# Duskin (4665)

## Positive dynamic changes ahead

**Share price: ¥3,190** **Market cap: ¥162.7bn**

**31 March 2023**

## Initiating coverage

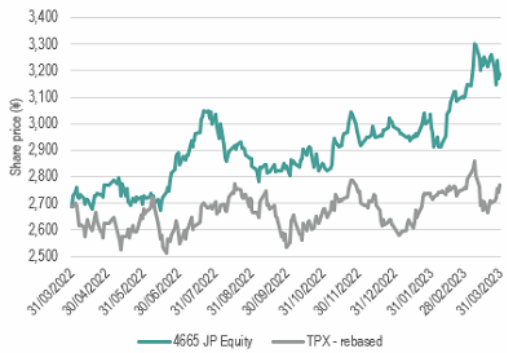
- **Undergoing lifecycle change** – Duskin is a Japanese market-leading franchise operator of residential and commercial services and a doughnut restaurant chain. The business displays strong franchise durability, low capital intensity, minimal leverage, and a strong track record of free cash flow generation. It is currently undergoing positive change through its capital allocation strategy, investing in growth to increase corporate value, and to return cash to shareholders.
- **Enhancing growth potential and distribution** – we believe Duskin will experience a renaissance, improving its long-term earnings trajectory. Shareholders are set to benefit from a robust distribution policy.

## Committed to transformation

- **Deploying capital effectively** – the company has targeted a spend of ¥70 billion from FY3/2023 to FY3/2025, focusing on a combination of M&A to attract long-term growth, and smart factory investment to increase productivity and address labor shortage risk. We believe the company's key risk is its limited potential for steady organic growth, which is now being proactively addressed.
- **Returning cash to shareholders** – with strong underlying fundamentals and free cash flows which make dividends more likely to be sustainable, management is targeting a generous 3-year cumulative total payout of over 100%.
- **ESG** – We score the company as '**Green**' under our Astris-Sustainability model scorecard.
- **Valuations** – as Duskin enters its investment phase, both expenses and capex will rise, dampening earnings and free cash flow. However, we believe these proactive measures will result in improving long-term earnings visibility, with underlying fundamentals remaining firm. On our estimates, the shares are trading on FY3/2025 EV/EBITDA 5.2x on a steep margin recovery.

| Year-end | 3/2021 | 3/2022 | 3/2023E | 3/2024E | 3/2025E |
|---|---|---|---|---|---|
| Sales (¥bn) | 153.77 | 163.21 | 169.69 | 176.05 | 181.64 |
| OP (¥bn) | 4.65 | 9.90 | 7.90 | 6.64 | 12.49 |
| NI (¥bn) | 2.82 | 8.13 | 7.16 | 6.32 | 10.49 |
| EPS (¥) | 57.19 | 164.71 | 145.10 | 128.06 | 212.44 |
| DPS (¥) | 40.00 | 83.00 | 87.06 | 76.84 | 127.47 |
| Sales growth YoY (%) | -3.4 | +6.1 | +4.0 | +3.7 | +3.2 |
| OP growth YoY (%) | -29.3 | +112.8 | -20.2 | -15.9 | +88.1 |
| NP growth YoY (%) | -49.5 | +188.3 | -11.9 | -11.7 | +65.9 |
| EPS growth YoY (%) | -48.0 | +188.0 | -11.9 | -11.7 | +65.9 |
| PER (x) | 55.8 | 19.4 | 22.0 | 24.9 | 15.0 |
| EV/EBITDA (x) | 9.9 | 6.7 | 6.9 | 7.4 | 5.2 |
| EV/Sales (x) | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 |
| PBR (x) | 1.1 | 1.1 | 1.1 | 1.0 | 1.0 |
| ROE (%) | 2.0 | 5.5 | 4.7 | 4.1 | 6.6 |
| ROCE (%) | 3.0 | 6.2 | 4.9 | 4.0 | 7.2 |
| FCF yield (%) | 1.7 | 8.6 | 2.4 | 1.7 | 3.8 |
| Dividend yield (%) | 1.3 | 2.6 | 2.7 | 2.4 | 4.0 |
| *Total shareholder returns (%) | 1.3 | 2.6 | 8.0 | 4.0 | 6.7 |

Source: Company, Astris Advisory (estimates)
*Note: FY3/2023 based on buybacks conducted, FY3/2024 and FY3/2025 total shareholder returns based on 100% payout ratio




Source: Bloomberg

### Price Performance

| | YTD | 1mth | 3mth | 12mth |
|---|---|---|---|---|
| Abs (%) | +6.6 | +2.9 | +6.6 | +18.6 |
| Rel (%) | +0.7 | +2.4 | +0.7 | +15.3 |

### Company sector

Consumer Products-Miscellaneous
Commercial Services & Supplies

### Stock data

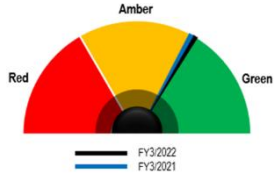
| | |
|---|---|
| Price (¥) | 3,190 |
| Mkt cap (¥bn) | 162.7 |
| Mkt cap ($m) | 1,222.7 |
| 52-week range (¥) | 2,658-3,325 |
| Shares O/S (m) | 51 |
| Average daily value ($m) | 1.9 |
| Free float (%) | 75.8 |
| Foreign shareholding (%) | 12.8 |
| Ticker | 4665 |
| Exchange | Tokyo Prime |
| Net Debt/Equity (x) | N/A |
| FFO leverage (x) | 0.1 |
| BBG BUY \| HOLD \| SELL | 0 \| 0 \| 1 |

Source: Bloomberg

### Business Overview

Duskin operates a rental business for cleaning products such as mats and mops for both home and business. The food business operates a doughnut restaurant chain 'Mister Donut', with both businesses having a dominant domestic market share.

### Astris-Sustainability ESG rating




**Reference Ratings**

| | |
|---|---|
| MSCI | AA |
| Sustainalytics | 19.0 |
| Refinitiv | N/A |
| S&P Global | 40.0 |
| Bloomberg | N/A |

### Next events

Q4 FY3/2023 results May 2023

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**This report has been commissioned and paid for by the company**

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# Quality franchise checklist

## Astris Advisory assessment

We characterize Duskin as a high-quality franchise, based on the following checklist.

**Table 1: High-quality franchise checklist**

| Characteristics to identify compounders | Grade (H/M/L) | Details |
|---|---|---|
| 1) Strong brand and network | ▲ H | **Leading domestic market share** in core activities with an established nationwide network. Duskin is a household brand. |
| 2) Focus on free cash flow generation | ▲ H | Duskin has **sustainably generated annual positive free cash flow for over 20 years**. |
| 3) Franchise resilience | ▲ H | Duskin's average franchise contract length is **36 years**. |
| 4) Capital-light business model | ► M | The historic 5-year average is 3.5% of revenue; this will increase to approximately 8.5% for the next 3 years as capital is put to work. |
| 5) Returns cash to shareholders | ▲ H | Targeting a **3-year cumulative total shareholder return of over 100%**. |
| 6) Strong balance sheet | ▲ H | Net cash position makes up **58%** of current market capitalization. |
| 7) Organic growth prospects | ▼ L | Operating in a mature domestic market as a dominant player **requires M&A and/or diversification**. |
| 8) Focus on returns on capital | ► M | Management is committed to focusing on returns on capital, and disciplined capital allocation. |
| 9) Commitment to innovation and investment in franchises | ▲ H | Duskin continues to invest in R&D and is investing in Smart Factory operations in its production and logistics facilities. |
| 10) Sound ESG rating | ▲ H | Duskin rates as 'green' in our ESG scorecard. |

Source: Company, Astris Advisory

# Summary

Duskin is the dominant market leader in **residential and commercial service franchises**, specializing in rental mops and mats. It also operates Japan's largest **doughnut restaurant franchise** called 'Mister Donut'.

The business has the **hallmarks of a high-quality franchise**. With a strong household brand, it has proven to be a **durable franchise with low capital intensity, minimal leverage, and a strong track record of positive free cash flow generation**. However, the company is facing a long-term challenge in generating steady organic growth. Its success has also resulted in a cash-rich balance sheet, where capital has been preserved and not effectively allocated.

We believe the company is undergoing a **positive dynamic change**, concentrating on deploying its capital for two key objectives:

- **Capital allocation renaissance** – to invest in growth initiatives to increase corporate value. The company has targeted a spend of ¥70 billion from FY3/2023 to FY3/2025, focusing on M&A to attract long-term growth and smart factory investment to increase productivity and address labor shortage risk.
- **Returning cash to shareholders** – Management is targeting a 3-year cumulative total payout of over 100%.

We believe these two initiatives will result in the following:

**Positive changes to realize growth potential**

- **Investors will view this as a positive development** – Duskin will be seen as undergoing a lifecycle change as it puts its capital to work to instigate change, as opposed to being a mature cash cow business.
- **Realizing longer-term growth potential** – the earnings trajectory of the company will be viewed as having improved via effective investment and increasing productivity.

**Total shareholder returns of 100%**

- **Shareholder distribution is robust** – the company has strong underlying fundamentals and free cash flows, making dividends more likely to be sustainable.

**Astris Advisory estimates** Duskin will drive medium-term growth via the following factors:

- Sales growth – the key driver will be the Food Group with new Mister Donut store openings. We have not included any impact from acquisitive growth or impact from R&D.

**Margins to resume uptrend**

- Improving profitability – the reduction in investment costs and increasing productivity from smart factory automation will boost margins, as well as the Food Group improving the sales mix.

**On Astris Advisory estimates**, the shares are trading on FY3/2025 EV/EBITDA multiple of 5.2x, which is at a major discount to overseas peers.

# Company description

## Overview

Duskin is a household name in Japan

Since its founding in 1963, **Duskin has operated as a franchise business model**, continually seeking new business opportunities. Its activities currently encompass a wide variety of businesses, from rental services for cleaning tools such as mats and mops, to professional technical services and retail food services.

Mops have over 90% market share in the residential sector

'Mister Donut' has over 80% domestic market share

The rental cleaning mop has **over 90% market share** in the domestic residential sector, serving approximately 4.3 million households. The restaurant franchise **'Mister Donut' is the leading doughnut shop operator** with over 80% domestic market share by store numbers.

The founder Seiichi Suzuki traveled to the United States in 1961 bringing back dust control technology, and he developed a rental cleaning mop saturated with a special absorbent effective at collecting dirt without the need to use water. A **household brand in Japan**, the name Duskin is derived from the combination of the English word 'dust' and 'zokin', the latter being the common term for a cleaning cloth in Japanese.

The first to import the franchise model from the US

In 1969, Suzuki joined the IFA (International Franchise Association) as Japan's first member. From the 1970s it **sought out new franchise businesses from the US**, allying with ServiceMaster for licenses such as 'ServiceMaster' (professional cleaning service) and 'Merry Maids' house cleaning. An agreement was made with Mister Donut of America in 1970, and the first 'Mister Donut' store was opened in 1971 under license from International Multifoods Corporation (currently JM Smucker (SJM US)).

In 1994 the mat and mop rental business commenced in Taiwan followed by the Mister Donut business in 2004.

Duskin was listed in 2006 on the First Section of the Tokyo and Osaka Stock Exchanges. Currently, it is listed on the Tokyo Prime Market.

**Table 2: Timeline summary**

IPO in December 2006

| Key dates | Details |
|---|---|
| February 1963 | The company was established by founder Seiichi Suzuki |
| January 1971 | Commence business alliance with US ServiceMaster |
| April 1971 | Opening of the first 'Mister Donut' restaurant in Osaka |
| September 2004 | Capital and business alliance with Mitsui Trading and Co. (8031) |
| **December 2006** | **Listed on the Osaka Stock Exchange.** |
| February 2008 | Capital and business alliance with Mos Food Services (8153) |
| February 2017 | Acquired 90% of Big Apple Worldwide Holdings Sdn. Bhd. |
| **April 2022** | **Transferred to the Prime section of the Tokyo Stock Exchange.** |

Source: Company

## Business segmental data

There are three core business segments at Duskin:

