

Kitanotatsujin Corporation

2930

Tokyo Stock Exchange First Section/Sapporo Securities Exchange

23-Dec.-2020

FISCO Ltd. Analyst

Ikuo Shibata



FISCO Ltd.

<http://www.fisco.co.jp>

■ Index

■ Summary	01
■ Company profile	03
1. Business description	03
2. History	04
3. External evaluations of the Company	05
■ Company features	06
1. Overwhelmingly strong product appeal	06
2. Stability through regular (subscription) purchases	07
3. Effective marketing methods	07
■ Financial highlights	07
1. Trends in past results	07
2. FY2/21 1H financial highlights	09
3. Summary of FY2/21 1H	10
■ Results of activities and measures to address issues	11
1. Results of new product releases	11
2. Measures to address issues	12
■ Outlook	13
■ Growth strategy	14
■ Shareholder returns	15

Summary

In FY2/21 1H, sales and profits declined due to a decrease in the number of new customer acquisitions Is in a transition period toward the next growth phase and is focusing on rebuilding the organizational structure and resolving issues with a view to medium- to long-term growth

Kitanotatsujin Corporation <2930> (hereafter, also “the Company”) conducts an e-commerce (EC) business for online sales of health foods and cosmetics to general consumers. On the J North Farm (Kitano-Kaitekikobo) website, which is its original brand, it focuses on the development and sales of products that specialize in supporting bodily problems, such as constipation, atopy, and acne. In particular, KAITEKI OLIGO, which uses oligosaccharide as a raw material, has been driving the Company’s growth over the long term. Also, sales of the DEEP PATCH series, which has been a major hit recently, are growing significantly, and alongside the rise in the percentage of total sales provided by “basic skin care products” compared to when sales were centered on “health foods,” member attributes have also expanded to include middle-aged and elderly men who are aware of anti-aging. Conversely, the number of new customer acquisitions is trending downward, including because a structure has not been sufficiently established in the Customer Acquisition Department, and the Company is working to rebuild the organizational structure toward the next growth phase.

In the FY2/21 1H results, sales and profits decreased, with net sales declining 9.2% year on year (YoY) to ¥4,592mn and operating profit falling 25.9% to ¥1,030mn. On the other hand, compared to the initial forecasts, net sales exceeded the forecast, but profits did not. Sales of the DEEP PATCH series (currently four products) continue to steadily grow, and its presence in terms of the composition of total sales by product is rising*1. However, the reason net sales as a whole declined was that sales of existing products overall slumped due to the decline in the number of new customer acquisitions. But this was within the scope of expectations, and the number of new customer acquisitions and net sales both exceeded their initial forecasts due to active investment in advertising expenses. However, in profits, the decline in sales pushed down earnings, and operating profit decreased significantly, while the operating margin fell to 22.4% (27.5% in the same period in the previous fiscal year). Profits also fell below the initial forecasts, although this was because of a temporary deterioration in ROAS*2, mainly due to an increase in advertising expenses in order to acquire new customers.

*1 Has been certified by Guinness World Records as the No. 1 for global sales in the microneedle cosmetics market.

*2 An acronym of Return On Advertising Spend, indicating the return on advertising expenses calculated using sales achieved from posting an advertisement. It seems that the two main reasons that ROAS temporarily deteriorated were 1) acquisitions of products with low unit prices were strong and 2) there was a partial mistake in setting the upper limits of CPO. However, with regards to 1, it is possible that this will be covered over the full fiscal year through continuous purchases, while for 2, the problem has already been resolved and ROAS is recovering in tandem.

For the FY2/21 results, the Company has left unchanged its initial forecasts of net sales to decrease 18.5% YoY to ¥8,227mn and operating profit to decline 31.2% to ¥2,006mn. So it expects sales and profits to decline, including due to the measures it is conducting with an eye to the future. Just as in the previous fiscal period (FY2/20), when the results reached new record highs, we can expect growth of the DEEP PATCH series and continuous use of other mainstay products. However, the Company has positioned this year as “a year to rebuild the organizational structure” toward the next growth phase, and the outlook is that results will recede temporarily. In other words, it intends to focus on resolving the issues that became apparent in the previous fiscal period by strengthening the Creative Department and the Product Development Department.

