COMPANY RESEARCH AND ANALYSIS REPORT

MonotaRO Co., Ltd.

3064

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Index

Summary

Started operation of the industry top class-sized Kasama distribution center that utilizes auto-guided vehicle robots in April 2017

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. As of June 30, 2017, the number of registered accounts has reached 2.461 million and over 10 million items are sold to these customers.

1. 2Q FY12/17 non-consolidated results

The Company sustained robust growth in non-consolidated sales and earnings through 2Q FY12/17 with ¥40,058mn in sales (up 24.6% YoY), ¥5,785mn in operating income (up 24.5%), ¥5,824mn in ordinary income (up 25.4%), and ¥4,140mn in net income (up 33.1%). Sales strengthened on growth in new customer acquisitions aided by reinforcement of listing ads, improved landing pages (including enhanced search features), and TV commercials. Existing customer sales rose as well thanks to success with measures aimed at boosting usage frequency. In earnings, higher margins on private-brand and imported products with strong-yen benefits and other positive trends more than offset pressure from higher costs, such as expenses related to opening the Kasama distribution (logistics) center (Kasama DC). Operating income reached an all-time high for 2Q.

2. Consolidated earnings outlook

The Company maintained period-start forecast for FY12/17 consolidated results at ¥84,239mn in sales (up 21.0% YoY) and ¥11,596mn in operating income (up 22.2%). Reaching these targets would consecutive increases to 16 fiscal years for sales and eight fiscal years for profits. Progress rates through 2Q were sales at 49.6% (vs. 47.8% in the previous year) and operating income at 48.0% (vs. 47.5%), moving further ahead than at this point in FY12/16. This pace indicates that the Company has sufficient leeway to attain full-year forecast and is likely to exceed its targets.

3. Start operation of the Kasama distribution center (Kasama DC)

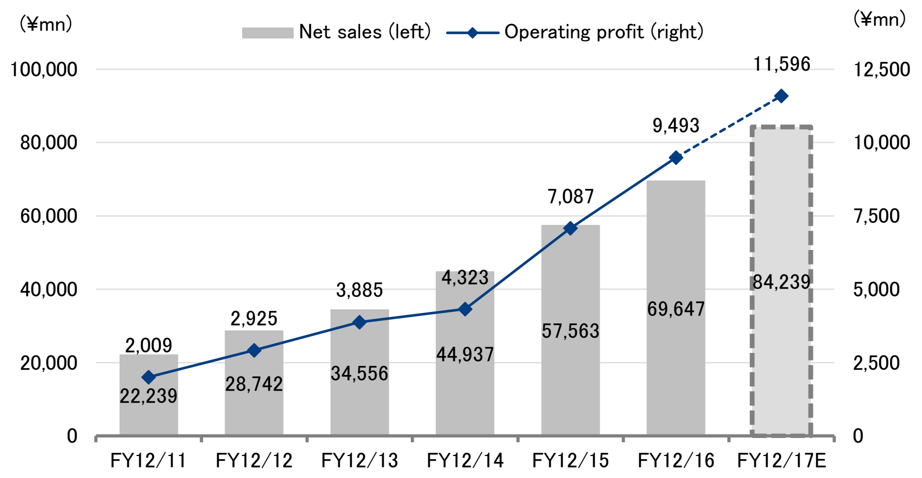
The Company completed Kasama DC (located in Ibaraki Prefecture), a new logistics site with an industry top-class size of 56,200m², in February 2017 and started operations in April. It will continue to operate the Amagasaki DC (located in Hyogo Prefecture), the main center up to now with 43,000m² and doubles, capacity with the two sites at a total of 99,200m². These facilities are enabling the Company to expand inventory capacity from about 300,000 items, when it only had the Amagasaki DC, to 500,000 items with the two sites and have established logistics capabilities that can support up to ¥150bn in sales. The Kasama DC enhances on-site work efficiency through use of auto-guided vehicle robots. This format significantly shortens walking time, which previously accounted for a large portion of picking operations, by having robots bring shelves to workers. The site's 154 self-direct delivery robots are currently traveling 1,300km daily. Operation of the Company's new picking method is proceeding smoothly.

The ratio of logistics-related costs to sales climbed in 1H FY12/17 because of Kasama DC opening costs and additional dispatched workers enlisted at the Amagasaki DC to handle higher shipments and shipment item volume that surpassed expectations. Kasama DC, which realizes high productivity, is likely to contribute to reduction of the logistics-related cost ratio from the latter half of 2H FY12/17.

Key Points

- Sustained strong sales growth in 1H, profit increased while absorbing higher logistics-related costs
- On track to reaching FY12/17 forecast with healthy sales progress through 2Q of 49.6%, anticipating progress in lowering the logistics-related cost ratio from the latter half of 2H FY12/17 through Kasama DC operations
- Started operation of the industry top-class size Kasama DC outfitted with auto-guided vehicle robots in April

Trends in sales and operating income



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

Results trends

Sustained strong sales growth in 1H, profit increased while absorbing higher logistics-related cost

● **Review of 2Q FY12/17 results (non-consolidated)**

The Company sustained robust growth in non-consolidated sales and earnings through 2Q FY12/17 with ¥40,058mn in sales (up 24.6% YoY), ¥5,785mn in operating income (up 24.5%), ¥5,824mn in ordinary income (up 25.4%), and ¥4,140mn in net income (up 33.1%).