**Table 3: Business segment details**

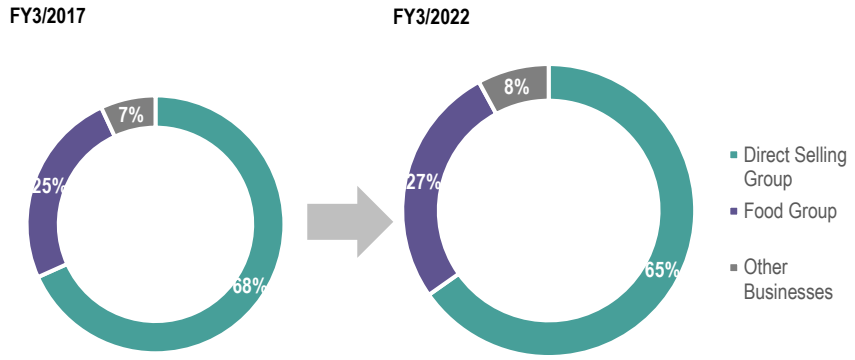
| Business Segment | Sub-segment | Key services | Core products/services | Key business alliance |
|---|---|---|---|---|
| **Direct Selling Group** | **Clean Service** | • Clean Service | Rental and sales of cleaning and hygiene products, with approximately 60,400 sales representatives | CXS – business alliance for development and supply of detergent and wax (former Japan arm of Diversey (DSEY US))<br><br>NAC (9788) – largest Duskin franchisee with 1,900 sites |
| | **Care Service** | • ServiceMaster | Professional cleaning services (e.g. air conditioners) | Licensed from ServiceMaster IPCo LLC |
| | | • Terminix | Pest control and comprehensive sanitary management | Licensed from The Terminix Company (Rentokil Initial (RTO LN)) |
| | | • Merry Maids | Home cleaning and helper services | Licensed from ServiceMaster IPCo LLC |
| | | • Total Green | Plant and flower upkeep | - |
| | | • Home Repair | Fixing scratches and dents | - |
| | **Other** | • Rent-All | Rental for special events and daily use items | - |
| | | • Uniform Service | Leasing, sales, and cleaning of uniforms | - |
| | | • Health & Beauty | Cosmetics and health food sales | - |
| | | • Health Rent | Rental and sales of home healthcare items | - |
| | | • Duskin Life Care | Quality home care for seniors | - |
| | | • Duskin Healthcare | Hygienic environments for medical institutions | Licensed from Aramark (ARMK US) |
| **Food Group** | | • Mister Donut | Eat-in and takeout Donuts and other items (994 shops in Dec 2022) | - |
| | | • Pie Face | Pie specialty stores from Australia (1 shop) | Licensed from Pie Face Holdings (United Petroleum) |
| | | • Katsu & Katsu | Japanese pork cutlet restaurants (15 sites) | - |
| | | • MOSDO | Collaboration shop with MOS Burger (1 shop) | Mos Food Holdings (8153) |
| **Other businesses** | | • Domestic non-franchise businesses | Core activities:<br>- Leasing and insurance agents | - |
| | | • Overseas operations | Core activities:<br>- Rental of cleaning and hygiene products<br>- Donut restaurants<br>- Overseas licensing and raw material procurement | - |

Source: Company

**Mister Donut overseas operate primarily under a master franchise license**

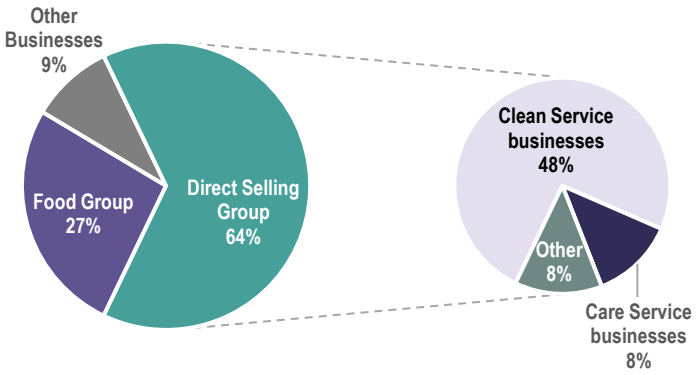
The sales mix has remained relatively constant, highlighting the mature and stable nature of the businesses.

**Figure 1: Sales mix by Business Segment – FY3/2017 vs FY3/2022**



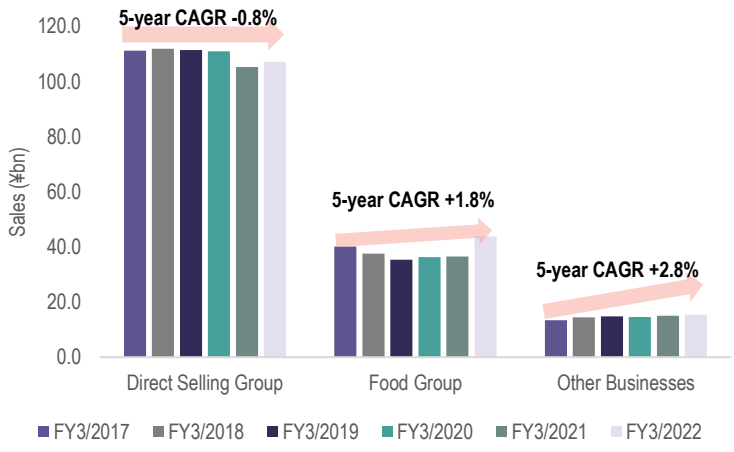

Source: Company

**Figure 2: FY3/2022 sales mix by Business Segment – with the breakdown of Direct Selling Group**




Source: Company

**Figure 3: Annual sales trend by Business Segment**



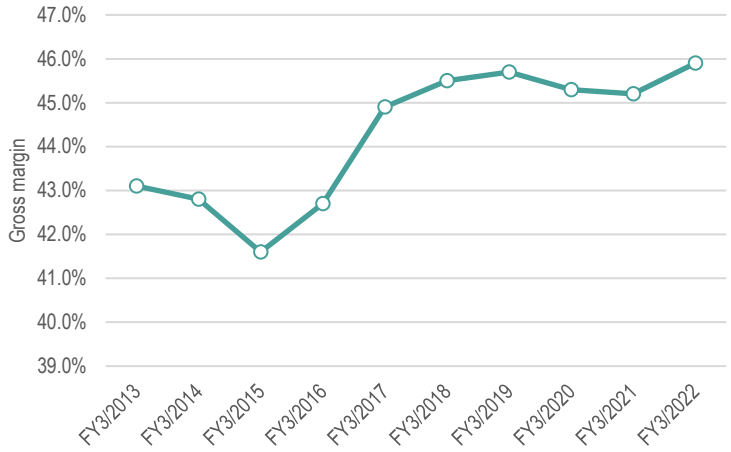

Source: Company

## Recent trends in profitability

We note from FY3/2017 that gross margins have been stabilized. The operating margin was negatively impacted by the pandemic in FY3/2021, with the Direct Selling Group experiencing limited opportunities to interact directly with customers. The Food Group has proven to be more resilient, with **robust customer demand for takeout** which was a key recovery driver in FY3/2022.

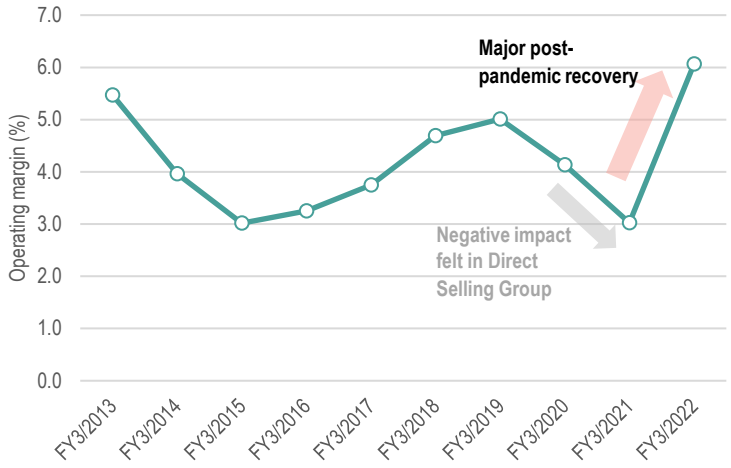
FY3/2022 operating margin of 6.1% was the highest recorded since FY3/2011.

**Figure 4: Annual GPM trend**




Source: Company

**Figure 5: Annual OPM trend**




Source: Company

## Key changes in segmental profit profile

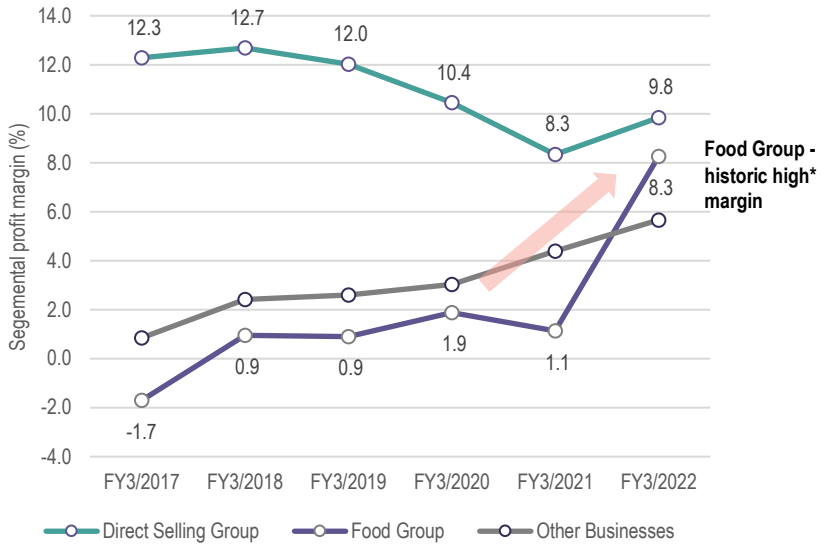
Since FY3/2017 we note the following:

- Direct Selling Group which is the core earnings driver has experienced a gradual downturn in profitability.

- Food Group which has historically experienced very low profitability recorded its highest segmental profit margin in FY3/2022 at 8.3%. The 10-year average segmental margin is a low 0.9%.

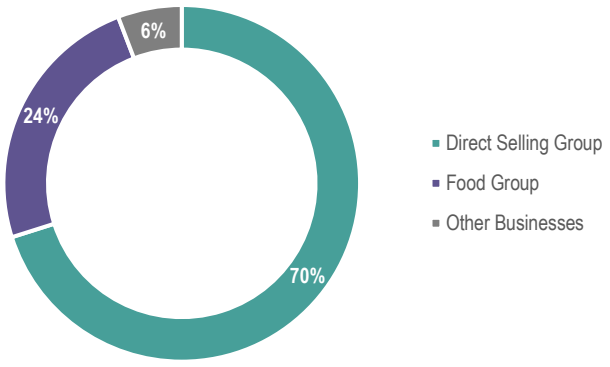
**Food Group – 10-year average margin 0.9%; rose to 8.3% in FY3/2022**

Figure 6: Annual segmental profit margins




Source: Company
Note*: Food Group segmental disclosure commenced FY3/2013

Figure 7: FY3/2022 pre-elimination total segmental profit split

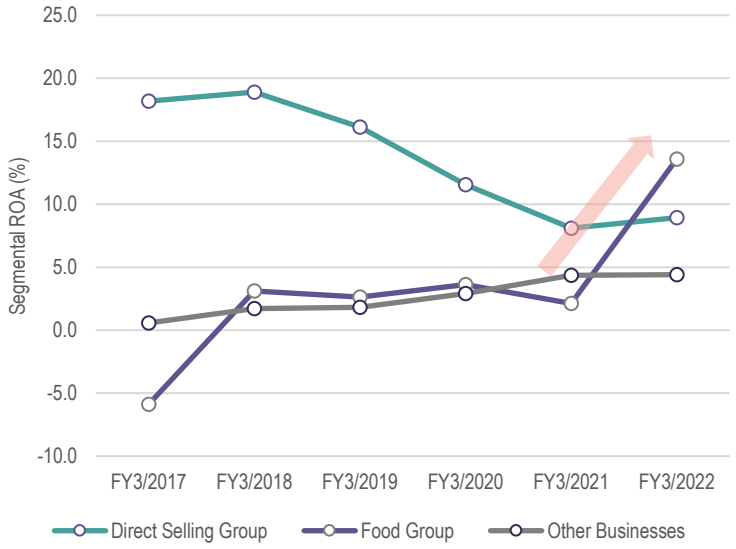



Source: Company

We also note that Return On Assets has improved at the Food Group, above the level seen at the core Direct Selling Group. In effect, the secondary business has become more efficient at driving returns.

Figure 8: Annual segmental ROA (derived from segmental profit over segment assets)

Takeout business driving sales volume




Source: Company

The key issues regarding profitability facing the company in our view are:

- **Food Group – whether the recent record-high margins are sustainable.**
- **Direct Selling Group – what can be done to improve returns at the core business segment.**

# Food Group – improvements all round

## Challenges over franchise management

The historically low profitability of the Food Group is explained by the following:

- **Challenges over franchisee management** – in times when existing store sales were weak, Duskin found it difficult to balance the needs of maintaining profitability between itself and the franchisees.
- **New store openings** – previous attempts at increasing store numbers were too rapid, resulting in increased costs.
- **Head office costs** – despite store closures being conducted, head office costs remained at elevated levels.
- **Low price strategy** – until 2016 Mister Donut operated a ¥100 per item discount pricing campaign for a third of every month.

## Record margin in FY3/2022

Mister Donut executed FY3/2022 margin improvement in the following manner:

Switch from low to premium pricing

- **Switch to premium pricing** – the company introduced a value-added product strategy termed '**misdo meets'**, which comprised product co-development with external highly-skilled pâtissiers using top-class ingredients. The ¥100 pricing has been discontinued.

Takeout business driving sales volume

- **Pandemic-driven takeout demand** – takeout demand grew significantly during the period, making up 80% of total Food Group sales. Takeout business is beneficial from two fronts: 1) the average shopping basket value is higher than the sit-down business, and 2) more efficient as it requires fewer fixtures (like plates) and operational needs.

### Sustainability of margins

To conclude, we believe that Duskin can maintain operating margins above 8% for its Food Group business. There are challenges over cost inflation, but current evidence suggests that profitability is sustainable:

- **Demand unaffected despite two price hikes** – recent trading (please see Recent trading section) has not been affected despite the company instigating the following price hikes to mitigate cost pressures (raw materials, FX, and utilities):
    - March 2022 – approximate 5% to 9% price hike
    - November 2022 - approximate 4% to 7% price hike

Successful colloboration with Pokémon amongst others

- **Effective ongoing 'misdo meets'** – Q3 FY3/2023 introduced collaboration products with **Pokémon** which has proven to be a hit; we believe this premium pricing strategy is working and will continue.
- **Franchise management has improved**, and the company has set a segmental operating margin target of 8.7% for FY3/2025.