Kitanotatsujin Corporation

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

23-Dec.-2020

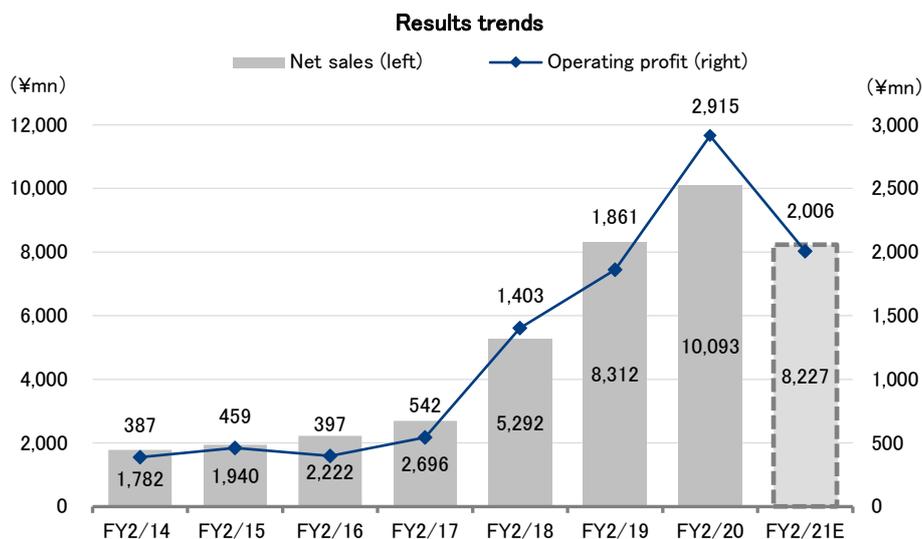
<https://www.kitanotatsujin.com/en/>

Summary

Up until now, the Company has operated a business with high profit margins by developing multiple products in relatively uncontested niche markets where each product is worth between ¥1.0–2.0bn, aiming for a total business scale of around ¥10bn. As a result, in FY2/20, net sales surpassed ¥10.0bn and the Company also maintained a high operating margin. In addition, by acquiring the expertise to operate products at around the ¥5.0bn level with a high profit margin, the Company is now slated to develop multiple products at the ¥5.0–10.0bn level in large-scale mass markets going forward, and it has laid out a strategy aiming to achieve net sales of ¥100.0bn and operating profit of ¥30.0bn in the future. Specifically, in addition to creating new markets, such as with the DEEP PATCH series, it seems that it is imagining major market categories like all-in-one gel and shampoo. On the other hand, in regard to its overseas expansion, the Company is eyeing further expansion, including in the Taiwan operations, and its policy is to focus particularly on promoting online sales, which are easy to expand horizontally. If the Company expands its products for mass markets and realizes overseas business development while maintaining its strengths, we at FISCO evaluate it as having the potential to set its sights on net sales of ¥100bn. Furthermore, by utilizing economies of scale, the Company’s strategy could also involve large-scale M&As led by the Company, which could accelerate the pace of its expansion. How the Company will go about evolving without losing its distinctive character is an area for demonstrating the skill of management.

Key Points

- In FY2/21 1H, sales and profits decreased due to the decline in the number of new customer acquisitions. However, net sales were higher than initially forecast due to the active investment in advertising expenses, but profits were lower than forecast
- For the FY2/21 results, the Company has left the initial forecasts unchanged and is forecasting declines in sales and profits for the full fiscal year. It has positioned this year as “a year to rebuild the organizational structure” and it intends to focus on strengthening the Creative Department and the Product Development Department.
- In the large-scale mass markets, the Company aims to develop multiple products with individual scales at the ¥5.0–10.0bn level, aiming to be a company with net sales of ¥100.0bn and operating profit of ¥30.0bn in the future



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

We encourage readers to review our complete legal statement on “Disclaimer” page.

Company profile

Conducts an e-commerce business through J North Farm, its original brand

1. Business description

The Company conducts online sales of health and beauty products, etc. to general consumers. On the J North Farm website, which is its original brand, it focuses on the development and sales of products that specialize in supporting health and beauty problems. In particular, KAITEKI OLIGO, which uses oligosaccharide as a raw material, has been driving the Company's growth over the long term. Also, sales of the DEEP PATCH series (currently four products)*, which has been a major hit recently, are growing significantly, and alongside changes to the product composition favoring "basic skin care products" over the conventional "health foods," member attributes have also expanded to include middle-aged and elderly men who are aware of anti-aging.

* A new concept that applies microneedle technology used in medical treatment to directly inject into the skin the cosmetic component that has been solidified into a needle shape.

KAITEKI OLIGO is a highly pure, high-quality food with functional claims (it is effective for constipation) created by compounding several types of oligosaccharide, including sugar beets produced in Hokkaido, as the main ingredients. In addition, the Company handles 34 products that meet purchasers' specific needs (as of the end of August 2020), including HYALO DEEP PATCH, which concentrates and replenishes moisture by using microneedles of hyaluronic acid to reach the deep parts of fine wrinkles around the eyes; EYE KIRARA, which is a cream to improve bags under the eyes; and CLEAR NAIL SHOT α , which is a penetrating, specialized nail care product that contributes to beautiful and healthy nails.

For product manufacturing, the Company does not have its own manufacturing bases as it mainly consigns manufacturing to its OEM partners. On the other hand, at the end of December 2015, it established the Taiwan Branch Office as a base for strengthening online sales in local markets in Asia, followed by the establishment of the South Korea Liaison Office in January 2019 to progress consigned manufacturing to overseas companies.

Product overview (in order of launch)

Item	Description
KAITEKI OLIGO	Japan's first "food with functional claims" with 5 ingredients to improve bowel movements is a high-purity, high-quality oligosaccharide food effective for improving constipation
KOJUKAN	The Company's first food with functional claims, with low-molecular weight lychee polyphenol as the main ingredient, to which is added ingredients including hyaluronic acid, vitamin C and L-citrulline
MINNANO HADAJUNTO ~ ATO CARE TYPE ~	A moisturizing-care product that is 100% derived from plants, with the main ingredient being sugars made from sugar beet produced in Hokkaido
KAITEKI DOKA SLIM CHA	A health food formulated using a unique blend of natural herbs developed by thoroughly studying the peristaltic motion of the intestines
20NEN HOIPPU	A facial cleanser to improve facial skin dullness that uses a proprietary manufacturing method called direct flame pot kneading and that adds whey to the ingredients as the moisturizing compound
MINNANO HADAJUNTO ~ CLEAR TYPE ~	An acne-prevention skin care product coated with plant oils, including lavender and peppermint, and which uses sugars made from sugar beet produced in Hokkaido as the main ingredient
EZOSHIKI SU-SUCHA	A health food independently developed by the Company which blends three types of tea leaves in a perfect balance— bamboo grass that has been used as a herbal remedy in Hokkaido since the olden days, red perilla, and tencha (tea leaves) of the rose family. The product suppresses allergy symptoms, including sneezing, runny nose, and nasal congestion
KITANO DAICHINO YUMESHIZUKU	A food with functional claims that increases sleep-promoting hormones and boosts sleep quality
ZUKI SHIRAZUNO MI	A health food formulated from feverfew, giant knotweed, and bitter (magnesium chloride)

