COMPANY RESEARCH AND ANALYSIS REPORT

MonotaRO Co., Ltd.

3064

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst
Hideo Kakuta

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

In FY12/19, once again achieved a YoY increase in sales of more than 20%.
Sales and profits are forecast to continue to increase in FY12/20 for 11 consecutive fiscal periods.
Business with large corporations and new customer acquisitions will drive growth.
The development of new systems to increase the sophistication of the supply chain is progressing as planned

MonotaRO Co., Ltd. <3064> (hereafter, also "the Company") is headquartered in Amagasaki, Hyogo Prefecture. The Company conducts online direct marketing of maintenance, repair, and operating (MRO) products* for production plants and construction work and automobile upkeep through the Internet.

* Maintenance, repair and operating (MRO) products refer to products used in the manufacturing process such as abrasives, drills, and work gloves, which are for internal use by companies and not for resale. The nature of such materials is highly individual for each industry.

A key characteristic of the Company's business model is that it sells MRO products at a single price. This policy has won the Company strong support from small to mid-size customers, who are usually forced to accept unfair prices from sellers in a conventional market. In this way the Company has established a solid position as a unique online direct marketing operator in a niche market. The Company handles more than 18 million items for a customer base of 4,109,000 accounts (as of December 31, 2019) and sells about 590,000 items with same-day shipment (including roughly 461,000 items for which the Company has its own inventories).

1. FY12/19 non-consolidated results

In the FY12/19 full-year, non-consolidated results, sales and profits continued to grow by double digits, with net sales increasing 20.1% year-on-year (YoY) to ¥126,543mn, operating income rising 15.1% to ¥16,430mn, ordinary income growing 15.4% to ¥16,444mn, and net income increasing 15.1% to ¥11,309mn. Net sales continued to grow by more than 20% YoY due to the implementation of various marketing measures. In new customer acquisition, the number of accounts acquired grew due to measures including strengthening listing advertising, conducting search engine optimization (SEO), and broadening the scope of products handled (more than 18 million products). For the number of new accounts in the year, the Company acquired 745,000 accounts (a new record high) for a cumulative total of 4,109,000 accounts. In the online direct marketing business (excluding business with large corporations), sales increased YoY but did not achieve the forecast. The reasons for this are considered to include that demand was less than expected in advance of the hike in the consumption tax, and a slowdown in the manufacturing sector due to changes in the macro-economic environment. In the purchase management system business (business with large corporations), the number of large corporations the Company conducted business with was 817 corporations (up 213 corporations YoY), while net sales were ¥20.1bn (up 48%), and the high sales-growth rate was maintained. The gross profit margin declined 1.1 percentage point (pp) YoY. The main factors behind this were an increase in the delivery cost rate, a decline in the gross profit margin due to changes in the product mix and the increase in business with large corporations, and a fall in overseas royalties. The SG&A expenses ratio fell 0.4pp YoY due to the reduction in the ratio of advertising expenses to net sales and scale effects. As a result of the above, operating income increased 15.1% YoY and the operating income margin declined 0.6pp. The YoY growth was steady, but compared to the Company forecast, operating income was 4.6% below forecast.

2. Consolidated outlook for FY12/20

For the FY12/20 full-year consolidated results, the Company is forecasting that the high growth of almost 20% will be maintained for both sales and profits, with net sales to increase 19.0% YoY to ¥156,468mn, operating income to rise 17.2% to ¥18,569mn, ordinary income to grow 17.0% to ¥18,584mn, and net income attributable to owners of the parent to increase 18.3% to ¥12,997mn. If these forecasts are achieved, sales will increase for 19 consecutive fiscal periods and profits for 11 consecutive periods. To increase sales, the priority strategies will be to expand new customer acquisition and to increase sales to existing customers, and to promote the purchase management system business (business with large corporations). A strength of the Company is that it is able to progress various marketing measures based on the further utilization of the search and purchase behavior data that it has obtained from more than 4 million accounts. The purchase management system business (business with large corporations) is also expected to achieve a high growth rate in this fiscal period. The activities of the sales base in Nagoya, which was opened in the previous fiscal period, will become fully fledged. The gross profit margin is forecast to increase slightly to 28.5% (up 0.3pp YoY). The SG&A expenses ratio tends to fall in a typical year due to scale effects, but it is expected to increase slightly in this fiscal period, to 16.7% (up 0.5pp). This will be mainly due to the costs to introduce new systems. As a result, operating income is forecast to increase 11.9% compared to sales (down 0.2pp YoY) and 17.2% YoY. The Company has continued to achieve growth rates of around 20% for both sales and profits, thanks to the overwhelming strength of its business model. In this fiscal period, it is expected to further fine tune this business model through introducing new systems (for product information management and orders management). The results forecasts for upcoming fiscal periods do not reflect the effects of the COVID-19 coronavirus.

