

Kitanotatsujin Corporation

2930

Tokyo Stock Exchange First Section/Sapporo Securities Exchange

4-Dec.-2019

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FISCO Ltd.

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

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Summary

Sales and profits have recently increased due to the “injecting cosmetics” series being a major hit In FY2/20 also, net sales are expected to surpass ¥10bn

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. Recently, there has been significant growth in the major hit “injecting cosmetics” series, and the percentage of sales from skin care products (cosmetics) is increasing compared to in the past, when sales were centered on health foods, and with this the breadth of membership has expanded to include middle-aged and elderly men who are interested in anti-aging solutions.

In the FY2/20 1H results, sales and profits grew, with net sales increasing 28.0% year-on-year (YoY) to ¥5,055mn and operating profit rising 45.8% to ¥1,390mn. However, net sales fell short of initial forecasts due to one-time factors, while profits exceeded forecasts. The “injecting cosmetics” series has been a big hit, which contributed to the increase in sales. In particular, sales of HYALO DEEP PATCH, which was released in September 2016, have grown at a faster-than-expected pace, and now has a larger presence in the sales mix by product. However, sales undercut the forecast due to the fact that production of the explosive hit product HYALO DEEP PATCH could not keep pace with demand, resulting in shipping delays. Meanwhile, profits exceeded the forecast due to the fact that the Company temporarily curbed advertisement placements and suppressed orders due to the fact that, as mentioned above, production of HYALO DEEP PATCH could not keep pace with demand. With respect to new products, the Company released the second product in the “injecting cosmetics” series, and the launch has gone smoothly (as of September 30, 2019).

The Company has left unchanged its initial forecasts FY2/20, which are for major increase in sales and profits, with net sales rising 31.6% to ¥10,939mn and operating profit growing 45.2% to ¥2,702mn, so if the company achieves the forecasts, it ¥exceeds its near-time goal ¥10bn. The same as in the prior fiscal year, the Company expects the “injecting cosmetics” series, centered on HYALO DEEP PATCH, to drive the growth in results. Also, the Company is planning to release around five new products over the full fiscal year. For profits, it is expected that the active investment in advertising and personnel expenses will increase, and that there will be expenses related to the relocation of the Head Office and the opening of the Tokyo Branch Office. But even so, the outlook is for profits to increase due to the higher sales and for the operating margin to improve to 24.7% (22.4% in the previous fiscal year).

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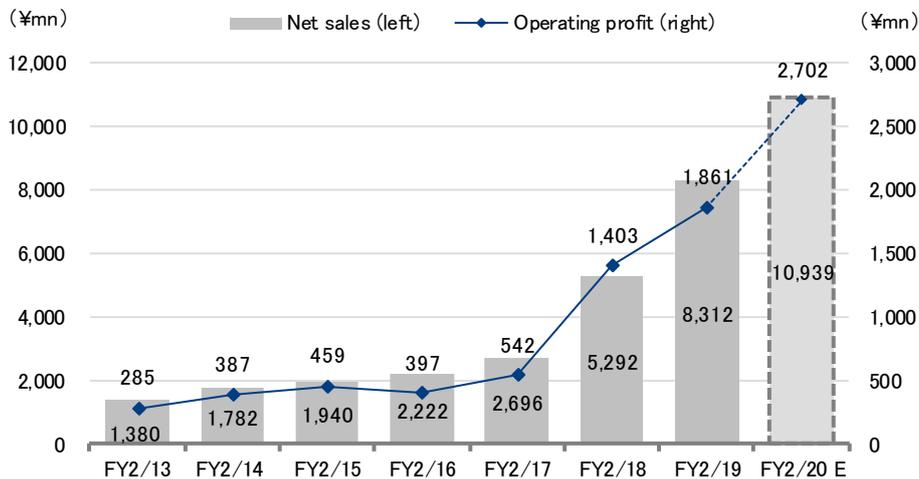
Summary

The Company's growth strategy is the same as up to the present time; namely, to realize stable growth by aiming to have the top products in niche markets through utilizing its overwhelming product appeal in product fields in which it is easy for customers to feel their effects for their health, beauty, and other concerns, and therefore for which it is easy to obtain repeat sales. The Company is accelerating the growth through actively investing in advertising, and in the near future it has in sight achieving its targets of net sales of ¥10bn. Going forward, as the next growth stage it has set targets of net sales of ¥30bn, and it seems that is aiming to achieve them by 5 years' time. At FISCO, we consider that, in addition to the sustainable growth, the key to achieving further growth will be developing a large number of products that are top in their niche market with a sales scale of ¥300mn to ¥1bn. Going forward, we will be focusing on the following 5 points; 1) the state of the development of new products and their contributions to earnings, 2) the strengthening of the customer acquisition system and its effects, 3) the progress made in reducing costs, including in overseas production, 4) the fully fledged business development in Asia, and 5) the investment strategy that utilizes its solid financial base (particularly M&A).

Key Points

- In FY2/20 1H sales and profits increased, driven by the “injecting cosmetics” series being a big hit
- However, production of the explosive hit product HYALO DEEP PATCH did not keep pace with demand, leading to shipping delays. As a result, net sales fell short of the Company’s forecast (the production system has been strengthened)
- The Company has kept its full year FY2/20 forecasts unchanged, and expects an increase in both sales and profits (expects net sales to surpass ¥10bn)
- Has entered a new stage toward achieving the next target (of net sales of ¥30bn within 5 years)

Results trends



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

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Company profile

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

1. Business description

The Company conducts online sales of health foods and cosmetics 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 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. Recently, the hit product HYALO DEEP PATCH, the first product in the "injecting cosmetics" series, has seen a significant increase in sales. In FY2/20 1H, in addition to strong membership count, the percentage of sales from cosmetics is increasing compared to in the past, when sales were centered on health foods, and with this the breadth of membership has expanded to include middle-aged and elderly men who are interested in anti-aging solutions.

KAITEKI OLIGO is a highly pure, high quality food with functional claims (the details are given below, it is effective for constipation) created by compounding several types of oligosaccharide, including sugar beet produced in Hokkaido, as the main ingredients. In addition, the Company handles 30 products (as of the end of September 2019), including HYALO DEEP PATCH, which concentrates and replenishes moisture by using micro-sized needles 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.

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-SU-CHA	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)
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

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Company profile

Item	Description
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 (The first product in the "injecting cosmetics" series)	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 (The second product in the "injecting cosmetics" series)	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 (The third product in the "injecting cosmetics" series)	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.

Source: Prepared by FISCO from securities reports and press releases

The Company itself does not have production bases for its products and it mainly consigns production to its OEM partners. On the other hand, at the end of August 2015 it established a Taiwan branch office as a base for strengthening online sales in local markets in Asia.

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.

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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 been driving growth at the same time 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 (the end of August 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), and other offices worked to create a business foundation targeting accelerated growth.

Meanwhile, in terms of external evaluations of the Company, in September 2015 in EY Entrepreneurs of the Year Japan*1, which is a part of an international scheme to recognize entrepreneurship, Mr. Kinoshita was elected as the representative of the Hokkaido block. 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. In Japan, it started 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.

More recently, aspects such as the Company's profitability and growth potential have been positively evaluated in the media on a number of occasions. For example, in Forbes Asia, the regional Asia version of the U.S. economic magazine Forbes (the July/August 2018 issue), it was selected among "Asia's 200 Best Under a Billion," which are its selection of 200 excellent companies with sales of less than U.S.\$1 billion in the Asian Pacific region (second selection since the August 2014 issue). In addition, in the national edition of NIKKEI dated July 9, 2019, the Company was included in the "NEXT1000," which included medium-sized listed companies with high average ROE over the past three years, having a three-year average ROE of 40.8%. Most recently, the Company received the Internet Shopping Award at the Asia Direct Marketing Summit 2019, and in an article published in the October 4, 2019 edition of Toyo Keizai Online entitled "Must See for Investors! Executive Rankings as Evaluated by the Market," Representative Director & President Katsuhisa Kinoshita was selected as the top executive.

Company profile

On August 7, 2019, it was selected as a constituent stock of the JPX-Nikkei Mid and Small Cap Index* for two consecutive years (applied on August 31, 2019).

* 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 TSE 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 the results of the long-running mainstay products, including KAITEKI OLIGO, or of HYALO DEEP PATCH, the first product in the "injecting cosmetics series" which is currently a big hit, each of the products are supported by long-term demand and positioned as the top product in their respective niche market. 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 2019, all of the Company's products that were evaluated won awards. In particular, KAITEKI OLIGO won the Grand Gold Award for the eighth consecutive year, Minna no Hadajuntou (After Care Type) won it for the seventh consecutive year, and Minna no Hadajuntou (Clear Type) for the fifth consecutive year. Also, 20NEN HOIPPU won the Gold Award for the seventh consecutive year, EYE KIRARA for the fourth consecutive year, HYALO DEEP PATCH for the third consecutive year, and CLEAR NAIL SHOT α for the third consecutive year. In addition, HANDPURENA, MEN's EYE KIRARA, and KAITEKI OLIGO for Children were each awarded the Gold Award for the first time.

The key to creating hit products that are supported by consumers is highly accurate test marketing. From among the many candidates, it selects those whose effects are easily experienced and that are likely to be purchased repeatedly. In addition, its consistent policy has been to only launch a product that is highly likely to sell well based on the results of a monitor survey of a prototype product.

Company features

2. Stability from regular purchases

The same as 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 the 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. In the future also, it intends to continue with a strategy of aiming for multiple products that are top of their niche market, not to pursue an explosive growth in results (a boom) that tends to be temporary, and rather to steadily capture long-term demand in each of these respective markets at the same time as aiming to achieve stable results growth by diversifying risk.

* 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 for 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 B1*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

Increasing the number of regular-purchase members and realizing strong growth through active investments in advertising

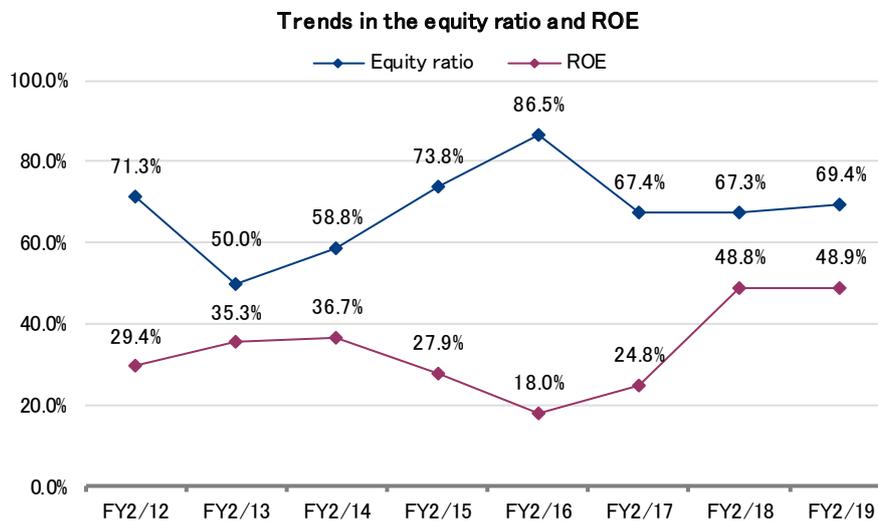
1. Trends in past results

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 Minna no Hadajuntou 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 “injecting cosmetics” 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.

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%. However, in FY2/19, the operating margin declined slightly because the Company strategically invested in advertising more than it had initially planned in order to avoid opportunity losses and to increase the acquisition of new members. But even so, it was maintained at a level of 22.4%.

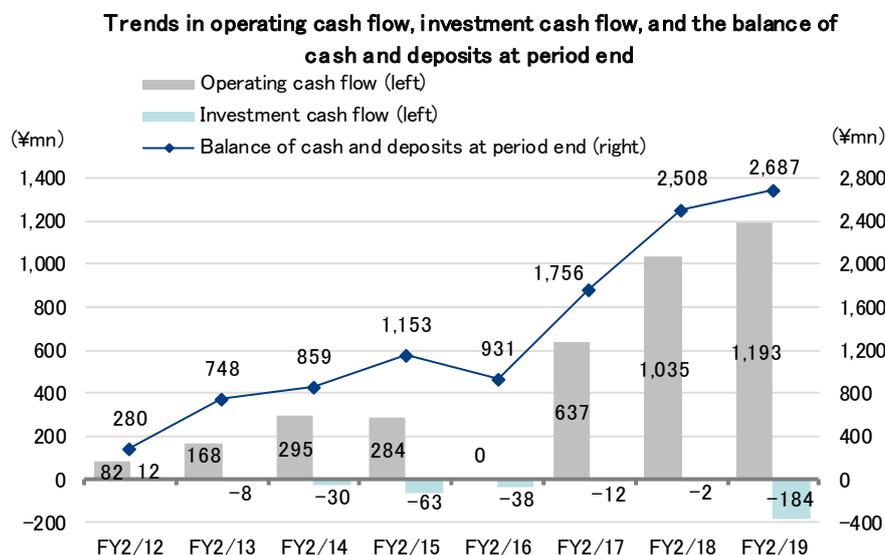
Meanwhile, the equity ratio, which is an indicator of financial stability, reached the high level of 86.5% in FY2/16 through a capital increase from a public offering and the accumulation of retained earnings. It fell in FY2/17 to 67.4% in order to secure liquidity from cash on hand through long-term borrowing, but there are no concerns about the stability of the Company's financial base. In addition, ROE (return on equity), which is an indicator of capital efficiency, has trended around the 50% level recently, supported by the Company's high profitability, and its financial condition can be evaluated as being extremely good.



Source: Prepared by FISCO from Company 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.

Financial highlights



Source: Prepared by FISCO from Company materials

2. FY2/20 1H financial highlights

In the FY2/20 1H results, sales and profits increased, with net sales rising 28.0% YoY to ¥5,055mn, operating profit growing 45.8% to ¥1,390mn, ordinary profit climbing 45.8% to ¥1,390mn, and net profit increasing 42.8% to ¥947mn. However, net sales fell short of the initial forecast due to one-time factors, while profits exceeded the initial forecast.

The big hit of the “injecting cosmetics” series had a significant contribution to the increase in sales. In particular, sales of HYALO DEEP PATCH, which was released in September 2016, have grown at a faster-than-expected pace, and now has a larger presence in the sales mix by product. With this, sales in 1H (quarterly basis) set a new record high. Also, other mainstay products performed well, supported by continued demand. However, sales undercut the forecast due to the fact that production of the explosive hit product HYALO DEEP PATCH could not keep pace with demand, resulting in shipping delays.

Meanwhile, with regards to profits, the costs ratio increased slightly due to the changes in the product mix, while SG&A expenses also increased in conjunction with the bolstering of the system (increase in personnel and Head Office relocation, etc.). Despite this, the Company posted a significant increase in operating profit due to the increase in net sales. The operating margin also increased to 27.5% (versus 24.1% in the same period of the previous year). However, profits exceeded the forecast due to the fact that the Company temporarily curbed advertisement placements and suppressed orders due to the fact that, as mentioned above, production of HYALO DEEP PATCH could not keep pace with demand. It is thus necessary to view these as one-time factors.

For the Company's financial condition, total assets were up 13.5% on the end of the previous fiscal year to ¥4,814mn, mainly due to the increase in cash and deposits and accounts receivable. The equity ratio rose to 75.0% (compared to 69.4% at the end of the previous fiscal year), because shareholders' equity significantly increased 22.7% YoY to ¥3.611mn due to the accumulation of retained earnings.

Financial highlights

FY2/20 1H financial highlights

	FY2/19 1H		FY2/20 1H		Change		(¥mn)		
	Results	% of total	Results	% of total	Amount	% change	FY2/20 1H		Achievement rate
							Initial forecast	% of total	
Net sales	3,950		5,055		1,105	28.0%	5,296		95.4%
Cost of sales	866	21.9%	1,200	23.7%	334	38.6%	-	-	-
SG&A expenses	2,127	53.8%	2,461	48.7%	334	15.7%	-	-	-
Operating profit	953	24.1%	1,390	27.5%	437	45.8%	1,288	24.3%	107.9%
Ordinary profit	954	24.2%	1,390	27.5%	436	45.8%	1,289	24.3%	107.8%
Net profit	663	16.8%	947	18.7%	284	42.8%	901	17.0%	105.1%

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

■ Topics

Released two products in the hit “injecting cosmetics” series. Worked to bolster the management foundation, including increasing personnel

1. Track record in releasing new products

So far in FY2/20, the Company released two products in the “injecting cosmetics” (as of the end of September 2019). Specifically, it released 1) MIKEN DEEP PATCH (released on July 9), 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; 2) ODEKO DEEP PATCH (released on September 27), 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 in indentations in the forehead to directly deliver the beauty ingredients to the keratin layer. Regarding the former, there were more than 20,000 advanced purchase reservations at the time of launch, and record-high sales in the first month of sales. The latter has received a lot of attention as the third product of the “injecting cosmetics” series, for which cumulative sales at the time of launch exceeded 12 million items.

With respect to the “injecting cosmetics” series, which has continued to release big hits, on top of utilizing the strength of strong customer acquisition capabilities based on the Company's overwhelming product strength and thorough marketing, the Company is countering against similar products* with trademark registrations, so there is a high likelihood that the Company will be able to establish an overwhelming position in the market. It appears that the Company plans, going forward, to one after another release series products as core products.

* The Company has already obtained trademarks for keywords believed to be necessary for effective advertising.

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Topics

Furthermore, the Company is working to release upgraded versions of existing products. On April 4, 2019, the Company launched sales of an upgraded version of Minna no Hadajunto (After Care Type), a moisturizing skin care cosmetic. The Hadajunto series is one of the Company's mainstay products, but the costs ratio is high, so in order to secure appropriate profits at the Company's standards, the Company had no choice but to curb advertising investment, and over the past few years sales have been on a declining trend. This latest upgraded version has a much lower costs ratio, and going forward the Company plans to get back on a growth track by making appropriate investment in advertising.

2. Use of Foods with Functional Claims System

For the Company's measures to utilize the Foods with Functional Claims System that came into effect in April 2015, most recently in May 2019, the Consumer Affairs Agency accepted its application for KAITEKI OLIGO, which contains five ingredients for improving bowel movements, into the system as a "food with functional claims, and on September 2, 2019, renewal sales were launched. This product has the functional claim that "This product contains raffinose, lactulose, fructo-oligosaccharides, isomalto-oligosaccharides, and alpha-cyclodextrin, so it has the function to improve the bowel movements of people prone to constipation (increase stool volume and frequency)." It will be the first "food with functional claims" in Japan that contains multiple oligosaccharides as the functional ingredients. In addition, with regards to KITANO DAICHINO YUMESHIZUKU (a tablet-type supplement with rafuma, a plant-derived ingredient which boosts sleep quality), which had its application accepted by the Consumer Affairs Agency in November 2018, renewal sales of the product were launched from June 24, 2019 as a "food with functional claims," and experts are recommending it as a product that can be trusted. The Company currently has three products* that are "foods with functional claims."

* In addition to KITANO DAICHINO YUMESHIZUKU, KAITEKI OLIGO, and KOJUKAN (accepted in May 2017).

3. Strengthening the Management Foundation

In continuation from FY2/19, the Company is working to increase its personnel. In FY2/20, the Company plans to increase its personnel significantly by approximately 50% (around 60 people), and in 1H it newly hired 40 people. With this, the Company increased the size of the customer acquisition department to 55 people (it had 37 people as of the end of FY2/19). Going forward, the Company plans to bolster its customer acquisition system by increasing personnel, particularly in the customer acquisition department, and by doing so work to discover products with small sales figures which it has not been able to sufficiently work on thus far. Also, with respect to the in-house analysis and operation system aimed at optimizing the advertising system which the Company introduced from FY2/19, the Company is using the system smoothly while continuing to boost its functionality. In addition to building a system that enables even inexperienced employees to generate profits at an early stage, the Company is having aspects that cannot be handled by this system co-exist with "direct operation by human management" by experienced personnel to maximize advertising effectiveness and efficiency. Also, the Company is increasing efficiency by using Robotic Process Automation (RPA) for routine operations, and bolstering the customer acquisition system will contribute to solidifying earnings.

With respect to the office infrastructure, on March 18, 2019, the Company relocated its Head Office to Sapporo Sosei Square in central Sapporo City, in preparation for future business expansion. Furthermore, on April 15, the Company opened the Tokyo Branch Office (Nihonbashi, Chuo Ward). In particular, at the Tokyo Branch Office, the Company plans to hire around 30 people with high-level skills and abundant experience, as the Company expects benefits on the personnel hiring front.

* A large complex completed in May 2018 which has become a new landmark in Sapporo City.

■ Outlook

FY2/20 results forecast left unchanged Continuing on from the previous fiscal year, the outlook is for net sales to exceed ¥10bn due to the increases in sales and profits

The Company has left unchanged its initial forecasts for FY2/20, which are for major increases in sales and profits, with net sales to increase 31.6% YoY to ¥10,939mn, operating profit to rise 45.2% to ¥2,702mn, ordinary profit to grow 45.2% to ¥2,703mn, and net profit to climb 46.2% to ¥1,890mn. If the Company achieves the forecasts, it exceeds its near-time goal ¥10bn.

Similar to 1H, the Company expects the “injecting cosmetics” centered on HYALO DEEP PATCH, to drive results growth. Also, further strengthening of the customer acquisition system will increase the efficiency and accuracy of advertising investment, and the Company also plans to dig deeper into existing products which it has not been able to sufficiently work on up until now. It appears that the Company plans to release approximately five new products in the full fiscal year (as initially planned).

For profits, it is expected that the investment including unspent amount of 1H in advertising will continue, that personnel expenses will increase, and that there will be expenses related to the relocation of the Head Office and the opening of the Tokyo Branch Office. But the outlook is still for profits to increase due to the higher sales and for the operating margin to improve to 24.7% (22.4% in the previous fiscal year).

At FISCO, despite the fact that net sales in FY2/20 1H undercut the Company’s forecast, we judge that it is fully possible that the Company will achieve its net sales forecast for the full FY2/20. This is based on the fact that the production system has been strengthened following delays in shipping, the fact that the backlog of orders awaiting shipment has increased significantly, the fact that two products were launched in the newly-released “injecting cosmetics” series, and the fact that the expansion of regular-purchase members contributes to the improvement in business performance. On the other hand, in terms of profits, although there was an upturn in 1H performance, it is highly likely that profits will end up right around the forecast because the Company is expected to aggressively invest in advertising for the “injecting cosmetics” series. What should be focused on is the pace at which the “injecting cosmetics” series will grow in order to expand business performance in FY2/21 and onward. As the customer base expands to different targets (middle-aged and elderly men, etc.), there are more cases of individual customers purchasing multiple products, and there is a possibility that the pace of growth will change. Consequently, it will be necessary to carefully monitor what kind of impact this will have on the upturn in performance for FY2/20 and the growth in results for FY2/21 and beyond.

FY2/20 forecasts

	FY2/19		FY2/20		Change	
	Results	% of total	Forecast	% of total	Amount	% change
Net sales	8,312		10,939		2,626	31.6%
Operating profit	1,861	22.4%	2,702	24.7%	840	45.2%
Ordinary profit	1,861	22.4%	2,703	24.7%	841	45.2%
Net profit	1,293	15.6%	1,890	17.3%	596	46.2%

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

Growth strategy

Entered a new growth stage targeting net sales of ¥30bn

The Company does not publish specific medium-term management targets, but based on its policy of prioritizing profits above sales, basically it is pursuing 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. The Company is succeeding in linking phased marketing to the acquisition of profits in the future through actively investing in advertising to acquire new members (and to accumulate regular-purchase members), which is accelerating the pace of growth. In the near future it has in sight achieving the targets of net sales of ¥10bn. Going forward, as the next growth stage it has set targets of net sales of ¥30bn, and it seems that is aiming to achieve them by 5 years' time.

At FISCO, we think that it is fully possible that the Company can achieve net sales of ¥30bn within 5 years, as this will be on a line extending from its current growth (based on an annual sale-increase rate of 30%). For profits also, judging from the height of the Company's inherent profitability, realizing operating profit of ¥10bn (an operating margin of 33%) is not considered to be that high of a hurdle to clear. In addition to the continuing growth of the mainstay products, the key to achieving these targets is likely to be realizing sustainable growth from constantly releasing around 5 new products a year, and from among them, cultivating as many as possible to achieve the top share of their respective niches with sales of around ¥300mn to ¥1bn.

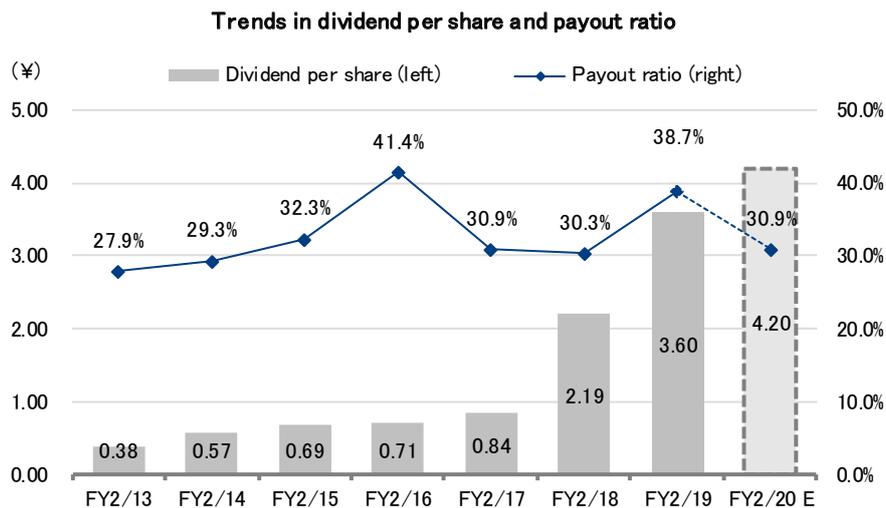
Going forward, we will be focusing on the following 5 points; 1) the state of developing new products and their contributions to results, 2) the strengthening of the customer acquisition system and its effects, 3) the progress made in reducing costs, including in overseas production, 4) the fully fledged business development in Asia, and 5) the M&A strategy. Particularly for 1) and 2), in addition to being the twin drivers of growth in the future, it is highly possible that they will further evolve. Conversely, 3) to 5) can be positioned as factors that will add to results. Especially with regards to 4), since the Company is prioritizing responding to the strong domestic demand, we cannot see any major progress for it at the present time. But if going forward, the Taiwan branch gets on track through the strengthening of its organizational aspects (such as personnel and advertising budget), and if the plan is also to enter the Chinese mainland and Southeast Asia, then it has enormous potential for the future. With regards to 5), it would target a company with a customer base through the EC online sales companies it is close to, but it currently seems to be at the stage of conducting a careful investigation, including for the management structure after M&A. Therefore, depending on the extent of the progress made in 4) to 5), it would seem possible that in 5 years' time, results will actually exceed the targets of net sales of ¥30bn and operating profit of ¥10bn (they will be achieved ahead of schedule). Going further, the "injecting cosmetics" series, which is currently a big hit, is growing at a faster pace than before while widening the range of targeted customers, so it is necessary to watch what kind of impact this will have on future growth.

Shareholder returns

Targets a dividend payout ratio of 30% or above, and the dividend is expected to continue to increase alongside the profit growth

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 FY2/20, the Company has upwardly revised the interim dividend from ¥2.00 per share to ¥2.10 per share, and thus plans to increase the annual dividend per share by ¥0.60 to ¥4.20 (interim dividend ¥2.10, period-end dividend ¥2.10, dividend payout ratio 30.9%). It aims to stably pay dividends targeting a dividend payout ratio of at least 30% as the standard, but there remains plenty of room to increase the dividend in the future alongside the growth in profits.



Note: the dividend per share is after being adjusted for the following six share splits (fractions of less than 1 yen have been rounded-up)

February 9, 2013 (1:4); 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

In addition, the Company has enhanced its shareholder benefits program. For FY2/19, all shareholders who held at least 100 shares received a gift of a Company product with a label price of at least ¥3,564 (including tax) once a year according to the number of shares they held. For FY2/20, the program was changed so that all shareholders who hold at least 100 shares receive a gift of MEN'S EYE KIRARA, an eye cream specifically for use under the eyes (label price of ¥4,864, including tax) once a year. (The gift is reviewed each period and may be changed in the future.)



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