COMPANY RESEARCH AND ANALYSIS REPORT

MonotaRO Co., Ltd.

3064

Tokyo Stock Exchange Prime Market

3-Oct.-2023

FISCO Ltd. Analyst

Hideo Kakuta

FISCO

FISCO Ltd.

https://www.fisco.co.jp

Index

Summary

Double-digit net income and profit increase YoY in FY12/23 2Q. Developed measures effective at improving the purchasing frequency of customers with low order frequency

MonotaRO Co., Ltd. <3064> (hereinafter “the Company”), headquartered in Amagasaki, Hyogo Prefecture, conducts online direct marketing of maintenance, repair and operating (MRO) products. The main characteristics of MRO products are that they encompass a wide range of items used in manufacturing processes. Some examples of MRO products are abrasives, drills, and work gloves. The nature of such materials is highly individual for each industry. The MRO products market has a size of ¥5-10 trillion, and the main sales channels are door-to-door tool dealers, hardware stores, and auto parts dealers, among others. The online marketing channel has a high growth performance. Peer companies in the same industry include ASKUL Corporation <2678>, MISUMI Group Inc. <9962>, and Amazon Japan G.K.

A key characteristic of the Company’s business model is that it sells MRO products at a unified price. This policy has won the Company strong support, mainly from small- and medium-sized companies, which are usually forced to accept uncertain prices. In this way, the Company has established a solid position as a unique online direct marketing operation in a niche market. The Company serves a wide range of client sectors. The manufacturing, building and construction, and automobile-related sectors represent more than 60% of its business. In the past few years, the purchase management system business (business with large companies) has also been growing rapidly. The Company handles more than 20 million items for a customer base of 8,578,000 accounts (as of June 30, 2023) and possesses an inventory of 519,000 items. The Company’s MRO product platform is differentiated by factors such as an unparalleled lineup of long-tail products and cost effective private-brand (PB) products (around 330,000 products), product recommendations on its website and short lead times. The Company has delivered exceptional financial results in terms of profitability and stability, with an ROE of 28.4% (in FY12/22) and an equity ratio of 65.9% (as of June 30, 2023), in addition to high growth performance exceeding double digits.

1. FY12/23 2Q non-consolidated results

In the FY12/23 2Q non-consolidated results, the Company achieved stable increases to both sales and profit, as net sales increased 13.0% year on year (YoY) to ¥119,347mn, Operating Income rose 17.6% to ¥15,923mn, and net income grew 18.0% to ¥11,205mn. In comparison to the initial plan, net sales fell short (by 3.2%), but Operating Income and net income were both higher. Results in the mainstay businesses of online direct marketing business for companies and purchase management system business (business with large companies) were slightly lower than expected. One reason cited for this is the number of existing customers who have not made orders. The number of customers increased steadily from the end of the previous period to 571,000 accounts. Operating Income exceeded the plan mainly because the gross profit margin was higher than expected and because SG&A expenses were lower than planned. The Operating Income margin increased by 0.5 percentage points (pp) YoY to 13.3%, 0.8pp above the plan, which showed steady progress.