## Direct Selling Group – Entering investment phase

### Challenges with growth

The mainstay Clean Service business (primarily rental mops and mats to the residential market) made up 48% of FY3/2022 sales (see Figure 2). This ex-growth market is experiencing increasing customer churn, due to lifestyle changes in Japan:

- Intercom and/or viewing monitors at residential entrances making face-to-face customer interaction more difficult for Duskin sales representatives.
- Increasing dual-income families resulting in absent homes during working hours.
- Substitution risk from disposable floor wipes and robot cleaners, particularly favored by the younger demographic.

The company has identified secular growth opportunities in Care Services and senior care services; however, these have relatively low barriers to entry and competition is arguably high.

### Major automation capex initiative

As part of Duskin's Medium-Term Management Policy 2022 (please see Strategy section on page 29), the company has embarked on a major capital investment to maximize corporate value. The details are as follows:

- An approximate total capex of **¥42 billion**, spread between FY3/2023 to FY3/2025. **50% of this is maintenance capex, and the rest is for this new project**.
- To address the labor shortage which is considered a key business risk, Duskin will build a **new production system based on Smart Factories** for production and logistics sites. The aim is to develop and adopt new equipment to reduce manpower and automate workflow working with RFID adoption. These include automatic sorters, inspection, and packing equipment.

We then make the following assumptions, and calculate a simple illustration of the potential return:

- The project is completed on time by the end of FY3/2025 and will generate a conservative NPV of zero.
- With an estimated cost of capital of 5%. We ignore any impact from working capital and maintenance capex cash flows.

**Table 4: Simple illustration of capex project and potential returns**

| Key assumptions | Description |
|---|---|
| Total capex | ¥21 billion dedicated to this project, with ¥7 billion spent equally over 3 years (t0, t1 and t2) |
| The estimated cost of capital | 5.0% |
| Depreciation schedule | 10-years |
| Corporation tax rate | 30% |

Source: Company, Astris Advisory

| Year (t) | Post-tax cash flow (¥bn) | Present value (¥bn) | Implied pre-tax cash flow (¥bn) | Depreciation (¥bn) | Implied EBIT impact (¥bn) |
|---|---|---|---|---|---|
| 0 (FY3/2023) | -7.00 | -7.00 | | | |
| 1 | -7.00 | -6.67 | | -0.70 | -0.70 |
| 2 | -7.00 | -6.35 | | -1.40 | -1.40 |
| 3 | 2.86 | 2.47 | 4.08 | -2.10 | 1.98 |
| 4 | 2.86 | 2.35 | 4.08 | -2.10 | 1.98 |
| 5 | 2.86 | 2.24 | 4.08 | -2.10 | 1.98 |
| 6 | 2.86 | 2.13 | 4.08 | -2.10 | 1.98 |
| 7 | 2.86 | 2.03 | 4.08 | -2.10 | 1.98 |
| 8 | 2.86 | 1.93 | 4.08 | -2.10 | 1.98 |
| 9 | 2.86 | 1.84 | 4.08 | -2.10 | 1.98 |
| 10 | 2.86 | 1.75 | 4.08 | -2.10 | 1.98 |
| 11 | 2.86 | 1.67 | 4.08 | -1.40 | 2.68 |
| 12 | 2.86 | 1.59 | 4.08 | -0.70 | 3.38 |
| **NPV** | | **0.00** | | | |

Source: Company, Astris Advisory

Our conclusion here is that even with a zero NPV, Duskin's Smart Factories project could generate cost savings of ¥2.0 billion per annum. This is a material amount, given it makes up 20% of FY3/2022 operating profit. **This project should be able to generate positive free cash flow and is earnings accretive**.

The company has disclosed that it expects to see an **annual cost saving of ¥1.4 billion** from FY3/2025 accompanying the start of RFID usage.

## Group companies

Duskin has 38 consolidated subsidiaries, the majority being regional entities for the Direct Selling Group. Only two consolidated subsidiaries are not 100% owned – we highlight these and the affiliate companies.

**Table 5: Group Companies – subsidiaries, not 100% owned, and affiliates**

| Consolidated subsidiary | Group company status | Stake | Activities |
|---|---|---|---|
| Ever Fresh Hakodate | Consolidated | 68.9% | Production for the Food Group segment. |
| Big Apple Worldwide Holdings Sdn. Bhd. | Consolidated | 90.0% | The direct operator of the 'Big Apple' halal donut restaurant chain in Malaysia and Cambodia. |
| **Affiliate companies** | | | |
| NAC Co., Ltd.(9788) | | 26.0% | Key franchisee of the Direct Selling Group |
| Duskin Serve Taiwan Co., Ltd. | | 49.0% | Taiwan Clean Service and Care Service |
| Mister Donut Taiwan Co., Ltd. | | 50.0% | Mister Donut operations |

Source: Company

## R&D

**R&D centered around cleaning and washing-related products**

Duskin has spent an average of 0.4% of sales on R&D expenditure. This may not be a substantial figure, but the company holds 142 patents in Japan and 4 outside of Japan. The company is engaged in cleaning, washing, and processing technology with a focus on improving quality and in response to ESG factors. In FY3/2022 there were 44 staff conducting R&D, focused around four key areas:

- **Foundational research** – experimental research, for example, the study of health-inhibiting substances in house dust, such as mite allergens, food allergens, mold, pollen, and SVOCs (semi-volatile organic compounds).
- **Applied research** – application of expertise from foundational research on new materials and technologies.
- **Dust control research** - researches and develops new rental product materials and manufacturing and processing methods.
- **Hygiene control research** – research and development of manufacturing and processing methods for hygiene-related product materials, mainly chemical products, and filters.

# Strategy

## Core objectives

Duskin's long-term strategy is to be '**the most attentive service provider in the world**'. Currently in the third final phase of this long-term strategy called "ONE DUSKIN", the current term covers FY3/2023 to FY3/2025 and encompasses three strategic themes:

1. **Reforming the business portfolio**

Duskin aims to respond to the changing business environment, by reforming and expanding existing businesses as well as investing in new growth opportunities. This will involve:

- Taking a more aggressive stance on M&A for businesses with synergies.
- Boosting R&D, particularly in areas where social issues can be addressed e.g. aging demographic, and regional revitalization.
- Expansion overseas.

2. **Establishing a solid foundation**

A multi-faceted approach to consolidate Duskin's business to enhance corporate value via:

- Adopting RFID on rental products, and making laundry plants into Smart Factories.
- Human capital management – secure and develop human resources.
- Reinforce management systems for the company and business lines; manage the business with a greater awareness of the cost of capital.
- Makes advances in DX (digital transformation) and enhances CX (customer experience).

3. **Coexistence with local communities**

Aim to contribute to social sustainability, environmental conservation, and sustainable growth.

## Key initiatives

We highlight the key initiatives being applied to the business segments.

**Table 6: Key initiatives per business segment**

| Business segment | Initiatives | Details |
|---|---|---|
| **Direct Selling Group** | Organizational | Aim to strengthen face-to-face relationships and acquire new residential customers, empowering the sales representatives at an organizational level. |
| | CX | Improve customer communication via digital channels via e-commerce and SNS, and upgrade and improve the free online membership site 'DDuet'. |
| | Network construction | To increase sites capable of offering areas of increasing demand such as house cleaning, nursing care, and welfare equipment rental for seniors. |

| Business segment | Initiatives | Details |
|---|---|---|
| | Laundry and distribution | Streamline operations and make labor savings by introducing RFID and smart factories. |
| **Food Group** | New business model development | Introduce new store formats such as kitchen-less stores and drive-thrus, and sales of high value-add doughnuts. |
| | Strengthening value chain | Bring key raw material processing and distribution (e.g. delivery, pick-up boxes) in-house. |
| | Merchandising | Create new products and sales opportunities to leverage the brand. |

Source: Company

# Our commentary on the Smart Factory initiative

## Benefits of a Smart Factory

A Smart Factory is a networked digitized facility with connected devices, machines, and systems that continually collect data, allowing analysis and diagnostics resulting in optimized performance. A true Smart Factory can run autonomously, self-optimizing performance, and self-adapt to new conditions in real-time.

According to *Deloitte Insights (2019)*, the impact of Smart Factory initiatives has been measured as follows:

**Improvements in labor productivity, utilization and output**

- +12% change in labor productivity
- +11% change in factory capacity utilization
- +10% change in production output.

## Duskin's challenges

We see Duskin's Direct Selling Group facing the following operational challenges:

- Operating 45 production and logistic facilities nationwide with laundry plants.
- Mops are color-coded for different methods of washing and require sorting.
- Mops undergo a final manual check before shipment to customers.
- Managing high volume - approximately 31 million rental mops and mats in circulation.
- Both Duskin and the franchisee manually count products shipped and returned.

This is on the back of a labor shortage, and inflationary cost pressures. The **adoption of RFID** on mops and mats is estimated to cost **¥5.3 billion over 2 years** (starting FY3/2023).

## Value creation

The company has highlighted the introduction of sorters, inspection, and packing as areas where smart factory initiatives will be adopted. We see the following as creating value:

**Benefits from conveyance, error detection and automated packing**

- **Smarter conveyance** – automated sorters can replace human material handlers, resulting in more efficient and accurate delivery to the laundry machines.
- **Quality sensing and error detection** – inspection can reduce the shipment of defective items and detection data can assist in engineers correcting issues to increase productivity.

- **Packing** – automation can result in eliminating downtime, improving turnaround time, increase sales due to reduced production costs and better customer service.

# Business model

## Key concepts and impact

A franchise business drives revenue and earnings by the following means:

- The franchisor develops an original and competitive business, supported by a strong brand.
- The franchisor increases market share and geographic reach by granting access to proprietary expertise, processes, and trademarks to franchisees for a fee.

**Average Duskin franchise contract length is 36 years**

Duskin conducts its core activities under a franchise framework (activities that do not fit under this scheme are categorized in the Other Businesses segment). We believe it is fair to say that Duskin has a successful track record, given that the **average franchise contract length is 36 years.**

The successful track record has resulted in the following:

**Dominant market share in mop rental and donut restaurants**

- Dominant market share in residential mop rental at approximately 90%, and 55% for commercial.
- Approximately 83% of the market share is for domestic donut shops (by shop numbers).
- A solid nationwide network.

**A defensive business with a strong track record**

**This has resulted in very defensive characteristics of the business, chiefly strong franchise durability, high and recurring cash flow generation, no leverage, and low actual capital intensity.**

On the other hand, domestically there are indications that the **market is ex-growth for the core Direct Selling Group business**, with limited opportunities for steady organic growth.

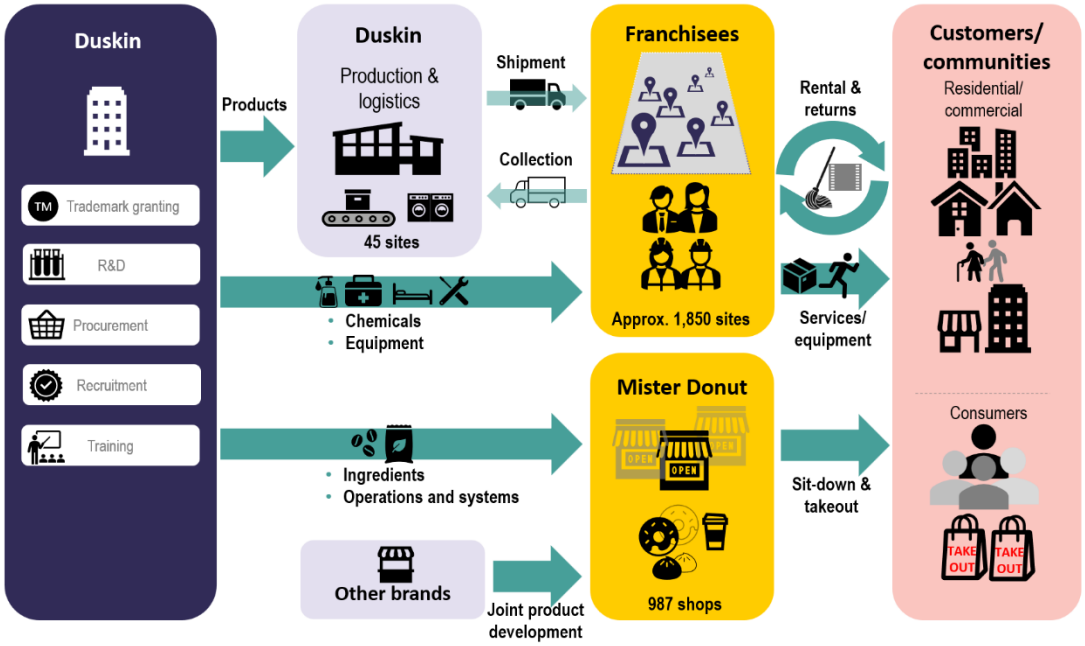
### Identifying corporate philosophy

Duskin's management philosophy stems from founder Suzuki's pursuit of '**Prayerful management**'. This may have lost some of its nuances in more contemporary times, but we view it as reflecting a sense of care and duty to all stakeholders – something that is akin to modern corporate governance.

### Workflow

Duskin operates a nationwide network of franchisees, providing the products, services, and infrastructure to deliver a quality offering as well as operating a business that becomes rooted in their local communities.

