

EDION CORP (2730)

Capital efficiency focus

8th March 2024

Share price: ¥1,547

Market cap: ¥173.3bn

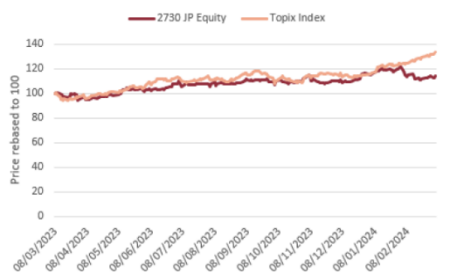
Higher margin PB product launches, continued cost down efforts & a growing focus on capital efficiency were key 1-3Q highlights.

Company sector

Specialty Retail (GICS Industry)

Stock data

Price (¥)	1,547
Mkt cap (¥bn)/(\$m)	173.3 / 1,178.0
52-week range (¥)	1,265 - 1,664
Shares O/S (m)	112.0
Average daily value (\$m)	3.3
Free float (%)	63.2
Foreign shareholding (%)	6.1
Ticker	2730
Exchange	Tokyo Prime
Net Debt/Equity (x)	42.6%



Source: Bloomberg

- **Despite broadly flat 1-3Q sales YoY, a change in sales mix resulted in GPM weakness & a YoY OP decline. This was a function of warm weather impacting air conditioning growth, as well as strong sales of low margin mobile phones & gaming related products.**
- **Ongoing warm winter weather in Japan means the tough operating environment continues to impact high margin air conditioning unit sales, rendering the FY sales target potentially optimistic. EDION has maintained its FY forecasts as it believes its OP target is achievable given an approx. ¥7bn SG&A cost buffer in the 4Q.**
- **ELS (house renovation) sales growth is set to resume in the 4Q following the negative YoY impact from subsidies in FY 3/23 & is likely to be a key growth driver of 4Q & FY 3/25 earnings. EDION is aiming for sales growth & an acceleration in margin improvement as it upsells targeted renovation packages.**
- **The first high margin collaborative EDION x Nitori PB products were launched in Dec & have been well received, with additional products to follow in 2024. Similarly, EDION has continued to launch new e angle products, offering high functionality at affordable prices, as it increases its PB exposure to drive higher margins.**
- **Lowering costs also remains a key area of focus, & a trial of reduced operating hours across c. 13% of stores has resulted in a significant improvement in efficiency. The purchase of the Namba store in Nov 2023 is also set to raise long-term OP, whilst an impending overhaul of logistics contracts aims to minimise the risk of higher costs from incoming overtime restrictions.**
- **EDION is proactively assessing its capital efficiency with a view to improving ROE & ROIC, with management acutely aware that its current P/B ratio of 0.7x is too low. We expect capital efficiency progress, as well as the >30% dividend payout ratio policy, strong balance sheet & positive FCF, to highlight the stock's appeal, & encourage investors to book time with senior management: [here](#).**

BUSINESS OVERVIEW

EDION is a leading consumer electronics retailer with a remodelling business.