2. Consolidated outlook for FY12/23

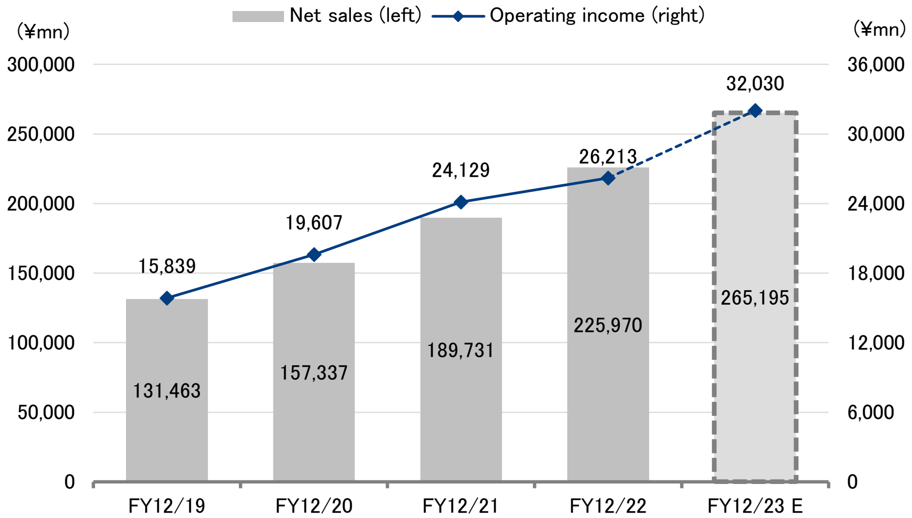
For the FY12/23 full-year consolidated results, the Company's forecasts are for net sales to increase 17.4% YoY to ¥265,195mn, Operating Income to rise 22.2% to ¥32,030mn, ordinary income to grow 21.2% to ¥31,986mn, and net income attributable to owners of the parent to increase 22.1% to ¥22,789mn. Forecasts call for double-digit growth (according to the initial plan) in net sales and every profit item. In online direct marketing business, the Company is forecasting 1.18 million accounts will be newly registered (1.22 million accounts in the previous fiscal year), on par with a year ago. As for existing customers, the Company expects growth to slow slightly, but will strengthen measures on all fronts including advertising and distribution. In particular, since personalized flyers are expected to be effective in the medium term for making customers with low order frequency (including dormant customers) restart using MonotaRO services, increasing order frequency, and increasing the number of product types ordered, a budget was added during the term to strengthen measures. High growth is expected to continue in the purchase management system business (business with large companies) as well. In royalty business, Zoro's business in the US and Europe was expected to achieve increases sales and profit at the start of FY12/23, but grew at a slower pace than expected given macro-related factors in the US in 1H. In terms of Operating Income, the Company forecasts an Operating Income margin of 12.1% (up 0.5pp YoY) and a 22.2% YoY increase in the amount of Operating Income.

Following the end of FY12/23 2Q, the main factors behind the change in results materialized. Negative factors include worsening business confidence in the manufacturing sector and concerns about a slowdown in growth in the number of ordering customers and volume per order due to higher sales per. Positive factors include an ease in the rise of import costs (container shipping rates, etc.) and improvements to the sales ratio of delivery costs stemming from an increase in sales per package. At the end of FY12/23 2Q, the rate of progress compared to the full-year plan was 46.9% for net sales (48.6% in the same period of the previous fiscal year) and 48.0% for Operating Income (50.1%). We at FISCO expect net sales to weaken slightly due to the impact of the external environment, much like in 1H, but forecast that each profit item will draw close to the full-year plan, assuming that factors such as the effects of price revisions and lower delivery costs continue.

Key Points

- Double-digit net income and profit increase YoY in FY12/23 2Q. Net sales fell just short of the plan as the growth in the number of ordering customers was less than expected
- Operating Income in FY12/23 will increase 22% YoY to ¥32.0bn (according to the plan). Results expected to draw close to the profit plan through the effect of price revisions and improved shipment efficiency, despite a weak achievement of the sales plan
- Will promote use by customers with low order frequency by sending personalized flyers from a medium-term perspective
- The Company has continued to increase dividends for over 10 years. For FY12/23, it forecasts a dividend of ¥16.0 per share (up ¥2.5 YoY) and a dividend payout ratio of 34.8%

Trends in net sales and operating income (consolidated)



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

Results trends

Double-digit net income and profit increase YoY in FY12/23 2Q. Net sales fell just short of the plan as the growth in the number of ordering customers was less than expected

In the FY12/23 2Q non-consolidated results, the Company achieved stable increases to both sales and profit, as net sales increased 13.0% YoY to ¥119,347mn, Operating Income rose 17.6% to ¥15,923mn, and net income grew 18.0% to ¥11,205mn. In comparison to the initial plan, net sales fell short (by 3.2%), Operating Income income and net income were both higher.

Results in the mainstay businesses of online direct marketing business for companies and purchase management system business (business with large companies) were slightly lower than expected. One reason cited for this is the number of existing customers who have not made orders. The number of customers increased steadily from the end of the previous period to 571,000 accounts. In purchase management system business (business with large companies), on a non-consolidated basis, the number of large companies the Company conducted business with increased by 563 companies YoY, and net sales showed high growth with a 35.4% YoY increase. However, these figures fell just short of the plan.