Figure 9: High-level workflow overview




Source: Company

## Revenue recognition

Revenues are recognized on the shipment of products (mops and mats), materials, and equipment to franchisees. For Care Services and Mister Donut franchisees, royalty income is based on sales at franchise stores. The key principles are as follows:

- Direct Selling Group, Clean Service – revenue recognition on shipment to the franchisee, net of any returns, discounts, and rebates. Prices are adjusted for the use of loyalty points.
- Direct Selling Group, Care Service – 1) sale of material and equipment recognized on shipment to the franchisee, 2) royalty income based on sales of franchised stores, and at time of occurrence.
- Food Group, Mister Donut – 1) sale of ingredients recognized on shipment to the franchisee, 2) royalty income based on sales of franchised stores, and at time of occurrence.

# Competitive advantages

**Product differentiation, long track record and an extensive network**

We believe Duskin's key competitive advantages are as follows:

- A strong brand that has a track record of durability.
- An established nationwide network.
- A capital-light business model.
- Financial strength with a high level of capital.

## ROIC

We believe ROIC is a key indicator of a company's ability to generate value. Duskin's last 10-year track record shows a mild uptrend but highlights the company's over-capitalized balance sheet which distorts the overall return (please refer to the Balance Sheet analysis for further details).

Figure 10: Trend in ROIC




Source: Refinitiv

# Peer group analysis

There is no direct peer, but we have selected the following peers to assess Duskin's returns and valuations:

- **Cleaning-related companies** – manufacturer of household cleaning/hygiene products, rental mops and mat providers, and facility management/cleaning services.
- **Fast-food/coffee shop chains and franchises** – franchise operators of well-known brand coffee shops and restaurants.

**Table 7: Domestic cleaning-related companies**

| Company | Description |
|---|---|
| Poppins Corporation | Provides childcare services as well as senior care and housekeeping. |
| LEC Inc | A household goods manufacturer making cleaning products and pesticides. |
| Earth Corporation | A household goods manufacturer making cleaning products and pesticides. |
| TOKAI Corp | Provides healthcare facility management, pharmacy operations, rental mops and mats, and cleaning services. |

Source: Companies, Bloomberg

**Table 8: Domestic fast-food/coffee shop chains**

| Company | Description |
|---|---|
| McDonald's Holdings Company Japan, Ltd. | Directly run and sub-license franchise hamburger restaurants in Japan; owned 35.3% by Mcdonald's entities. |
| Doutor Nichires Holdings Co., Ltd. | Directly run and operates a franchise of coffee shops, Western food restaurants, and Japanese cuisine eateries. |
| KOMEDA Holdings Co., Ltd. | Operates a franchise of coffee shops. |
| Key Coffee Inc. | Coffee bean wholesaler, and operates a chain of coffee shops and Italian restaurants. |
| Fujiya Co., Ltd. | Established in 1910, Fujiya manufactures Western confectionery, operates restaurants, and sells sweets and canned beverages. |
| BR 31 Ice Cream Co., Ltd. | Operates the Baskin Robbins ice cream franchise in Japan; 43.41% are owned by Fujiya and Baskin Robbins International Holdings respectively. |

Source: Companies, Bloomberg

- **Global peers** – we have focused more on cleaning-related companies as there are more directly comparable peers in business services.

**Table 9: Global services and cleaning-related companies**

| Company | Description |
|---|---|
| Aramark | Foodservice/catering, facility management, and uniform services provider. |
| Cintas Corporation | Business services provide uniforms, mats, mops, cleaning and restroom supplies, first aid, and safety products. |
| UniFirst Corporation | Supplies uniforms and protective clothing, as well as restroom and cleaning products such as floor mats, mops, air fresheners, and soap. |
| Rentokil Initial plc | Business services ranging from pest control to facility management. |
| Diversey Holdings, Ltd. | Manufacturer of chemicals for hygiene and sanitization. |
| Newell Brands Inc | Multiple consumer and commercial products including the Rubbermaid line for food services, sanitary maintenance, and waste management. |
| Elior Group SA | Contract catering services, healthcare hospitality, cleaning and hygiene solutions, and facility management. |
| Healthcare Services Group, Inc. | Housekeeping, laundry, dining, and nutritional services within the healthcare industry. |
| Compass Group PLC | B2B food services and facility management |
| Sodexo SA | Provides catering, facilities management, employee benefits, and personal home services. |

| Company | Description |
|---|---|
| Ecolab Inc. | Specialists in food safety and product quality, for global food & beverage processors and manufacturers. |

Source: Companies, Bloomberg

**Table 10: Global fast-food/coffee shop chains**

| Company | Description |
|---|---|
| SSP Group Plc | Contract food travel market specialists with in-house brands such as Upper Crust and Ritazza, and operate as a franchisee for major international brands. |
| Krispy Kreme, Inc. | Multinational doughnut and coffeehouse chain. |
| Starbucks Corporation | The world's largest multinational coffeehouse chain. |
| Denny's Corporation | Large family restaurant chain. |

Source: Companies, Bloomberg

Our core findings are as follows:

- **Profitability** – we believe there is **potential for operating margins to improve**.
    - From a domestic perspective, Duskin's operating margins are on par with its cleaning-related peers. The upside potential comes from its exposure to the fast food/coffee shop business, with the peer average LTM OPM at 7.2%.
    - A similar conclusion is reached when looking at both overseas cleaning-related and food/coffee peers, particularly with global services company peers on LTM OPM of 7.1%. Although high double-digit margins are not realistic (Cintas being an exception), there is real scope for improvement.
    - **Duskin's ROIC is at a low level, highlighting the excess capital held.**

**Duskin trading at notable discounts on EV/EBITDA and EV/Sales multiples**

- **Valuations** – we believe EV-based multiples capture Duskin's relative undervaluation, taking into account its capital structure and accounting policy differences with overseas peers.
    - EV/EBITDA multiple of 7.4x appears low versus domestic food/coffee peers at 12.5x, and significantly lower versus global peers at 11.8x to 14.3x.
    - EV/Sales multiple of 0.6x is low versus domestic food/coffee peers, and global comparatives on approximately 2.0x.
    - The conclusion here is that domestically, **the market has been ignoring the value of the Food Group business due to its patchy track record**, and should therefore experience a re-rating with an improving outlook.

## Table 11: Peer analysis on key valuation and leverage metrics – trading and related businesses and indexes

| Ticker | Company/Index | MktCap US$ (m) | Profitability OPM LTM (%) | OPM 10-yr average (%) | ROE LTM (%) | ROIC LTM (%) | Valuation EV/EBITDA 12M Fwd (x) | EV/Sales 12M Fwd (x) | Div yield 12M Fwd (%) | FCF yield 12M Fwd (%) | PER 12M Fwd (x) | PBR (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **4665 JP** | **Duskin** | **1,227** | **5.1** | **4.2** | **4.9** | **4.8** | **7.4** | **0.6** | **2.4** | **1.7** | **24.9** | **1.0** |
| *Domestic cleaning-related companies* | | | | | | | | | | | | |
| 7358 JP | Poppins Corporation | 134 | 4.9 | 6.0 | 10.8 | 9.4 | 9.0 | 0.5 | 2.4 | 2.0 | 18.9 | 2.2 |
| 7874 JP | LEC Inc | 263 | 1.8 | 6.1 | 4.3 | 2.2 | 8.2 | 0.3 | 3.4 | 0.0 | 21.8 | 0.9 |
| 4985 JP | Earth Corporation | 767 | 4.9 | 3.4 | 8.6 | 8.5 | 6.7 | 0.6 | 2.7 | 4.0 | 15.2 | 1.7 |
| 9729 JP | TOKAI Corp | 517 | 5.9 | 6.9 | 7.4 | 7.2 | 2.9 | 0.3 | 3.1 | 7.0 | 12.6 | 0.9 |
| **Simple average** | | | **4.4** | **5.6** | **7.8** | **6.9** | **6.7** | **0.6** | **2.9** | **3.3** | **17.3** | **1.3** |
| *Domestic fast-food/coffee shop chains/franchises* | | | | | | | | | | | | |
| 2702 JP | McDonald's Holdings Company Japan | 1,798 | 9.6 | 5.0 | 9.9 | 9.9 | 13.0 | 1.7 | 0.7 | 3.1 | 30.6 | 3.5 |
| 3087 JP | Doutor Nichires Holdings Co., Ltd. | 1,031 | 1.0 | 5.5 | 0.6 | 0.6 | 5.3 | 0.4 | 1.7 | 3.5 | 21.3 | 0.9 |
| 3543 JP | KOMEDA Holdings Co., Ltd. | 718 | 20.2 | 26.2 | 12.9 | 6.3 | 14.1 | 3.7 | 2.4 | 5.1 | 17.9 | 2.8 |
| 2594 JP | Key Coffee Inc. | 237 | 0.7 | 0.8 | 1.4 | 1.3 | 26.5 | 0.7 | 0.5 | 1.0 | 59.6 | 1.4 |
| 2211 JP | Fujiya Co., Ltd. | 208 | 4.3 | 2.2 | 6.3 | 6.3 | 6.3 | 0.5 | 1.2 | 2.8 | 18.1 | 1.1 |
| 2268 JP | BR 31 Ice Cream Co., Ltd. | 179 | 7.8 | 3.9 | 11.4 | 10.6 | 9.9 | 1.4 | 0.8 | 6.5 | 28.0 | 3.4 |
| **Simple average** | | | **7.2** | **7.3** | **7.1** | **5.8** | **12.5** | **1.4** | **1.2** | **3.7** | **29.3** | **2.2** |
| *Global services and cleaning-related companies* | | | | | | | | | | | | |
| ARMK US | Aramark | 9,686 | 4.1 | 4.0 | 7.6 | 2.0 | 10.9 | 1.0 | 1.3 | 4.8 | 17.8 | 3.1 |
| CTAS US | Cintas Corporation | 44,233 | 20.3 | 16.2 | 38.1 | 23.7 | 20.3 | 5.2 | 1.1 | 2.9 | 31.6 | 12.9 |
| UNF US | UniFirst Corporation | 2,979 | 6.5 | 11.3 | 5.4 | 5.3 | 10.7 | 1.5 | 0.6 | 2.0 | 25.1 | 1.8 |
| RTO LN | Rentokil Initial plc | 15,461 | 12.4 | 11.2 | 19.8 | 7.5 | 11.1 | 2.6 | 1.5 | 2.2 | 21.5 | 6.6 |
| DSEY US | Diversey Holdings, Ltd. | 1,995 | 2.3 | 4.5 | -20.0 | -5.2 | 9.9 | 1.3 | 0.0 | -1.1 | 13.9 | 3.0 |
| NWL US | Newell Brands Inc | 5,952 | 8.2 | 9.9 | 5.2 | 2.2 | 10.7 | 1.4 | 6.4 | 13.5 | 13.2 | 1.7 |
| ELIOR FP | Elior Group SA | 656 | -1.6 | 2.8 | -46.6 | -20.7 | 6.7 | 0.4 | 1.9 | 8.3 | 17.3 | 0.8 |
| HCSG US | Healthcare Services Group, Inc. | 961 | 3.7 | 5.4 | 7.9 | 7.7 | 11.6 | 0.5 | 2.2 | 8.1 | 20.3 | 2.2 |
| CPG LN | Compass Group PLC | 40,387 | 5.7 | 6.2 | 20.7 | 12.0 | 12.0 | 1.1 | 2.3 | 3.8 | 21.4 | 5.8 |
| SW FP | Sodexo SA | 13,637 | 5.0 | 5.0 | 17.3 | 6.7 | 7.8 | 0.6 | 3.5 | 7.0 | 14.4 | 2.9 |
| ECL US | Ecolab Inc. | 46,063 | 11.3 | 14.1 | 15.1 | 6.9 | 17.9 | 3.6 | 1.3 | 2.9 | 31.9 | 6.4 |
| **Simple average** | | | **7.1** | **8.2** | **6.4** | **4.4** | **11.8** | **1.7** | **2.0** | **4.9** | **20.8** | **4.3** |
| *Global fast-food/coffee shop chains* | | | | | | | | | | | | |
| SSPG LN | SSP Group Plc | 2,428 | -0.3 | -4.3 | -4.4 | -0.6 | 10.4 | 1.0 | 1.5 | -0.6 | 27.2 | 9.0 |
| DNUT US | Krispy Kreme, Inc. | 2,230 | 2.2 | 2.9 | -1.3 | -0.7 | 15.9 | 2.0 | 1.0 | 2.8 | 38.4 | 1.9 |
| SBUX US | Starbucks Corporation | 118,389 | 12.9 | 15.2 | Na | 26.6 | 18.7 | 3.7 | 2.1 | 3.1 | 28.0 | -13.6 |
| DENN US | Denny's Corporation | 689 | 13.1 | 12.2 | Na | 24.9 | 12.2 | 2.3 | 0.0 | 6.7 | 19.3 | -18.4 |
| **Simple average** | | | **7.0** | **6.5** | | **12.6** | **14.3** | **2.3** | **1.2** | **3.0** | **28.2** | **-5.3** |

Source: FactSet, Bloomberg, Astris Advisory

# Balance sheet

Our peer group valuation analysis highlighted Duskin's relatively low EV valuation multiples. By looking at the balance sheet, we see the following:

- Duskin's strong balance sheet is emphasized by **high liquidity and lack of leverage**. Most domestic peers are cash-rich, although KOMEDA Holdings (3543) used some leverage to amplify returns.
- **Capital efficiency appears on the low side.** Despite running a capital-light business that required only low maintenance capex, asset turnover is arguably on the low side versus both domestic and global peers. Low capital efficiency stems from:
    - **Duskin is overcapitalized** – in Q3 FY3/2023 the company held ¥37.3 billion in cash and marketable securities, and investment securities worth ¥55.3 billion; a total of ¥92.6 billion making up 58% of market capitalization.
    - **Why is it overcapitalized?** – we view this as a combination of **Duskin's ability to generate stable, consistent returns, whilst capital allocation had not kept pace.**

