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Views from the Japan Equities Small Cap Desk

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"…currently seeing an outstanding recovery trend in ready-built housing sales"

"…homeworking will embed itself in our society in some way or another"

What next for home appliances and furniture store stocks?

While the coronavirus pandemic has taken a heavy toll on the Japanese economy, some industries have been enjoying a surge in demand. Consumers have been stocking up on preserved food and everyday goods during the first wave of the spread of the virus and drugstores as well as food supermarkets have consequently benefited from this shopping spree. They not only saw their sales increase but posted record profits thanks to a decline in costs as they were forced to suspend promotional sales activities.

When the first wave passed its peak and social distancing measures were relaxed, people turned their attention to consumer durables. This uptick in consumption was a result of not only new demand in response to a change in lifestyle such as homeworking but also special cash payments of JPY100,000 (USD940) per person from the government, which also boosted sales of home electronics, furniture and DIY carpentry goods at a rapid pace. Home appliances stores and home improvement centres followed drugstores and grocery stores and booked high earnings across the board.

Additionally, we are currently seeing an outstanding recovery trend in ready-built housing sales. Earnings results of major housing developers for the April-June quarter appeared lacklustre as they were forced to sell their products (detached houses) at discounts to clear their inventories that had piled up in reaction to a last-minute jump in demand ahead of the consumption tax increase in October last year. However, it seems there is a simultaneous feeling of an imminent recovery.

Behind the strong sales of ready-built houses lies a change in lifestyle as in the case of home appliances, furniture and home carpentry goods. While many companies encouraged their employees to work from home, only a few families can prepare a comfortable working environment in their houses. As a result, many employees are feeling a strong sense of frustration at home. To move to bigger and more comfortable houses must be an ardent desire for those who feel their current homes are too small.

If working from home becomes the norm, we no longer have to live close to our offices any more. We may not be putting ourselves at a disadvantage even if we move from condominium complexes near the business district to detached houses that are further away from the city centre or the nearest railway station. In doing so, we will be able to afford a bigger workroom and a more comfortable private space.

Another reason for a strong demand for detached houses is that prices of condominiums have risen so sharply in recent years due to skyrocketing building costs that they have become unaffordable for most people. Given condominiums are mostly built of reinforced concrete, condominium builders and those of office buildings and factories compete each other in securing construction crew, which led to soaring condominium prices in recent times. On the other hand, construction costs of ready-built houses have been relatively stable because they are largely built of wood and demand has been flagging in the long term.

We still do not know how long the current momentum in housing sales will continue as we also have to take into consideration the coronavirus infection status in the future. But even if the pandemic abates smoothly, homeworking will embed itself in our society in some way or another. Given home buying is one of the biggest events in our lives, I do not believe that we can change or turn back our lifestyle that easily.

While stock prices of major housing developers climbed following their earnings announcements for the April-June quarter, their stocks are still trading at 10 times at most the projected earnings for the current fiscal year per share. I believe that their P/E ratios tend to remain low due to two reasons.

1) They are prone to get mired in cut-throat competition because it is difficult for them to differentiate their products from those of industry peers.
2) They always have to take inventory risks in their business operations. But their extremely low valuation might be corrected from now on.

Meanwhile, stock prices of most building material makers have been lagging with P/E ratios hovering at low levels. Despite weak demand for building materials in reaction to the demand rush ahead of the consumption tax hike, I believe their earnings will turn up from the second half of this fiscal year after hitting bottom in the first half, as housing developers are supposed to shift from an inventory adjustment phase to a new development phase.

That said, upturns in other areas are indispensable for a full-scale earnings recovery, given thin profit margins of building materials for ready-built houses. Sales of condominiums may be sluggish for a while given high building costs. But if the costs decline in the mid-term, demand for inexpensive properties in suburbs are likely to gain steam.

With regard to custom-built houses, as their major demands are for rebuilding, they are insulated from the influence of external factors with no conspicuous movements observed. But a change in lifestyle will reach this area, too, sooner or later. There are both positive and negative catalysts in rental housing markets. For example, new demand for small spaces for work may emerge.

Source: Based on article by Tatsuro NIGAURI, published in The Nikkei Online Edition on 28 August 2020

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Tatsuro Nigauri is a Japanese small-cap equities manager with three decades of experience managing money based in Tokyo. He joined the firm in Oct 2002 and has managed the Japan Equity Small Cap Absolute Value strategy since its inception in 2004 and the UCITS funds since their launch in 2017. He started his career as a research analyst at the Daiwa Institute of Research in 1991. Nigauri is an award-winning manager and has received many accolades, including the Lipper Fund Awards Japan (2012, 2013 and 2016), the R&I (Rating and Investment Information) Fund Awards (consecutive years from 2012-2019) and the J Money Fund Awards (2016 and 2017).
He obtained a BA degree in economics from the University of Tokyo in Japan, and is a Certified Member Analyst of the Security Analysts Association of Japan.

NOTE: Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

Disclosures

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