of ¥224,899mil (+0.7% YoY). Primary reasons for the YoY decline in cumulative Q1~Q3 OP are:

- A shortfall in office renewals in the Furniture Business:** While Kokuyo initially expected to see a dip in new office projects in FY22, the firm thought it would be offset by strong demand for office renewal projects. However, although demand is still strong, some projects were postponed or suspended – a reflection of negative sentiment by corporates on the economy.
- A greater than expected rise in raw material costs:** 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%), however, thanks to gradual passing through of cost increases to selling price, GPM recovered to 38.0%.
- The weak stationery business in China due to lockdowns in Shanghai in Q2:** The stationery business sales in China saw YoY decline until Q2 due to lockdown in Shanghai. However, in Q3 alone, sales in China rapidly recovered as a reaction to the lifting of lockdown. In addition, India sales have also been steadily recovering as schools are reopening.

Recurring profit [RP] and net profit [NP] improved +20.7% YoY and +13.5% YoY, respectively, mainly due to FOREX (+¥1,078mil) and gains from the sale of strategically held shares (+¥1,022mil). Also, having reported an impairment cost of ¥5,342mil associated with equity method holdings on Pentel (unlisted, Japan) in FY21 1H, there was no such cost reported in FY22 Q1~Q3.

Earnings Summary (Adjusted Basis - Cumulative)							
¥mil	FY21		FY22				
	Q3	FY	Q3	YoY (%)	FYCE (Old)	FYCE (New)	YoY (%)
Sales	223,300	292,617	224,899	0.7	307,000	306,000	4.6
OP	18,300	19,907	14,963	-18.4	20,800	19,300	-3.0
RP	14,540	16,415	17,555	20.7	23,200	22,200	35.2
NP*	11,505	13,703	13,053	13.5	16,400	18,500	35.0

Source: Kokuyo's FY21 & FY22 Q3 earnings results materials
 * FY21 figures are adjusted to the new revenue recognition method.
 * NP attributed to the parent's shareholders

EXECUTIVE SUMMARY

- Kokuyo reported FY22 Q3 earnings with GP of ¥87,246mil (-0.8% YoY) and OP of ¥14,963mil (-18.4% YoY) on sales of ¥224,899mil (+0.7% YoY).
- The largest reason for YoY decline in cumulative Q1~Q3 OP is that the Furniture Business – Kokuyo's core business – fell short of guidance as customers postponed their office renewal plans. The Furniture Business recorded cumulative FY22 Q1~Q3 OP of ¥12,795mil (-17.6% YoY) on sales of ¥100,357mil (-5.1% YoY).
- On the other hand, the Stationery Business for the 9-month period saw OP improve 5.0% YoY to ¥5,230mil on sales of ¥58,312mil (+6.5% YoY). Demand in China rebounded as lockdowns ended. Also, in India, the reopening of schools and rebranding led to a recovery in the earnings.
- On the back of the Furniture Business shortfall, Kokuyo revised down its FY22 guidance from OP of ¥20,800mil (+4.5% YoY) on sales of ¥307,000mil (+4.9% YoY) to OP of ¥19,300mil (-3.0% YoY) on sales of ¥306,000mil (+4.6% YoY).
- The annual cash dividend remains unchanged at ¥57.00 / share, giving an estimated pay-out ratio of 35.6%.
- Kokuyo is currently running its medium-term plan to FY24. There is, so far, no change to the plan's target.

FY22 1H PERFORMANCE BY BUSINESS SEGMENTS

Workstyle Field (Furniture and Business Supply Distribution Business)

The Workstyle Field Segment reported FY22 Q3 OP of ¥15,111mil (-13.5% YoY) on sales of ¥172,222mil (-2.5% YoY). In Q3 alone, segment OP was ¥2,291mil (-42.0% YoY / -31.8% QoQ) on sales of ¥49,913mil (-5.2% YoY / -5.3% QoQ).

The Furniture Business: Kokuyo's core business, recorded cumulative FY22 Q1~Q3 OP of ¥12,795mil (-17.6% YoY) on sales of ¥100,357mil (-5.1% YoY). Although there are 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. Although office furniture business kicked off the year with a healthy order backlog from new office buildings and strong office renewal demand, customers' appetite for the office renewal was put on hold due to the macroeconomic environment in Q3.

Initially, Kokuyo planned to offset the decline in new office building-related demand in FY22 by a surge in renewal demand, however, customers postponed / suspended their renewal plans due to economic uncertainty. 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 sales mix of the Furniture Business deteriorated and led to a drop in segment OPM by 1.9ppt to 12.7% for the 9-month period. In Q3 alone, segment OP fell -48.3% YoY / -26.5% QoQ to ¥1,868mil on sales of ¥27,986mil (-10.9% YoY / -4.1% QoQ), and OPM fell to 6.7%, from FY21 Q3 OPM of 11.5% and FY22 Q2 OPM of 8.6%.

The Business Supply and Distribution Business: Cumulative FY22 Q1~Q3 OP came in at ¥2,315mil (+19.0% YoY) on sales of ¥71,864mil (+1.4% YoY). Thanks to a recovery in office supply procurement by large corporates as workers started going back to the office, spending per customer improved. The number of companies that use Kaunet, Kokuyo's own office supply sales platform, increased from 5,212 companies in FY21, to 5,290 in FY22 Q3. Kokuyo's strategy to cross-sell business supply services to large customers of the Furniture Business proved successful. In Q3 alone, the Business Supply Distribution generated OP of ¥423mil (+25.0% YoY / -48.2% QoQ) on sales of ¥21,926mil (+3.1% YoY / -7.0% QoQ).

Lifestyle Field (Stationery Business and Interior Retail)

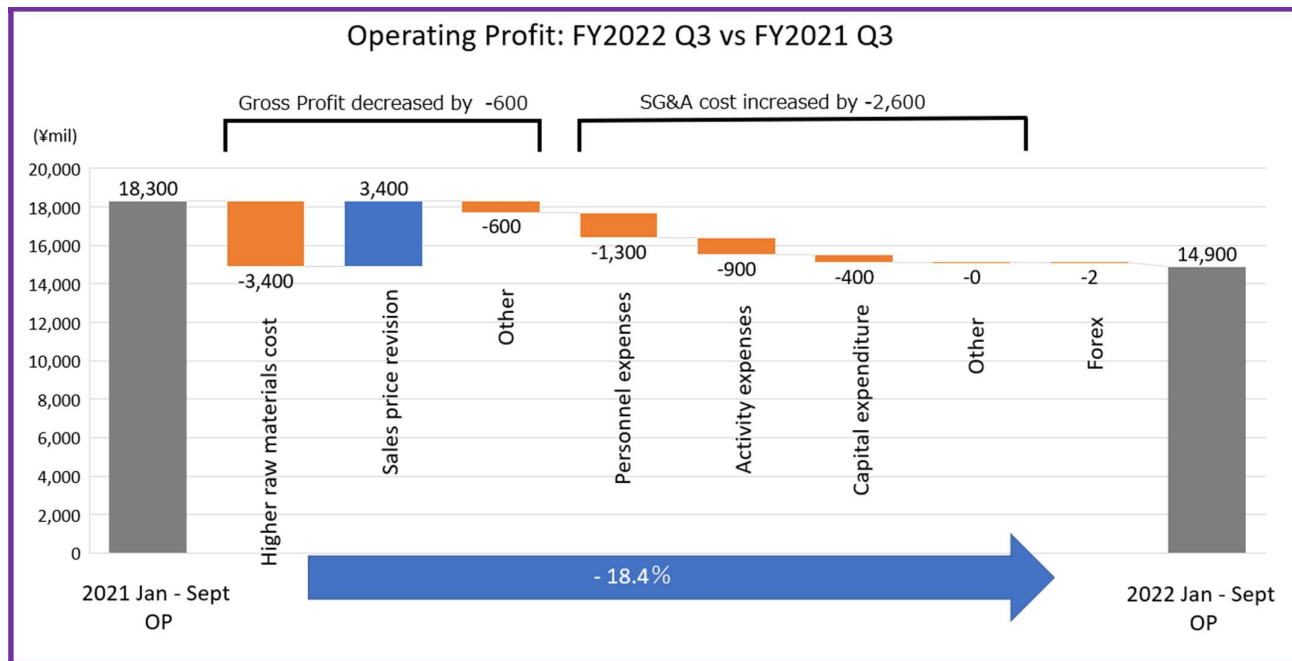
Lifestyle Field reported FY22 Q1~Q3 cumulative OP of ¥5,939mil (+3.1% YoY) on sales of ¥72,452mil (+6.3% YoY). In Q3 alone, segment OP rose +29.7% YoY / +50.6% QoQ to ¥1,992mil on sales of ¥24,409mil (+14.4% YoY / +6.8% QoQ). The segment comprises of two businesses – Stationery and Interior Retail.

The Stationery Business: Cumulative FY22 Q1~Q3 OP improved 5.0% YoY to ¥5,230mil on sales of ¥58,312mil (+6.5% YoY). Although several lockdowns in urban areas like Shanghai finally took their toll in Q2 due to the impact from supply chain disruptions, resulting in a shortage in stationery supplies in China in April, the firm saw a rapid rebound in demand for its stationery items targeted at Chinese high school girls. Kokuyo initially assumed FY22 Stationery Business sales in China to grow +30.0% YoY to ¥14,000mil, up from FY21 sales of ¥11,000mil. FY22 1H sales came in at ¥4,000mil (-20% YoY). However, FY22 Q1~Q3 cumulative stationery sales in China surged to ¥9,300mil (+7.0% YoY). Given the 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 fully lifted.

Another growth market for Kokuyo is India and sales have begun to gradually recover, in line with management's expectations. However, while higher raw material costs affected Q2 earnings, Kokuyo is looking for further recovery thanks to (1) the reopening of schools, (2) the introduction of new prices, and (3) the rebranding of its merchandise. In Q3 alone, the Stationery Business overall reported OP of 1,833mil (+48.0% YoY / +75.4% QoQ) on sales of ¥19,815mil (+17.7% YoY / +10.5% QoQ).

The Interior Retail Business, which is operated by Kokuyo's subsidiary ACTUS (previously part of the Office Furniture Business in the Spatial Value Domain), which runs real (i.e., bricks and mortar) and online stores, earned FY22 Q1~Q3 OP of ¥708mil (-8.7% YoY) on sales of ¥14,140mil (+5.3% 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 Q3 alone, the business reported OP of ¥158mil (-46.6% YoY / -42.8% QoQ) on sales of ¥4,594mil (+2.3% YoY / -6.5% QoQ).



FY22 OUTLOOK

Kokuyo revised down its FY22 guidance given the shortfall in the Furniture Business earnings. The firm cut FY22 OP from ¥20,800mil (+4.5% YoY) on sales of ¥307,000mil (+4.9% YoY) to OP of 19,300mil (-3.0% YoY) on sales of ¥306,000 (+4.6% YoY). FY22 recurring profit [RP] was also reduced by ¥1,000mil to ¥22,200mil (+35.2% YoY) but net profit attributed to the parent's shareholders [NP] was revised up by ¥2,100mil to ¥18,500mil (+35.0% YoY) due to gain from the sale of Pentel shares and a reduction in corporation tax associated with previous evaluation losses on Pentel shares.

Kokuyo has been receiving enquiries for office refurbishment and renewal from companies that need to prepare their office space to meet post-COVID safety measures requirements and to adapt to the new work style. The uptrend in the office renovation demand has been so far in line with Kokuyo's forecast, however, given the macroeconomic uncertainties due to supply shortages triggered by prolonged lockdowns in China, the situation in Ukraine, and the rapid weakness in the yen, which led to higher costs of energy and raw materials, customers (relatively large corporations) likely postpone investment on office space renovation. Moreover, Kokuyo reckons that shortfall in Q1~Q3 will not be sufficiently offset by orders in Q4. FY22 Furniture Business guidance was revised down from OP of ¥19,100mil (+7.6% YoY) on sales of ¥139,900mil (+2.8% YoY) to OP of ¥16,750mil (-5.6% YoY) on sales of ¥137,600mil (+1.1% YoY). However, in Q4, Kokuyo expects to see the effects from price revisions amid the rapid surge in raw materials costs and continued strength in demand for office renewal.

FY22 is the first year of Kokuyo's three-year medium-term plan. Although FY22 guidance was revised down, there is so far no change in the medium-term target.

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, Kokuyo's shareholder equity was ¥217,348mil (66.9%) with retained earnings of approx. ¥202,588mil. 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. 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. Kokuyo has not changed its planned annual cash dividend despite FY22 guidance was revised.

SEGMENT DATA

Kokuyo (7984 JP): Segment Sales and OP												
¥bil		FY21				FY22						
		Q1	1H	Q3	FY	Q1	1H	Q3	YoY (%)	FYCE (Old)	FYCE (New)	YoY (%)
Workstyle Field	Net sales	68.7	123.9	176.6	229.4	69.6	122.3	172.2	-2.5	235.4	232.9	1.5
	OP	9.0	13.5	17.4	20.3	9.5	12.8	15.1	-13.5	22.1	19.95	-1.7
	OPM (%)	13.1	10.9	9.9	8.8	13.6	10.5	8.8	-1.1pp	9.4	8.6	-0.2pp
Furniture Business	Net sales	42.4	74.3	105.7	136.0	43.2	72.4	100.3	-5.1	139.9	137.6	1.1
	OP	8.1	11.9	15.5	17.7	8.4	10.9	12.7	-17.6	19.1	16.75	-5.6
	OPM (%)	19.2	16.0	14.7	13.0	19.4	15.1	12.7	-2.0pp	13.7	12.2	-0.8pp
Business supply distribution	Net sales	26.3	49.6	70.8	93.4	26.4	49.9	71.8	1.4	95.5	95.3	2.0
	OP	0.8	1.6	1.9	2.5	1.1	1.9	2.3	19.0	3.00	3.05	22.0
	OPM (%)	3.3	3.2	2.7	2.7	4.1	3.8	3.2	+0.5pp	3.2	3.4	+0.5pp
Lifestyle Field	Net sales	24.2	46.9	68.1	90.7	25.2	48.0	72.4	6.3	99.6	98.8	8.9
	OP	2.4	4.2	5.7	7.0	2.6	3.9	5.9	3.1	8.2	8.1	15.7
	OPM (%)	10.3	9.0	8.4	7.7	10.4	8.2	8.2	-0.2pp	8.2	8.2	+0.5pp
Stationery business	Net sales	19.8	37.9	54.7	72.7	20.6	38.5	58.3	6.5	79.9	79.2	8.9
	OP	2.2	3.7	4.9	6.0	2.4	3.4	5.2	5.0	7.2	7.05	17.5
	OPM (%)	11.3	9.9	9.1	8.3	11.4	8.8	9.0	-0.1pp	9.0	8.9	+0.6pp
Interior retail business	Net sales	4.3	8.9	13.4	18.0	4.6	9.5	14.1	5.3	19.7	19.6	8.9
	OP	0.2	0.5	0.7	0.9	0.3	0.5	0.7	-8.7	1.0	1.05	16.7
	OPM (%)	5.9	5.4	5.2	5.2	5.8	5.8	5.0	-0.2pp	5.1	5.4	+0.2pp
Other	Net sales	0.1	0.2	0.3	0.4	0.1	0.2	0.2	-5.4	0.4	0.4	0.0
	OP	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	n/a	-0.1	-0.2	n/a
	OPM (%)	2.4	6.8	n/a	2.3	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Reconciliation	Net sales	-9.4	-15.8	-21.8	-30.3	-8.5	-14.1	-20.0	n/a	-28.4	-26.1	n/a
	OP	-1.5	-3.1	-4.8	-7.3	-2.0	-4.0	-5.9	n/a	-9.4	-8.55	n/a
Total	Net sales	83.6	155.3	223.3	292.6	86.4	156.4	224.8	0.7	307.0	306.0	4.6
	OP	9.9	14.7	18.3	19.9	10.0	12.7	14.9	-18.4	20.8	19.3	-3.0
	OPM (%)	11.9	9.4	8.2	6.8	11.6	8.1	6.7	-1.5pp	6.8	6.3	-0.5pp

Source: Nippon-IBR based on Kokuyo's Field Expansion presentation & FY22 Q3 earnings results presentation

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