**Table 12: Liquidity, leverage, and capital efficiency**

| Company | Liquidity Current ratio (x) | Quick ratio (x) | Leverage Net debt to equity (x) | Net debt to EBITDA (x) | Interest cover (x) | Total debt to capital (%) | Equity ratio (%) | Efficiency Asset turnover (x) | Inventory turnover (x) | Inventory days | Cash cycle (days) | Capital intensity (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Duskin** | **2.2** | **1.9** | **-0.3** | **0.0** | **N/A** | **1.0** | **76.1** | **0.8** | **7.8** | **44.4** | **50.8** | **1.2** |
| *Domestic cleaning-related companies* | | | | | | | | | | | | |
| Poppins Corporation | 2.6 | N/A | -0.4 | -2.2 | 117.9 | 15.6 | 62.3 | 2.0 | N/A | N/A | 38.1 | 0.5 |
| LEC Inc | 3.5 | 2.6 | 0.3 | 1.1 | 36.0 | 47.5 | 45.8 | 0.7 | 3.6 | 100.0 | 131.5 | 1.5 |
| Earth Corporation | 1.4 | 0.8 | -0.2 | -1.3 | 323.2 | 3.1 | 50.4 | 1.2 | 3.0 | 121.7 | 39.8 | 0.8 |
| TOKAI Corp | 2.6 | 2.4 | -0.4 | -2.6 | 275.1 | 4.1 | 72.7 | 1.2 | 18.0 | 22.0 | 24.0 | 0.9 |
| **Average** | **2.5** | **1.9** | **-0.2** | **-1.3** | **188.1** | **17.6** | **57.8** | **1.3** | **8.2** | **81.2** | **58.4** | **0.9** |
| *Domestic fast-food/coffee shop chain* | | | | | | | | | | | | |
| McDonald's Holdings Co. Japan | 1.4 | 1.4 | -0.3 | -1.4 | 6,761.2 | 0.2 | 74.5 | 1.3 | 215.6 | 1.7 | 21.8 | 0.8 |
| Doutor Nichires Holdings | 3.0 | 2.8 | -0.3 | -11.8 | -137.2 | 2.2 | 79.4 | 0.9 | 11.3 | 35.6 | 10.7 | 1.1 |
| KOMEDA Holdings Co., Ltd. | 1.3 | 1.3 | 1.0 | 4.3 | 67.7 | 55.3 | 38.5 | 0.3 | 71.7 | 4.6 | 35.6 | 2.9 |
| Key Coffee Inc. | 2.4 | 1.6 | -0.2 | -3.7 | 57.9 | 1.3 | 69.6 | 1.3 | 4.8 | 92.5 | 90.9 | 0.8 |
| Fujiya Co., Ltd. | 1.8 | 1.4 | -0.2 | -1.3 | 1,080.5 | 2.7 | 65.6 | 1.3 | 9.5 | 38.5 | 52.2 | 0.8 |
| BR 31 Ice Cream Co., Ltd. | 1.7 | 1.4 | -0.4 | -1.5 | 295.7 | 7.9 | 57.1 | 1.1 | 6.7 | 54.9 | 75.1 | 0.9 |
| **Average** | **1.9** | **1.7** | **-0.1** | **-2.6** | **1,354.3** | **11.6** | **64.1** | **1.0** | **53.3** | **38.0** | **47.7** | **1.2** |
| *Global services and cleaning-related companies* | | | | | | | | | | | | |
| Aramark | 1.0 | 0.8 | 2.3 | 6.1 | 1.6 | 70.9 | 20.1 | 1.1 | 29.7 | 11.8 | 27.8 | 0.9 |
| Cintas Corporation | 1.8 | 1.5 | 0.8 | 1.1 | 17.9 | 45.8 | 40.6 | 1.0 | 8.9 | 39.4 | 65.9 | 1.0 |
| UniFirst Corporation | 4.4 | 3.7 | -0.2 | -1.4 | N/A | 3.1 | 78.9 | 0.8 | 9.6 | 37.8 | 58.9 | 1.2 |
| Rentokil Initial plc | 1.9 | 1.8 | 0.9 | 2.1 | 17.3 | 72.3 | 22.0 | 0.6 | 16.8 | 21.8 | 62.4 | 1.7 |
| Diversey Holdings, Ltd. | 1.3 | 0.9 | 2.3 | 9.5 | 0.6 | 71.7 | 18.3 | 0.6 | 5.5 | 68.1 | 41.4 | 1.6 |
| Newell Brands Inc | 1.3 | 0.6 | 1.4 | 4.0 | 4.1 | 60.4 | 26.5 | 0.7 | 3.1 | 118.9 | 96.1 | 1.4 |
| Elior Group SA | 0.7 | 0.7 | 1.6 | 11.6 | -8.0 | 63.4 | 23.4 | 1.3 | 16.6 | 22.1 | -51.6 | 0.7 |
| Healthcare Services Group, Inc. | 2.8 | 2.7 | -0.2 | -2.2 | 17.9 | 5.5 | 59.3 | 2.3 | 63.4 | 5.8 | 59.4 | 0.4 |
| Compass Group PLC | 1.0 | 0.9 | 0.6 | 1.2 | 18.2 | 45.2 | 31.3 | 1.5 | 18.5 | 7.7 | -21.9 | 0.7 |
| Sodexo SA | 1.1 | 1.1 | 0.8 | 2.2 | 9.4 | 60.2 | 21.1 | 1.1 | 59.7 | 6.1 | 37.0 | 1.0 |
| Ecolab Inc. | 1.3 | 0.9 | 1.1 | 4.6 | 9.7 | 54.2 | 33.7 | 0.7 | 5.3 | 68.6 | 72.3 | 1.5 |
| **Average** | **1.7** | **1.4** | **1.0** | **3.5** | **8.9** | **50.2** | **34.1** | **1.1** | **21.6** | **37.1** | **40.7** | **1.1** |
| *Global fast-food/coffee shop chains* | | | | | | | | | | | | |
| SSP GRP/d | 0.7 | 0.7 | 3.7 | 4.4 | 0.2 | 84.5 | 8.0 | 0.7 | 29.4 | 12.5 | -0.8 | 1.3 |
| KRISPY KREME O/d | 0.3 | 0.3 | 0.6 | 4.1 | 4.2 | 37.5 | 38.0 | 0.5 | 30.1 | 12.2 | -66.2 | 2.1 |
| STARBUCKS CORP/d | 0.8 | 0.5 | -2.4 | 1.6 | 9.3 | 237.1 | -31.1 | 1.1 | 13.4 | 26.4 | 21.8 | 0.9 |
| DENNYS/d | 0.5 | 0.5 | -10.9 | 5.5 | 5.9 | 109.9 | -7.4 | 0.9 | 62.2 | 5.9 | 4.3 | 1.1 |
| **Average** | **0.6** | **0.5** | **-2.3** | **3.9** | **4.9** | **117.3** | **1.9** | **0.8** | **33.8** | **14.3** | **-10.2** | **1.4** |

Source: Refinitiv, FactSet

We believe there is a change regarding capital allocation, as the company has disclosed the following.

- **Strategically manage the business with capital costs in mind**.
- **Aim for capital efficiency** by:
    - Under the current 3-year Medium-Term Management Policy, to undertake business investment totaling **¥70 billion** (from FY3/2023 to FY3/2025), which includes **maintenance capex of ¥21 billion**, and **¥20 billion for M&A** and the remainder **(¥29.0 billion) for Smart Factories and other initiatives**.
    - To distribute over ¥7.5 billion on shareholder returns. The dividend payout ratio has been raised from 50% to 60% starting FY3/2023.
    - Aim to reduce the overall balance of cross-shareholdings.

**Table 13: Current status of investment securities**

| Company | Stake held (%) | Details | Cross-shareholding status (yes/no) |
|---|---|---|---|
| NAS Co (9788) | 24.15 | Key franchise partner (and affiliate) | No |
| Mos Food Services (8153) | 4.11 | Development of the "MOSDO" restaurant format (Mister Donut and Mos Burger) | Yes |
| Nippn Corp (2001) | 3.18 | Supplier of raw materials for the Food Group | Yes |
| Daiwa House Industries (1925) | 0.14 | A key relationship for the Direct Selling Group | Yes |
| Royal Holdings (8179) | 2.81 | A key relationship for the Direct Selling Group | No |
| AZ-Com Maruwa (9090) | 1.24 | Distribution partner for Direct Selling Group and Food Group. | Yes |
| Sumitomo Realty & Development (8830) | 0.08 | A key relationship for the Direct Selling Group | Yes |
| Kaneka (4118) | 0.22 | A key relationship for the Food Group | Yes |
| Nitta Corp (5186) | 0.43 | A key relationship for the Direct Selling Group | Yes |
| Toppan Inc (7911) | 0.02 | A key relationship for the Direct Selling Group | Yes |
| Tigers Polymer Corp (4231) | 1.49 | A key relationship for the Direct Selling Group | Yes |
| Yagi & Co Ltd (7460) | 0.79 | A key relationship for the Direct Selling Group | Yes |
| Fuji Co Ltd (8278) | 0.03 | A key relationship for the Food Group | No |
| Aeon Delight (9787) | 0.03 | A key relationship for the Direct Selling Group | No |
| Fujita Corporation (3370) | 1.32 | A key franchisee of Mister Donut | No |
| Kisoji (8160) | 0.01 | A key relationship for the Direct Selling Group | No |

Source: Refinitiv

# Capital allocation

Over the last 5 financial years, Duskin has the following track record of cumulative capital allocation:

**Duskin has been continuously free cash flow positive since FY3/2001**

- **Strong recurring free cash flow generation** – the company has been free cash flow positive for the last 5 years, even with the challenges over the pandemic. Duskin has been continuously free cash flow positive since FY3/2001 (where disclosure is permissible).

- **Recent financing activities** – the company raised long-term debt (worth ¥1.53 billion) in FY3/2022, to provide funding for the ESOP (employee stock ownership plan) scheme that was introduced in June 2021.

**Business portfolio reform is expected to involve M&A**

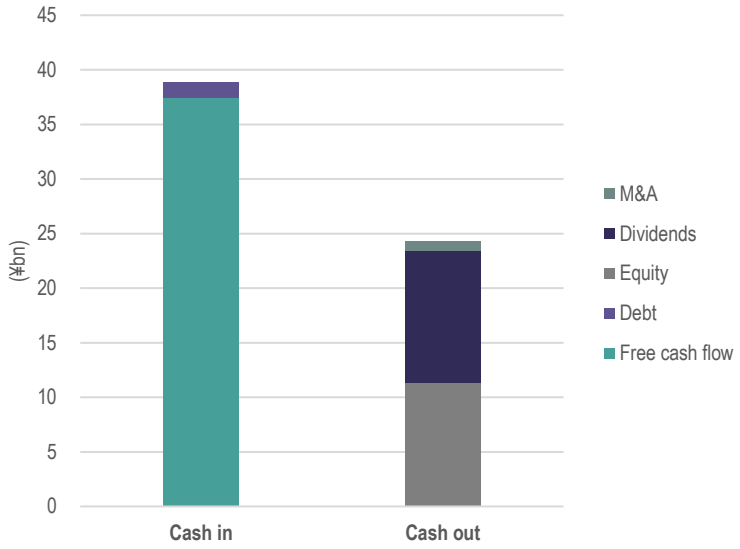
- **Capital allocation** – Duskin has focused its capital deployment on shareholder returns. However, there was still surplus free cash flow that has not been allocated. Historically, M&A activity has been low and small-scale but there are indications that **management has become more proactive recently with strategic importance in reforming the business portfolio.**

**Table 14: M&A track record (FY3/2011 - to date)**

| Date | Company | Description |
|---|---|---|
| October 2010 | Azare Products and Kyowa Cosmetics | Acquired 100% of cosmetics manufacturer Azare Products for an undisclosed fee. Acquired 59.91% direct stake in Kyowa Cosmetics, building a 100% stake via 28.33% stake held by Azare Products and 11.36% treasury shares. |
| January 2014 | Chugai Co., Ltd | Acquired 100% of a manufacturer and wholesaler of corporate uniforms for ¥0.85 billion. |
| February 2017 | Big Apple Worldwide Holdings Sdn.Bhd | Acquired 90% of the company, becoming a consolidated subsidiary.Fee undisclosed. |
| September 2018 | NAC (9788) | Duskin Co Ltd raised its stake to 24.881% from 0.098%, by acquiring a 24.783% stake, or 5.588m newly issued ordinary shares, in Nac Co Ltd for ¥5.46 billion. |
| May 2021 | EDIST | Acquired 100% of the clothes rental site business EDIST for ¥18 million from Adventure (6030). |
| March 2022 | REMODELA | Acquired an undisclosed minority stake; an Osaka-based online platform for managing refurbishment work on rental properties, in a privately negotiated transaction. |
| November 2022 | Nile Holdings | Acquired 15% of the holding company of Qracian, and set up a business alliance. Qracian is a well-known rapid-response plumbing maintenance business, the current owners including Nippon Investment Company Fund I Japan, LP. |

Source: Company, Refinitiv

Figure 11: 5-year cumulative capital generation and allocation (FY3/2018 – FY3/2022)




Source: Company

We conclude that the company is positioned to invest significantly in the business without the need for major leverage.

# Recent results

## Q1-3 FY3/2023 results

### Key financials

| JPY (bn) | Q1-3 FY3/2022 | Q1-3 FY3/2023 | Growth YoY (%) |
|---|---|---|---|
| **Sales** | **123.18** | **128.18** | **+4.0** |
| Gross profit/(loss) | 57.02 | 58.05 | +1.8 |
| ***Gross margins*** | ***46.3%*** | ***45.3%*** | |
| Operating profit/(loss) | 10.31 | 9.02 | -12.5 |
| ***Operating margins*** | ***8.4%*** | ***7.0%*** | |
| Recurring profit | 12.14 | 11.06 | -8.9 |
| Net income attributable to the parent | 8.34 | 7.59 | -9.0 |

Source: Company

### Per business segment (pre-elimination)

| JPY (bn) | Q1-3 FY3/2022 | Q1-3 FY3/2023 | Growth YoY (%) |
|---|---|---|---|
| **Sales** | | | |
| Direct Selling Group | 82.09 | 82.79 | +0.9 |
| Food Group | 32.16 | 35.47 | +10.3 |
| Other Businesses | 11.41 | 12.31 | +7.9 |
| **Segmental profit/(loss)** | | | |
| Direct Selling Group | 9.98 | 7.81 | -21.8 |
| Food Group | 3.23 | 4.54 | +40.5 |
| Other Businesses | 0.69 | 0.64 | -7.0 |
| **Segmental profit margins** | | | |
| Direct Selling Group | 12.2% | 9.4% | |
| Food Group | 10.0% | 12.8% | |
| Other Businesses | 6.0% | 5.2% | |

Source: Company

### Key highlights

Q1-3 FY3/2023 results highlighted the following:

- **Stable operations in the Direct Selling Group, and strong growth in the Food Group.** All three business segments saw sales growth YoY, with the Food Group showing a strong performance from Mister Donut as customer numbers and average spending increased YoY.
- **Direct Selling Group's profitability declined YoY but was ahead of the company plan.** Commencing RFID implementation, increase in fuel costs, and sales activities led to an operating margin decrease YoY.
- **Food Group's margin enhancement was driven by volume.** Despite rising input and operating costs, the company recorded strong operating margins driven by top-line growth. There were 11 new store openings, bringing the total to 994 shops. The exit from the ice cream business led to cost savings.

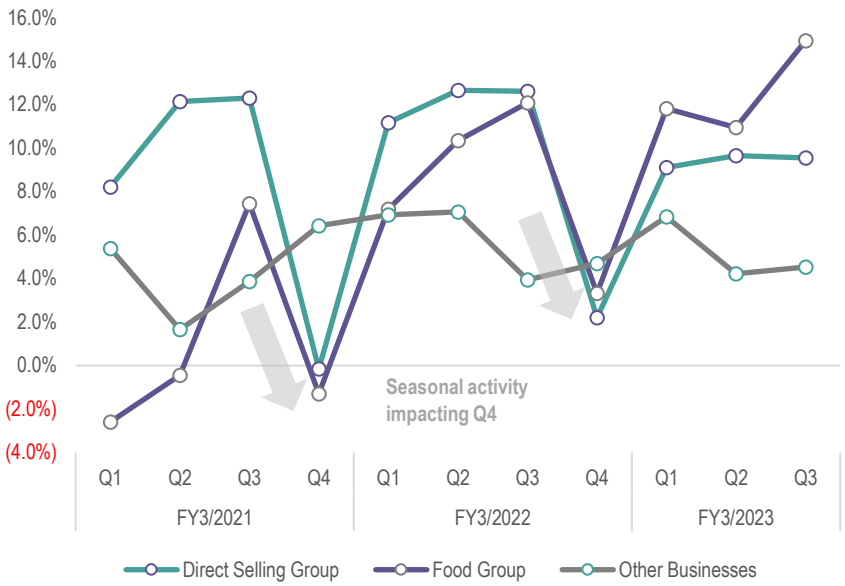
### Seasonality

Duskin conducts the following activities which dampen profitability in Q4:

- Direct Selling Group – preparation costs for sales activities to commence in April.

- Food Group – sales of Mister Donu 'Lucky Bags' (assortment bags) sold in December (Q3) pulls in demand from Q4, consequently resulting in falling sales volume QoQ.

**Figure 12: Quarterly trend in profit margins**




Source: Company

# Medium-term management policy

## Targets

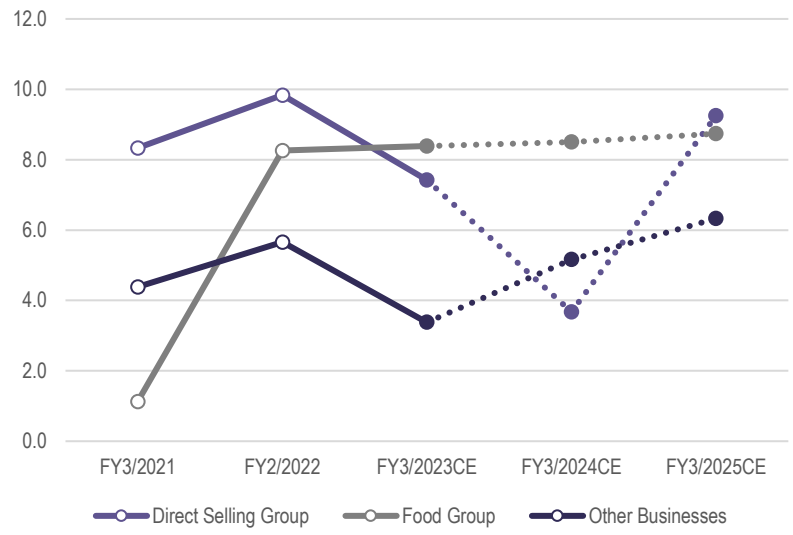
The company is in the third and ultimate phase of its long-term plan covering 2018 to 2023 called 'VISION23'. The numerical targets are to achieve the following by FY3/2025.

**Table 15: Quantitative targets for ONE DUSKIN Phase 3**

| ¥bn | FY3/2022 | FY3/2023 target | FY3/2024 target | FY3/2025 target |
|---|---|---|---|---|
| **Sales** | **163.21** | **170.00** | **178.70** | **183.000-** |
| Direct Selling Group | 107.13 | 111.8 | 117.0 | 118.9 |
| Food Group | 43.82 | 46.5 | 49.4 | 51.5 |
| Other Businesses | 15.41 | 14.8 | 15.5 | 15.8 |
| ---Intersegment | (3.15) | (3.10) | (3.20) | (3.20) |
| **Sales growth YoY (%)** | **+6.1** | **+4.2** | **+5.1** | **+2.4** |
| Direct Selling Group | +1.7 | +4.4 | +4.7 | +1.6 |
| Food Group | +19.8 | +6.1 | +6.2 | +4.3 |
| Other Businesses | +2.4 | -4.0 | +4.7 | +1.9 |
| | | | | |
| **Operating profit** | **9.90** | **7.80** | **4.50** | **12.0-** |
| Direct Selling Group | 10.54 | 8.30 | 4.30 | 11.00 |
| Food Group | 3.62 | 3.90 | 4.20 | 4.50 |
| Other Businesses | 0.87 | 0.50 | 0.80 | 1.00 |
| ---Intersegment | (5.13) | (4.90) | (4.80) | (4.50) |
| **OPM (%)** | **6.1** | **4.6** | **2.5** | **6.6** |
| Direct Selling Group | 9.8 | 7.4 | 3.7 | 9.3 |
| Food Group | 8.3 | 8.4 | 8.5 | 8.7 |
| Other Businesses | 5.7 | 3.4 | 5.2 | 6.3 |
| **OP growth YoY (%)** | +112.8 | -21.2 | -42.3 | +166.7 |
| | | | | |
| **Recurring profit** | **12.21** | **9.60** | **6.50** | **14.00** |
| Growth YoY (%) | +84.1 | -21.4 | -32.3 | +115.4 |
| **Net income** | **8.13** | **6.60** | **4.40** | **10.00** |
| Growth YoY (%) | +188.2 | -18.8 | -33.3 | +127.3 |
| | | | | |
| **ROE Target (%)** | | | | **6% of higher** |
| ***ROE (%)** | **5.5** | **4.6** | **3.1** | **6.8** |

Source: Company
*Implied ROE based on company guidance with a 60% dividend payout

Figure 13: Segmental profit margin targets




Source: Company

Cash allocation is a key part of the 3-year plan – the total budget for new investments is ¥49.0 billion, equivalent to 30.5% of current market capitalization.

Table 16: Cash allocation targets and investment costs

| Objectives | Amount | Details |
|---|---|---|
| 1. Maintenance capex | ¥21.0 billion (¥7.0 billion per year) | Maintain existing businesses |
| **2. M&A and investments** | **Up to ¥20.0 billion – could go above depending on the transaction** | **To drive sales growth; the focus is likely to be on domestic businesses** |
| **3. Investment in smart factories/automation/DX** | **¥21.0 billion** | **Combined with maintenance capex, the total comes to ¥42.0 billion.s** |
| **4. RFID** | **¥5.3 billion over 2 years (FY3/2023 ¥1.0 billion, FY3/2024 ¥4.3 billion), expensed under COGS.** | **Cost efficiencies earmarked from FY3/2025 worth ¥1.4 billion.** |
| **5. The remainder of the investment budget** | **¥2.7 billion** | **Wide-ranging from R&D to sustainable investments** |
| 6. Returning cash to shareholders | More than ¥7.5 billion | Dividends are set at the higher of 60% payout ratio or 2.5% dividend over equity. |

Source: Company

## M&A

Duskin's overall approach to M&A on the following:

- Synergies with existing businesses.
- Whether franchising is a possibility.
- Ability to generate sustainable growth.

We believe the latest 15% stake investment in Qracian is an example of this, being a well-known brand for quick response plumbing services.

## Shareholder returns

The 60% payout is due to start from FY3/2023 – this level of payout is on the higher end of the range for domestic peers (the average is 40%) and more akin to global services peers at 63%.

**Management is targeting a 3-year cumulative shareholder returns in excess of 100%**

Concerning share buybacks, management is said to take a flexible approach. However, management has stated that the goal is to provide shareholders with a 3-year cumulative return of over 100% over the period; there is no further requirement to hoard capital. This implies significant buyback activity to come in the medium term.

# Astris earnings estimates and key assumptions

Astris' key earnings forecasts are as follows:

**Table 17: Astris Advisory earnings estimates**

| Year-end | FY3/2023E | FY3/2024E | FY3/2025E |
|---|---|---|---|
| **Sales** | | | |
| Direct Selling Group | 107.55 | 109.70 | 110.80 |
| *Growth YoY (%)* | *+1.0* | *+2.0* | *+1.0* |
| Food Group | 48.19 | 51.56 | 55.17 |
| *Growth YoY (%)* | *+10.0* | *+7.0* | *+7.0* |
| Other Businesses | 13.95 | 14.79 | 15.68 |
| *Growth YoY (%)* | *+8.0* | *+6.0* | *+6.0* |
| **Total sales (¥bn)** | **169.69** | **176.05** | **181.64** |
| *Growth YoY (%)* | *+4.0* | *+3.7* | *+3.2* |
| | | | |
| **OP (¥bn)** | **7.90** | **6.64** | **12.49** |
| OPM (%) | 4.7 | 3.8 | 6.9 |
| | | | |
| **EBITDA (¥bn)** | **15.93** | **14.97** | **21.08** |
| EBITDA margins (%) | 9.4 | 8.5 | 11.6 |
| | | | |
| **FCF (¥bn)** | **3.93** | **2.83** | **6.12** |
| FCF margin (%) | 2.3 | 1.6 | 3.4 |
| FCF conversion (%) | 39.1 | 31.9 | 41.7 |
| **FCF yield (%)** | **2.4** | **1.7** | **3.8** |

Source: Astris Advisory
Note: FCF conversion is FCF/Pre-tax Profit

The core assumptions of these estimates are as follows:

- **Sales growth** – we believe the key driver for sales growth will be the Food Group with Mister Donut continuing to generate higher volumes through new store openings, and continued success with the premium pricing products 'misdo meets'.
- **Profitability** – we estimate that operating margins will decline in FY3/2024E as the company conducts its RFID project for its rental products and invests in Smart Factory capex. However, we estimate a major recovery into FY3/2025E as productivity and cost savings appear in the Direct Selling Group.
- **Sustainable free cash flow generation** with free cash flow conversion rates steady at around 40% even with the high capex initiative.

# Company information

## Management (14 members, 28.5% female ratio, 42.8% outside directors)

| Representative Director and Chairman | Teruji Yamamura |
|---|---|
| Shareholding (direct) | 0.08% |
| **Career history** | |
| 1982 | Joined the Company |
| 2004 | Director and Assistant General Manager, Clean Service Business Group |
| 2007 | Director; Care Service Business Group, Rent-All and Home Instead (now Life Care) |
| 2009 | Appointed Representative Director and President |
| 2018 | Representative Director, President, and CEO |
| 2022 | Appointed Representative Director and Chairman (current post) |

**40 years experience at Duskin**

| Representative Director, President, and CEO | Hiroyuki Okubo |
|---|---|
| Shareholding (direct) | 0.01% |
| **Career history** | |
| 1985 | Joined the Company |
| 2018 | Operating Officer; Manager, Corporate Planning |
| 2020 | Operating Officer, Information System; Manager, Corporate Planning<br>Director and Operating Officer; President's Office and Information System Manager, Corporate Planning<br>Director and Operating Officer; President'sOffice, Information System and Shared Services Center Manager, Corporate Planning |
| 2021 | Director and Operating Officer; President's Office, Corporate Planning, Information System and Shared Services Center<br>Director and Operating Officer, Corporate Planning Group |
| 2022 | Representative Director, President, and CEO, Auditing, Cloud Promotion Project (current post) |

| Board Director and COO | Kazushi Sumimoto |
|---|---|
| Shareholding (direct) | 0.03% |
| **Career history** | |
| 1983 | Joined the Company |
| 2014 | Director, Home Instead (now Life Care); Division Manager, Rent-All |
| 2016 | Director; Corporate Planning, Life Care Development Group, Rent-All, Uniform Service and Health & Beauty |
| 2018 | Director and Senior Operating Officer, Corporate Planning and Production & Logistics |
| 2019 | Director and Executive Operating Officer; Corporate Planning, General Affairs, Accounting, Public Relations, Information System and Production & Logistics |
| 2020 | Director and Executive Operating Officer, Direct Selling Group General Manager; Strategy Management, Direct Selling Group<br>Director and COO, Direct Selling Group General Manager; Strategy Management, Direct Selling Group |
| 2022 | Board Director and COO, Direct Selling Group (current post) |

| Board Director and COO | Tetsuya Wada |
|---|---|
| Shareholding (direct) | 0.01% |
| **Career history** | |
| 1986 | Joined the Company |
| 2018 | Operating Officer; General Manager, Mister Donut Business Group |
| 2020 | Operating Officer, Food Group; Division Manager, Food Business Development |
| | Director and COO, Food Group; Division Manager, Food Business Development |
| | Board Director and COO, Food Group (current post) |

| Board Director and CFO | Naoto Miyata |
|---|---|
| Shareholding (direct) | 0.01% |
| **Career history** | |
| 2014 | General Manager, Public & Financial Institutions Banking Dept., Sumitomo Mitsui Banking Corporation |
| 2018 | Joined the Company as General Manager, Corporate Account |
| 2020 | Operating Officer, Accounting |
| | Director and CFO; Legal Affairs and Corporate Compliance, Accounting and General Affairs |
| 2021 | Board Director and CFO, Corporate Administration Group (current post) |

| Board Director and Operating Officer | Shinichiro Ueno |
|---|---|
| Shareholding (direct) | 0.00% (2,263 shares) |
| **Career history** | |
| 2000 | Joined the Company |
| 2009 | Manager, Clean Service Sales Planning |
| 2012 | Chairman and CEO Duskin Shanghai Co., Ltd. |
| 2019 | Manager, International Division |
| 2021 | Operating Officer, Public Relations, Manager, International Division |
| 2022 | Board Director and Operating Officer, Corporate Planning Group (current post) |

**Consumer sector background**

| Outside Director | Nobuko Sekiguchi |
|---|---|
| Shareholding (direct) | 0.00% (100 shares) |
| **Career history** | |
| 2005 | Joined Capcom Co., Ltd. |
| 2007 | General Manager of Accounting Department |
| 2011 | Corporate Officer, Head of Corporate Planning Division |
| 2016 | Managing Corporate Officer and Head of Corporate Planning & Human Resources Division |
| 2019 | Resigned from Capcom Co., Ltd. |
| | Appointed Outside Director to the Company (current post) |
| 2020 | Outside Director, Audit and Supervisory Committee Member, H2O Retailing Corporation (current post) |
| 2022 | Outside Director, Audit and Supervisory Committee Member, Kobe Steel, Ltd. (current post) |

| Consumer sector background | Outside Director | Yukiko Tsujimoto |
|---|---|---|
| | Shareholding (direct) | -% |
| | **Career history** | |
| | 1986 | Joined Procter & Gamble Far East Inc |
| | 2006 | Director, Procter & Gamble Japan K.K |
| | 2008 | Director, P&G K.K. |
| | 2012 | Resigned from the position of Director, Procter & Gamble Japan K.K<br>External Relations Director, Procter & Gamble Japan K.K. |
| | 2014 | Resigned from the position of Director, P&G K.K.<br>Resigned from Procter & Gamble Japan K.K<br>Representative Director, Shapes Co., Ltd. (current post) |
| | 2020 | Appointed Outside Director, the Company (current post) |
| | 2022 | Appointed Outside Director SAKATA INX CORPORATION (current postt)<br>Advisor to the City of Kobe (Recruitment and Training) (current post) |

| Consumer (textiles) sector background | Outside Director | Fumi Musashi |
|---|---|---|
| | Shareholding (direct) | -% |
| | **Career history** | |
| | 1982 | Joined CHORI CO., LTD |
| | 2016 | President CHORI (CHINA) CO., LTD. |
| | 2018 | Chairman and President CHORI (CHINA) CO., LTD. |
| | 2020 | Assistant General Manager of Corporate Planning Division and Assistant to the Executive Chief Representative for China CHORI CO., LTD |
| | 2022 | Part-time Adviser CHORI CO., LTD<br>Resigned from CHORI CO., LTD<br>Appointed Outside Director, the Company (current position) |

| | Audit and Supervisory Board Member | Takashi Yoshida |
|---|---|---|
| | Shareholding (direct) | 0.02% |
| | **Career history** | |
| | 1985 | Joined the Company |
| | 2006 | Section Chief, Legal Affairs, Legal Affairs and Corporate Compliance |
| | 2008 | Manager, Legal Affairs and Corporate Compliance |
| | 2016 | Appointed Audit and Supervisory Board Member (current position) |

| | Audit and Supervisory Board Member | Hideyuki Naito |
|---|---|---|
| | Shareholding (direct) | 0.01% |
| | **Career history** | |
| | 1982 | Joined the Company |
| | 2007 | Manager, Auditing |
| | 2016 | Director, Corporate Management; Manager, Accounting |
| | 2018 | Senior Operating Officer, General Affairs and Accounting |
| | 2020 | Senior Operating Officer, General Affair<br>Audit and Supervisory Board Member (current position) |

| | Outside Audit and Supervisory Board Member | Sachiko Kawanishi |
|---|---|---|
| | Shareholding (direct) | -% |
| | **Career history** | |
| | 1981 | Joined Honeywell Information Systems Japan, Inc. (now NEC Nexsolutions, Ltd.) |
| | 1988 | Joined Tohmatsu Awoki & Sanwa (now Deloitte Touche Tohmatsu LLC) |
| | 1992 | Registered as Certified Public Accountant |
| | 2000 | Senior Managing Director, Internet Disclosure, Co., Ltd. (current post) |
| | 2016 | Appointed Audit and Supervisory Board Member, the Company at the Company (current post) |

| Outside Audit and Supervisory Board Member | Kyoichiro Arakawa |
|---|---|
| Shareholding (direct) | 0.01% |
| **Career history** | |
| 1992 | Joined Showa Ota & Co. (now Ernst & Young ShinNihon LLC) |
| 1997 | Registered as a Certified Public Accountant<br>Joined KPMG Century Audit Corporation (now KPMG AZSA LLC) |
| 2007 | Director MIT Corporate Advisory Services, Co., Ltd. |
| 2014 | President and CEO, Best Partners Co., Ltd. (current post) |
| 2016 | Appointed Audit and Supervisory Board Member (current position) at the Company |
| 2020 | Representative, BP Asia Consulting Co., Ltd. (current position) |

| Outside Audit and Supervisory Board Member | Hidekazu Saruki |
|---|---|
| Shareholding (direct) | -% |
| **Career history** | |
| 1999 | Passed National Bar Examination |
| 2001 | Registered at Osaka Bar Association and joined Miyake Godo Law Office (now Miyake & Partners) |
| 2011 | Partner, Miyake & Partners (current post) |
| 2015 | Outside Audit and Supervisory Board Member, Nishimura Securities Co., Ltd. (current post) |
| 2022 | Appointed Audit and Supervisory Board Member (current position) at the Company |

Souce: Company

## Contact details

| Address |
| --- |
| 1-33 Toyotsu-cho, Suita-shi<br>Osaka 564-0051<br>Japan |
| IR Contact:<br>Tel: +81 (6) 6821-5071 |

Source: Company

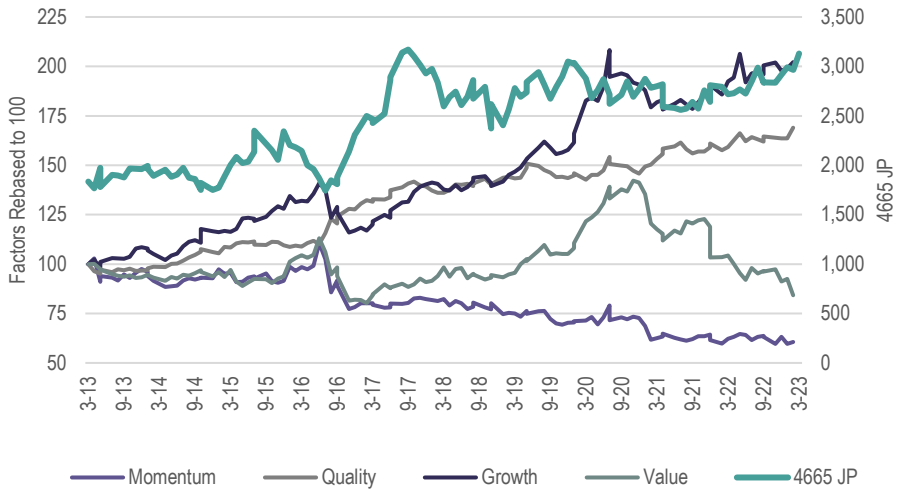
## Shareholder details (as of March 2022)

| Major shareholders | Stake (%) |
| --- | --- |
| The Master Trust Bank of Japan, Ltd. (Trust Account) | 13.63 |
| Custody Banl of Japan Ltd. (Trust Account) | 4.74 |
| Nippn Corporation | 3.59 |
| Duskin Employee Stock Ownership Plan | 3.16 |
| Hirotaka Ogasawara | 2.82 |
| Duskin Franchisee Stock Ownership Plan | 2.21 |
| Sumitomo Mitsui Banking Corporation | 1.67 |
| MOS Food Services, Inc. | 1.51 |
| Sumitommo Realty & Development Co., Ltd. | 1.49 |
| Daiwa House Industry Co., Ltd. | 1.39 |

Source: Bloomberg

# Astris Quant Sheet

## Share price chart and factor analysis

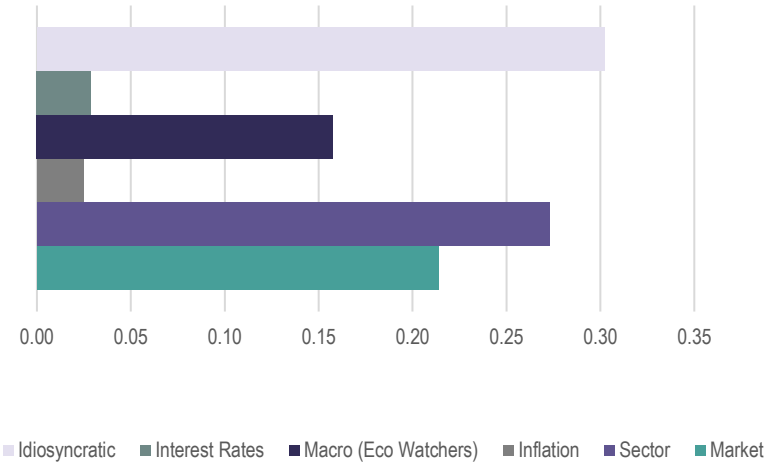



Source: FactSet

| Factors | 1 Year | 3 Year | 10 Year |
|---|---|---|---|
| Momentum: 12 Month - 1 Month Performance | -0.07 | -0.15 | -0.21 |
| Quality: ROE, Free Cash Flow Yield | 0.11 | -0.11 | 0.04 |
| Growth: Operating Profit Growth | 0.17 | 0.11 | -0.16 |
| Value: Book to Market | 0.04 | -0.09 | -0.20 |

Source: FactSet

## Performance drivers




Source: FactSet

| Factors | 1 Year | 3 Year | 10 Year |
|---|---|---|---|
| Topix 1st Section | 0.01 | 0.54 | 0.44 |
| MSCI Japan | -0.01 | 0.50 | 0.41 |
| Topix Services | 0.06 | 0.50 | 0.65 |
| Topix Retail | 0.26 | 0.42 | 0.66 |
| MSCI Japan Commerical Services & Supplies | 0.01 | 0.45 | 0.60 |
| Topix Small Cap Index | 0.04 | 0.68 | 0.56 |
| | | | |
| **Macro** | | | |
| 10Y JGB | -0.33 | -0.42 | -0.19 |
| JPYUSD | 0.05 | -0.35 | 0.24 |
| CPI Nationwide | 0.09 | -0.27 | -0.19 |
| Industrial Production | -0.36 | 0.05 | -0.06 |

Source: FactSet

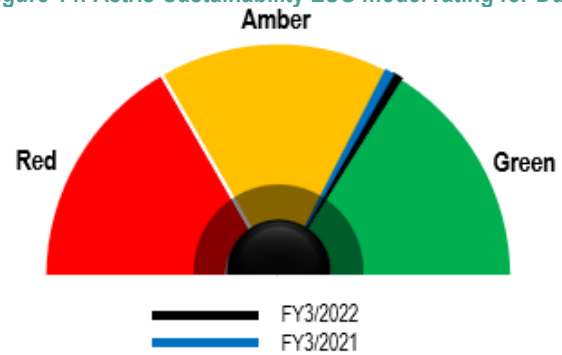
# Astris-Sustainability ESG assessment

## Ratings and scorecard

Our in-house Astris-Sustainability ESG model rates Duskin with a score of **66.2%**, placing it in the **'Green'** rating of our assessment in FY3/2022.