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Company profile

Item	Description
MINNANO HADAJUN LOTION	A lotion formulated from humidity-retention components, such as lipidurea, squalene, and ceramide, and whose main ingredient is sugars made from sugar beet produced in Hokkaido
MINNANO HADAJUNBURO	A moisture-sealing, moisture-care bath additive formulated from sugars made from sugar beet produced in Hokkaido, and also other ingredients including extracts from natural deposits at hot springs and sea buckthorn.
EYE KIRARA	A cream that improves bags under the eyes. It is formulated from ingredients including MGA, which is one type of vitamin C-derivative that supports collagen, and plant oils rich in natural vitamin K that help to make the blood flow smoothly
CLEAR FOOT VEIL	A barrier-type foot care product for use specifically by people with constantly itchy feet
NO ! NO ! SMELL !	A medicated deodorant foot cream that addresses existing issues with foot odor while also treating skin conditions to make it difficult for odor to reappear.
KUROUMEBIYORI	A health food that leads to a life without concerns through normalizing the body and protecting it from the inside
CLEAR NAIL SHOT α	A penetrating, specialized nail care product that deeply penetrates the nail to the source of problems, which leads to beautiful and healthy nails
CARE NANO PACK	A sleeping pack that leads to tightened pores that do not stand out
HYALO DEEP PATCH (DEEP PATCH series product 1)	A premium, night-care product, in which micro-sized needles of hyaluronic acid reach the deep parts of the fine wrinkles around the eyes, concentrating and replenishing moisture
MAYME WHITE 60	A fast-acting skin whitening cream that leads to ideal whitening in 60 seconds with rapid-action whitening and a deep-layer approach
LUMINAPEEL	A hand peeling gel developed to solve problems with aging hands that are susceptible to UV-related damage
WRINKY FLAT	A fast-acting, anti-wrinkle beauty gel that stretches wrinkles and leads to younger looking skin in just one minute after it is applied
LID KIRARA	A beauty gel exclusively for the upper eyelids that returns skin to its original condition by thoroughly tightening the upper eyelid skin. It has a fast-acting effect with the skin tightening immediately after application, and a continuity effect, with the foundation being raised by its continuous use
BUILD MAKE 24	A hybrid protein formulated from 1,750 mg of HMB per single serving that focuses on making body conditioning extremely efficient
RIMO SAVON	A laundry detergent that coats clothing fibers in the Company's proprietary coating compound with each wash, which makes it difficult for pet hairs to stick to clothes, and if they do stick, enables them to be easily removed. The Company's first product to be classified in miscellaneous goods
HANDPURENA	A care cream for aging hands, with a concentrated approach to hand skin that makes the skin feel soft when it is used
NECK ESTHE MIST	An aging-care mist for the neck, which uses a mist to bring tightness and firmness to signs of aging on the neck
MEN's EYE KIRARA	Eye-shot cream for under the eyes made to suit men's skin texture
OKOSAMAYOU KAITEKI ORIGO	A powdered oligosaccharide food blended with oligosaccharides made to suit the balance of bifidobacteria in children's intestines
MIKEN DEEP PATCH (DEEP PATCH series product 2)	An anti-aging cosmetic product specifically for eyebrows that softens hardened skin and leads to younger looking skin by injecting a needle with condensed hyaluronic acid and other beauty ingredients directly between the eyebrows.
ODEKO DEEP PATCH (DEEP PATCH series product 3)	An anti-aging cosmetic product specifically for the forehead that leads to firm and glossy skin by injecting a needle with condensed hyaluronic acid and other beauty ingredients directly into forehead indentations to directly deliver the beauty ingredients to the keratin layer.
ASESU CARE	This specialized supplement for men provides an internal approach to addressing perspiration issues. The combination of five components that support autonomous functions are designed to address unique aspects of male physiology, and also help to control odor.
CHEEK PORE PATCH (DEEP PATCH series product 4)	Focusing on consumers' concern of the cheek pore zone, microneedles distribute moisturizing and toning compounds that tighten skin.
PEEL SHOT	A peeling gel for skin blemishes especially for men's skin types.
HARISHU	An aging-care mist lotion especially for men with sagging skin.

Source: Prepared by FISCO from securities reports and press releases

2. History

The Company was established in May 2002 as Hokkaido dot See Oh dot Jay Pee KK by current Representative Director & President Katsuhisa Kinoshita (in March 2009, the Company name was changed to the current name of Kitanotatsujin Corporation). However, the history of its establishment goes back to May 2000, when Mr. Kinoshita, who had worked at Recruit Holdings <6098>, aimed to expand the e-commerce market and launched the EC website Hokkaidou.co.jp which marked the start of online sales of specially produced Hokkaido foods.

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Company profile

The first turning point was in July 2007 when, with the aim of differentiating itself in a situation of an increasing number of competing EC websites, the Company established the Kaiteki Friend Club site (currently, J North Farm) as a site for comprehensive sales of health and beauty products. In addition, in September of the same year, it established Hokkaido Wakeari Ichiba as a website specializing in outlet (non-standard product) food sales. In particular, Hokkaido Wakeari Ichiba, which was rare among websites at that time, was featured on many mass media outlets, garnering a lot of attention. However, as this business was comparatively easy to imitate, the more that it attracted attention, the more that competition intensified.

The second turning point was when the Company decided to compete by using overwhelming superior product quality and functions that other companies could not easily imitate. It transferred management of the Hokkaidou.co.jp and Hokkaido Wakeari Ichiba businesses, and at the same time, pivoted to the development and sales of health and beauty products through the Company's own brand, J North Farm. During this period, KAITEKI OLIGO became a hit product, and it has continued to achieve high growth as the Company has worked to steadily expand the base of regular-purchase members. In May 2012, it was listed on the Sapporo Securities Exchange (SSE) Ambitious market, and then in March 2013, its listing was upgraded to the SSE's main market. Moreover, in November 2014, it was additionally listed on the Tokyo Stock Exchange (TSE) Second Section, and then on November 24, 2015, its listing was upgraded to the TSE First Section. So it achieved an upgrade to a new listing market for four consecutive years.

Subsequently, the Company established the Taiwan Branch Office (end of December 2015), and started bolstering the organization, including the product development system and customer acquisition system (introduced an automated advertisement system, etc.). In addition, the Company established the South Korea Liaison Office (January 2019), relocated the Head Office (March 2019), opened the Tokyo Branch Office (April 2019), expanded its distribution centers (October 2020), and also worked to create a business foundation targeting accelerated growth.

3. External evaluations of the Company

In September 2015, Mr. Kinoshita was elected as the representative of the Hokkaido bloc in EY Entrepreneurs of the Year Japan*1, which is a part of an international scheme to recognize entrepreneurship. In February 2017, Mr. Kinoshita was awarded the Special E-Commerce Promotion Award at the Japan Venture Awards 2017*2 hosted by the Organization for Small & Medium Enterprises and Regional Innovation, JAPAN (sponsors: The Small and Medium Enterprises Agency, METI, etc.)

*1 An international awards system that honors the efforts and achievements of entrepreneurs who take on challenges in new business areas. It started in Japan in 2001 as EY Entrepreneurs of the Year Japan, and each year it honors entrepreneurs selected from all over the country.

*2 A system that honors managers in high-minded venture companies that manage businesses which are innovative, have high growth potential, and contribute to the revitalization of regions.

The Company also recently received the Asian Online Sales Summit 2019 Internet Shopping Award, and was ranked fourth in the Medium-Sized Listed Companies with High Average Five-Year Operating Profit per Employee (NEXT1000) in the national edition of the Nihon Keizai Shimbun on March 24, 2020. Furthermore, as the Company's profitability and growth potential were evaluated so highly, Forbes Asia (August 2020 edition), the Asian version of the US economic magazine Forbes, selected it for Asia's 200 Best Under A Billion, a collection of the 200 best listed companies in the Asia Pacific region with net sales of under US\$1 billion (fourth time selected, third consecutive year). In such ways, the Company has been highly evaluated externally for various aspects.

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Company profile

On November 11, 2020, it was selected as a constituent stock of the JPX-Nikkei Mid and Small Cap Index* for a third consecutive year (applied in 2020).

* A stock index jointly calculated by Tokyo Stock Exchange Inc. and Nikkei Inc. JPX Nikkei Index 400 introduces the concept of selecting companies that have high investment appeal to investors as its constituent stocks. The JPX-Nikkei Mid and Small Cap Index applies the same concept to select mid and small cap stocks of companies that efficiently utilize capital and conduct management with investors in mind. In addition, the index aims to spread and promote the awareness of investment appeal to a wide range of companies. (From the JPX Japan Stock Exchange Group website)

Company features

Strengths include regularly purchased products with high customer satisfaction and effective marketing

1. Overwhelmingly strong product appeal

The reason for the Company's growth so far is because it has used the overwhelming appeal of its products to expand its base of highly loyal customers. It has launched a series of hit products by specializing in providing consumers with support for the body-related problems that they find most concerning, and at the same time, by maximizing customer satisfaction through a product development concept that prioritizes quality above all and that provides thorough follow-up services. Although they do not stand out in comparison to the major growth of its mainstay products, such as long-running KAITEKI OLIGO or the hit DEEP PATCH series, each of these products has been supported since their sales launch by long-term demand as they've been positioned as top products in their respective niche markets. These products have also won numerous awards*, mainly in the food field, such as by Monde Selection, an international rating organization that reviews the quality of products. These awards can be said to indicate the strength of the Company's product capabilities.

* In Monde Selection 2020, 13 of the Company's products won awards. In particular, MINNANO HADAJUNTO (ATO CARE TYPE) won the Grand Gold Award, the highest award, for the eighth consecutive year and MINNANO HADAJUNTO (CLEAR TYPE) for the sixth consecutive year. Also, KAITEKI OLIGO won the Gold Award for the ninth consecutive year, 20NEN HOIPPU for the eighth consecutive year, EYE KIRARA for the fifth consecutive year, HYALO DEEP PATCH for the fourth consecutive year, and HANDPURENA and MEN's EYE KIRARA for the second consecutive year. MIKEN DEEP PATCH and ODEKO DEEP PATCH, which were released in the previous year, each won the Gold Award.

The secret to the Company's creation of hit products that are supported by consumers is based on its policy of "only selling products good enough to surprise consumers" and its strategy of thoroughly monitoring prototypes and commercializing only those that pass all 750 quality checks it has independently created. Therefore, no more than 2% of product development projects actually result in a sales launch, surely a factor behind the Company realizing overwhelming levels of customer satisfaction and quality control. Although the Company intends to continue policies it has implemented up until now, it currently finds itself in a transition period in its approach to large-scale mass markets and the shift to "basic skin care products" from its previous focus on "health foods."

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Company features

2. Stability through regular (subscription) purchases

Just as with other EC businesses, the Company has a growth model in which the expansion of the membership base drives results. But in the case of the Company, in addition to the fact that its products are premised on their continuous use, its customer base is composed of highly loyal members who suffer from pressing problems. Therefore, a feature of its business is that the rate of regular purchases* is high, which gives it management stability. Also, in business development for large-scale mass markets, there has been no change to the Company's aim of stably growing results by focusing on steadily capturing long-term demand in each market and diversifying risks, rather than pursuing explosive results growth (a boom), which tends to be transient.

* Regular purchases account for approximately 70% of net sales.

3. Effective marketing methods

Another feature of the Company is a marketing method using detailed data analysis. After conducting multiple types of sales tests at each stage, such as for markets, products, advertisements, and webpages, and comparing and analyzing the results, it finds the definite "winning pattern" and only then starts fully fledged sales. Particularly with regards to advertising investment, an important policy for an EC business is that it directly links it to sales, but the Company judges this only after measuring the advertisement-investment effects for each media up to the level of customers' lifetime value. Therefore, even if member numbers and net sales are expected to temporarily increase due to investments in advertising, that investment may be foregone depending on assumptions regarding the retention rate after the fact. Amidst this background is the Company's approach of thoroughly prioritizing profits, and it also reflects its high profit margin. Recently, it has been working on further improvements in efficiency and accuracy through its in-house advertising system starting operations, the introduction of BI*1 tools and combinations with RPA*2.

*1 A system that collects, analyzes, and processes the information accumulated in the various information systems in the Company, and converts it into useful information to assist in the investigation of business strategies and quick decision-making.

*2 Abbreviation of Robotic Process Automation. It refers to the use of robots (cognitive technologies, such as artificial intelligence) to automate operations.

Financial highlights

In FY2/21 1H, sales and profits decreased due to the decline in the number of new customer acquisitions

1. Trends in past results

Looking back on the Company's past results, they have grown alongside the increase in the number of regular-purchase members, while the growth since FY2/13 has been particularly large. This was because up to that time the results' dependence on KAITEKI OLIGO had been high, but from then on, the MINNANO HADAJUNTO series and 20NEN HOIPPU became established as new main products, and new products like EYE KIRARA contributed to the growth in results. In addition, the DEEP PATCH series is currently seeing a large increase in sales. Therefore, it can be said that while lowering its dependence on KAITEKI OLIGO, the extension of new earnings pillars has enabled balanced growth.

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

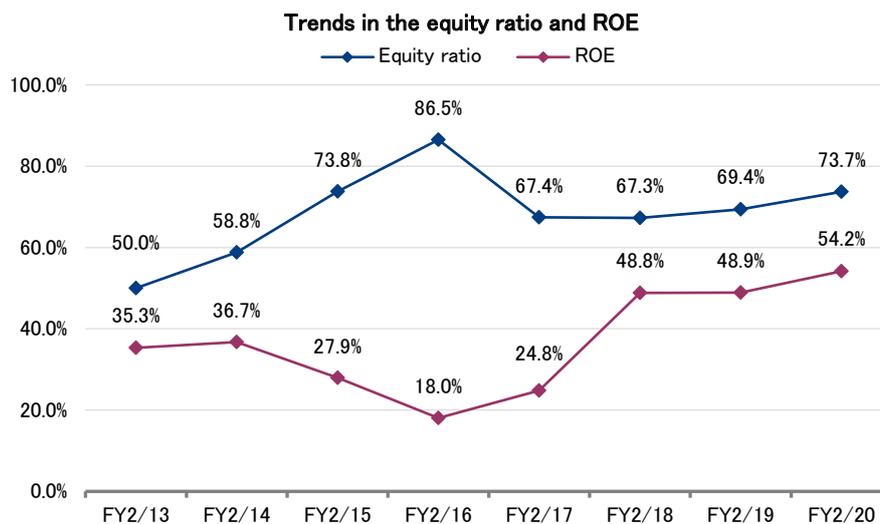
<https://www.kitanotatsujin.com/en/>

Financial highlights

In profits also, alongside the growth in sales from the effective investment in advertising expenses, the operating margin had risen to the high level of above 25%. In FY2/19, the operating margin dropped to 22.4% at one point; however, this was due to strategically making investments in advertising at a higher level than planned to avoid opportunity losses and increase new customer acquisitions. Conversely, for FY2/20, the Company consciously suppressed advertising expenditure, and the operating margin increased significantly to 28.9%. Temporary factors* has probably had a major impact in this.

* This was due to temporarily minimizing advertising expenses, including delays in deliveries of HYALO DEEP PATCH, which has become a major hit.

Meanwhile, the equity ratio, which is an indicator of financial stability, reached the high level of 86.5% at the end of FY2/16 through a capital increase from a public offering and the accumulation of retained earnings. It fell in FY2/17 to 67.4% at one point in response to measures to secure liquidity from cash on hand through long-term borrowing, but it has been rising again since then. In addition, ROE (return on equity), which is an indicator of capital efficiency, has been around the 50% level recently, supported by the Company's high profitability, and its financial condition can be evaluated as extremely good.



Source: Prepared by FISCO from the Company's materials

For the cash flow situation also, a feature of the Company's business is that a large amount of capital investment is not required and investment cash flow falls within the range of its abundant operating cash flow, so the balance of cash and cash equivalents at the end of the fiscal period has accumulated significantly. In FY2/16, operating cash flow temporarily declined, but this was due to inventory investment alongside the growth in net sales, in addition to investment in advertising and publicity expenses and upfront investment with an eye to the future. Since FY2/17, it has once again trended significantly positively. Therefore, going forward it seems that an issue will be how the Company will use its solid financial base and abundant operating cash flow to realize further growth.

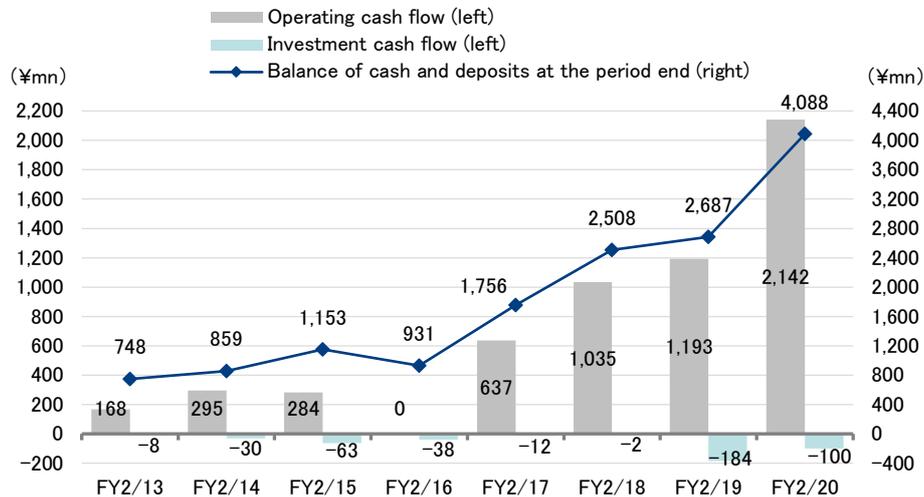
Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Financial highlights

Trends in operating cash flow, investment cash flow, and the balance of cash and deposits at period end



Source: Prepared by FISCO from the Company's materials

2. FY2/21 1H financial highlights

In the FY2/21 1H results, sales and profits decreased, with net sales declining 9.2% YoY to ¥4,592mn, operating profit falling 25.9% to ¥1,030mn, ordinary profit decreasing 25.7% to ¥1,033mn, and net profit declining 24.2% to ¥717mn. However, net sales were above the initial forecast, but profits fell below.

Sales of the DEEP PATCH series (currently four products) continue to steadily grow, and their presence is also rising in regards to the composition of total sales by product. The first product in the series, HYALO DEEP PATCH, maintained its strong sales, while sales of the products launched in the previous fiscal year, MIKEN DEEP PATCH (second) and ODEKO DEEP PATCH (third) also contributed to results. The newly released CHEEK PORE PATCH (fourth) also made a steady start. In addition, it appears that results were not that greatly affected by the coronavirus. However, the reason why net sales as a whole declined was that sales of existing products overall slumped due to the decline in the number of new customer acquisitions, which is an issue carried over from 2H of the previous fiscal year. But this was within the scope of expectations, and the number of new customer acquisitions and net sales both exceeded their initial forecasts due to the active investment in advertising expenses (raising the CPO* upper limits).

* An abbreviation of Cost Per Order, it is the amount of advertising expenses required for one order. As the upper limit for advertising expenses, the Company sets a CPO upper limit for each product, and based on this, it calculates and manages CPO every day and aims to optimize advertising expenses.

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Financial highlights

However, in profits, the decline in sales pushed down earnings, and the cost of sales deteriorated due to changes to the product mix*1. As a result, operating profit decreased significantly, while the operating margin fell to 22.4% (27.5% in the same period in the previous fiscal year). Profits also fell below the initial forecasts, although as previously explained, this was due to 1) an increase in advertising expenses in order to acquire new customers and 2) a temporary decline in ROAS due to the strong sales of products with high LTV*2, which have low sales unit prices. However, the current decline in ROAS can be expected to contribute to sales and profits in the future, so it is not necessarily bad news. Moreover, ROAS is currently recovering, including from a review of the CPO upper limits.

*1 The DEEP PATCH series has a relatively high cost ratio.

*2 These are products that can be expected to make major contributions to total annual sales, because although their sales unit prices are low, they are frequently purchased. In the short term, they are a factor causing ROAS to decline, but they can be expected to fully contribute to profits if looking over the full fiscal year.

Regarding the financial condition, total assets were down 3.5% compared to the end of the previous fiscal year to ¥5,697mn, mainly due to decreases in cash and deposits, accounts receivable, and investments and other assets. Conversely, shareholders' equity increased 9.5% to ¥4,759mn due to the accumulation of retained earnings, and therefore the equity ratio rose to 83.5% (73.7% at the end of previous fiscal year).

FY2/21 1H financial highlights

	FY2/20 1H		FY2/21 1H		Change		(¥mn)			
	Results	% of total	Results	% of total	Amount	% change	FY2/21 1H		Difference	
							Initial forecast	% of total	Amount	Achievement rate
Net sales	5,055	-	4,592	-	-463	-9.2%	4,345	-	246	5.7%
Cost of sales	1,200	23.7%	1,130	24.6%	-70	-5.9%	1,081	24.9%	49	4.5%
Gross profit	3,851	76.2%	3,462	75.4%	-388	-10.1%	3,264	75.1%	198	6.1%
SG&A expenses	2,461	48.7%	2,432	53.0%	-28	-1.2%	2,034	46.8%	397	19.5%
Operating profit	1,390	27.5%	1,030	22.4%	-360	-25.9%	1,229	28.3%	-199	-16.2%
Ordinary profit	1,390	27.5%	1,033	22.5%	-356	-25.7%	1,230	28.3%	-196	-16.0%
Net profit	947	18.7%	717	15.6%	-299	-24.2%	832	19.1%	-114	-13.7%

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

3. Summary of FY2/21 1H

To summarize FY2/21 1H from the above, the results, which included declines in sales and profits, were within the scope of the anticipated scenario. In addressing points of evaluation, questions to consider include whether the Company was able to apply the brakes to the downward trend in the number of new customer acquisitions and if it is making progress in rebuilding the organizational structural toward the next growth phase. Reflecting on these points, there is positive news on the one hand, that the number of new customer acquisitions was higher than expected due to active investment in advertising expenses, but there is also negative news, that this invited a temporary decline in ROAS, so discussion could be had about how to judge this situation. At FISCO, we evaluate that the reasons for the temporary decline in ROAS have already been clarified and that the measures to address it implemented, which will lead to an improvement in the future. Conversely, there is the opinion that as ROAS improves, trends will show the number of new customer acquisitions falling once again. From this point, new acquisitions will not be commensurate with advertising expenditure, so it is considered that the issue of strengthening the customer acquisition structure will still remain. Therefore, it can be said that the biggest theme for 2H onwards will be "increasing the number of new customer acquisitions while maintaining high ROAS" by strengthening the Creative Department. Also, it seems that increasing new customer acquisitions will be vital for the early releases of products for large-scale mass markets as well.

Results of activities and measures to address issues

The DEEP PATCH series has been certified by Guinness World Records™. Is working to resolve issues and the specific results of these efforts will appear going forward

1. Main topics

(1) Results of new product releases

There were three new products in 1H: CHEEK PORE PATCH*1, which is the fourth product in the DEEP PATCH series, PEEL SHOT*2 and HARISHU*3. On top of an addition to the standout DEEP PATCH series, the other two products are unique in that they are cosmetics products for men. The cosmetic market for men is expected to grow in the future*4, and the Company is focusing on developments for it. All three of these products are for niche markets and do not constitute releases of products for mass markets, which is a strategy being developed by the Company.

*1 Focusing on consumers' concern of the cheek pore zone, microneedles distribute moisturizing and toning compounds to tighten skin (released in March 2020).

*2 A peeling gel for skin blemishes especially for men's skin types (released in May 2020).

*3 An aging-care mist lotion especially for men with sagging skin (released in August 2020).

*4 According to Cosmetics Market Guidebook 2020 No. 2 by Fuji Keizai Co., Ltd., the cosmetic market for men has grown to be worth approximately ¥120bn and is expected to grow even more in the future.

(2) DEEP PATCH series has been certified by Guinness World Records

On September 10, 2020, the Company's DEEP PATCH series was certified by Guinness World Records™ as being the No. 1 for global sales in the microneedle cosmetics market. While the microneedle cosmetics market is still small, it is attracting attention globally, and for the Company, which has entered it ahead of other companies and moreover with products of excellent quality, it can be said to be a market in which it can clearly demonstrate its advantages. It has secured reliable consignment manufacturers domestically, and holds the design rights to the microneedle shape, which is a point of differentiation. So it is in an overwhelmingly strong position in terms of protecting its intellectual property as well.

(3) Approach to regular-purchase customers

While on the one hand the Company is focusing its efforts on the issue of new customer acquisitions, it is also implementing fully fledged measures to approach existing, regular-purchase customers. As a result, it has achieved a certain level of results toward growing LTV (total sales to a customer over a lifetime), including raising the cross-sales rate*1. Also, the retention rate*2 has improved significantly as a result of establishing a specialist contact point for the purpose of enhancing the retention rate.

*1 Cross sales is a sales method enabling consumers to not only buy the product they are currently purchasing, but other products as well. Compared to before the efforts to promote it, the cross-sales rate has risen from 1.3% to 8.8%.

*2 Compared to before the establishment of the specialist contact point, the retention rate has risen from 8.0% to 14.1%.

Kitanotatsujin Corporation | 23-Dec.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Results of activities and measures to address issues

(4) Other measures

In addition to the above, the Company is working on various other measures. These include strengthening sales by once again utilizing affiliates*1 through a specialist team and on shopping malls like Amazon, delivering advertisements through methods other than online advertising*2, and conducting customer interviews. Going forward, its policy is to work in earnest on measures such as posting advertisements on major advertising media and utilizing video advertisements.

*1 One method of online advertising is a framework of posting advertisements of products or services (supplied by advertisers) on managed media, such as blogs or websites operated by a media owner (the affiliate). While using these media, viewers click advertisement links and follow through to purchase products. Advertisers then pay fees (remuneration) to the affiliates. Recently, the Company has renewed its policy to strengthen efforts in this area due to the increase in highly skilled, results-based remuneration affiliates.

*2 In fashion magazines for men and TV ads on terrestrial TV in some regions, such as Hokkaido.

(5) Overseas business development

The Taiwan Branch Office had been steadily realizing sales growth since the previous period (FY2/20), but due to the coronavirus pandemic, consumer behavior froze in Taiwan causing growth to slow even more severely than in Japan. However, its contribution to the Company's total results is low, so the impact of this is limited. Also, a structure is being put in place toward growth in the future, including increasing the number of products handled and recruiting and training several specialist personnel from Taiwan. Moreover, the Company is progressing preparations to enter Asian countries other than Taiwan.

2. Measures to address issues

The Company has been aware that the decline in the number of new customer acquisitions is an issue since 2H of the previous period, and is working on measures to address it. As a general rule, the hurdle to clear to acquire new customers (acquisition costs) tends to rise as the customer base widens, and the Company has been affected by this. But as its human resources training and establishment of structures has not kept up with the rapid growth of its business scope, there are two issues specific to the Company that must be addressed in order to clear this hurdle: 1) it has not conducted appropriate advertising of creative activities and 2) delays have occurred in the releases of new products. In particular, toward the next growth phase, it is currently in a transition period of shifting from its existing emphasis on niche markets to mass markets. Therefore, it is focusing on rebuilding its organizational structure to resolve issues and with an eye to growth in the medium to long term, including by strengthening the Creative Department and the Product Development Department.

(1) Strengthening the Creative Department

The Company is working on various measures, including building a training structure to produce employees with high-level skills and an abundance of experience and strengthening the recruitment of people with experience who can be immediately deployed in the field and expected to contribute to results in the short term. As a result of these efforts, an improvement to a certain extent can be seen, but as some time will be required for a complete rebuilding, specific results will appear in the future.

(2) Strengthening the Product Development Department

The Company is implementing measures including strengthening recruitment of people who previously worked at major cosmetics manufacturers, expanding the genres of development products, and improving market research methods. As a result of these efforts, the Product Development Department has steadily grown, but no mass market products have been released to date, despite a great increase in the number of products being considered for development. Going forward, its policy is to increase the development speed while maintaining the highest levels of quality.

■ Outlook

In FY2/21, results are forecast to temporarily recede due to rebuilding the organizational structure with an eye to the future

For the FY2/21 results, the Company has not changed its initial forecasts for net sales to decrease 18.5% YoY to ¥8,227mn, operating profit to decline 31.2% to ¥2,006mn, ordinary profit to fall 31.4% to ¥2,007mn, and net profit to decrease 31.2% to ¥1,357mn. So for the full fiscal year, it expects sales and profits to decline because it is rebuilding the organizational structure with an eye to the future.

Just as in the previous fiscal year (FY2/20), in which results reached new record highs, we can expect growth of the DEEP PATCH series and continuous use of other mainstay products. But the Company has positioned this year as “a year to rebuild the organizational structure” to address the previously discussed issues and with an eye to growth in the medium to long term, so the outlook is that results will recede temporarily. In other words, toward solving the structural problems that became apparent from the previous period (such as the decline in the number of new customer acquisitions alongside the widening of the customer base and the development of products for large-scale mass markets), its policy is to focus on strengthening the Creative Department and the Product Development Department.

At FISCO, we think it will be necessary to continue to pay attention to the impact of the coronavirus, but we evaluate that it is fully possible for the Company to achieve its results forecasts based on the fact that the number of new customer acquisitions was more than expected in 1H, and that ROAS, which had temporarily deteriorated, is recovering. In particular, when judged from its accumulative growth model, the net sales forecast can be considered slightly conservative, while the key point for profits is likely to be maintaining and improving ROAS. Whatever the case, for the Company, which has grown rapidly, the current period should be understood to be a transition period toward the next growth phase, and although results will temporarily recede, we shall be focusing on specific progress made toward strengthening the Creative Department and the Product Development Department. In particular, it seems that an important theme will be to what extent it realizes “increasing the number of new customer acquisitions while maintaining high ROAS,” which is an issue remaining from 1H.

FY2/21 forecasts

	FY2/20		FY2/21		Change		(¥mn)
	Results	% of total	Full-year forecast	% of total	Amount	% change	
Net sales	10,093	-	8,227	-	-1,865	-18.5%	
Operating profit	2,915	28.9%	2,006	24.4%	-908	-31.2%	
Ordinary profit	2,923	29.0%	2,007	24.4%	-916	-31.4%	
Net profit	1,974	19.6%	1,357	16.5%	-617	-31.2%	

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

Growth strategy

Work towards expanding into the large-scale mass markets

Aim to become a company with net sales of ¥100.0bn in the future

The Company does not publish specific medium-term management targets, but looking back at its strategy to date, based on its policy of prioritizing profits above sales, basically it has pursued a strategy of constantly releasing products every period following sufficient test marketing with the aim of them becoming the top in their niche market, and at the same time, steadily capturing demand through effectively investing in advertising and publicity expenses. In particular, the Company has operated a business with high profit margins by developing multiple products in relatively uncontested niche markets where each product is worth between ¥1.0–2.0bn, aiming for a total business scale of around ¥10.0bn. As a result, in FY2/20, net sales surpassed ¥10.0bn, thereby achieving its initial target and also maintaining a high operating margin. The Company is now slated to develop multiple products at the ¥5.0–10.0bn level in large-scale mass markets going forward, and it has laid out a strategy aiming to achieve net sales of ¥100.0bn and operating profit of ¥30.0bn in the future, while maintaining a high profit margin. Specifically, in addition to creating new markets, such as the DEEP PATCH series, it seems that it is imagining major market categories, such as all-in-one gel and shampoo. In the background to this, 1) the Company has the skill to maintain high profit margins regardless of niche market or top share, 2) it has acquired the expertise to create businesses at the level of ¥4.0–5.0bn per product, and 3) it recognizes that the niche markets targeted to date are encountering limits to growth. Accordingly, we recognize that the Company's strategies reflect a response to its organizational capabilities and business foundation, and a desire to accelerate growth. On the other hand, in regard to its overseas expansion, the Company is eyeing further expansion, including in the Taiwan operations, and its policy is to focus particularly on promoting online sales, which are easy to expand horizontally. In particular, it appears to be promoting a sales strategy based on platforms such as Google, Yahoo!JAPAN, Facebook, Twitter, Criteo, and Amazon, among others.

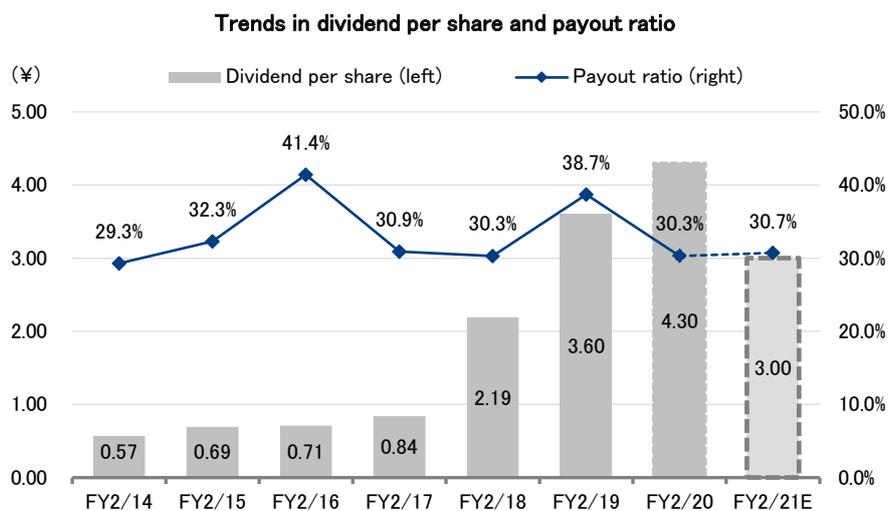
At FISCO, we think that if the Company realizes sustainable long-term growth (8–10 years), it is fully possible it could set its sights on net sales of ¥100bn, and we evaluate the Company as having this potential. Naturally, expansion into large-scale mass markets and overseas expansion are essential strategic themes for achieving this goal, and the recent change in direction appears to be a rational one. In particular, if the Company can accumulate not only market-making hit products such as HYALO DEEP PATCH but also around 15 to 20 products that can project a presence (originality) in part of the large-scale mass markets, we believe that net sales of ¥100.0bn will naturally be achieved. In addition, if the Company achieves this, the strategy will enable it to readily leverage economies of scale and conduct large-scale M&As on its own initiative, which could further accelerate its scale expansion. Naturally, cosmetic products and mass markets entail different levels of difficulty compared to the health foods and niche markets that the Company has engaged in thus far, and the degree to which it can make progress in these directions without losing its distinctive character is a matter for demonstrating management skill. In this sense, it can be said that an important touchstone will be resolving the current issues and firmly building a foundation toward growth from FY2/22 onwards, and we shall be paying attention to the results of activities in FY2/21.

Shareholder returns

**In FY2/21, the dividend is expected to decrease following the forecast for a decrease in profits
 However, there is significant room for further dividend increases in line with profit growth going forward**

The Company's basic policy is to return profits to shareholders in accordance with its results, while also aiming to supplement retained earnings to strengthen its financial base.

For FY2/21, the dividend forecasts are for a YoY decrease of ¥1.3 to ¥3.0 per share (interim: ¥1.8, year-end: ¥1.2; dividend payout ratio: 30.7%) as the Company is currently forecasting a decrease in profits. Naturally, it is perfectly possible that the dividend forecast could be revised depending on earnings trends, and future trends will therefore need to be monitored. The Company aims to stably pay dividends targeting a dividend payout ratio of at least 30%. But when looking from a medium- to long-term perspective, there remains room for the dividend to increase alongside growth in profits.



Note: Dividend per share is after adjusting for the following five share splits (fractions of less than 1 yen have been rounded up)
 January 3, 2014 (1:2), June 1, 2015 (1:2), April 1, 2017 (1:2), November 6, 2017 (1:2), and February 15, 2018 (1:3)
 Source: Prepared by FISCO from the Company's financial results

The Company is enhancing its shareholder benefits program. As a gift in FY2/21, all shareholders who were recorded in the shareholders' registry as holding 1 unit of shares (100 shares) or more at the end of February 2021 will receive a once-yearly gift of KAITEKI OLIGO, which is a food with functional claims that improves constipation (label price ¥3,065 (including tax)). (The gift is reviewed in each fiscal period and may change in the future.)



Disclaimer

FISCO Ltd. ("FISCO") offer stock price and index information for use under the approval of the Tokyo Stock Exchange, the Osaka Stock Exchange and Nikkei Inc.

This report is provided solely for the purpose of offering information, and is not a solicitation of investment nor any other act or action.

FISCO prepared and published this report based on information which it considered reliable; however, FISCO does not warrant the accuracy, completeness, fitness nor reliability of the contents of this report or the said information.

The issuers' securities, currencies, commodities, securities and other financial instruments mentioned in this report may increase or decrease in value or lose their value due to influence from corporate activities, economic policies, world affairs and other factors. This report does not make any promises regarding any future outcomes. If you use this report or any information mentioned herein, regardless of the purpose therefor, such use shall be made based on your judgment and responsibility, and FISCO shall not be liable for any damage incurred by you as a result of such use, irrespective of the reason.

This report has been prepared at the request of the company subject hereto based on the provision of information by such company through telephone interviews and the like. However, the hypotheses, conclusions and all other contents contained herein are based on analysis by FISCO. The contents of this report are as of the time of the preparation hereof, and are subject to change without notice. FISCO is not obligated to update this report.

The intellectual property rights, including the copyrights to the main text hereof, the data and the like, belong to FISCO, and any revision, reprocessing, reproduction, transmission, distribution or the like of this report and any duplicate hereof without the permission of FISCO is strictly prohibited.

FISCO and its affiliated companies, as well as the directors, officers and employees thereof, may currently or in the future trade or hold the financial instruments or the securities of issuers that are mentioned in this report.

Please use the information in this report upon accepting the above points.

■ 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