Next event

FY 3/2024 results in May 2024

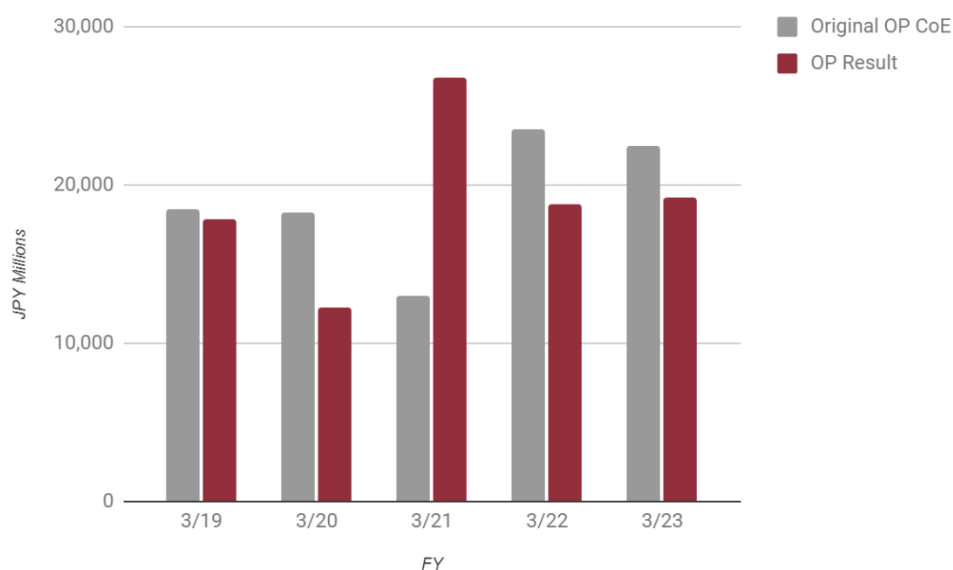
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Year end	3/2022	3/2023	1-3Q 3/2024	3/2024E
Sales (¥bn)	713.8	720.6	537.6	745.0
OP (¥bn)	18.8	19.2	12.3	19.5
NP (¥bn)	13.1	11.4	8.1	11.5
EPS (¥)	125.4	112.4	81.3	116.8
DPS (¥)	44.0	44.0	n/a	44.0
Sales growth YoY (%)	-7.1	1.0	-0.2	3.4
OP growth YoY (%)	-29.8	2.1	-13.6	1.6
NP growth YoY (%)	-21.2	-13.1	-14.2	0.9
EPS growth YoY (%)	-19.3	-10.4	-11.6	3.9
PER (x)	9.1	11.4	n/a	13.2
EV/EBITDA (x)	4.7	5.3	8.8	9.4
PBR (x)	0.6	0.6	0.8	0.8
ROE (%)	6.7	5.7	4.9	n/a
ROIC (%)	5.3	5.6	4.3	n/a
FCF yield (%)	2.6	5.2	n/a	n/a
Dividend yield (%)	3.9	3.4	n/a	2.8

RESULTS VS FORECAST HISTORY



EARNINGS

1-3Q sales were broadly flat YoY at -0.2%YoY versus an OP decline of -13.6%YoY, with EDION achieving 72% & 62.7% of its FY sales & OP targets respectively.

The company's FY 3/24 forecast implies 4Q sales growth of +13.9%YoY, a GPM of 29.6% versus 29.2% in the 1-3Q, & SG&A growth of +16%YoY to Y54.3bn. EDION concedes it is likely to be difficult for sales growth to catch up & achieve the FY forecast, but believes there is margin improvement potential & a cost saving buffer totalling approx. Y7bn that could be realised in the 4Q, which ought to allow it to reach its FY OP target.

- *Sales*: 1H total sales declined -0.3%YoY with 1H total store sales -0.4%YoY. 3Q total store sales were flat YoY due to strong sales of mobile phones in Dec ahead of the regulatory change from Jan 2024¹, limiting discounts.

- *Inbound*: Whilst inbound tourism is picking up, the impact to date has been limited as stores registered for duty free trading account for only 1% of total store sales.

As a result of weaker than expected sales, 1-3Q inventory increased +19%YoY to Y138bn. EDION targets a normalised inventory level of Y115bn in FY 3/25.

- *ELS*: ELS division sales were weak in October due to the negative YoY impact from government subsidies in 2022. Subsidies ended in Nov 2022 & sales have picked up since, with Nov +3.3%YoY & Dec +6.4%YoY. Jan & Feb sales remained strong at +6.4%YoY & +12.4%YoY respectively, with strength expected to continue through March & into FY 3/25 as sales growth normalises.

We note a number of EDION's competitors are pursuing M&A to accelerate growth in this area & that EDION is itself also actively considering M&A.

¹ In Jan 2024, the upper limit on the discount for smartphones linked to phone contracts was raised from the flat rate of Y20,000 to Y40,000 due to the revision of the Ministerial Ordinance on Article 27-3 of the Telecommunications Business Act on 27th Dec 2023.

Sales breakdown of major products:

	3Q YoY	1-3Q YoY	Jan	Feb
TV / video / audio	-7.2%	-8.1%	-2.7%	-7.7%
Fridges	-1.1%	-1.4%	-1.5%	-2.2%
Washing Machines/ Cleaners	-0.2%	1.3%	-1.7%	-9.1%
Aircon	-4.0%	3.5%	-8.3%	-5.2%
PCs	-24.8%	-17.1%	-24.7%	-11%
Mobiles*	20.8%	9.1%	n/a	n/a
Games/ Toys*	13.1%	9.1%	n/a	n/a
ELS	-1.5%	-6.8%	6.4%	+12.4%

* No monthly data provided.

- *GPM*: The 1-3Q GPM declined -0.4ppt YoY to 29.2% due to a shift in sales mix, with continued strength in low margin game-related products & strong sales of low margin mobile phones ahead of the change in law on mobile phone plan discounting from Jan 2024.

3Q sales of high margin air conditioning / heating units declined -4%YoY due to unseasonably warm weather, resulting in 1-3Q air conditioning unit sales growth of +3.5%YoY versus +15.9%YoY in 1-3Q 3/23.

We expect higher margin PC-related sales to improve YoY in Feb & March, versus weak PC & peripheral sales in Feb & Mar FY 3/23 due to the expiry of Windows 8.1, leading to an improved 4Q sales mix.

Jan total store sales declined -4.5%YoY, with ongoing weakness in all categories except for ELS, which posted sales growth of +6.4%YoY following +3.3%YoY in Nov & +6.4%YoY in Dec. Total store sales recovered to +0.4%YoY in Feb with ELS sales leading the growth.

- *PBs*: As of the 3Q, PBs accounted for approx. 26% of total appliance sales versus 25% at the 1H & the medium-term FY 3/26 target of 35%.

EDION continues to launch new e angle products, which feature high functionality at affordable prices. Its latest new product, a dishwasher with automatic washing powder dispensing, was launched on 20th Dec 2023 & has been well received.

On 15th Dec 2023, EDION launched its first 3 jointly developed products with business alliance partner Nitori (9843), under the EDION x Nitori brand, including a steam oven toaster, an electric kettle & a drip kettle, all of which have been well received. EDION has focused on smaller items with its Nitori collaboration to date but is planning to release larger items in 2024.



Collaboration product examples. Source: Company.

- OP: 1-3Q OP declined -13.6%YoY to Y12.3bn as a result of GPM deterioration. SG&A declined -0.2%YoY to Y144.6bn, with the main area of cost control being personnel costs which declined -Y399m YoY to Y59.2bn. Depreciation also declined -Y235m YoY to Y41.9bn, whilst facility costs increased +Y325m YoY to Y41.9bn due to new store openings.

FY 3/24 OUTLOOK

Jan total sales declined -4.5%YoY, making it difficult for EDION to achieve the required +13.9%YoY 4Q sales growth to reach its FY forecast, although Feb total sales recovered slightly to +0.4%YoY. The company has not revised down its FY forecast as it expects a 4Q cost buffer to allow it to make up the shortfall.

- SG&A: EDION expects to continue the strict cost control exercised in the 1-3Q, when SG&A declined -0.2%YoY, indicating the 4Q SG&A increase of +16%YoY to Y54.3bn (+Y7.2bn YoY) implied by its FY forecast is unlikely & therefore represents a buffer.

Within its SG&A figures, the main assumptions are a +Y5.1bn YoY increase to Y18.6bn for facilities & admin costs; +Y1.2bn YoY to Y21.3bn for personnel costs; & +Y1.2bn YoY to Y11.8bn for advertising.

In reality, EDION expects 4Q facility & admin costs to be broadly flat YoY, with ongoing government subsidies keeping utility costs flat YoY. It also aims to maintain advertising at a minimum level & is negotiating with credit card companies on fees given the rise in cashless payments.

- *Shorter store operating hours*: The personnel cost savings that featured in 1-3Q earnings are forecast to continue in the 4Q as EDION reduces operating hours at stores. As of the 3Q, **160 stores were operating between 10am-7pm (from 10am-9pm previously)**, which is set to be extended to 200 stores in FY 3/24.

Cost reductions exceeded expectations, with a decline in personnel costs despite an increase in base salaries. **Reduced operating hours also mean stores become significantly more operationally efficient**, with a working day completed with one 8 hour shift (& a 1 hour lunch break) instead of having to cover 2 shifts or by including overtime pay or adding part-time workers.

The extent of a further roll-out of reduced hour stores in FY 3/25 will depend on the success of the stores trialling shorter hours in FY 3/24. Nonetheless, a number of stores, including those in shopping malls or city centres, are set to continue with their current operating hours.

- *2024 problem:* EDION believes there is a **risk of a significant increase in distribution costs in 2024 due to incoming overtime restrictions** amidst a tight labour market. To minimise any cost rise, it plans to overhaul its contracts with logistics companies, as well as becoming more flexible with delivery times & reducing nighttime deliveries.

- *Store openings:* EDION opened 4 stores but also closed 4 in the 3Q. As of Dec, the total number of stores was 1,211 (456 directly operated, 755 franchise) a net increase of +2 YoY. In Jan-Feb 2024, it opened 2 stores & closed 6 versus its FY 3/24 plan to open 9. No further openings are planned for the 4Q.

In FY 3/25 & over the medium term, EDION plans to open 10 mid-sized stores per year.

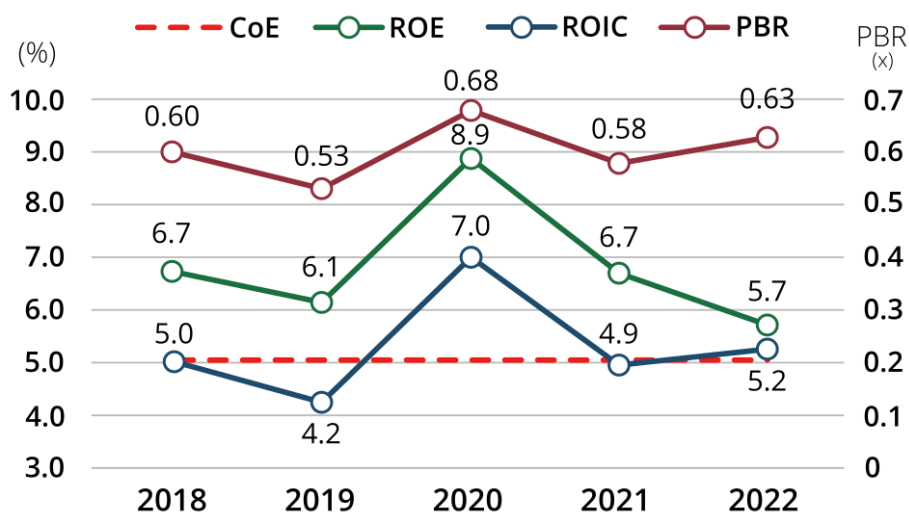
- *Namba flagship store:* On 27th Nov 2023, EDION acquired the trust beneficiary rights related to the land & buildings of the EDION Namba main store. **The store had been leased but was purchased for ¥54bn with a 20-year RoI plan** based on the lease payment savings.

EDION expects an approx. ¥1.3bn annual positive OP impact when calculating the decline in rent & increase in interest payable on debt, with the positive impact on 4Q OP expected to be approx. +¥400m.

The majority of its debt remains in short term variable borrowings, but the company is mindful that it could be vulnerable to an increase in interest rates & therefore secured approx. ¥12bn long-term fixed additional borrowing in Dec 2023. EDION is considering options to limit increases to its interest-bearing debt obligations over the medium term.

- *Yokohama West exit store:* The new, large Yokohama West store opened on 15th Dec 2023. It had a strong start, with historic high opening day sales & long queues despite having limited brand recognition in the Kanto region. **EDION believes the new store can boost brand recognition in the area.**

CAPITAL EFFICIENCY



Source: Company.

EDION is aware of its subpar P/B ratio of 0.7x & is focusing on improving capital efficiency. As of the 3Q, it had a RoE of 5.7% & a cost of capital of 8.7% (5% cost of equity capital plus 3.7%

expected growth rate). To raise its RoE to >8%, **it is working on improving profitability, its capital policy & its cash allocation.**

It is also assessing its medium-term growth vision, aiming to increase investor engagement, improve governance & promote sustainability.

SHAREHOLDER RETURNS

EDION has a dividend payout ratio policy of >30% & plans to pay a FY 3/24 dividend of Y44 (flat YoY) in FY 3/24.

The company completed share buybacks in FY 3/22 & FY 3/23 to set aside shares for potential conversion of its zero coupon CB. Approx. 30% has been converted between Y1,450-1,550, with the remainder currently convertible at Y1,450. Potential total dilution is 10%.

- *Individual shareholder benefit scheme:* EDION has changed its benefit scheme to promote long term shareholding, with benefits accumulating for holding shares for >2 years & >3 years.

Shares owned	Shareholder benefits (giftcard)	Additional benefit for continuous shareholding of >1 year	Additional benefit for continuous shareholding of:		
			1-2 years	2-3 years	Over 3 years
100 ~ 499	Y3,000		Y1,000	Y2,000	Y3,000
500 ~ 999	Y10,000	Y1,000	Y2,000	Y3,000	Y4,000
1,000 ~ 1,999	Y15,000				
2,000 ~ 4,999	Y20,000				
5,000 ~ 9,999	Y25,000				
>10,000	Y50,000	Y2,000	Y2,000	Y3,000	Y4,000

Source: Company

PREVIOUS REPORTS

- EDION (2730) – Initiating Coverage: [‘Capitalising on USPs’](#)

J GAAP Financial statements

Income statement (¥bn)	FY 3/21	FY 3/22	FY 3/23
Sales	768.11	713.77	720.58
COGS	542.5	504.1	509.7
Gross profit	225.6	209.7	210.9
Gross profit margin (%)	29.4	29.4	29.3
Operating expense	198.9	190.9	191.7
Total OP	26.79	18.80	19.19
OP margin (%)	3.5	2.6	2.7
Non-Op Income (Loss)	1.5	-1.0	2.3
Pretax Income	25.3	19.8	16.9
Tax	8.6	6.7	5.5
Effective tax rate (%)	34.2	33.7	32.6
Net income	16.63	13.11	11.39

Balance sheet (¥bn)	FY 3/21	FY 3/22	FY 3/23
Cash & equivalents	43.1	29.9	13.2
Accounts & notes receivable	39.0	39.6	37.9
Inventories	97.9	106.0	116.1
Other short-term assets	12.5	15.1	18.6
Current assets	192.5	190.6	185.7
Property, plant & equipment (net of depreciation)	125.9	125.5	122.1
Long term investments & receivables	2.3	3.3	3.9
Other long-term assets	65.7	58.6	57.6
Total non-current assets	193.9	187.4	183.6
Total assets	386.4	378.0	369.4
Payables & accruals	57.2	49.9	49.4
Short-term debt	3.1	11.0	11.7
Other short-term liabilities	43.5	48.1	46.8
Total current liabilities	103.8	109.0	107.8
Long term debt	53.6	44.5	34.4
Other long-term liabilities	35.1	25.0	25.5
Total non-current liabilities	88.8	69.5	59.9
Total liabilities	192.6	178.5	167.7
Share capital & APIC	96.9	96.9	96.9
Treasury stock	4.9	10.1	15.0
Retained earnings	107.7	118.2	125.1
Other equity	-5.9	-5.5	-5.3
Equity before minority interest	193.8	199.5	201.7
Total equity	193.8	199.5	201.7
Total liabilities & equity	386.4	378.0	369.4

Cash flow statement (¥bn)	FY 3/21	FY 3/22	FY 3/23
Net income/pre-tax profit	16.6	13.1	11.4
Depreciation/amortization	11.5	11.7	11.0
Other non-cash items	15.9	-9.4	4.6
Changes in working capital	-1.1	-4.8	-14.8
Net cash from discontinued operations	0.0	0.0	0.0
Cash from Operating Activities	43.0	10.6	12.1
Change in fixed & intangible assets	-4.9	-8.6	-6.7
Net change in long-term investments	0.0	-0.9	-0.6
Net cash from acquisitions & divestitures	-1.5	0.0	0.0
Other investing activities	-1.5	-1.0	-1.1
Net cash from discontinued operations	0.0	0.0	0.0
Cash from Investing Activities	-8.0	-10.5	-8.3
Dividends paid	-3.6	-4.7	-4.1
Cash from (repayment) debt	-3.9	-2.7	-10.5
Cash from (repurchase) of equity	0.0	-5.4	-5.0
Other financing activities	-0.4	-5.4	-5.0
Net cash from discontinued operations	0.0	0.0	0.0
Cash from Financing Activities	-7.9	-13.2	-20.5
FX impact	0.0	0.0	0.0
Net cash flow	27.1	-13.2	-16.6
Free cash flow	37.4	3.1	6.7
EBITDA	38.3	30.5	30.2

Key metrics	FY 3/21	FY 3/22	FY 3/23
Profitability			
Gross margin (%)	29.4	29.4	29.3
Operating margin (%)	3.5	2.6	2.7
Net margin (%)	2.2	1.8	1.6
ROIC (%)	7.8	5.3	5.6
Liquidity			
Current ratio (x)	1.9	1.7	1.7
Quick ratio (x)	0.8	0.6	0.5
Leverage			
Debt/Equity ratio	29.3	27.9	22.8
Net Debt/Equity ratio	7.1	12.9	16.3

DISCLAIMER

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