

MILBON CO., LTD (4919 JP)

FY23 EARNINGS RISKS LIE IN RAW MATERIALS PRICE DURING 1H AND RECOVERY IN CHINA.

FY22 EARNINGS RESULTS SUMMARY

Milbon Co., Ltd (4919 JP) reported FY22 (Dec year-end) earnings with gross profit [GP] of ¥29,509mil (+10.2% YoY) operating profit [OP] of ¥7,551mil (+6.6% YoY) on sales of ¥45,238mil (+10.7% YoY).

Due to the increase in raw materials costs, which became more apparent in Q3 onwards, FY22 gross profit margin [GPM] deteriorated by -0.3ppt YoY to 65.2%. Milbon had stockpiled extra inventory of some core raw materials, hence was able to avoid the full-fledged impact from cost increase until after Q3. The firm expects earnings will be dampened by the continued rise in materials costs until FY23 1H.

FY22 SG&A also rose due to increases in personnel, travel and subsistence costs, along with higher costs for reopening and large-scale events. Overseas, the firm spent on R&D and one-off cost associated with the factory in China. As a result, OPM fell by 0.6ppt YoY to 16.7%. Although the profit margin was affected by higher raw materials costs, the impact was relatively limited because:

1. Raw materials cost hikes were offset as fixed costs were sufficiently covered by increases in sales volume.
2. Pricing in the professional-use market is higher than that of consumer-use toiletry products, hence a lower raw material cost ratio. Although some of the rival brands raised prices of their professional-use haircare products, Milbon did not follow suit.
3. Over half of Milbon's existing products were launched in the past five years. New product prices are based on the firm's assessment of the most up-to-date trends in customer value, commodity prices and production costs. Given the majority of its products were recently launched, pricing tends to reflect current market conditions.

Milbon (4919 JP): Earnings Summary (Cumulative)							
(¥mil)	FY21		FY22				
	1H	FY	1H	FY Actual	YoY (%)	FYCE	vs. FYCE
Sales	19,217	40,849	21,467	45,238	10.7	43,900	3.0
COGS	6,650	14,083	7,198	15,729	11.7	14,760	6.6
GP	12,566	26,765	14,269	29,509	10.2	29,140	1.3
GPM (%)	65.4	65.5	66.5	65.2	-0.3ppt	66.4	-1.2ppt
SG&A	9,248	19,681	10,444	21,957	11.6	21,590	1.7
SG&A / Sales (%)	48.1	48.2	48.7	48.5	+0.3ppt	49.2	-0.7ppt
OP	3,317	7,084	3,824	7,551	6.6	7,550	0.0
OPM (%)	17.3	17.3	17.8	16.7	-0.6ppt	17.2	-0.5ppt
RP	3,355	7,158	4,137	7,829	9.4	7,410	5.7
RPM (%)	17.5	17.5	19.3	17.3	-0.2ppt	16.9	+0.4ppt
NP*	2,413	5,109	2,875	5,577	9.2	5,230	6.6

Source: Nippon-IBR based on Milbon's FY21 & FY22 earnings presentation materials
* NP attributed to the parent's shareholders

EXECUTIVE SUMMARY

- Milbon Co., Ltd (4919 JP) reported FY22 (Dec year-end) earnings with gross profit [GP] of ¥29,509mil (+10.2% YoY) and operating profit [OP] of ¥7,551mil (+6.6% YoY) on sales of ¥45,238mil (+10.7% YoY). OPM fell 0.6ppt YoY due to 1) raw material price hikes, 2) higher SG&A.
- The company's e-commerce platform, *milbon:iD*, which supports salons in the sale of haircare products, saw the number of registered salons on the site reach 4,800, up from 3,200 salons as of the FY21-end. The number of *milbon:iD* users also rose from 170,000 in FY21 to 450,000 as of FY22. As a result, Milbon's e-commerce sales more than doubled to ¥1,155mil, up from the ¥511mil achieved in FY21.
- Milbon is guiding for record earnings in FY23 with GP of ¥32,160mil (+9.0% YoY) and OP of ¥8,300mil (+9.9% YoY) on sales of ¥49,200mil (+8.8% YoY). The company is cautious on its outlook for raw materials costs – expecting hikes to continue during 1H – and 2) the pact of recovery in China.
- Globally, Milbon has identified seven key regions for its products – 1) Japan, 2) Korea, 3) China, Hong Kong and Taiwan, 4) ASEAN, 5) North America (the US and Canada), 6) EU, and 7) Middle East (Turkey) – where the firm will promote “local production and local consumption”.
- Milbon plans has budgeted CAPEX of ¥2,927mil in FY23, substantially down from FY22's ¥4,097mil. The dividend payment is estimated at ¥88/share, or pay-out-ratio of 49.3%, vs. medium-term target of 50%.
- The medium-term target's (FY23~FY26) remain unchanged at OP of ¥27,360mil on sales of ¥58,000mil, with Domestic sales of ¥43,700mil (5-year CAGR 5.8%) and Overseas sales of ¥14,300mil (CAGR 12.6%).

By region, net sales in Japan rose +7.3% YoY as demand for the firm's hair colour and hair care products remained firm. In the US, the successful collaboration with local distributors supported FY22 net sales growth of +46.7% YoY (yen-denominated basis [YDB] / on a local currency [LCY] basis +22.6% YoY). Korea net sales rose +23.5% YoY YDB / LCY +16.6% YoY), despite Korea's economy being hit by inflation and a rise in interest rate from 2H, thanks to continued strong demand for the firm's core hair colour products.

Net Sales Breakdown by Products (Cumulative)									
(¥mil)	FY21		FY22					FY23	
	1H	FY	1H	FY	YoY (%)	FYCE	FY v. FYCE	FYCE	YoY (%)
Hair care products	11,087	24,029	12,218	26,312	9.5	25,570	2.9	27,942	6.2
Hair colouring products	6,999	14,549	8,148	16,631	14.3	15,570	6.8	17,403	4.6
Permanent wave products	727	1,424	751	1,450	1.8	1,510	-4.0	1,594	9.9
Cosmetic products	293	579	262	572	-1.3	900	-36.4	673	17.6
Others	109	266	87	272	2.3	350	-22.3	1,588	483.5
Total	19,217	40,849	21,467	45,238	10.7	43,900	3.0	49,200	8.8

Source: Nippon-IBR based on Milbon's earnings presentation materials (FY20, FY21 & FY22)

Sales by Country

Japan

Milbon reported FY22 Japan OP of ¥6,194mil (+1.4% YoY) on sales of ¥35,334mil (+7.3% YoY), which produced an OPM of 17.5%, down from FY21's 18.5%. Although the impact of the COVID pandemic in Japan was prolonged throughout FY22, the effect on the performance of the firm's hair salons was negligible.

Given many people in Japan still wear masks, hair colour has become a fashion item / way for individuals to express themselves, resulting in hair colour sales growth of 12.4% YoY in FY22. With rising demand for hair colouring, such as double colour and bleach on colour, sales of products that help treat damaged hair due to colouring, as well as products to make the colour last longer, have expanded.

Milbon reported FY22 domestic haircare product sales (gross basis) of ¥24,897mil (+5.6% YoY), of which approx. ¥13,557mil (+8.7% YoY) is from the firm's premium brands. Given COVID restrictions led to customers not frequenting salons as regularly as they used to, especially in the urban areas, it has become vital that hairdressers encourage sales of salon-bought haircare products in an effort to maintain their business.

The benefits of the Milbon's efforts can be seen in the sharp increase in the number of salons that registered with *milbon:iD* – the firm's unique e-commerce platform – which hit 4,800 in FY22, compared to 1,300 in FY20 and 3,200 in FY21. Of those 4,800 salons, approx. 500 have more than 200 *milbon:iD* customers. Salon customers are registered with *milbon:iD* through a QR code provided by their salons. The number of registered users of *milbon:iD* surged to 450,000 in FY22, up from only 30,000 in FY20 and 170,000 in FY21.

Milbon's e-commerce revenue in FY22 more than doubled, coming in at ¥1,150mil compared to FY21's ¥511mil. The firm estimates that approx. 70% or ¥17,428mil of the domestic haircare revenues from its haircare products comes from salon sales. Moreover, the spend per person exceeded the ¥10,000 mark to approx. ¥12,000, which compares to the typical cost of ¥7,000~8,000 for a hair cut in a Central Tokyo salon. However, only an estimated 30~35% of the 450,000 registered users of *milbon:iD* are active users. How to mobilise those dormant customers will be the next step for the *milbon:iD*'s further success.

In terms of profitability in the domestic business, there was a bit of a cushion on the cost side as the firm did not use its planned SG&A budget due to long lasting COVID restrictions on business activities. However, FY22 OPM in Japan deteriorated by 1.0 ppt YoY, due to a hike in raw materials cost and overall SG&A costs rose +11.6% YoY on the back of an increase in personnel costs, such as hiring new Field Persons [FPs] and logistics.

Overseas

FY22 overseas earnings surpassed Milbon's expectations, generating sales of ¥9,904mil (+25.2% YoY YDB / LCY +14.6% YoY). Although there was some FOREX impact, the LCY-based sales growth suggests that the firm enjoyed 1) an expanding customer base, and 2) an increase in sales volumes. FY22 overseas OP expanded +38.9% YoY to ¥1,357mil, boosting the OPM by 1.3ppt to 13.7%, mainly due to 1) solid growth in Korea, where the firm reported FY22 OP of ¥1,351mil (+21.8% YoY) on sales of ¥4,159mil (+23.5% YoY), generating an OPM of 32.5%, thanks to solid sales of hair colour products, 2) contracted losses in the US from -¥561mil in FY21 to -¥168mil in FY22, and 3) turned black in other areas (which include Thailand, Malaysia, Taiwan, Hong Kong, Turkey, Indonesia, Philippine, Singapore, Vietnam and Germany).

Details by country are as follows:

- US:** By continuing to expand its alliances with local distributors to cultivate new salons, FY22 US sales surged +46.7% YoY [YDB] to ¥1,328mil. Although the high YoY growth reflects the positive impact from the weak yen, US sales rose +22.6% YoY [LCY] thanks to strong sales of the premium haircare range Global Milbon. Hair colour product *Sophistone* is also proving popular and has helped cultivate new customers. Although the US business remains in the red with an operating loss of -¥168mil, the losses have shrunk vs FY21's operating loss of -¥561mil.
- China:** Operations in China fell into the red in FY22, due to the repeated lockdowns, which lasted throughout the year. FY22 sales fell 1.6% YoY to ¥2,114mil YDB / LCY -13.6% YoY and reported an operating loss of ¥9mil, compared to OP of ¥449mil in FY21. During the lockdown, Milbon worked on building good relationships with targeted salons through its distributors, which resulted in helping the recovery once the lockdown was lifted in June. Milbon started preparations for the production of core hair colour products at its factory in China, due to commence in FY23– one-year earlier than the original schedule.
- Korea:** Milbon Korea – the largest part of the firm's overseas operations comprising 9.2% of total consolidated net sales – generated FY22 OP of ¥1,351mil (+21.8% YoY) on sales of ¥4,159mil (YDB +23.5% YoY / LCB +16.6% YoY). Salons in Korea were affected by macroeconomic environment such as inflation and higher interest rates. Consumption was also somewhat affected by the Halloween disasters in Itaewon during Oct~Dec 2022. However, FY22 sales remained solid with hair colour products, some 80% of the sales in Korea, leading the growth.

FY23 OUTLOOK

Milbon is guiding for a historical record earnings with FY23 GP of ¥32,160mil (+9.0% YoY) and OP of ¥8,300mil (+9.9% YoY) on sales of ¥49,200mil (+8.8% YoY). However, the firm is taking cautious view on the outlook for 1) raw materials as it expects the hikes in raw material costs to continue during 1H, and 2) the pace of the recovery in China. In addition, SG&A is estimated to rise +8.7% YoY on the assumption that personnel costs will increase as Milbon is actively recruiting staff, though the FY23 forecast does not include any potential pay rise for existing employees.

Milbon (4919 JP): Earnings Results and Guidance									
(¥mil)	FY21			FY22				FY23	
	Results	YoY (%)	Adjusted	Results (Adjusted)	YoY (%)	CE (adjusted)	Results v. CE	CE (Adjusted)	YoY (%)
Sales	41,582	16.4	40,849	45,238	10.7	43,900	3.0	49,200	8.8
DM	33,643	12.6	32,938	35,334	7.3	35,150	0.5	38,021	7.6
Overseas	7,938	35.8	7,910	9,904	25.2	8,750	13.2	11,179	12.9
GP	27,498	17.6	26,765	29,509	10.3	29,140	1.3	32,160	9.0
GPM (%)	66.1	+0.7ppt	65.5	65.2	-0.3ppt	66.4	-1.2ppt	65.4	+0.2ppt
SG&A	19,681	15.8	19,681	21,957	11.6	21,590	1.7	23,860	8.7
SG&A / Sales (%)	47.3	-0.3pp	48.2	48.5	+0.3ppt	49.2	-0.7ppt	48.5	flat
OP	7,817	22.3	7,084	7,551	6.6	7,550	0.0	8,300	9.9
OPM (%)	18.8	+0.9ppt	17.3	16.7	-0.6ppt	17.2	-0.5ppt	16.9	+0.2ppt
RP	7,158	23.6	7,158	7,829	9.4	7,410	5.7	8,250	5.4
RPM (%)	17.2	+1.0ppt	17.5	17.3	-0.2ppt	16.9	+0.4ppt	16.8	-0.5ppt
NP for the parent's s/holders	5,109	21.5	5,109	5,577	9.2	5,230	6.6	5,800	4.0

Source: Nippon-IBR based on Milbon's earnings presentation materials FY21 & FY22.

FY23 EARNINGS FORECAST BY REGION

Milbon identifies seven key regions representing the global market for its products. Those seven regions are: (1) Japan, (2) Korea, (3) China, Hong Kong and Taiwan, (4) ASEAN, (5) North America (US and Canada), (6) EU, and (7) Middle East (Turkey). The firm promotes “local production and local consumption” and aims to 1) establish a dedicated sales infrastructure, 2) have localised R&D, and 3) set up manufacturing and distribution facilities in each region. The firm has identified that each region has its own preference for hair care due to differences in culture and hair quality, hence it is important to tailor its products to match local demands.

Sales and OP Breakdown by Country - Results and Guidance										
(¥mil)		FY21		FY22					FY23 CE	
		1H	FY	1H	FY	YoY (%)	FY CE	FY v. FYCE (%)	FY CE	YoY (%)
Japan	Sales	15,413	32,938	16,627	35,334	7.3	35,150	0.5	38,021	7.6
	OP	2,745	6,106	3,201	6,194	1.4	6,706	-7.6	7,021	13.4
	OPM (%)	17.8	18.5	19.3	17.5	-1.0ppt	19.1	-1.6ppt	18.5	+1.0ppt
US	Sales	406	905	603	1,328	46.7	1,052	26.2	1,430	7.6
	OP	-218	-561	-125	-168	n/a	-260	n/a	-160	n/a
	OPM (%)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
China	Sales	1,091	2,148	1,058	2,114	-1.6	2,487	-15.0	2,641	24.9
	OP	269	449	-76	-9	n/a	206	n/a	240	n/a
	OPM (%)	24.7	20.9	n/a	n/a	n/a	8.3	n/a	9.1	n/a
Korea	Sales	1,596	3,368	2,043	4,159	23.5	3,604	15.4	4,543	9.2
	OP	531	1,109	693	1,351	21.8	1,055	28.1	1,212	-10.3
	OPM (%)	33.3	32.9	33.9	32.5	-0.4ppt	29.3	+3.2ppt	26.7	-5.8ppt
Others	Sales	709	1,487	1,133	2,301	54.7	1,607	43.2	2,565	11.6
	OP	-10	-20	130	184	n/a	-158	n/a	-12	n/a
	OPM (%)	n/a	n/a	11.5	8.0	n/a	n/a	n/a	n/a	n/a
Overseas Total	Sales	3,803	7,910	4,839	9,904	25.2	8,750	13.2	11,179	12.9
	OP	571	977	622	1,357	38.9	843	61.0	1,278	-5.8
	OPM (%)	15.0	12.4	12.9	13.7	+1.3ppt	9.6	+4.1ppt	11.4	-2.3ppt

Source: Nippon-IBR based on Milbon's FY22 Q2 & Q4 earnings results material
 * YoY figures are based on Japanese yen denominated sales and OP numbers

Japan

Milbon is guiding for FY23 Japan OP of ¥7,021mil (+13.4% YoY) on a new record level in sales of ¥38,021mil (+7.6% YoY), mainly thanks to strong demand for hair care and hair colour products. The importance of selling haircare products and establishing an online shopping infrastructure such as *milbon:iD* has become key to retaining customers, both now and in the future, and for them to become repeat purchasers of Milbon's hair products.

For salons, the advantage of *milbon:iD* is that they can promptly promote hair care products when the customer is about to renew their purchases. In addition, by generating revenues by selling products online, it can limit declines in sales should there be potential closures in the future. The average spend per customer on *milbon:iD* is now at ¥12,000, vs ¥7,000~8,000 if a customer buys products at a salon, and is almost equal to what customers pay for hair colour and cut in a reasonably priced salon.

Milbon plans to take further steps to promote product sales at salons by introducing the Smart Salon concept in FY23, which was designed to enhance product sales through *milbon:iD*. Smart Salon is a salon space that offers a new product-buying experience that combines real and digital under professional advice. Salons best suited to adopt the Smart Salon concept are those planning to refurbish the shopfloor space and open new branches. The firm realised that most salon customers do not buy Milbon products solely on the recommendation of their hairdresser. At Smart Salons which are opened and operated by salons that agree with the Milbon's Smart Salon concept, customers can try the products

directly and/or buy the trial size before deciding to buy the hair care products. Milbon aims to increase number of registered users of *milbon:iD* to 1mil by FY26, up from 450,000 as of FY22-end.

As noted above, the key for the further boost salon product sales growth will be to mobilise dormant *milbon:iD* users. The firm reckons that the Smart Salon concept will improve the active user ratio of *milbon:iD*.

Overseas

FY23 Overseas earnings guidance is OP of ¥1,278mil (-5.8% YoY) on sales – which are likely to reach a new record level – of ¥11,179mil (+12.9% YoY). Although each overseas operation will see sales expand as many businesses reopen post-COVID, Milbon plans to resume large-scale events in Korea and Others areas, which will reduce each region's OP by ¥139mil YoY (-10.3% YoY) to ¥1,212mil and by ¥197mil to an operating loss of ¥12mil, respectively. In Korea, the firm plans to hire staff and launch events to attract young talented hairdressers as their customers.

FY23 developments overseas are as follows:

- After the reopening in China, Milbon plans to host events that will draw a few thousand hairdressers and salon owners.
- Preparing for the production of hair colour products in the China factory from FY23, a year earlier ahead of schedule.
- Continue to promote educational events and cultivate salons with local distributors in North America.
- Initiate global R&D functions in the US, Thailand and China in addition to Japan and to develop products best matched to each market.
- Enhance the global production between factories in Japan, Thailand, and China.

Milbon's aim is to expand new business in each market and establish a global distribution network with a two-week delivery system to achieve overseas sales of ¥14,300mil in FY26, the final-year of the current medium-term management plan (FY23~FY26) which guides for 4-year CAGR in overseas sales of 9.6%.

Medium-term management plan (FY22~26)				
(¥mil)	FY21	FY26	FY22~FY26 CAGR (%)	
Sales	40,849	58,000	7.3	
Japan	32,938	43,700	5.8	
Overseas	7,910	14,300	12.6	
Gross Profit [GP]	26,765	38,160	7.4	
GPM (%)	65.5	65.8	+0.3ppt	
SG&A	19,681	27,360	6.8	
Operating Profit [OP]	7,084	10,800	8.8	
OPM (%)	17.3	18.6	+1.3ppt	
Recurring Profit [RP]	7,158	10,810	8.6	
NP attributed to the parent	5,109	7,670	8.5	
NPM (%)	12.5	13.2	+0.7ppt	

Source: Milbon Co., Ltd. FY22~26 New medium-term plan press release

CAPITAL ALLOCATION POLICY

CAPEX

Milbon plans to invest total of ¥23,000mil in CAPEX out of operating cash flow [CFO] of ¥44,000mil over the five-year medium-term plan between FY22 and FY26. With FY22 being the first year of the new medium-term management plan, Milbon made investments in Japan and overseas, including those related to digital transformation [DX]. In FY22, Milbon generated CFO of ¥5,000mil, while investing ¥4,097mil in CAPEX and returned ¥2,800mil in shareholder returns, generating a dividend pay-out ratio of 50.2%. The firm is guiding for FY23 CAPEX of ¥2,927mil, which includes projects including facilitating Yumegaoka and Thai factories, and digital platform-related investments such as *milbon:iD*, and digital marketing of Smart Salon. Depreciation is estimated at ¥2,301mil (+13.5% YoY).

Shareholder Return

The firm has earmarked a dividend pay-out ratio of 50%. In FY22, Milbon paid out 50.2% of net profit to shareholders in dividends. The firm is guiding for a dividend payment of ¥88.00 in FY23, or pay-out ratio of 49.3%.

During the medium-term plan, Milbon aims to achieve ROE of 13.9% and ROIC of 13.6%.

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