Operating Income increased steadily by 17.6% YoY mainly as a result of an increase in gross profit from price changes and a decrease in delivery cost rates due to an increase in sales per package. Operating Income exceeded the plan mainly because the gross profit margin was higher than expected and because SG&A expenses were lower than planned. SG&A expenses decreased by 4.2%, and the SG&A expenses ratio dropped 0.1pp or 17.0% compared to the plan, mainly due to a decrease in the ratio of other expenses (such as facilities maintenance costs) and a decrease in the outsourcing expenses ratio (such as cost of temporary staff at DC due to a decrease in the number of boxes shipped). As a result, the Operating Income margin showed steady progress by increasing 0.5pp YoY to 13.3% which was 0.8pp higher than expected. The Company is also incredibly financially sound, with an equity ratio of 65.9% (as of June 30, 2023) and a current ratio of 201.2% (as of June 30, 2023).

Non-consolidated income summary for FY12/23 2Q

(¥mn)

	FY12/22 2Q		FY12/23 2Q						YoY		Compared to forecasts	
	Results	vs. sales	Forecast	vs. sales	Results	vs. sales	YoY	Compared to forecasts	Progress*	Reasons for change	Progress*	Reasons for change
Net Sales	105,653	100.0%	123,309	100.0%	119,347	100.0%	13.0%	-3.2%	○	[Online direct marketing business for companies (monotaro.com)] • Sales rose on growth in the sales price per order and the frequency of orders • The number of customers increased (up by 1,162,000 accounts)	△	[Online direct marketing business for companies (monotaro.com)] • Fell short of the plan mainly because the number of customers who placed the order was lower than expected. It appears that the increase of product prices and the economy had an impact
(Of which net sales of business with large companies)	23,636	22.4%	33,254	27.0%	31,993	26.8%	35.4%	-3.8%	○	• Continual high growth (up 35.4% YoY) due to an increase in the number of customers and number of ordering customers	△	• Plan unachieved (down 3.8% from the forecast)
Gross Profit	30,708	29.1%	36,572	29.7%	36,174	30.3%	17.8%	-1.1%	○	• The gross profit margin increased 1.2pp YoY • Increased product gross profit ratio (up 0.7pp as a result of gradual changes to sales prices made from FY12/22 2Q, etc.) • Delivery cost ratio and various expense ratios (up 0.6pp due to the impact of increased sales per package, etc.) • The amount of royalties received decreased, etc.	△	• The gross profit margin was 0.6pp above forecast • Increased product gross profit ratio (up 0.4pp due to improvements in the gross profit ratio for both domestic and imported products) • Improved delivery cost ratio and various expense ratios • Decreased royalties received (up 0.5pp due to the impact of increased sales per package, import shipping fees, etc.)
SG&A expenses	17,167	16.2%	21,142	17.1%	20,250	17.0%	18.0%	-4.2%	○	• The SG&A expenses ratio increased 0.8pp YoY • Increased personnel costs due to increased wages, etc. (up 0.4pp) • Higher facilities rent expense accompanying operation of the Inagawa DC (up 0.4pp), higher depreciation (up 0.3pp), etc.	○	• SG&A expenses down 4.2% vs. the plan, SG&A expenses ratio down 0.1pp • Decreases to other expense ratios (facilities maintenance costs, equipment and consumable costs, down 0.4pp) • Decreased outsourcing expenses ratio (cost of temporary staff at DC decreased due to decrease in number of boxes shipped, down 0.2pp)
Operating Income	13,540	12.8%	15,429	12.5%	15,923	13.3%	17.6%	3.2%	○	• Amount of Operating Income increased 17.6% YoY due to increased gross profit • Operating Income margin increased 0.5pp YoY mainly due to improvement to gross profit margin	○	• Operating Income was 3.2% above forecast and the Operating Income margin was 0.8pp above forecast, owing mainly to a decrease in SG&A expenses
Net income	9,493	9.0%	10,696	8.7%	11,205	9.4%	18.0%	4.8%	○	• The net income margin increased 0.4pp YoY due to an increased operating income margin, etc.	○	• The net income margin was 0.7pp above forecast

* FISCO's assessment of progress
Source: Prepared by FISCO from the Company's financial results summary

Business outlook

Operating Income in FY12/23 expected to increase 22% YoY to ¥32.0bn. Aims to achieve the profit plan through the effect of price revisions and improved shipment efficiency, despite a weak achievement of the sales plan

For the FY12/23 full-year consolidated results, the Company's forecasts are for net sales to increase 17.4% YoY to ¥265,195mn, Operating Income to rise 22.2% to ¥32,030mn, ordinary income to grow 21.2% to ¥31,986mn, and net income attributable to owners of the parent to increase 22.1% to ¥22,789mn. Forecasts expect double-digit growth in net sales and every profit item.