3. The development of new systems to increase the sophistication of the supply chain is progressing as planned. The Korean business achieved break-even

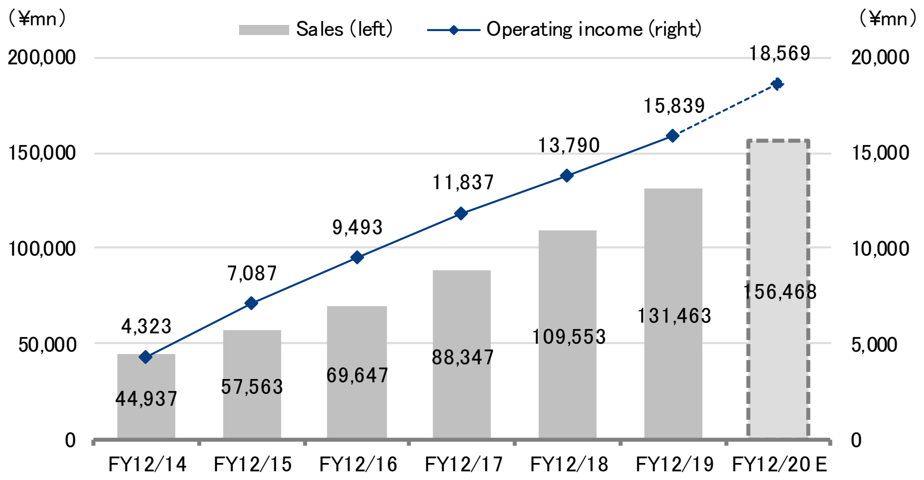
The project to develop new systems, which is being progressed to increase the sophistication of the supply chain, is progressing according to plan. The initial versions are scheduled to start operations in the first half of 2020. The Company started this project at the beginning of 2019 to introduce new systems for product information management and ordering management. Both are important initiatives that will affect the productivity and the service level of the next generation of Company businesses. The product information management system will improve the efficiency of the handling of many products. In the future, the aim is to make the system multilingual so that the production information input by suppliers can be shared with overseas bases as well. The orders management system will be able to reduce delivery lead times by judging the optimal delivery method based on a variety of rules, and it is expected to lead to improved convenience and an increase in orders. Also, the aims for it includes standardizing distribution operations and minimizing separated loadings, which will enable the Company to further optimize the distribution network and keep down delivery and distribution-related costs. For both systems, as the first phase, the initial versions will start operations in the first half of 2020 (around April) and subsequently, the Company plans to conduct their second phase of development.

In 2013, the Company established the consolidated subsidiary NAVIMRO, which started an online direct marketing business of MRO products in South Korea. Its sales have been increasing each year, and it achieved break-even for operating income for the first time in FY12/19, its seventh year of business. In FY12/19, its net sales were ¥4.51bn and operating income was ¥0.01bn. For FY12/20, the forecasts are for net sales of ¥5.4bn and operating income of ¥0.08bn. It uses the same business model as in Japan, so sales and profits are expected to grow stably in the future as it realizes scale effects and long-tail effects alongside its expansion in scale.