Our in-house methodology* takes what we have selected as core measurable ESG factors, ranking its performance versus its domestic GICS Industry Group- Commercial & Professional Services with a market capitalization of ¥50bn to ¥400bn (a total of 46 companies).

Figure 14: Astris-Sustainability ESG model rating for Duskin




Source: Astris Advisory (*Note – for details of our in-house rating system please contact Astris Corporate Advisory)

## ESG scorecards

| | FY3/2021 | FY3/2022 |
|---|---|---|
| **Environmental (10 factors from a selected peer group)** | | |
| **Astris Environmental score** | **57.8** | **63.0** |
| **Social (13 factors from a selected peer group)** | | |
| **Astris Social score** | **73.6** | **73.5** |
| **Governance (37 factors from a selected peer group)** | | |
| **Astris Governance score** | **64.0** | **64.5** |
| **TOTAL SCORE (Out of a total of 60 factors)** | **65.1** | **66.2** |

Source: Company, FactSet, Astris Corporate Advisory

Our methodology has highlighted the following key topics:

## Environmental

The company's reported $CO_2$ intensity is lower than the median of its reporting peer group.

## Social

Under human capital management, note that women make up 37.7% of the total workforce. 42.8% of the board of directors are non-executives (including audit and supervisory board members).

## Governance

The corporate governance system at Duskin is a mix of experienced company veterans, outside directors from consumer-related sectors, and law/accounting professionals. There are 9 directors (with 3 Outside Directors and 3 Outside Audit and Supervisory Committee members):

- **Board of Directors** – comprised of 9 directors (with 3 Outside Directors) in total chaired by the Representative Director, President, and CEO Hiroyuki Okubo. The 3 Outside Directors are female.
- **Audit and Supervisory Committee** – comprised of one Outside Director as chair, wit two Outside Directors, and 3 Outside Auditors.
- **Director Evaluation Review Committee –** this committee provides the necessary advice in response to inquiries from the Board of Directors regarding the selection of executive officers and director candidates and the determination of remuneration, consisting of an Outside Director as chairperson, another Outside Director, and one Outside Audit & Supervisory Board Member (a total of 3 directors).

## Controversies

We note we have been unable to find major controversies that may have significant financial or reputational repercussions for the company and its shareholders.

# Areas of discussion

## Highlighting key topics for investors

We believe the following will be key areas for discussion with investors:

1. Food Group
    a. With a patchy historic track record, how realistic is sustaining historically high profitability at Mister Donut?
    b. Are the current levels of success being experienced a passing trend in the domestic market?
2. Smart Factory investment
    a. How automated are the current production and logistics centers, and how much increase in productivity are you targeting with the investments?
    b. Is there a reason for the timing of this new initiative?
3. M&A
    a. What sort of franchise businesses are you attracted to?
    b. As a starting point, is a ¥20 billion war chest sufficient to drive meaningful acquisitive growth?
    c. In response to cost inflation, does it make sense to conduct value/supply chain M&A?
    d. Why is overseas growth not a major area of focus?
4. Shareholder returns
    a. What is the thinking behind targeting a cumulative three-year total return ratio of over 100%?
    b. Is this target for the specified period only, hence not sustainable?

## JGAAP Financial Summary

| (¥bn) | FY 3/21 | FY 3/22 | FY 3/23E | FY 3/24E | FY 3/25E |
|---|---|---|---|---|---|
| **Sales** | **153.77** | **163.21** | **169.69** | **176.05** | **181.64** |
| COGS | 84.34 | 88.30 | 91.63 | 95.07 | 98.09 |
| **Gross profit** | **69.44** | **74.91** | **78.06** | **80.98** | **83.56** |
| Gross profit margin (%) | 45.2 | 45.9 | 46.0 | 46.0 | 46.0 |
| **Total OP** | **4.65** | **9.90** | **7.90** | **6.64** | **12.49** |
| OP margin (%) | 3.0 | 6.1 | 4.7 | 3.8 | 6.9 |
| Non-operating income | 2.26 | 2.62 | 2.44 | 2.53 | 2.49 |
| Non-operating expenses | (0.28) | (0.31) | (0.29) | (0.30) | (0.30) |
| **Recurring profit** | **6.63** | **12.22** | **10.05** | **8.87** | **14.68** |
| Pre-tax profit | 6.63 | 12.22 | 10.05 | 8.87 | 14.68 |
| Tax | (1.47) | (3.45) | (2.84) | (2.50) | (4.14) |
| Effective tax rate (%) | 22.1 | 28.2 | 28.2 | 28.2 | 28.2 |
| **Net income** | **2.85** | **8.18** | **7.21** | **6.37** | **10.53** |
| Non-controlling NI | 0.03 | 0.05 | 0.05 | 0.05 | 0.05 |
| **Parent attributable NI** | **2.82** | **8.13** | **7.16** | **6.32** | **10.49** |
| | | | | | |
| Sales growth YoY (%) | -3.4 | +6.1 | +4.0 | +3.7 | +3.2 |
| OP growth YoY (%) | -29.3 | +112.8 | -20.2 | -15.9 | +88.1 |
| Pre-tax profit YoY (%) | -49.1 | +169.5 | -13.6 | -11.7 | +65.4 |
| NI growth YoY (%) | -49.5 | +188.3 | -11.9 | -11.7 | +65.9 |

| Cash flow statement (¥bn) | FY 3/21 | FY 3/22 | FY 3/23E | FY 3/24E | FY 3/25E |
|---|---|---|---|---|---|
| **Profit before tax** | **4.31** | **11.63** | **10.05** | **8.87** | **14.68** |
| Depreciation/amortization | 7.69 | 7.72 | 8.03 | 8.33 | 8.60 |
| Changes in working capital | (0.43) | 1.43 | 2.38 | 2.00 | 0.77 |
| Other non-cash items | 0.66 | (0.04) | 0.31 | 0.13 | 0.22 |
| Tax paid | (2.14) | (1.14) | (2.84) | (2.50) | (4.14) |
| **Cash from Operating Activities** | **10.10** | **19.60** | **17.93** | **16.83** | **20.12** |
| Capex | (7.36) | (5.65) | (14.00) | (14.00) | (14.00) |
| Acquisition of business | (0.23) | (0.21) | (0.21) | - | - |
| Other investing cash flow | 2.56 | (2.67) | (0.05) | (1.36) | (0.71) |
| **Cash from Investing Activities** | **(5.02)** | **(8.52)** | **(14.26)** | **(15.36)** | **(14.71)** |
| Total cash dividends paid | (2.56) | (2.49) | (4.10) | (4.30) | (3.79) |
| Debt issuance/(retirement) | - | 1.48 | - | - | - |
| Equity financing | (0.00) | 0.18 | (2.43) | - | - |
| Other | (0.00) | (0.01) | (0.01) | (0.01) | (0.01) |
| **Cash from Financing Activities** | **(2.57)** | **(0.84)** | **(6.54)** | **(4.31)** | **(3.81)** |
| FX impact | (0.01) | 0.05 | 0.02 | 0.04 | 0.03 |
| **Net cash flow** | **2.50** | **10.28** | **(2.86)** | **(2.81)** | **1.63** |
| | | | | | |
| **Free cash flow** | **2.75** | **13.95** | **3.93** | **2.83** | **6.12** |
| **EBITDA** | **11.15** | **16.41** | **15.93** | **14.97** | **21.08** |
| | | | | | |
| EBITDA margin (%) | 7.3 | 10.1 | 9.4 | 8.5 | 11.6 |
| Free cash flow margin (%) | 1.8 | 8.5 | 2.3 | 1.6 | 3.4 |
| Free cash flow conversion (%) | 63.7 | 120.0 | 39.1 | 31.9 | 41.7 |
| Capex/sales (%) | 4.8 | 3.5 | 8.3 | 8.0 | 7.7 |
| Capex/depreciation (%) | 95.6 | 73.1 | 174.4 | 168.1 | 162.9 |
| CFO margin (%) | 6.6 | 12.0 | 10.6 | 9.6 | 11.1 |

| Balance sheet (¥bn) | FY 3/21 | FY 3/22 | FY 3/23E | FY 3/24E | FY 3/25E |
|---|---|---|---|---|---|
| Cash & equivalents | 18.43 | 23.36 | 20.50 | 17.70 | 19.33 |
| Marketable securities | 19.71 | 30.60 | 30.60 | 30.60 | 30.60 |
| Accounts receivables | 11.88 | 12.27 | 11.56 | 11.56 | 11.56 |
| Inventory | 12.27 | 10.41 | 9.81 | 9.81 | 9.81 |
| Other | 6.96 | 7.46 | 7.03 | 7.03 | 7.03 |
| **Current assets** | **69.24** | **84.10** | **79.50** | **76.70** | **78.33** |
| Tangible assets | 50.15 | 49.47 | 55.86 | 62.06 | 68.10 |
| Goodwill | 0.36 | 0.27 | 0.27 | 0.27 | 0.27 |
| Intangible assets | 9.28 | 7.87 | 9.07 | 10.20 | 11.28 |
| Long term investments | 50.77 | 46.18 | 46.18 | 46.18 | 46.18 |
| Other | 8.61 | 10.16 | 10.16 | 10.16 | 10.16 |
| **Fixed assets** | **119.16** | **113.95** | **121.53** | **128.86** | **135.99** |
| **Total assets** | **188.40** | **198.05** | **201.03** | **205.56** | **214.32** |
| Short term borrowing | - | - | - | - | - |
| Trade payables | 6.96 | 6.96 | 7.41 | 7.69 | 7.93 |
| Guarantee deposit for rental products | 9.14 | 9.06 | 9.24 | 9.41 | 9.56 |
| Other | 18.49 | 21.98 | 21.99 | 23.54 | 23.92 |
| **Current liabilities** | **34.59** | **38.01** | **38.64** | **40.64** | **41.41** |
| Long term borrowing | - | 1.53 | 1.53 | 1.53 | 1.53 |
| Other LT liabilities | 7.97 | 7.49 | 7.49 | 7.49 | 7.49 |
| **Long term liabilities** | **7.97** | **9.02** | **9.02** | **9.02** | **9.02** |
| **Shareholder's equity** | **145.51** | **150.66** | **153.01** | **155.54** | **163.52** |
| Share acquistions rights | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 |
| Non-controlling interests | 0.27 | 0.31 | 0.31 | 0.31 | 0.31 |
| **Total net assets** | **145.84** | **151.03** | **153.37** | **155.90** | **163.89** |
| **Total liabilities & net assets** | **188.40** | **198.05** | **201.03** | **205.56** | **214.32** |

| Key metrics | FY 3/21 | FY 3/22 | FY 3/23E | FY 3/24E | FY 3/25E |
|---|---|---|---|---|---|
| **Profitability** | | | | | |
| Gross margin (%) | 45.2 | 45.9 | 46.0 | 46.0 | 46.0 |
| Operating margin (%) | 3.0 | 6.1 | 4.7 | 3.8 | 6.9 |
| Net margin (%) | 1.8 | 5.0 | 4.2 | 3.6 | 5.8 |
| ROA (%) | 1.5 | 4.2 | 3.6 | 3.1 | 5.0 |
| ROE (%) | 2.0 | 5.5 | 4.7 | 4.1 | 6.6 |
| ROCE (%) | 3.0 | 6.2 | 4.9 | 4.0 | 7.2 |
| ROIC (%) | 2.5 | 4.8 | 3.7 | 3.1 | 5.6 |
| **Liquidity** | | | | | |
| Current ratio (x) | 2.0 | 2.2 | 2.1 | 1.9 | 1.9 |
| Quick ratio (x) | 1.6 | 1.9 | 1.8 | 1.6 | 1.7 |
| **Leverage** | | | | | |
| Debt/Equity ratio (x) | - | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Debt/Equity ratio (x) | net cash | net cash | net cash | net cash | net cash |
| Equity ratio (x) | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Interest cover (x) | N/A | N/A | N/A | 434.0 | 816.2 |
| Net Debt/EBITDA (x) | N/A | N/A | N/A | N/A | N/A |
| **Valuation** | | | | | |
| EPS reported (¥) | 57.19 | 164.71 | 145.10 | 128.06 | 212.44 |
| **PER (x)** | **55.8** | **19.4** | **22.0** | **24.9** | **15.0** |
| **Diluted PER (x)** | **55.8** | **19.4** | **22.0** | **24.9** | **15.0** |
| DPS (¥) | 40.0 | 83.0 | 87.1 | 76.8 | 127.5 |
| Dividend payout ratio (%) | 69.9 | 50.4 | 60.0 | 60.0 | 60.0 |
| Dividend yield (%) | 1.3 | 2.6 | 2.7 | 2.4 | 4.0 |
| **Total shareholder returns (%)** | **1.3** | **2.6** | **8.0** | **4.0** | **6.7** |
| **Free cash flow yield (%)** | **1.7** | **8.6** | **2.4** | **1.7** | **3.8** |
| **Diluted free cash flow yield (%)** | 1.7 | 8.6 | 2.4 | 1.7 | 3.8 |
| PBR (x) | 1.1 | 1.1 | 1.1 | 1.0 | 1.0 |
| EV/sales (x) | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 |
| EV/EBITDA (x) | 9.9 | 6.7 | 6.9 | 7.4 | 5.2 |
| EV/EBIT (x) | 23.8 | 11.2 | 14.0 | 16.6 | 8.9 |
| EV/FCF (x) | 40.2 | 7.9 | 28.2 | 39.0 | 18.1 |

Source: Company, Astris Advisory estimates

***Our earnings model for this company is available to download on our corporate research portal.**

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