

MonotaRO Co., Ltd.

3064

Tokyo Stock Exchange First Section

8-Apr.-2019

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

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■ Summary

FY12/18 sales reached ¥100bn FY12/19 sales and earnings both expected to grow approx. 20% Progress on construction to double shipping capacity of the Kasama DC

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 17 million items for a customer base of 3,363,000 accounts (as of December 31, 2018) and sells about 524,000 items with same-day shipment (including roughly 411,000 items for which the Company has its own inventories).

1. FY12/18 non-consolidated results

The Company sustained robust growth in non-consolidated sales and earnings through FY12/18 with ¥105,331mn in sales (up 24.4% YoY), breaking through ¥100,000mn for the first time, and ¥14,278mn in operating income (up 17.3%), ¥14,250mn in ordinary income (up 17.0%), and ¥9,825mn in net income (up 12.9%). Both sales and profits sustained growth momentum. Sales rose substantially YoY due to healthy trends in new customer acquisitions and rising sales at existing customers. The Company boosted new customer acquisitions on successes with various measures, such as reinforcement of listing advertisements, search engine optimization (SEO), airing a new-version TV commercial, and broadening product scope (to over 17 million items). Sales to existing customers grew at a healthy pace as the effect from measures to enhance usage frequency expanded and continued. Furthermore, the purchase management system (business with large corporations) also performed favorable (up 54% YoY). Gross margin dropped 1.4 pp YoY. The main components of this were an increase in delivery cost rate due to price increases, changes in the product mix, an increase in business with large corporations, and a decrease in the gross margin due to a fall in overseas royalties. Meanwhile, the SG&A expense ratio decreased by 0.6 pp YoY, mainly reflecting the effect of increased sales and a decrease in costs associated with the start of operations at the Kasama Distribution Center (“DC”) recorded in the previous year. As a result, operating income increased 17.3% YoY and the operating margin dropped by 0.8 pp.

Summary

2. Consolidated outlook for FY12/19

The Company's FY12/19 consolidated targets are ¥136,258mn in net sales (up 24.4% YoY), ¥16,536mn in operating income (up19.9%), ¥16,530mn in ordinary income (up19.9%), and ¥11,715mn in net income attributable to owners of the parent (up 23.1%). This outlook expects continuation of strong growth in sales and profits with approximately 20% increase. If it can achieve these targets, the Company will realize 18 consecutive periods of sales growth and 10 of earnings growth. The Company's core strategies for increasing sales are to expand new customer acquisitions, expand sales to existing customers, and promote the purchase management system business (business with large corporations). Net sales growth of 24.4% is in line with the level of growth in the previous year. For new customer acquisitions, the Company will make further use of marketing data with the aim of acquiring 721,000 new accounts (625,000 new accounts in the previous year). The purchase management system business (business with large corporations) is also expected to achieve a high rate of growth in FY12/19. The Company will increase its corporate sales members and strengthen its organization and systems, including the opening of a sales office in the Chubu region. The gross profit margin is forecasted at 28.7% (down 0.5 pp YoY). On the other hand, the SG&A expenses ratio is expected to decline by 0.1 pp YoY. As a result, operating income is forecasted to increase 19.9% YoY, with the ratio to sales at 12.1% (down 0.5 pp). Both sales and earnings have been growing at around 20%, indicating an extremely strong business model. Ceaseless refinement of distribution, systems, and marketing to evolve the business model further also enhances the reliability of the earnings forecast.

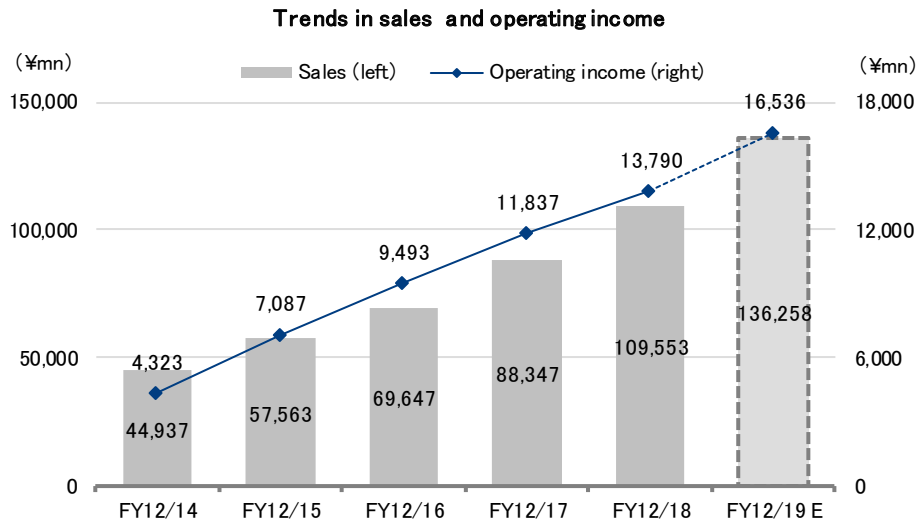
3. Kasama DC shipping capacity being doubled to cope with business expansion

Under the Company's business model, "quick, timely" delivery of various products is of key importance. On the other hand, if inventories are increased or labor is used excessively, distribution-related costs will increase. The distribution-related cost ratio to sales is on a broad declining trend and under control. In 1H FY12/19, the rate is expected to remain at 6.1% due to the lingering impact of increases in personnel expenses and outsourcing costs, but in 2H it is expected to drop to 5.8% as shipments increase in April following the completion of the highly productive Kasama DC expansion. The Company is carrying out construction (second phase construction) to double the shipping capacity of the Kasama DC, and operations are expected to begin in April following construction completion in March 2019. Specifically, the number of auto-guided vehicle robots will increase by 114 units from the current 154 units, and conveyors and shipping equipment will also be increased. A further 28 picking stations will be added to the current 16. Projection mapping technology will be applied to the picking stations to relieve the burden on workers and increase work accuracy. After the expansion is complete, the scale of sales that can be handled at the east and west DCs will be around ¥160bn.

Key Points

- Double digit growth in sales and earnings continued in FY12/18. Sales reached ¥100bn. Brisk performance in new customer acquisitions, existing customer orders, and business with large corporations
- Sales and earnings expected to grow rapidly at around 20% in FY12/19. Further refinement of a strong business model expected to yield an 18th consecutive year of sales growth and a 10th consecutive year of earnings growth
- Construction work to double the shipping capacity of the Kasama DC is progressing. Strengthen marketing capability based on data science

Summary



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

Results trends

Double digit growth in sales and earnings continued in FY12/18.

Sales reached ¥100bn.

Brisk performance in new customer acquisitions, existing customer orders, and business with large corporations

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

The Company sustained robust growth in non-consolidated sales and earnings through FY12/18 with ¥105,331mn in sales (up 24.4% YoY), breaking through ¥100,000mn for the first time, and ¥14,278mn in operating income (up 17.3%), ¥14,250mn in ordinary income (up 17.0%), and ¥9,825mn in net income (up 12.9%). Both sales and profits sustained growth momentum.

Sales rose substantially YoY, with steady performance in both new customer acquisitions and sales to existing customers. The Company boosted new customer acquisitions on successes with various measures such as reinforcement of listing advertisements, search engine optimization (SEO), airing a new-version TV commercial, and broadening the product scope to over 17 million items. It acquired 625,000 new accounts through FY12/18, a new record, giving it a total of 3,363,000 accounts. Sales to existing customers grew at a healthy pace having expanded and continued the effect of measures to increase the usage frequency implemented since March 2017.* In addition, the purchase management system business (business with large corporations) also performed well. The total number of partners rose to 604 companies, up 175 YoY, and the sales ratio from this business grew to 12.9%.

* Free delivery for the month on additional orders regardless of the amount after making a single order worth ¥7,000 (tax exclusive) or more (only applies to Web-based orders).

Results trends

Gross margin dropped 1.4 pp YoY. The main components of this were a 0.6 pp increase in the delivery cost ratio due to a price hike, and a 0.3 pp decrease in the gross profit margin due to changes in the product mix (decline in the gross profit margin due to expansion of new products, increase in the sales ratio of national brand products) and an increase in business with large corporations. An additional impact was felt due to a decline in overseas royalties. The US ZORO Business itself grew steadily, but recorded a decline in earnings as investments for system development for continued growth took priority, resulting in lower-than-expected royalties. The SG&A expense ratio declined by 0.6 pp YoY. Despite an increase in the outsourcing cost ratio to secure staff for the Amagasaki DC and Amagasaki Call Center, the overall cost ratio declined due to the effect of higher sales and a decline this year in costs related to the start of operations at the Kasama DC in the previous year.

As a result of these factors, operating income increased 17.3% YoY while the operating margin declined by 0.8 pp. Net income only expanded 12.9% YoY owing to resumption of a normal tax rate after the previous fiscal year's tax incentive (coverage of Kasama DC investments under the tax program promoting capital investments in productivity improvements).

Non-consolidated income summary for FY12/18

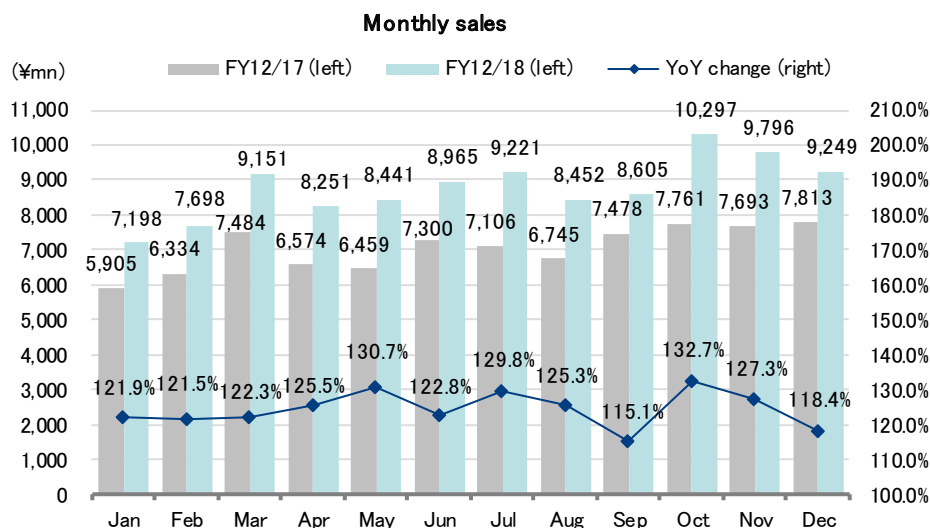
(¥mn)

	FY12/17		FY12/18			Change factors
	Results	vs. sales	Results	vs. sales	YoY	
Sales	84,656	100.0%	105,331	100.0%	24.4%	<ul style="list-style-type: none"> • Expansion of new customers (adding 625,000 accounts) with support from strengthened listing advertisements, improved SEO, new TV commercials, and increase in the number of handled items • Measures to increase usage frequency (campaign for free delivery fees) etc., led to increase in existing customer sales • Purchase management system business (business with large corporations) grew, driving up sales (up 54% YoY)
Gross profit	26,204	31.0%	31,147	29.6%	18.9%	<ul style="list-style-type: none"> • Gross margin dropped 1.4 pp YoY • Delivery cost ratio increased 0.6 pp due to price increase, etc. • Gross profit margin declined 0.3 pp due to changes in the product mix (decline in gross profit margin due to expansion in new products, increase in sales ratio of national brand products) and increase in business with large corporations. • Impact of a decrease in overseas royalties, etc.
SG&A expenses	14,035	16.6%	16,868	16.0%	20.2%	<ul style="list-style-type: none"> • SG&A expense ratio declined 0.6 pp YoY • Despite an increase in the outsourcing cost ratio at the Amagasaki DC, overall expenses ratio declined due to the impact of higher sales and a decline this year in costs related to the start of operations at the Kasama DC in the previous year.
Operating income	12,168	14.4%	14,278	13.6%	17.3%	• Net sales ratio dropped 0.8 pp YoY
Ordinary income	12,177	14.4%	14,250	13.5%	17.0%	• Net sales ratio dropped 0.9 pp YoY
Net income	8,699	10.3%	9,825	9.3%	12.9%	• Net sales ratio dropped 1.0 pp YoY due to higher tax rate

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

Looking at monthly results in 2018, the Company sustained around 20% sales growth in all months, even with severe weather changes such as heavy snow in January and typhoons, torrential rains and heat wave conditions in July to September.

Results trends



Source: Prepared by FISCO from the Company's IR news

Business outlook

Sales and earnings expected to grow rapidly at around 20% in FY12/19. Further refinement of a strong business model expected to yield an 18th consecutive year of sales growth and a 10th consecutive year of earnings growth

● Consolidated outlook for FY12/19

The Company's FY12/19 consolidated targets are ¥136,258mn in net sales (up 24.4% YoY), ¥16,536mn in operating income (up 19.9%), ¥16,530mn in ordinary income (up 19.9%), and ¥11,715mn in net income attributable to owners of the parent (up 23.1%). This outlook expects continuation of strong growth in sales and earnings with approximately 20% increase. If it can achieve these targets, the Company will realize 18 consecutive periods of sales growth and 10 of earnings growth.

The Company's core strategies for increasing sales are to expand new customer acquisitions, expand sales to existing customers, and promote the purchase management system business (business with large corporations). Expected sales growth of 24.4% is in line with the level of growth in the previous year. For new customer acquisitions, the Company will make further use of marketing data with the aim of acquiring 721,000 new accounts (625,000 new accounts in the previous year). For expansion of sales to existing customers, the Company will work to further shorten lead times by optimizing distribution and conducting timely promotions. The purchase management system business (business with large corporations) is also expected to achieve a high rate of growth in FY12/19 with sales of ¥19.5bn (up 44% YoY). The Company will increase its corporate sales members and strengthen its organization and systems, including the opening of a sales office in the Chubu region and carving out the organization responsible for the purchasing management system inside the IT division to make it independent.

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Business outlook

The gross profit margin is forecasted at 28.7% (down 0.5 pp YoY). Changes in the product mix and an increase in the ratio of business with large corporations, an increase in delivery prices, a decline in overseas royalties, and other factors, are expected to continue along the same trajectory as the previous fiscal year. On the other hand, the SG&A expenses ratio is expected to decline by 0.1 pp YoY, reflecting the streamlining and scale effects despite an increase in system-related expenses such as expansion of data marketing. As a result, operating income is forecasted to increase 19.9% YoY, with the ratio to sales at 12.1% (down 0.5 pp). Both sales and earnings have been growing at around 20%, indicating an extremely strong business model. Ceaseless refinement of distribution, systems, and marketing to evolve the business model further also enhances the reliability of the earnings forecast.

Consolidated targets

(¥mn)

	FY12/18		FY12/19			2Q FY12/19	
	Results	vs. net sales	Forecast	vs. net sales	YoY	Forecast	YoY
Sales	109,553	100.0%	136,258	100.0%	24.4%	63,780	23.4%
Gross profit	32,027	29.2%	39,065	28.7%	22.0%	18,284	18.8%
SG&A expenses	18,236	16.6%	22,529	16.5%	23.5%	10,816	24.7%
Operating income	13,790	12.6%	16,536	12.1%	19.9%	7,468	11.3%
Ordinary income	13,788	12.6%	16,530	12.1%	19.9%	7,462	11.6%
Net income attributable to owners of the parent	9,515	8.7%	11,715	8.6%	23.1%	5,191	12.7%

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

■ Topics

Construction work to double the shipping capacity of the Kasama DC is progressing. Strengthen marketing capability based on data science

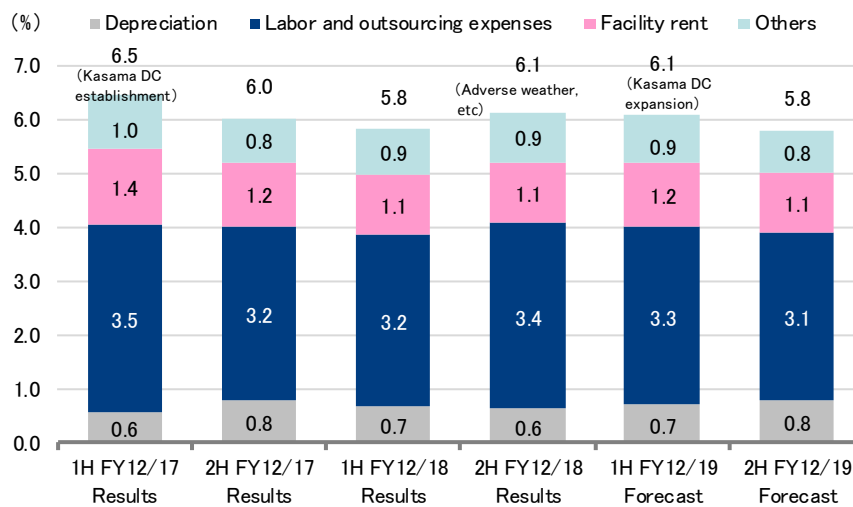
1. Kasama DC shipping capacity being doubled to cope with business expansion. Utilization of projection mapping in picking stations

Under the Company's business model, "quick, timely" delivery of various products is of key importance. On the other hand, if inventories are increased or labor is used excessively, distribution-related costs will increase. The distribution-related cost ratio to sales is on a broad declining trend and under control. With the full-scale start of operations at the Kasama DC in 1H FY12/17, one-time costs were incurred during the transition period and the distribution-related cost ratio to sales for 1H FY12/17 was 6.5%. In 1H FY12/17, however, the ratio declined to 5.8%. In 1H FY12/18, the impact of adverse weather (heat waves, torrential rain, typhoons) caused a decline in productivity, mainly at the Amagasaki DC. This caused the distribution-related cost ratio to climb to 6.1% as the ratios of personnel and outsourcing expenses increased. In 1H FY12/19, the ratio is forecast to remain at 6.1% due to the lingering impact of the increase in personnel and outsourcing expenses. The ratio is projected to fall back to 5.8% in 2H FY12/19 as shipping increases following the completion of the expansion of the highly productive Kasama DC in April.

Topics

The Company is carrying out construction work (second phase construction) to double the capacity of the Kasama DC to cope with the rapid expansion of its business. The construction is scheduled for completion in March 2019, with operations to start in April. Specifically, the number of auto-guided vehicle robots will increase by 114 units from the current 154 units, and conveyors and shipping equipment will also be increased. A further 28 picking stations will be added to expand to 44 stations. Projection mapping technology will be applied to the picking stations to relieve the burden on workers and increase work accuracy. After the expansion is complete, the scale of sales that can be handled at the east and west DCs will be around ¥160bn.

Distribution-related cost ratio



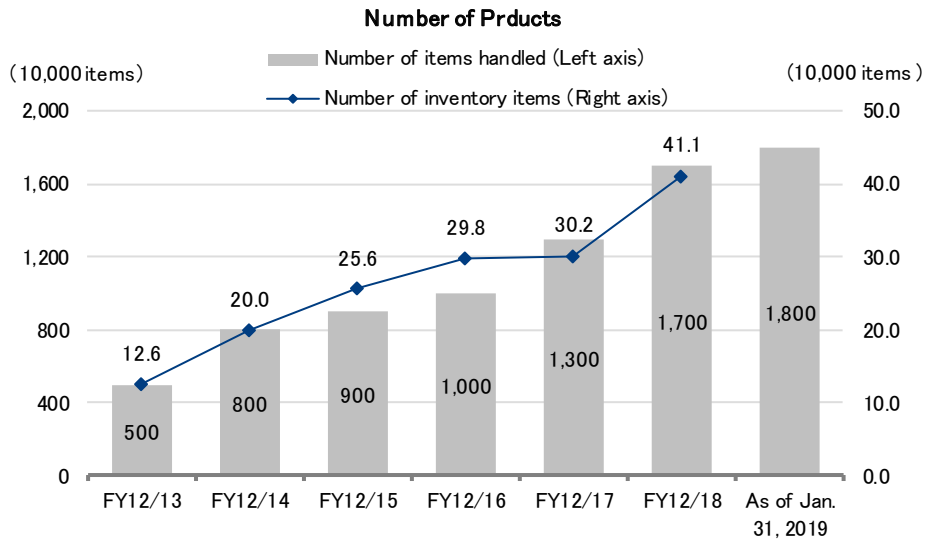
Source: Prepared by FISCO from the Company's results briefing materials

2. Expand the number of items handled to 18 million. Expand long-tail products

Since the Company's foundation, it has worked to expand the coverage of items handled with a focus on low-volume, high-mix long-tail products.* The number of items handled passed 10 million at the end of 2016, and by the end of January 2019 it had reached 18 million. The number of long-tail products expanded, including mainly air compressors, control equipment, and paint, as well as electrical materials, working apparel, cutting tools, store fixtures and furniture, experimental equipment and R&D products. Inventory items also expanded in parallel. At the end of 2016, inventory items stood at 298,000 items, expanding to 411,000 items by the end of 2018. A major factor in this expansion was the establishment of an east-west double DC structure with the Amagasaki and Kasama DCs. The increase in inventory items means an increase in same-day and next-day shipments, increasing the service level as well as the repeat ratio.

* Long-tail (products): A method of selling goods using the Internet. This approach seeks to boost overall net sales by preparing a wide range of items including niche products that have few selling opportunities and increasing customer numbers. Such product lines are referred to as long-tail products.

Topics



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

3. Opening offices in Osaka and Tokyo and promoting reinforcement of organization using data

In 2018, the Company opened sites in Umeda (Osaka) and Akasaka (Tokyo) with the main purpose of developing sophisticated marketing systems based on data science. The Company has already been one of the first to introduce machine learning for use in attracting customers and continuous purchasing. Now, it will step up its activities to a higher level. As an example, the Company presents an optimized selection of recommended items to customer, and has earned a reputation for its accuracy in this. Looking ahead, it will strive to produce optimal recommendations with even finer detail. This will lead to greater convenience as customers can obtain items that they really need all from a single supplier.

The Company plans to employ around 30 data scientists and IT engineers over the next two to three years. Data scientists are in high demand, mainly among major Internet corporations, and human resources with high levels of expertise are difficult to source. Recruitment is continuing as before.

Shareholder return policy

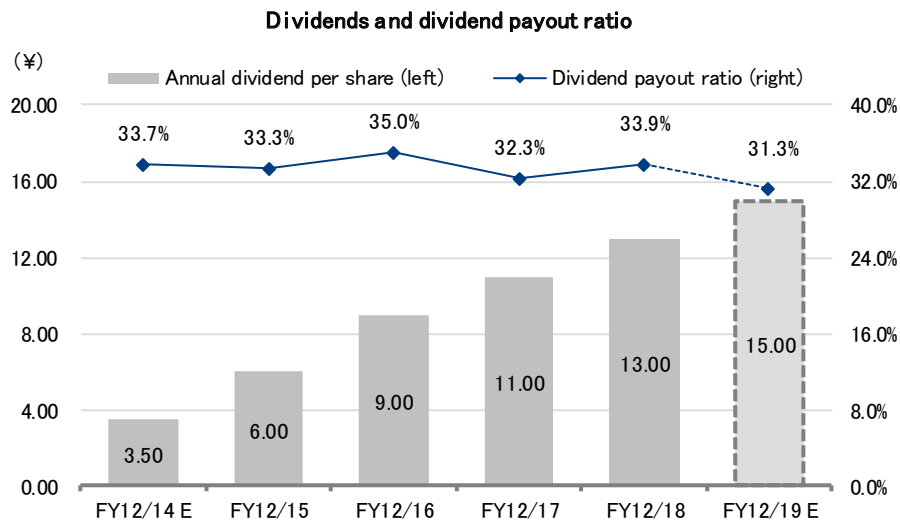
Stable dividend increase for a fifth consecutive year in December 2018

Forecasting a ¥15 dividend in FY12/19 (up ¥2 YoY), 31.8% dividend payout ratio

The Company adheres to a policy of paying a stable dividend in line with earnings. It has delivered five consecutive years of dividend increases since FY12/13 (dividend ¥3) and maintained a dividend payout ratio of 30% or higher. The dividend for FY12/18 was ¥13 (up ¥2 YoY) and the dividend payout ratio was 33.9%. For FY12/19, the forecast is for an interim dividend of ¥7.5 and a year-end dividend of ¥7.5, (both dividend increases) for an annual dividend of ¥15 (up ¥2 YoY) and a dividend payout ratio of 31.8%. The dividend increases are expected to continue at a fast pace, matching the high growth rate of the Company's profits.

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 *).

* Amounts do not include tax



Note: The Company conducted 2-for-1 stock splits in FY12/15. It also decided at its Board of Directors' meeting on July 27, 2018 to conduct a 2-for-1 stock split that took effect on October 1, 2018. We retroactively adjusted dividend values for the share split.

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



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