Key Points

- In FY12/19, once again achieved a YoY increase in sales of more than 20%. Results were slightly below forecast due to the effects of the consumption tax hike and the slowdown in demand from the manufacturing industry.
- For FY12/20, the forecast is for higher earnings for 11 consecutive fiscal periods. Business with large corporations and new customer acquisitions will drive growth.
- The development of new systems to increase the sophistication of the supply chain is progressing as planned, and they are scheduled to be released around April 2020. The Korean business achieved break-even.

Trends in net sales and operating income (consolidated)



Source: Prepared by FISCO from the Company's financial results

Results trends

In FY12/19, once again achieved a YoY increase in sales of more than 20%. Results were slightly below forecast due to the effects of the consumption tax hike and the slowdown in demand from the manufacturing industry

● Review of FY12/19 results (non-consolidated)

In MonotaRO's FY12/19 full-year, non-consolidated results, sales and profits continued to grow by double digits, with net sales increasing 20.1% YoY to ¥126,543mn, operating income rising 15.1% to ¥16,430mn, ordinary income growing15.4% to ¥16,444mn, and net income increasing 15.1% to ¥11,309mn.

Net sales continued to grow by more than 20% YoY due to the implementation of various marketing measures. In new customer acquisition, the number of accounts acquired grew due to measures including listing advertising and SEO measures, which enable one's own site to appear at the top of search engine results, and broadening the scope of products handled (more than 18 million products). For the number of new accounts in the year, it acquired 745,000 accounts (a new record high) for a cumulative total of 4,109,000 accounts. Sales to existing customers grew steadily, as the Company continued to implement measures to improve the frequency of use. In the online direct marketing business (excluding business with large corporations), sales increased YoY but did not achieve the forecast. The reasons for this are considered that demand was less than expected in advance of the hike in the consumption tax, and a slowdown in the manufacturing sector due to changes in the macro-economic environment. In the purchase management system business (business with large corporations), the number of large corporations the Company conducted business with was 817 corporations (up 213 corporations YoY), while net sales were ¥20.1bn (up 48%), and the high sales-growth rate was maintained

Gross margin dropped 1.1 pp YoY. The main reasons of this were a 0.4 pp decrease in the delivery cost ratio and a 0.1 pp decrease in the gross profit margin due to changes in the product mix and an increase in business with large corporations. An additional impact was felt due to a decline in overseas royalties. Although the Zoro business itself in the United States is growing steadily, profits decreased due to prioritizing investment in systems development for continuous growth, and alongside this, royalties declined more than expected. The SG&A expenses ratio fell 0.4pp YoY, mainly because of the reduction in the ratio of advertising expenses to net sales (change of the framework for catalogue production, reduction in TV commercials, etc.) and scale effects due to the increase in sales.

As a result of the above, operating income increased 15.1% YoY and the operating income margin declined 0.6pp. The YoY growth was steady, but compared to the Company forecast, operating income was 4.6% below forecast.

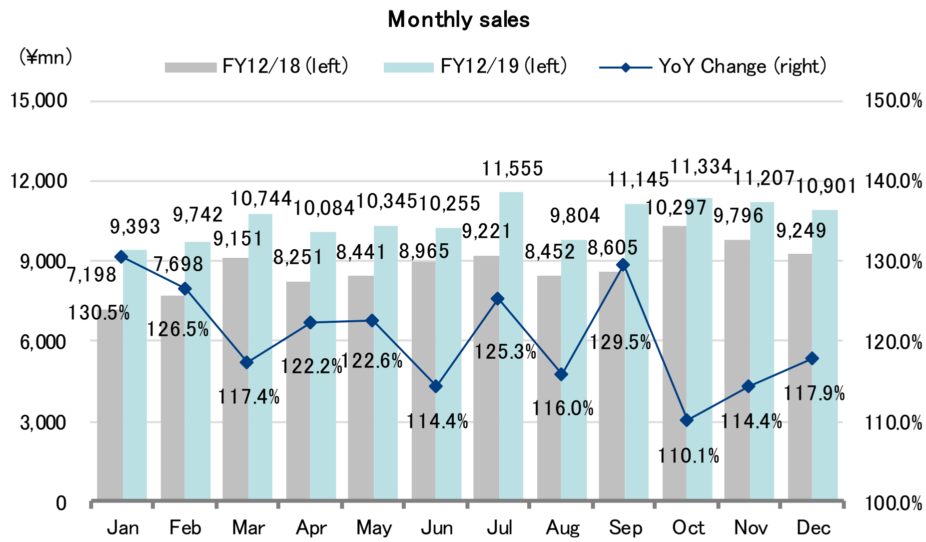
Non-consolidated income summary for FY12/19

(¥mn)

	FY12/18		FY12/19			Change factors
	Results	vs. sales	Results	vs. sales	YoY	
Sales	105,331	100.0%	126,543	100.0%	20.1%	• Increased new accounts (up 745,000 accounts) through various successful measures, including enhancing keyword search and product listing advertisements, strengthening SEO, and broadening the scope of products handled • In the purchase management system business (business with large corporations), sales rose (up 48% YoY) due to the increases in the numbers of corporations and users
Gross profit	31,147	29.6%	36,111	28.5%	15.9%	• Gross margin dropped 1.1 pp YoY • Delivery cost ratio increased (down 0.4 pp) • Changes in product mix (decline in the gross profit margin due to the increase in new products and the rise in the NB products sales ratio) and increase in business with large corporations (down 0.1pp) • Impact of a decrease in overseas royalties, etc.
SG&A expenses	16,868	16.0%	19,681	15.6%	16.7%	• SG&A expense ratio declined 0.4 pp YoY • The main factors were the reduction in the ratio of advertising expenses to net sales, and scale effects from the increase in sales
Operating income	14,278	13.6%	16,430	13.0%	15.1%	• Net sales ratio dropped 0.6 pp YoY
Ordinary income	14,250	13.5%	16,444	13.0%	15.4%	• Net sales ratio dropped 0.5 pp YoY
Net income	9,825	9.3%	11,309	8.9%	15.1%	• The percentage of sales decreased 0.4pp YoY, the tax rate declined.

Source: Prepared by FISCO from the Company's results briefing materials

Results trends



Source: Prepared by FISCO from the Company's results briefing materials

Business outlook

The outlook for FY12/20 is for sales and profits to increase for 11 consecutive fiscal periods. Business with large corporations and new customer acquisition will drive the growth

● Consolidated outlook for FY12/20

For the FY12/20 full-year consolidated results, the Company is forecasting that the high growth of almost 20% will be maintained for both sales and profits, with net sales to increase 19.0% YoY to ¥156,468mn, operating income to rise 17.2% to ¥18,569mn, ordinary income to grow 17.0% to ¥18,584mn, and net income attributable to owners of the parent to increase 18.3% to ¥12,997mn. If these forecasts are achieved, sales will increase for 19 consecutive fiscal periods and profits for 11 consecutive periods.

To increase sales, the priority strategies will be to expand new customer acquisition and to increase sales to existing customers, and to promote the purchase management system business (business with large corporations). The consolidated net sales growth rate 19.0% is forecast to be close to the level of the previous fiscal year (20.0%). For new customer acquisition, the Company will progress various marketing measures based on the further utilization of the search and purchase behavior data that it has obtained from more than 4 million accounts, and it is aiming for 918,000 new accounts (compared to 745,000 accounts in the previous fiscal period). In these measures, its policy is to refine the method of inferring the lifetime value of potential customers from Big Data to determine whether to strengthen or weaken marketing investment. The measures to increase sales to existing customers include implementing promotions that are optimized according to customer attributes, and also introducing the orders management system, which will shorten delivery times and increase sales per existing customer. In the purchase management system business (business with large corporations), in FY12/20 net sales are forecast to be ¥27.2bn (up 35% YoY) and the high growth rate is expected to be maintained in future fiscal periods also. The Company opened the sales base in Nagoya in the previous fiscal period, and activities in the Chubu region will become fully fledged. Royalties from overseas are forecast to decline slightly, due to a reduction in profits at the parent company, Grainger, because of the continued investment in the Zoro business in the United States and Europe.

The gross profit margin is forecast to increase slightly to 28.5% (up 0.3pp YoY). Although the increase in the percentage of net sales provided by the business with large corporations will act in the direction of reducing the profit margin, the profit margin is expected to be pushed up by the optimization of purchasing and the increase in product gross profit due to the strong yen. The SG&A expenses ratio tends to fall in a typical year due to scale effects, but it expected to increase slightly in this fiscal period to 16.7% (up 0.5pp). This is because in FY12/20, following the start of use of the product information management and orders management systems, there will be system usage fees, depreciation and amortization expenses, and personnel and other expenses. As a result, operating income is forecast to increase 11.9% compared to sales (down 0.1pp YoY) and 17.2% YoY. The Company has continued to achieve growth rates of around 20% for both sales and profits, thanks to the overwhelming strength of its business model. In this fiscal period, it is expected to further fine tune this business model through introducing new systems (for product information management and orders management). The results forecasts for upcoming fiscal periods do not reflect the effects of the COVID-19 coronavirus.

Consolidated targets

(¥mn)

	FY12/19		FY20/12		
	Results	vs. sales	Forecast	vs. sales	YoY
Sales	131,463	100.0%	156,468	100.0%	19.0%
Gross profit	37,095	28.2%	44,653	28.5%	20.4%
SG&A expenses	21,256	16.2%	26,084	16.7%	22.7%
Operating income	15,839	12.0%	18,569	11.9%	17.2%
Ordinary income	15,887	12.1%	18,584	11.9%	17.0%
Net income attributable to owners of the parent	10,984	8.3%	12,997	8.3%	18.3%

Source: Prepared by FISCO from Company material

Topics

The development of new systems to increase the sophistication of the supply chain is progressing according to plan, and they are scheduled to be released around April 2020. The Korean business achieved break-even

1. The development of new systems to increase the sophistication of the supply chain is progressing according to plan (scheduled to be released around April 2020)

The project to develop new systems, which is being progressed to increase the sophistication of the supply chain, is progressing according to plan. The initial versions are scheduled to start operations in the first half of 2020. The Company launched this project to introduce new systems for product information management and ordering management at the beginning of 2019. Both are important initiatives that will affect the productivity and the service level of the next generation of Company businesses. A product information management system is essential to improve efficiency when many products are handled, such as in the Company's case (it currently handles more than 18 million products). In the future, the Company aims to make the system multilingual so that the production information input by suppliers can be shared with overseas bases as well. Also, the Company has a business model of making deliveries from multiple inventory bases, so an orders management system is necessary to increase the sophistication of these operations. The new system can reduce delivery lead times by judging the optimal delivery method based on a variety of rules, and it is expected to improve convenience and increase orders. Also, the aims for it includes standardizing distribution operations and minimizing separated loadings, which will enable the Company to further optimize the distribution network and keep down delivery and distribution-related costs. For both systems, the initial versions will start operations in the first half of 2020 (around April) as the first phase and subsequently, the Company plans their second phase of development.

Building a new IT platform that will increase the sophistication of the supply chain

	Product information management system	Orders management system
Objectives and functions	■ Building the base of a master database (of products, vendors, etc.) to respond to the growth in product information alongside the increase in the number of products handled. ■ Opening a portal site for suppliers and establishing and maintaining workflow in order to improve efficacy in obtaining information and reduce costs in the future ■ Making product information multilingual for smooth overseas business development	■ Will determine the optimal delivery method based on various rules to reduce delivery lead times, which will lead to improvement of convenience and an increase in orders ■ Aiming to standardize distribution operations and minimize separated loadings, which will enable the Company to further optimize the distribution network and keep down distribution-related costs
Development method	Customization of one part based on packages	Customization of one part based on packages
Start of project preparations	Start of 2019	Start of 2019
Start of operations (initial versions)	First half of 2020 (scheduled for around April, progressing according to plan)	First half of 2020 (scheduled for around April, progressing according to plan)

Source: Prepared by FISCO from Company material

2. Plans a distribution network able to respond to an increase in the sales scale

The Company's FY12/19 full-year distribution-related costs increased 6.1% compared to sales (up 0.1pp YoY). Although progress has been made in shifting to the Kasama Distribution Center (DC) (more than 50%), which has advanced automation, it increased the unit salary for part-time workers in order to secure personnel at both of the DC. The FY12/20 distribution-related costs ratio forecast is 5.8% (down 0.3pp). Due to the effects of expanding the Kasama DC, it is expected that the personnel costs and outsourcing costs ratio will decrease from the shift to the Kasama CD.

While controlling the ratio of distribution costs, the Company will take on the challenge of achieving both a reduction in delivery lead times and an increase in distribution capacity. In FY2021, the newly established Ibaraki Chuo Satellite Center (SC) (Ibaraki Town, Higashi Ibaraki District, Ibaraki Prefecture) will become operational. This center is located 10 minutes by car from the Kasama DC, and it will mainly function as the Kasama DC's backyard to store products unloaded from the overseas containers arriving from the Hitachinaka Port. It is scheduled to have a shipping function, centered on high-demand products, such as PB products. The site has already been secured and the Company is currently investigating the buildings and equipment. The plan for FY2022 is to open the Inagawa DC (Inagawa Town, Kawabe District, Hyogo Prefecture) as a state-of-the-art DC in the Kansai area. The total floor space is expected to be around 130,000m2, which would be approximately triple that of the Amagasaki DC (total floor space: 44,000m2). The usable floor space will be gradually expanded alongside the increase in shipments. It will be a multi-floor center, and the plan is to conduct rentals. Once the Ibaraki Chuo SC and the Inagawa DC are established, the Company will be able to respond to an even further increase in sales scale. Moreover, it is currently considering DC in the next fiscal period, including their necessity.

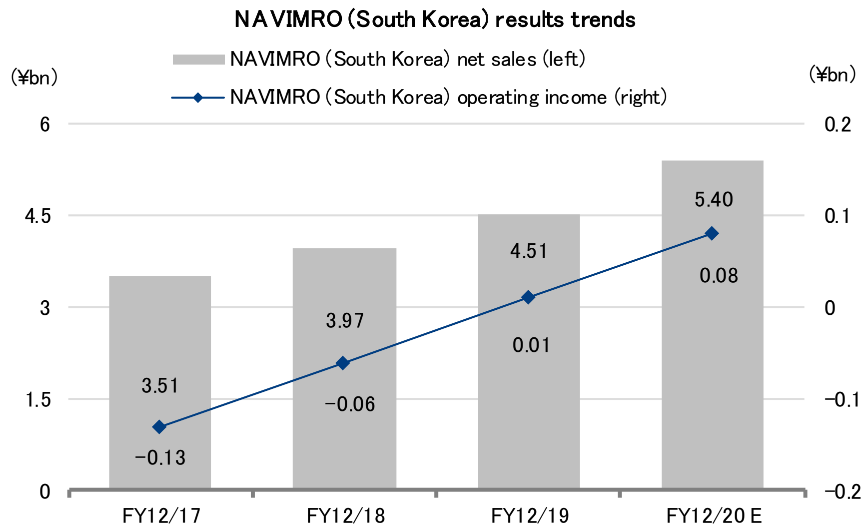
List of new installation conditions

Name (tentative)		Ibaraki Chuo SC	Inagawa DC
Address		Ibaraki-machi, Higashi Ibaraki-gun, Ibaraki Pref.	Inagawa-cho, Kawabe-gun, Hyogo Pref.
Floor size		About 49,000m^2	About 130,000m^2 (Expand floor size gradually)
Start Operation		About April 2021	About April 2022
Delivery Capacity		About 30,000 lines / day	About 180,000 lines / day (Start with about 100,000 lines / day)
Inventory Capacity		20,000-30,000 SKU, high demand products (Main function is back yard)	500,000 SKU
Invest・Rental Amount	Land	About 1.3 billion JPY	Rent: About 17.1 billion JPY (Dec. 2021 – Nov. 2031 Total Rent in ten-year-contract term)
	Building	About 6.0 billion JPY (Under examining)	
	Equipment		Under examining
Remark		Main function is back yard for Kasama DC. Having also function of shipping high-demand products. Storing imported products landed at Hitachinaka Port.	Renting 3 floors of 4 in first year. Renting another floor as shipping level goes up.
Construction Status		Development and preparation of site	Development and preparation of site
Picture			

Source: From the Company's results briefing material

3. NAVIMRO (South Korea) achieved break-even

In 2013, the Company established the consolidated subsidiary NAVIMRO, which started an online direct marketing business of MRO products in South Korea. Its sales have been increasing each year, and it achieved break-even for operating income for the first time in FY12/19, its seventh year of business. In FY12/19, net sales were ¥4.51bn and operating income was ¥0.01bn. For FY12/20, the forecasts are for net sales of ¥5.4bn and operating income of ¥0.08bn. It uses the same business model as in Japan, so sales and profits are expected to grow stably in the future as it realizes scale effects and long-tail effects alongside its expansion in scale.



Source: Prepared by FISCO from the Company's results briefing materials

Shareholder return policy

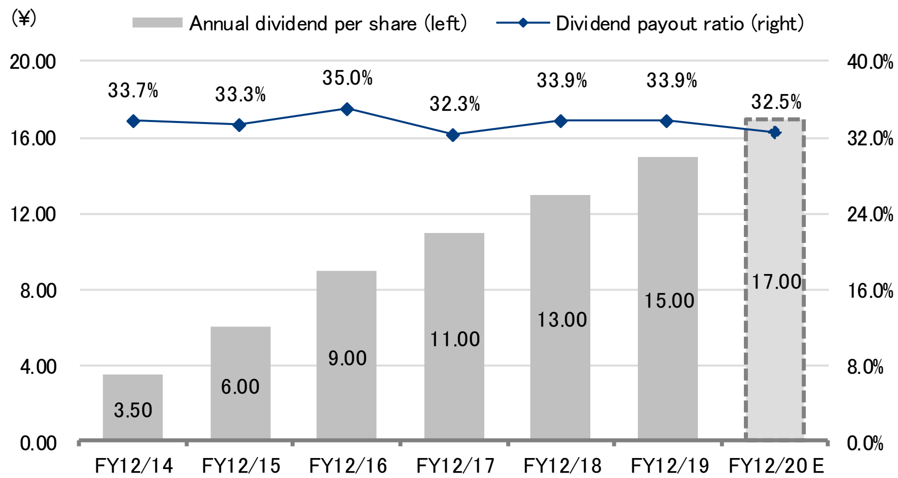
In FY12/19, increased the dividend for the six consecutive years. Forecasting a ¥17 dividend in FY12/20 (up ¥2 YoY), 32.5% dividend payout ratio

The Company adheres to a policy of paying a stable dividend in line with earnings. It has delivered six consecutive years of dividend increases since FY12/13 (a dividend of ¥3.0 per share) and maintained a dividend payout ratio of 30% or higher. The FY12/19 dividend was ¥15 (up ¥2 YoY, ¥7.5 at the end of 2Q and ¥7.5 at the period end), and the dividend payout ratio was 33.9%. As the Company's profit growth rate is high, we can expect a high pace of dividend increase in the future.

The Company offers shareholder benefits in the form of private-brand product gifts for each shareholder holding 100 or more shares for at least six months at the end of the fiscal year (December 31) (worth ¥3,000 for six months or longer, ¥5,000 for three years or longer, and ¥7,000 for five years or longer). The rate of conversion to products has also been favorably received.

* Excluding tax

Dividends and dividend payout ratio



Note: The Company conducted 2-for-1 stock splits in FY12/15 and FY12/18. We retroactively adjusted dividend values for the share split.
Source: Prepared by FISCO from the Company's financial results

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■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp