

## Lacto Japan | 3139 |

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On April 14, 2021, Lacto Japan Co., Ltd. announced earnings results for Q1 FY11/21.

		Sales (JPYmn)	YoY	Operating profit (JPYmn)	YoY	Ordinary income (JPYmn)	YoY	Net income (JPYmn)	YoY	EPS (JPY)	BPS (JPY)	ROA (OI-based)	ROE
FY11/14	Cons.	96,550	27.1%	1,532	118.8%	1,653	-1.0%	988	-1.9%	127.79	1,165.58	4.5%	12.2%
FY11/15	Cons.	98,001	1.5%	720	-53.0%	1,343	-18.8%	831	-15.9%	98.94	1,062.54	3.3%	8.5%
FY11/16	Cons.	88,679	-9.5%	3,349	365.1%	1,434	6.8%	946	13.8%	96.79	1,167.72	3.7%	8.7%
FY11/17	Cons.	101,335	14.3%	1,924	-42.6%	2,523	75.9%	1,755	85.5%	179.48	1,302.98	6.0%	14.5%
FY11/18	Cons.	115,441	13.9%	3,009	56.4%	2,613	3.6%	1,784	1.7%	182.31	1,462.35	5.5%	13.2%
FY11/19	Cons.	116,794	1.2%	3,144	4.5%	2,747	5.1%	1,963	10.0%	200.11	1,618.31	5.7%	13.0%
FY11/20	Cons.	110,838	-5.1%	2,959	-5.9%	2,781	1.2%	2,062	5.1%	209.47	1,774.58	6.1%	12.3%
FY11/21	Est. Cons.	115,000	3.8%	-	-	2,600	-6.5%	1,850	-10.3%	187.35	-	-	-

Source: Shared Research based on company data

Note: Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials released by the company).

### Q1 FY11/21 earnings results

#### Summary

- ▶ In Q1 FY11/21, Lacto Japan posted consolidated sales of JPY24.0bn (-15.0% YoY), operating profit of JPY813mn (+6.4% YoY), ordinary income of JPY737mn (-2.1% YoY), and net income attributable to parent company shareholders of JPY527mn (-3.4% YoY).
- ▶ Q1 progress versus full-year FY11/21 forecast\*<sup>1</sup> (announced January 14, 2021) was 20.9% for sales (21.7% in Q1 FY11/20 versus full-year FY11/20 results), 28.4% for ordinary income (25.1%), and 28.5% for net income (26.0%).
- ▶ Following the re-emergence of COVID-19 infections, the Japanese government issued a second emergency declaration in January 2021, and economic activities were severely restricted once again. Although Japan started vaccinations on February 17, 2021, the outlook remains unclear as there is still no indication as to when the pandemic will come to an end. In the domestic food industry, demand for ingredients for home-cooked meals was stable as eating at home became the norm amid a prolonged COVID-19 pandemic. On the other hand, the impact of stagnation in the restaurant and leisure industries due to COVID-19 prevention measures remained significant, resulting in weak demand for commercial food ingredients. For dairy ingredients in particular, demand for imported ingredients fell as inventories of domestic ingredients remained high due to sluggish demand.
- ▶ Under this business environment, especially for domestic sales of dairy ingredients, the company worked to boost sales volume and optimize customer inventory of domestic ingredients by actively handling domestic products. In the Asia Business, sales of dairy ingredients for products to be consumed in Japan were sluggish, mainly due to excess inventory of domestic ingredients. Cheese manufacturing and sales were firm thanks to strong demand for dairy ingredients in China on the back of an economic recovery.
- ▶ Sales down 15.0% YoY: In addition to the decline in sales volume due to the pandemic, sales fell in the dairy ingredient business for both Japan and Asia due in part to shipping delays caused by the global shortage of shipping containers resulting from China's economic recovery. Sales rose 7.4% YoY for the Meat Products category, but fell 14.8% YoY for the Dairy Ingredients and Cheese category and fell 28.0% YoY for the Asia Business and other businesses.



- ▶ Operating profit up 6.4% YoY: The gross profit margin improved by 1.0pp YoY to 7.0% due to expense reduction efforts including the cutback on SG&A expenses. SG&A-to-sales ratio rose 0.3pp YoY to 3.6%, but in real value SG&A expenses fell by 6.2% YoY. The operating profit margin improved by 0.7pp YoY to 3.4%.
- ▶ Ordinary income down 2.1% YoY: Ordinary income fell YoY as the company logged a foreign exchange loss of JPY50mn in Q1 FY11/21 versus a JPY15mn gain in Q1 FY11/20. After adjusting out JPY28mn in unfavorable foreign exchange rates, Q1 FY11/21 ordinary income comes out to JPY765mn, effectively resulting in a 5.7% YoY increase from the similarly adjusted ordinary income of JPY724mn a year earlier.

\* In order to avoid taking on exchange rate risk in the course of regular business transactions, as a rule the company enters into forward exchange contracts to cover the cost of the purchases made in foreign currencies at the time the contract is signed. Meanwhile, regarding the accounting treatment of the purchase transaction, procurement (purchase) is recorded at the time of shipment, which creates a lag from the point in time the purchase contract is signed. If the yen strengthens during that timeframe, the exchange rate will be lower than the forward rate at purchase and the actual cost of the goods will be lower than the cost based on forward exchange rate secured at the time the contract was concluded. Lacto Japan calculates its gross profit using the cost of goods sold based on the forward exchange rate at the time the goods were purchased, and records a forex hedging loss under non-operating expenses as a foreign exchange loss.

### Breakdown by business category

#### Dairy Ingredients and Cheese: Sales JPY17.1bn (-14.8% YoY)

- ▶ In the dairy ingredients business, commercial demand in Japan was sluggish, mainly in the restaurant and leisure industries, as the Japanese government issued a second emergency declaration following a resurgence in COVID-19 infections. This led to elevated inventory levels for domestic dairy ingredients. As a result, bid volumes for skim milk powder, butter, and other products fell, but the company actively sold domestic skim milk powder to feed manufacturers in response to the Japanese government's demand-supply mitigation program aimed at easing the oversupply of domestic inventories. Sales of the company's imported dairy ingredients were sluggish as major dairy manufacturers gradually began to substitute imported ingredients with domestic ones.
- ▶ In the cheese business, sales were sluggish due to weak demand for commercial products, especially in the leisure industry, which includes hotels, despite some signs of recovery in the restaurant industry.
- ▶ The global shortage of shipping containers caused by China's economic recovery delayed shipping schedules, resulting in some sales delays into later quarters.
- ▶ Sales volume fell 2.7% YoY to 43,141 tons.

#### Meat Products: Sales JPY3.1bn (+7.4% YoY)

- ▶ Sales of meat products, such as dry-cured ham and salami, were weak owing to sluggish commercial demand.
- ▶ On the other hand, procurement of ingredients, which had been temporarily delayed due to the pandemic, recovered, and demand for chilled and frozen pork was strong, especially for home-cooked meals.
- ▶ Sales volume rose 9.9% YoY to 5,736 tons.

#### Asia Business and other: Sales JPY3.8bn (-28.0% YoY)

#### Dairy ingredients: Sales JPY2.8bn (-35.9% YoY)

- ▶ Sales of dairy ingredients were weak for prepared dairy mixtures bound for Japan due to elevated inventory levels of domestic ingredients. In some Southeast Asian countries, such as Indonesia and the Philippines, sales were sluggish as COVID-19 infections remained rampant. Additionally, delays in shipping schedules caused by a shortage of shipping containers have pushed back dairy ingredient sales to Q2 and beyond.
- ▶ Sales volume fell 32.4% YoY to 9,918 tons.

#### Cheese manufacturing and sales: Sales JPY801 mn (+17.9% YoY)

- ▶ In China, Taiwan, and Singapore, where the spread of COVID-19 infections has been suppressed, sales were strong on the back of increasingly active food consumption for both home-cooked meals and restaurants.
- ▶ In Thailand, restrictions have been eased significantly following the lifting of the state of emergency in late February 2021, and sales to restaurants have started to pick up.
- ▶ Sales volume increased 10.5% YoY to 1,120 tons.

#### **The company's outlook for near-term business environment**

- ▶ Dairy ingredients and Cheese: According to the company, domestic raw milk production will be steady, but demand for ingredients used in commercial products will remain sluggish, especially for the restaurant and leisure industries, due to the pandemic. As a result of the demand-supply mitigation program aimed at easing the oversupply of domestic dairy ingredients, the company thinks imported butter will continue to be substituted with domestic butter, and skim milk powder will be used for feed.
- ▶ Meat Products: The COVID-19 situation in Japan is not yet under control, and commercial demand, including from the restaurant and leisure industries, remains stagnant. However, the company expects demand for products for use in home-cooked meals and prepared meals to remain strong.
- ▶ Asia Business (dairy ingredients): The company expects sales of dairy product ingredients geared for Japan to remain sluggish for some time. However, economic activity in Asia is gradually recovering, and demand is particularly strong in China and Singapore.
- ▶ Asia Business (cheese manufacturing and sales): Restaurant demand in some areas is recovering quickly, and the company intends to continue focusing on sales to China, where demand for dairy ingredients is strong. In addition, it is developing new products that address market needs.

#### **Financial position**

- ▶ Current assets of JPY46.0bn were up JPY5.4bn versus end-FY11/20. This was mainly due to a JPY2.3bn increase in accounts receivable and a JPY2.1bn increase in inventories. The increase in accounts receivable was attributable to the delay in collection of trade receivables into Q2 due to the last day of Q1 falling on a non-working day, and a JPY4.9bn increase associated with the factoring of receivables at the end of FY11/20. These increases more than offset the JPY2.3bn decline in trade receivables caused by lower sales. Fixed assets of JPY2.8bn were up JPY20mn versus end-FY11/20, as a JPY51mn increase in investment and other assets offset the JPY30mn decline in tangible fixed assets and intangible fixed assets combined.

- ▶ Current liabilities of JPY25.4bn were up JPY5.4bn versus end-FY11/120. This was mainly attributable to a JPY799mn increase in accounts payable due to the last day of Q1 falling on a non-working day, as well as a JPY5.0bn increase in short-term borrowings as a result of an increase in working capital. Fixed liabilities of JPY5.2bn were down JPY641mn versus end-FY11/20, due mainly to a decrease in long-term borrowings.
- ▶ Net assets of JPY18.2bn were up JPY600mn versus end-FY11/20 due to increases in foreign currency translation adjustments, deferred gains on hedges, and retained earnings.

Quarterly (cumulative) earnings

Cumulative (JPYmn)	FY11/19				FY11/20				FY11/21	FY11/21	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	% of Est.	Est.
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.		
Sales	27,886	57,712	87,536	116,794	28,222	57,912	85,065	110,838	23,994	20.9%	115,000
YoY	-5.3%	-2.5%	-0.5%	1.2%	1.2%	0.3%	-2.8%	-5.1%	-15.0%	-	3.8%
Dairy Ingredients and Cheese	21,109	42,675	64,795	85,206	20,061	39,927	59,925	78,330	17,090	21.0%	81,470
YoY	-3.9%	-2.6%	-1.3%	-0.1%	-5.0%	-6.4%	-7.5%	-8.1%	-14.8%	-	4.0%
% of sales	75.7%	73.9%	74.0%	73.0%	71.1%	68.9%	70.4%	70.7%	71.2%	-	-
Meat Products	2,941	6,104	9,291	12,280	2,900	6,107	8,781	11,895	3,116	24.0%	12,990
YoY	-11.8%	-7.7%	-3.3%	-2.4%	-1.4%	0.0%	-5.5%	-3.1%	7.4%	-	9.2%
% of sales	10.5%	10.6%	10.6%	10.5%	10.3%	10.5%	10.3%	10.7%	13.0%	-	11.3%
Asia Business and other	3,834	8,932	13,449	19,307	5,259	11,876	16,358	20,611	3,787	-	-
YoY	-7.6%	2.3%	6.2%	9.9%	37.2%	33.0%	21.6%	6.8%	-28.0%	-	-
% of sales	13.7%	15.5%	15.4%	16.5%	18.6%	20.5%	19.2%	18.6%	15.8%	-	-
Dairy ingredients	2,992	7,303	11,013	16,026	4,411	10,138	13,752	17,025	2,829	18.1%	15,640
YoY	-12.9%	0.0%	5.6%	9.9%	47.4%	38.8%	24.9%	6.2%	-35.9%	-	-8.1%
% of sales	10.7%	12.7%	12.6%	13.7%	15.6%	17.5%	16.2%	15.4%	11.8%	-	13.6%
Cheese	658	1,284	1,963	2,651	680	1,352	2,036	2,895	801	25.7%	3,120
YoY	31.9%	28.8%	26.5%	25.3%	3.3%	5.3%	3.7%	9.2%	17.9%	-	7.8%
% of sales	2.4%	2.2%	2.2%	2.3%	2.4%	2.3%	2.4%	2.6%	3.3%	-	2.7%
Other	184	345	473	630	168	386	570	691	157	-	-
YoY	-14.8%	-20.9%	-30.8%	-28.2%	-8.7%	11.9%	20.5%	9.7%	-6.5%	-	-
% of sales	0.7%	0.6%	0.5%	0.5%	0.6%	0.7%	0.7%	0.6%	0.7%	-	-
< Sales volume (tons)>											
Dairy Ingredients and Cheese	49,784	100,139	152,953	204,105	49,413	98,294	145,534	191,575	43,141	22.4%	192,431
YoY	-7.0%	-3.9%	-0.9%	2.9%	-0.7%	-1.8%	-4.9%	-6.1%	-12.7%	-	0.4%
Meat Products	4,985	10,511	16,317	21,532	5,220	11,453	16,143	21,925	5,736	22.8%	25,210
YoY	-13.9%	-7.5%	-1.1%	-0.3%	4.7%	9.0%	-1.1%	1.8%	9.9%	-	15.0%
Asia Business: dairy ingredients	11,298	27,892	41,746	59,925	14,676	34,921	48,281	60,159	9,918	18.7%	52,920
YoY	-5.7%	5.5%	8.7%	13.4%	29.9%	25.2%	15.7%	0.4%	-32.4%	-	-12.0%
Asia Business: cheese	874	1,804	2,732	3,737	1,014	1,983	2,949	4,197	1,120	24.4%	4,593
YoY	35.8%	40.0%	40.1%	40.1%	16.0%	9.9%	7.9%	12.3%	10.5%	-	9.4%
< Average price (JPY/kg) >											
Dairy Ingredients and Cheese	424	426	424	417	406	406	412	409	396	-	-
YoY	3.3%	1.3%	-0.4%	-2.9%	-4.3%	-4.7%	-2.8%	-2.1%	-2.4%	-	-
Meat products	590	581	569	570	556	533	544	543	543	-	-
YoY	2.3%	-0.2%	-2.2%	-2.1%	-5.8%	-8.2%	-4.5%	-4.9%	-2.2%	-	-
Asia Business: dairy ingredients	265	262	264	267	301	290	285	283	285	-	-
YoY	-7.7%	-5.2%	-2.9%	-3.1%	13.5%	10.9%	8.0%	5.8%	-5.1%	-	-
Asia Business: cheese	753	712	719	709	671	682	690	690	715	-	-
YoY	-3.0%	-8.0%	-9.7%	-10.6%	-10.9%	-4.2%	-3.9%	-2.8%	6.6%	-	-
CoGS	26,319	54,347	82,387	109,994	26,535	54,505	79,981	104,211	22,316	-	-
YoY	-5.8%	-3.0%	-0.7%	1.0%	0.8%	0.3%	-2.9%	-5.3%	-15.9%	-	-
CoGS ratio	94.4%	94.2%	94.1%	94.2%	94.0%	94.1%	94.0%	94.0%	93.0%	-	-
Gross profit	1,567	3,365	5,149	6,801	1,686	3,407	5,084	6,626	1,678	-	-
YoY	3.1%	7.3%	4.2%	4.4%	7.6%	1.2%	-1.3%	-2.6%	-0.5%	-	-
GPM	5.6%	5.8%	5.9%	5.8%	6.0%	5.9%	6.0%	6.0%	7.0%	-	-
SG&A expenses	831	1,757	2,660	3,656	922	1,826	2,709	3,667	865	-	-
YoY	10.4%	6.0%	3.6%	4.4%	10.9%	3.9%	1.8%	0.3%	-6.2%	-	-
SG&A ratio	3.0%	3.0%	3.0%	3.1%	3.3%	3.2%	3.2%	3.3%	3.6%	-	-
Operating profit	736	1,608	2,490	3,144	764	1,581	2,375	2,959	813	-	-
YoY	-4.0%	8.7%	4.9%	4.5%	3.8%	-1.7%	-4.6%	-5.9%	6.4%	-	-
OPM	2.6%	2.8%	2.8%	2.7%	2.7%	2.7%	2.8%	2.7%	3.4%	-	-
Gains (losses) on foreign exchange	-116	-185	-186	-114	15	-39	-21	3	50	-	-
YoY	-	-	-	-	-	-	-	-	224.7%	-	-
% of sales	-0.4%	-0.3%	-0.2%	-0.1%	0.1%	-0.1%	0.0%	0.0%	0.2%	-	-
OP + Gains (losses) on forex	620	1,423	2,303	3,030	780	1,542	2,354	2,962	863	-	-
YoY	-22.9%	12.8%	8.8%	5.4%	25.7%	8.4%	2.2%	-2.2%	10.7%	-	-
% of sales	2.2%	2.5%	2.6%	2.6%	2.8%	2.7%	2.8%	2.7%	3.6%	-	-
Ordinary income	536	1,253	2,087	2,747	753	1,434	2,209	2,781	737	28.4%	2,600
YoY	-28.2%	10.5%	8.4%	5.1%	40.6%	14.5%	5.8%	1.2%	-2.1%	-	-6.5%
Profit margin	1.9%	2.2%	2.4%	2.4%	2.7%	2.5%	2.6%	2.5%	3.1%	-	2.3%
Net income	376	888	1,490	1,963	546	1,040	1,608	2,062	527	28.5%	1,850
YoY	-23.8%	20.5%	15.4%	10.0%	45.3%	17.2%	7.9%	5.1%	-3.4%	-	-10.3%
Net margin	1.3%	1.5%	1.7%	1.7%	1.9%	1.8%	1.9%	1.9%	2.2%	-	1.6%
Foreign exchange											
USD/JPY	110.62	110.78	109.71	109.33	109.53	108.55	107.97	107.27	104.30	-	-
EUR/JPY	125.89	125.30	123.73	122.63	120.87	119.33	120.52	121.40	126.62	-	-

Source: Shared Research based on company data

Note: Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials released by the company).

Quarterly earnings (three months)

Quarterly (JPYmn)	FY11/19				FY11/20				FY11/21
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	27,886	29,826	29,824	29,258	28,222	29,690	27,153	25,773	23,994
YoY	-5.3%	0.4%	3.6%	6.4%	1.2%	-0.5%	-9.0%	-11.9%	-15.0%
CoGS	26,319	28,028	28,040	27,607	26,535	27,969	25,476	24,231	22,316
YoY	-5.8%	-0.2%	4.0%	6.5%	0.8%	-0.2%	-9.1%	-12.2%	-15.9%
CoGS ratio	94.4%	94.0%	94.0%	94.4%	94.0%	94.2%	93.8%	94.0%	93.0%
Gross profit	1,567	1,798	1,784	1,651	1,686	1,721	1,677	1,542	1,678
YoY	3.1%	11.1%	-1.1%	5.2%	7.6%	-4.3%	-6.0%	-6.6%	-0.5%
GPM	5.6%	6.0%	6.0%	5.6%	6.0%	5.8%	6.2%	6.0%	7.0%
SG&A expenses	831	926	903	997	922	904	883	958	865
YoY	10.4%	2.3%	-0.9%	6.7%	10.9%	-2.4%	-2.2%	-3.8%	-6.2%
SG&A ratio	3.0%	3.1%	3.0%	3.4%	3.3%	3.0%	3.3%	3.7%	3.6%
Operating profit	736	872	882	655	764	817	794	584	813
YoY	-4.0%	22.3%	-1.4%	3.1%	3.8%	-6.3%	-10.0%	-10.8%	6.4%
OPM	2.6%	2.9%	3.0%	2.2%	2.7%	2.8%	2.9%	2.3%	3.4%
Gains (losses) on foreign exchange	-116	-69	-1	72	15	-54	18	24	50
YoY	-	-	-	-40.3%	-	-	-	-66.5%	224.7%
% of sales	-0.4%	-0.2%	0.0%	0.2%	0.1%	-0.2%	0.1%	0.1%	0.2%
OP + Gains (losses) on forex	620	802	881	727	780	762	812	608	863
YoY	-22.9%	75.9%	2.7%	-3.9%	25.7%	-5.0%	-7.8%	-16.3%	10.7%
% of sales	2.2%	2.7%	3.0%	2.5%	2.8%	2.6%	3.0%	2.4%	3.6%
Ordinary income	536	717	834	660	753	680	775	572	737
YoY	-28.2%	84.9%	5.5%	-4.1%	40.6%	-5.1%	-7.1%	-13.3%	-2.1%
Profit margin	1.9%	2.4%	2.8%	2.3%	2.7%	2.3%	2.9%	2.2%	3.1%
Net income	376	512	602	473	546	495	567	455	527
YoY	-23.8%	110.6%	8.6%	-4.0%	45.3%	-3.4%	-5.9%	-3.9%	-3.4%
Net margin	1.3%	1.7%	2.0%	1.6%	1.9%	1.7%	2.1%	1.8%	2.2%

Source: Shared Research based on company data

Note: Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials released by the company).

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