The Company expects continual high growth for net sales by17.4%, despite falling 1.7pp from FY12/22 (up 19.1% YoY). The Company's annual forecasts are determined by predicting growth separately for the online direct marketing business, new and existing and for the business with large companies, and then adding them up. In new online direct marketing business, the Company is forecasting new account registrations in line with the previous fiscal year, at 1.18mn accounts (versus 1.22mn accounts in the previous fiscal year). The Company will strive to optimize customer acquisition from the perspective of balancing Life Time Value (LTV) and acquisition costs, focusing on promising corporations. As for existing customers, the Company expects total sales growth to be slightly lower but will strengthen measures on all fronts including advertising and distribution. It intends to keep working to personalize search results and otherwise improve sales site functions so that customers can find the products they are looking for faster, thereby enhancing their experience. It also intends to strengthen measures for personalized fliers during the term as a measure since they are expected to be effective in making customers with low order frequency (including dormant customers) restart using MonotaRO services, increasing order frequency, and increasing the number of product types ordered. In the purchase management system business (business with large companies), the Company is forecasting net sales of ¥69,250mn (up 38.4% YoY) in FY12/23, calling for ongoing sharp growth. While stepping up communication with customers, it plans to help improve the productivity of customers' MRO product purchasing operations in part by enhancing the purchase management system's search functions. In royalty business, Zoro's business in the US and Europe was expected to achieve increases sales and profit at the start of FY12/23, but grew at a slower pace than expected given macro-related factors in the US in 1H.

The annual gross profit margin is forecast to increase to 29.5% (up 0.5pp YoY). Positive effects throughout FY12/23 from price revisions made from FY12/22 2Q, an impact on the product gross profit ratio from a decline in the sales ratio of imported products, and a rise in sales per package among others are expected. The SG&A expenses ratio is expected to be broadly flat versus. FY12/22 at 17.4%. Depreciation related to the Inagawa DC Phase 2 launch and personnel costs including for raising the wages of all employees are planned. As a result, the Company is forecasting an operating margin of 12.1% (up 0.5pp YoY) and Operating Income growth of 22.2% YoY.

Following the end of FY12/23 2Q, the main factors behind the change in results materialized. Negative factors include worsening business confidence in the manufacturing sector and concerns about a slowdown in growth in the number of ordering customers. Positive factors include an ease in the rise of import costs (container shipping rates, etc.), improvements to the sales ratio of delivery costs stemming from an increase in sales per package, and the establishment of effective sales promotion methods for customers with low order frequency, although short-term effects are not expected. At the end of FY12/23 2Q, the rate of progress compared to the full-year plan was 46.9% for net sales (48.6% in the same period of the previous fiscal year) and 48.0% for Operating Income (50.1%). We at FISCO expect net sales to weaken slightly due to the impact of the external environment, much like in 1H, but anticipate that each profit item will draw close to the full-year plan, assuming that factors such as the effects of price revisions and lower delivery costs will continue.

FY12/23 consolidated results forecasts

(¥mn)

	FY12/22		FY12/23			
	Results	vs. sales	Forecasts	Results	YoY	2Q progress rates
Net sales	225,970	100.0%	265,195	100.0%	17.4%	46.9%
Gross profit	65,437	29.0%	78,288	29.5%	19.6%	-
SG&A expenses	39,224	17.4%	46,258	17.4%	17.9%	-
Operating Income	26,213	11.6%	32,030	12.1%	22.2%	48.0%
Ordinary income	26,398	11.7%	31,986	12.1%	21.2%	48.5%
Net income attributable to owners of the parent	18,658	8.3%	22,789	8.6%	22.1%	47.7%

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

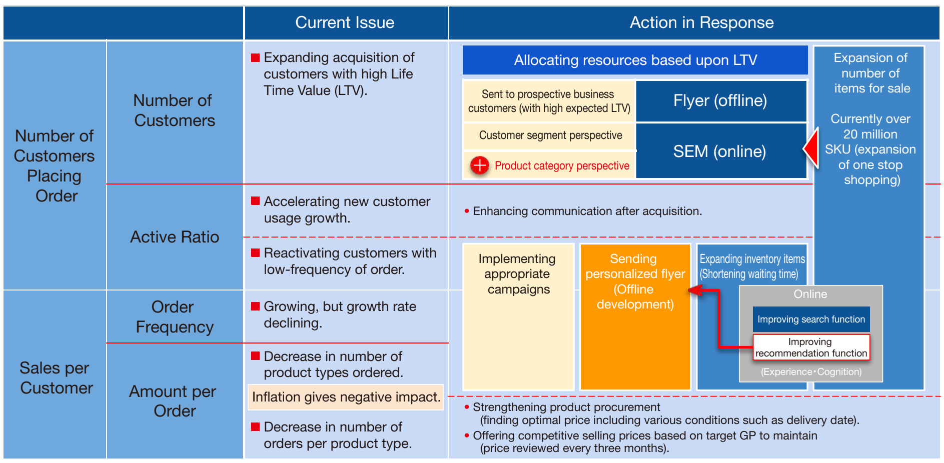
Topics

Sending personalized flyers to encourage low-frequency customers to make purchases from a medium-term perspective

1. Challenges for the momotaro.com business and responses

The Company's net sales can be divided into number of ordering customers and sales per customer. The number of ordering customers can be further classified by the number of customers and activity rate. For number of customers, the Company will strengthen initiatives according to its original strategy in order to capture and cultivate customers with high LTV. It has so far carried out sales promotions targeting customer segments with higher LTV using big data analysis through flyers and SEM (Search Engine Marketing), but going forward it will make further refinements by focusing more on a product category viewpoint. For activity rate, the issue will be improving the order frequency of customers with low order frequency (including dormant users) among its customer base. The Company's prior communication and sales promotion activities have been skewed toward the acquisition of new customers and high frequency users, and were insufficient for customers with low order frequency. In 1H, the Company conducted a demonstration of its response by creating and sending personalized flyers (matching individual customer needs), which showed that the flyers were capable of effectively promoting resumption and increased usage. The recovery of customers with low order frequency is more effective than the acquisition of new customers from a cost perspective, and can be expected to have a substantial outcome. Sales per customer is separated into order frequency and sales price per order. For order frequency, sending personalized flyers will help to counter the downward trend in its rate of increase. As for sales price per order, the price revisions since last year (implemented every three months) have had a negative impact, as exemplified by a decrease in the number of product types ordered. The Company's policy is to present optimal prices while taking into account competitive prices and price elasticity of demand, based on a targeted gross profit to maintain while strengthening product procurement.

Sales issues and responses for online direct marketing business for companies (monotaro.com)



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

2. Main factors behind change in SG&A expenses and future policy

In FY12/23 2Q results, the curtailment of SG&A expenses contributed to an increase (compared to the plan) of Operating Income. First of all, this was a period of change in the external environment, and there was a certain degree of impact mainly due to price revisions (high prices). The main factors included a decrease in personnel costs and outsourcing expenses (reduced by about ¥170mn in 1H) in conjunction with sales decreases and a decrease in the number of boxes shipped (reduced by about ¥230mn in 1H) due to price increases. There were also expenses that the Company was able to reduce as a result of continued managerial efforts and ingenuity. The Company had been anticipating expenses for logistics equipment repairment, building management, and external warehouses, but the building openings and transfers were completed without a hitch, which helped to reduce expenses (by about ¥370mn in 1H). In addition, system-related expenses were also reduced (by about ¥450mn in 1H) through the optimization of outsourced system development costs and cloud service costs, etc. There were also expenses that were postponed until 2H or later (about ¥110mn in 1H). Conversely, in 1H there were some items for which the expenses incurred were greater than anticipated. Investments and expenses such as an increase of about ¥270mn in 1H for flyers for existing customers (personalized flyers) and an increase of about ¥170mn in 1H for bonus payments to part-time employees will most likely continue to be incurred in 2H. The Company is firmly investing money in areas where it should (logistics, systems, sales promotions with high LTV, employee benefits, etc.) and managing finances conservatively in areas where it can be controlled. In 2H of FY2023, the Company plans to continue allocating the budget in a flexible and balanced manner, while maintaining a restrained tone.

Difference in 2023 2Q SG&A Expenses from Plan

SG&A Decreasing Factor	Amount
• Decrease in SG&A expenses due to decline in sales (Decrease in Personnel Costs, Outsourcing Expense, Packaging Costs, etc., as sales declined)	About -¥170mn
• Decrease in number of boxes shipped due to sales price adjustment (price increase) (Decrease in Personnel Costs and Outsourcing Expense due to decrease in operations at distribution bases)	About -¥230mn
• Actions postponed to 2023 Q3 or later (System consulting/outsourcing, purchase of logistics supplies and equipment, logistics facility maintenance and repairment)	About -¥110mn
• Decrease in SG&A expense below plan (Logistics-related costs) (Logistics equipment repairment and building management expenses not incurred, decrease in rents for external warehouses, etc.)	About -¥370mn
• Decrease in SG&A expense below plan (other than logistics-related costs) (Decrease in outsourced system development costs, cloud service costs, system usage costs, recruitment costs, etc.)	About -¥450mn
• Implementation of measures decided (Increase in advertising expenses due to sending more flyers to existing customers, etc.)	About +¥270mn
• Paid bonus to part-time employees	About +¥170mn
Total	About -¥890mn

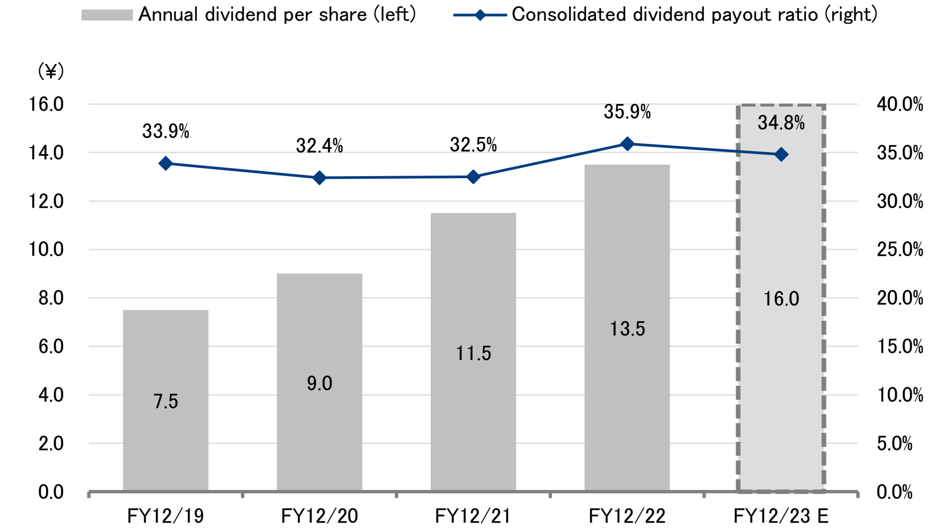
Source: Prepared by FISCO from the Company's results briefing materials

Shareholder return policy

The Company has continued to increase dividends for over 10 years. For FY12/23, it plans to pay a dividend of ¥16.0 per share (up ¥2.5 YoY).

The Company adheres to a policy of paying a stable dividend in line with earnings. It has delivered dividend increases for 10 years and maintained a dividend payout ratio in the range of 32-35%. For FY12/23, the Company is forecasting an annual dividend of ¥16.0 per share (up ¥2.5 YoY) (dividend payout ratio to 34.8%). As the Company's profit growth rate is high, dividends can be expected to increase at a rapid pace in the future. The Company also 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 Company says that the shareholder benefits have been favorably received, with a high rate of conversion to products

Dividends and consolidated dividend payout ratio



Note: A 2-for-1 stock split was conducted on April 1, 2021. Figures shown for the amounts of dividends prior to FY12/20 have been retroactively adjusted
Source: Prepared by FISCO from the Company's financial results

FISCO

Disclaimer

■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp