

S-POOL INC. (2471 JP)

IH EARNINGS OVERSHOT THE COMPANY ESTIMATE YET FY19 TARGET REMAINS UNCHANGED

FY2019 IH RESULTS SUMMARY

S-Pool (2471 JP) reported IH FY19 (year to Nov 2019) earnings results; operating profit was ¥763mil (+64.8% YoY) on sales of ¥8,296mil (+20.8% YoY). Both sales and OP were better than the company estimate of ¥8,068mil and ¥466mil, respectively.

Sales growth continued to be led by two of the firm's core segments – the Human Resources and The Special Needs Employment Support Service included in the Business Solution segment. Human Resources Solution Service sales hit ¥5,889mil (+20.9% YoY) and that of the Special Needs Employment Solution was ¥1,260mil (+44.4% YoY).

OP largely overshot the company estimate thanks to better than expected hydroponic farm facility sales (430 plots sold in IH vs. initial estimate of 306 plots) in the Special Needs Employment Support Service and the Logistic Business having turned profitable: Two previously loss-making segments, namely the Logistics and OMUSUBI – the employment process support service for restaurant chains and retailers – became profitable. As a result, all six business units are in the black.

Despite the IH progress of OP surpassing 60% of the full year target, the firm left its estimate unchanged.

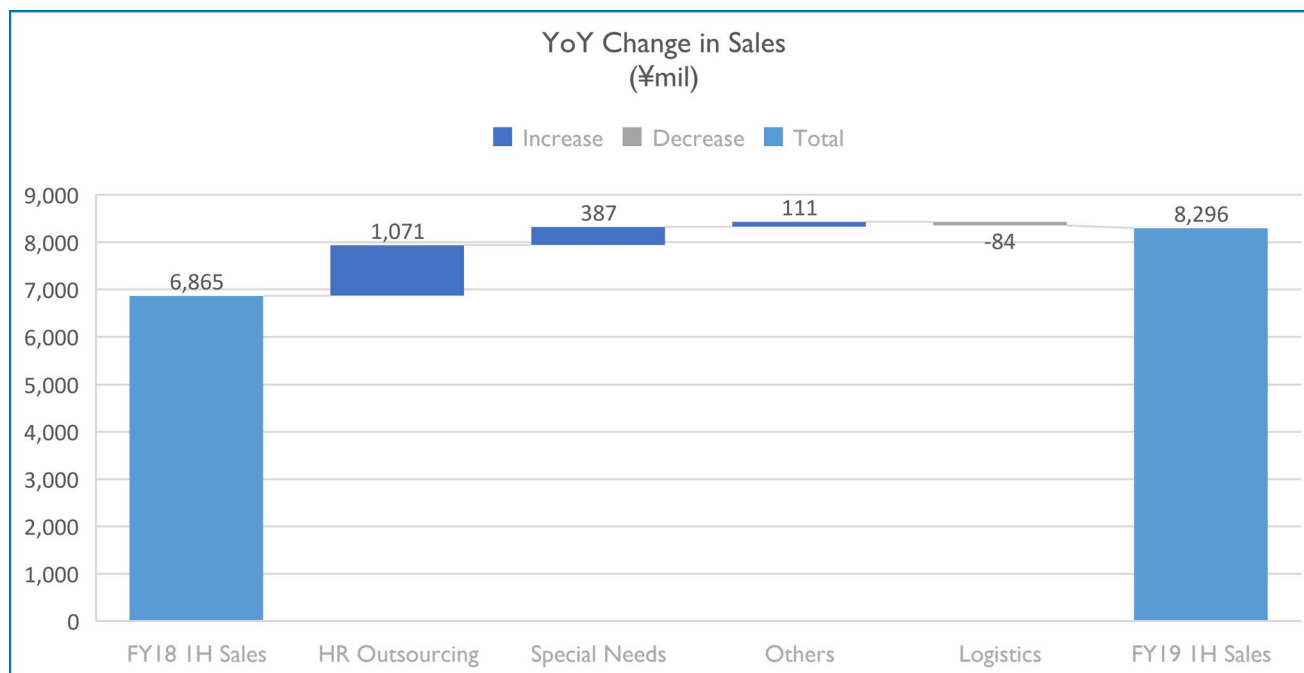
S-Pool Inc. (2471 JP): FY19 IH Results vs. Estimate

(¥mil)	IH Actual	IH CE	Difference	vs. CE (%)	vs. FY19CE progress (%)	FY19 CE	YoY (%)
Sales	8,296	8,068	228	2.8	48.6	17,066	15.3
GP	2,426	2,164	262	12.1	50.2	4,834	20.2
GPM (%)	29.2	26.8		+2.4ppt		28.3	+1.1ppt
SG&A	1,663	1,697	-34	-2.0	46.5	3,573	17.6
SG&A/Sales (%)	20.0	21.0		-1.0ppt		20.9	+0.4ppt
OP	763	466	297	63.7	60.6	1,260	28.1
OPM (%)	9.2	5.8		+3.4ppt		7.4	+0.8ppt
RP	778	460	318	69.1	62.3	1,248	23.9
NP	496	298	198	66.4	61.2	811	31.0

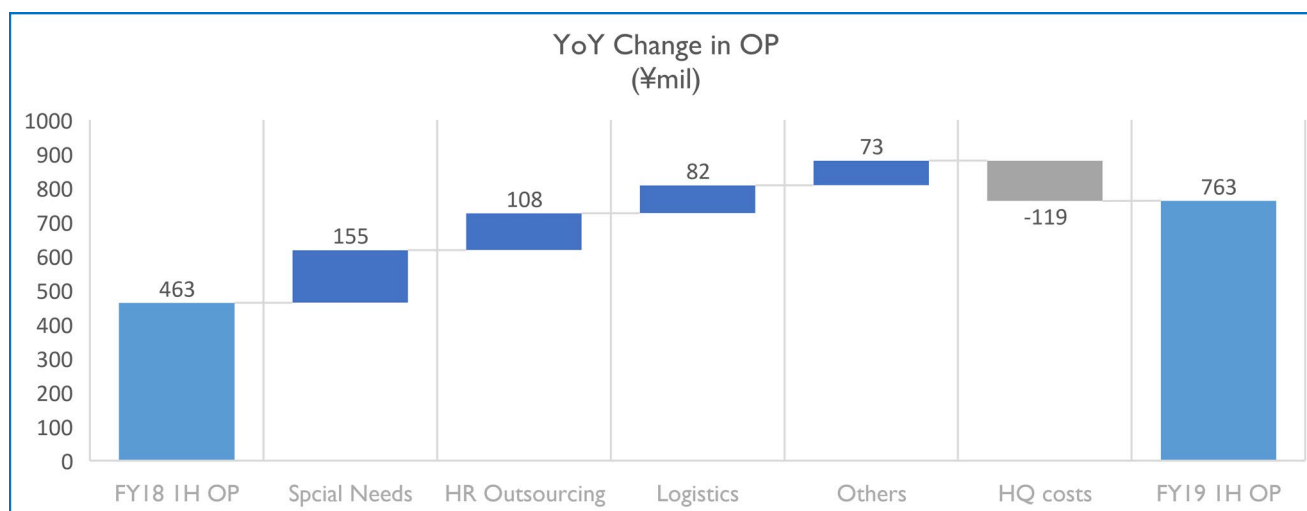
Source: Nippon Investment Bespoke Research UK Ltd based on S-Pool Inc.'s presentation materials

EXECUTIVE SUMMARY

- S-Pool Inc's (2471 JP) IH results shows that the firm has achieved more than 60% of FY19 profit guidance in IH. However, the firm did not revise its earnings.
- IH OP was ¥763 (+64.8% YoY) on sales ¥8,269mil (+20.8% YoY).
- Of the ¥299mil increase in OP, ¥155mil was contributed to the outperforming Special Needs Employment Support Business, thanks to better than expected sale of facilities.
- Two businesses, the Logistics Outsourcing and OMUSUBI – the employment process support service – moved out of the red and into the black in the IH.
- The Human Resources Solutions segment reported strong demand for call centre operators. The firm has become a major outsourcing partner to several large call centre companies such as Bell System 24 and Relia Communications. The hiring of key personnel – Field Consultants (FCs) – has been in line with expectations. The high staff retention ratio improved the efficiency of the business.
- The FY19 dividend of ¥10/share, +¥5/share YoY, includes a ¥3 commemorative dividend.
- The firm will be promoted to the Tokyo Stock Exchange 1st Section (TSE1) on July 26.



Source: S-Pool Inc. IH earnings presentation material



Source: S-Pool Inc. IH earnings presentation material

SEGMENTS

Segment Earnings

(¥million)	FY2017			FY2018			FY2019CE		
	Sales	OP	OPM (%)	Sales	OP	OPM (%)	Sales	OP	OPM (%)
Business Solutions	3,998	728	18.2	4,482	874	19.5	4,774	1,170	24.5
Human Resources Solutions	7,722	680	8.8	10,382	1,004	9.7	12,400	1,179	9.5
Adjustment	-25	-734		-68	-895		-108	-1,089	
Total	11,696	674	5.8	14,797	983	6.6	17,066	1,260	7.4

Source: S-Pool Inc.

HUMAN RESOURCES SOLUTIONS

The firm reported segment OP of ¥591mil (+22.3% YoY) on sales of ¥5,889mil (+20.9% YoY). While the growth rate has slowed compared to the recent years' level of ~30%, the business has become sizeable in terms of absolute value, therefore, the reduced pace in growth was anticipated by management. Nonetheless, the FY19 IH OPM slightly improved to 10% from 9.9% in IH FY18, despite a dip in new registrants at the beginning of the year that often leads to a rise in advertisement costs.

Monthly new registrants fell below 2,500 in Dec 2018 but recovered to above 4,000 in Apr 2019. As a result, average monthly registrants fell 2.1% YoY to 3,631 in IH. On the other hand, average monthly utilisation of staff was 4,740 (+14.4% YoY). Sales to call centre operators rose 24% YoY to ¥4,422mil. S-pool's share in major call centre operators such as Bell System 24 (6183 JP) and Relia Communications (4708 JP) has improved to circa 20%. In regional cities such as Hokkaido and Fukuoka, the firm obtains the top market share in those call centres. However, in Tokyo, it remains ranked in 2nd place. The firm reckons that there is room to gain more market share in urban cities such as Tokyo and Osaka.

Hiring of the key personnel, Field Consultants (FCs), has been progressing well. As of the end of FY18, there were 196 FCs. The firm aims to increase the numbers of FCs to 240 by the end of FY19. It plans to hire 50% (ca. 20+ people) from new graduates and the remaining 50% from job seekers that already have work experiences in call centres. Of total segment sales, circa ¥2,500mil (42%) is generated through the dispatch of teams with FCs. The job retention rate among the operating staff has also improved. For example, the firm measures job advertisement KPIs by job advertisement costs / segment sales. This year's budget is 2.5% but in IH, it was below 2.0%. The higher the job retention rate the lower the advertisement costs, which improves OP margin.

FY19 segment OP is estimated at ¥1,179mil (+17.4% YoY) on sales of ¥12,400mil (+19.4% YoY). The firm assumes that ca. 20% top line growth in the Human Resources segment is achievable given the current strong demand for team dispatches and the current level of staff retention rate. Sales from call centres is estimated to reach ¥9,411 (+22.8% YoY) in FY19. In IH, sales to call centres improved 23.9% YoY, from ¥3,568mil to ¥4,422mil. Based on the current company guidance, sales to call centres in the 2H is estimated at ¥4,989mil (+21.8% YoY). Although the current estimate suggests a slow-down in sales growth in the 2H, the ongoing business trend has not slowed compared to the IH.

BUSINESS SOLUTIONS

The firm reported the segment FY19 IH OP ¥673mil (+67.1% YoY) on sales of ¥2,425mil (+18.5% YoY) thanks to better than expected hydroponic facility sales in the Special Needs Employment Support Services and the Logistics and OMUSUBI businesses finally turning profitable.

Special Needs Employment Services

The Special Needs Employment Services earned ¥1,260mil in sales (+44.5%YoY) in the IH. OP from the business is estimated at circa ¥660mil (+23.4% YoY) out of the Business Solutions segment IH OP of ¥673. The number of facilities sold was 430 plots, far exceeding the original target of 292 plots, earning ¥645mil (+41.7% YoY), thanks to the earlier than expected opening of 3 new facilities in Chiba, Saitama and Aichi prefectures. The total number of facilities under management hit 2,469 plots (each plot generates circa ¥40,000 in management fees). As a result, the firm revised up the full-year plot sales estimate from 800 plots to 880 plots.

As of IH, it has an order backlog of 342 plots vs. the 2H sales estimate of 450 plots. In the 2H, two new farms are yet to open. If the facility sales progress as planned in the 2H, the firm will have nearly 3,000 plots under management as of the end of this year.

The newly built Saitama farms broaden the hiring capacity for jobseekers with intellectual disabilities by 250/annum, adding to the existing capacity of 350/annum in Chiba and Aichi combined. In IH, the firm earned ¥157mil (+35.3% YoY) from Recruitment Fees. Opening facilities in new locations is important for the business to grow. Since one person is typically allocated 2 hydroponic plots, the firm could only open a maximum of 700 plots a year (hiring 350 jobseekers with disabilities x 2 plots per person). Hiring additional 250 jobseekers in Saitama made it possible to open additional 500 plots/annum, generating more facility sales and management fee for the firm. In IH, revenues from Management Fees totalled ¥458mil (+52.7% YoY).

The Act regarding the Employment of Persons with Disabilities clarifies that the employment quota for workers with disabilities is to be raised to 2.3% of total employment at companies hiring more than 44 people. Japan has been rather behind in hiring workers with intellectual and mental disabilities compared to other developed economies. Due to the Government financial situation, there has been less budget allocated to people with disabilities.

Parents of those with disabilities are also aging, often finding it impossible to permanently support their children. Many local governments have become aware of the financial independence of persons with disabilities and are interested in S-Pool setting up new hydroponic farms in their prefectures. Local governments whose budgets are usually very tight, are keen on the idea that S-Pool's business model does not at all rely on government subsidies. However, the firm is not willing to spread the locations of its hydroponic facilities out too far as it makes it difficult to manage with limited human resources it has.

The firm's customer base comes from Japanese companies who need to hire workers with disabilities to meet the employment quota. In IH FY18, a total of 186 companies were signed up. In IH FY19, the list expanded to 230 companies and includes several large corporations that represent Corporate Japan. The complexity of hiring workers with disabilities, especially those with intellectual special needs, has seen a rising number of corporates choosing to outsource management of workplaces and workers with S-Pool. With the quota gradually rising over the next 2~3 years, the firm expects more corporate clients to take up its services. The firm has also been developing an urban hydroponic farm business model to improve its own management efficiency as well as to attract more corporates. Unlike the existing suburban model, the urban facilities will have a shorter timeframe within which to open by utilising unused warehouses and alike, so that the CAPEX can be lower. The urban business model can also smooth out the seasonality of the Special Needs Employment Support Services earnings. Current business model tends to earn chunks of revenue and profit by selling facilities upfront, which causes fluctuations in earnings.

In FY19, revenue of the Special Needs Employment Services is guided for ¥2,508mil (+26.3% YoY), of which the Facility sales is ¥1,204mil (+86.7% YoY), the Management Fee is ¥1,077mil (+47.5% YoY) and Recruitment Fee is ¥227mil (+44.6% YoY). The business OP is estimated at ¥1,070mil (+22.4% YoY).

Logistics Outsourcing

Logistics Outsourcing Business generated ¥42mil in OP (+¥82mil from the loss) on sales of ¥592mil (-12.5% YoY). The decline in sales is due to the firm's decision to stop including shipping fees in invoices for e-commerce customers that use the firm's Logistics Outsourcing services. Until last year, S-Pool paid the shipping fee and invoiced customers for it with a small margin added on. However, due to the rapid rise in shipping fees, the firm decided to itemise the shipping fee as an advanced payment and charge packaging and handling fees separately.

The firm has two distribution centres – one in Tsukuba, Ibaraki and the another in Shinagawa, Tokyo. Currently, the Tsukuba centre operates at full capacity. Shinagawa distribution centre is only utilised at 60%. The firm aims to improve Shinagawa's utilisation rate to 80% – the level at which it starts earnings ¥10mil/month in OP.

In FY19, the Logistics sales is guided for ¥1,040mil (-29.1% YoY), of which ¥785mil (-38.4% YoY) shall be logistics services for e-commerce customers. The remaining ¥255mil (+32.1% YoY) is to be earned by distribution centre operation outsourcing.

OMUSUBI, Employment Process Support Service

The Employment Process Support Service OMUSUBI is a service that supports setting up interviews between employers and employees. Main clients are restaurant and retail chains, whose employment process for part-time staff is mostly managed by branch managers. The OMUSUBI service provides call centre services and promptly contacts candidates for part-time positions on behalf of branch managers. Given the labour shortage, jobseekers can be taken by other employers if they do not respond to the applications as quickly as possible. However, restaurant managers are often too busy to handle online applications in time and miss out on opportunities to hire staff members.

In 1H, OMUSUBI sales surged 48.8% YoY to ¥198mil, handling circa 30,000 applications per month, and is close to break-even. To earn a stable OP, the firm needs to raise the utilisation rate – currently running at 50~60% – of all 4 call centres.

In 2H, S-Pool aims to further enhance its business with existing customers, including some of the Japanese listed restaurant chains, by promoting the efficiency of the outsourcing employment process that it provides. Although still operating just below break-even level this year, the firm aims to grow the business, targeting ¥300mil in OP on ¥1,000mil sales in 4 years' time (FY23).

S-Pool Inc. (2471): Segment Sales and Operating Profit

(¥million)			FY2017	H1	FY2018	H1	YoY	FY2019CE	YoY (%)
Human Resources Solution	Call Centres	Sales	5,607	3,568	7,663	4,422	23.9	9,411	22.8
	Sales Support		1,756	1,060	2,245	1,265	19.3	2,686	19.6
	Others		359	244	474	202	-17.2	303	-36.1
	Segment Total		7,722	4,872	10,382	5,889	20.9	12,400	19.4
		OP	680	483	1,004	591	22.4	1,179	17.4
		OPM (%)	8.8	9.9	9.7	10.0	0.1ppt	9.5	-0.2ppt
Business Solutions	Special Needs Employment Support Service	Sales	1,305	872	1,985	1,260	44.5	2,508	26.3
	Logistics Outsourcing Service		1,185	676	1,467	592	-12.4	1,040	-29.1
	Sales Support		559	268	536	266	-0.7	538	0.4
	New Business		1,022	228	516	307	34.6	686	32.9
	Segment Total	3,998	2,046	4,482	2,425	18.5	4,772	6.5	
		OP	728	403	874	673	67.0	1,170	33.9
	OPM (%)	18.2	19.7	19.5	27.8	+8.1ppt	24.5	+5.0ppt	
Total	Sales	11,721	6,918	14,865	8,314	20.2	17,172	15.5	
	OP	1,408	886	1,878	1,264	42.7	2,349	25.1	
Adjustment	Sales	-25	-52	-68	-18	-65.4	-108	n/a	
	OP	-734	-423	-895	-502	18.7	-1,089	n/a	
Value as in P&L	Sales	11,696	6,865	14,797	8,296	20.8	17,066	15.3	
	OP	674	463	983	763	64.8	1,260	28.2	
	OPM (%)	5.8	6.7	6.6	9.2	+2.5ppt	7.4	+0.8ppt	

Source: Nippon Investment Bespoke Research UK Ltd based on publicly available information on S-Pool Inc.

FY19 EARNINGS OUTLOOK

In FY19, the firm is guiding for OP of ¥1,260mil (+28.1% YoY) on sales of ¥17,066mil (+15.3% YoY), which would mark its 8th consecutive record in sales and its 5th consecutive record for OP. Despite 1H OP surpassing 60% of the full-year guidance, the firm has not announced an upward revision to the FY19 target. Moreover, facility sales in the Special Needs Employment Service business is likely to put in a stronger performance in 2H OP due to an increase in the number of hydroponic farm plots (246 plots in 3Q and 204 plots in 4Q vs. 120 plots in 1Q and 310 plots in 2Q), which should have a positive impact on the OPM. One reason for the firm not to revise up the earnings forecast at

this point is the windfall bonus it plans to offer its employees in the Q4. The firm commits to pay a windfall bonus in any year that its earnings exceed its targets.

The FY19 dividend is guided for ¥10/share and includes a ¥3/share commemorative dividend. The firm targets at 5% DoE (Dividend on Equity) instead of RoE – having once fallen into balance sheet insolvency post-Lehman crisis and RoE was not appropriate. However, shareholder equity ratio has already reached 40%.

It has been confirmed that as of 26 July, the firm will be promoted to the Tokyo Stock Exchange 1st Section, after having cleared the one missing criteria needed to be promoted – the number of shareholders. To meet the criteria, it offered 460,000 shares (2.9% of shares outstanding) in an off-floor block trade between 11 and 16 July.

S-Pool Inc (2471 JP)

(JPY million)	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19 (Est)
Sales	6,604	7,267	9,236	11,696	14,797	17,066
Operating Profit	207	59	507	674	983	1,260
Recurring Profit	191	49	496	687	1,007	1,248
Net Profit	165	-68	408	423	619	811
EPS (JPY)	58.89	-22.86	135.85	136.60	39.27	51.39
Adjusted EPS (JPY)	-	-	130.24	134.14	39.20	51.00
Cash flow from operation (CFO)	291	-253	725	801	724	-
Cash flow from investment (CFI)	-188	-388	-480	-577	-878	-
Cash flow from finance (CFF)	229	513	138	-58	1	-
Cash and cash equivalent	819	691	1,074	1,240	1,087	-
Free cash flow (FCF)	103	-641	245	224	-154	-
CFO per share (JPY)		-84.24	241.40	258.43	45.88	-
FCF per share (JPY)	36.67	-213.43	81.58	72.27	-9.76	-
Total asset	2,155	2,664	3,717	4,493	5,801	-
Liabilities	1,399	2,000	2,675	3,019	3,769	-
Net asset	756	663	1,041	1,473	2,032	-
Capital	351	351	351	366	368	-
Shareholders' equity	756	657	1,035	1,459	2,024	-
BPS (JPY)	251.66	218.74	344.52	462.71	128.27	-
OPM (%)	3.13	0.81	5.49	5.76	6.64	7.38
ROE (%)	34.96	-9.62	48.23	33.92	35.54	32.00
ROA (%)	10.59	2.08	15.61	16.27	19.00	11.40
Shareholders' equity ratio (%)	35.08	24.66	27.85	32.47	34.89	-
D/E ratio (%)	185.05	304.41	258.45	206.92	186.22	-
Total asset turnover (X)	3.61	3.02	2.89	2.85	2.87	-
Interest coverage (x)	15.92	6.56	56.33	112.33	164.00	-
Current ratio (%)	138.46	126.14	111.64	110.17	100.51	-
Interest-bearing debt	494	1,037	1,204	1,144	1,203	-
EBITDA	253	144	673	913	1,286	-
EBITDA margin (%)	3.83	1.98	7.29	7.81	8.69	-
Number of full-time employees	243	341	411	546	623	700
Annual dividend (JPY / share)	10.00	10.00	10.00	18.00	5.00	10.00
Normal dividend	10.00	10.00	10.00	18.00	5.00	7.00
Commemorative dividend	-	-	-	-	-	3.00
Dividend pay-out ratio (%)	17.00	-	7.40	13.20	12.70	-
DoE (%)	6.20	4.30	3.60	4.50	4.50	-
Shares outstanding as of the end of fiscal year (shares)	3,003,400	3,003,400	3,003,400	3,153,400	15,780,500	15,780,500
Interim average shares outstanding (shares)	2,809,089	3,003,338	3,003,338	3,099,494	15,776,586	15,776,586
Treasury shares (shares)	62	62	62	129	692	692
Potential dilution (shares)	-	-	129,407	56,886	30,393	-

Source: Nippon Investment Bespoke Research UK based on information available on Nikkei Value Search

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