Sales benefited from healthy trends in new customer acquisitions and existing customer sales growth. New customer acquisitions expanded with help from reinforcement of listing ads, improved landing pages (including enhanced search features), and TV commercials. New account acquisitions accelerated from 35,904 accounts per month in FY12/16 to 42,401 accounts per month in 2Q FY12/17. Existing customer sales maintained growth thanks to success with measures aimed at raising usage frequency and favorable macroeconomic conditions.

Gross margin dropped 0.1pp YoY, despite higher margins on private-brand and imported products, including strong-yen benefits. This was due to the heavy impact of changing recognition of credit-card payment fees from SG&A expenses to production costs (gross margin excluding change in production cost recognition increased 0.4pp YoY).

The SG&A expenses ratio, meanwhile, improved (declined) by 0.1pp, even with higher expenses primarily stemming from Kasama DC opening costs, due to the above-mentioned large impact from the change in recognition of credit card payment fees (the SG&A expenses ratio excluding change in production cost recognition rose 0.4pp YoY). Operating income set an all-time high for 2Q with a 24.5% YoY gain and also beat forecast by 3.0%. Quarterly net income expanded 33.1% YoY and surpassed forecast by 7.3%, including benefits from application of a tax incentive for capital investments that raise productivity at Kasama DC. The opening of Kasama DC in April went smoothly. Overall results were better than expected even though the full benefit of cost effectiveness was a little late in appearing.

Parent Income Summary for Q2 FY12/17

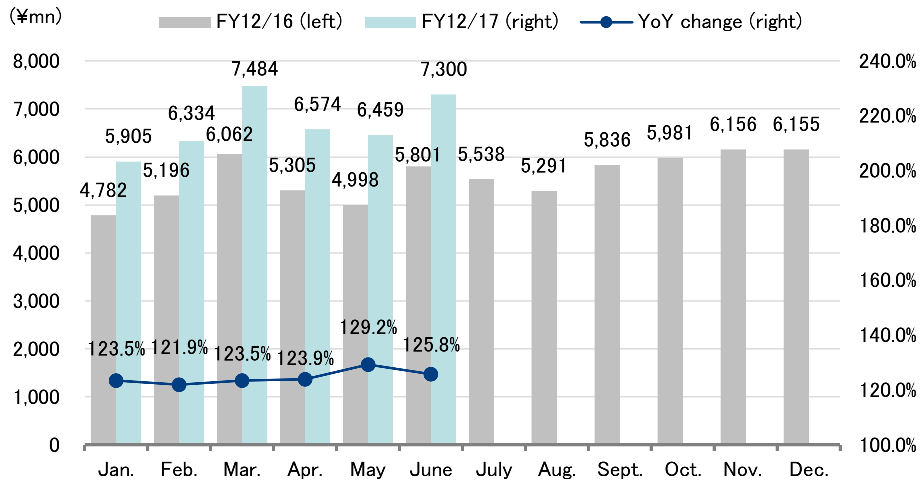
(¥mn)

	Q2 FY12/16		Q2 FY12/17					Change factors
	Results	vs. sales	Plan	Results	vs. sales	vs. plan	YoY change	
Net sales	32,147	100.0%	38,598	40,058	100.0%	3.8%	24.6%	• Sales strengthened on growth in new customer acquisitions aided by reinforcement of listing ads, improved landing pages (including enhanced search features), and TV commercials • Existing customer sales rose as well thanks to success with measures aimed at boosting usage frequency
Gross profit	10,154	31.6%	12,280	12,609	31.5%	2.7%	24.2%	• Gross margin dropped 0.1pp YoY • The negative factor is changing recognition of credit-card payment fees from SG&A expenses to production costs (gross margin for this term excluding change in production cost recognition was 32.0%, increased 0.4pp YoY) • The positive factor is higher margins on private-brand and imported products, including strong-yen benefits
SG&A expenses	5,509	17.1%	6,665	6,823	17.0%	2.4%	23.9%	• The SG&A expenses ratio dropped 0.1pp YoY • Cost reduction factor is changing recognition of credit-card payment fees from SG&A expenses to production costs (the SG&A expenses ratio for this term excluding change in production cost recognition was 17.5%, rose 0.4pp YoY) • The cost increase factor is Kasama DC establishment related expenses
Operating income	4,645	14.5%	5,615	5,785	14.4%	3.0%	24.5%	• 0.1pp YoY decrease
Ordinary income	4,645	14.5%	5,614	5,824	14.5%	3.7%	25.4%	• Same level
Net income	3,109	9.7%	3,860	4,140	10.3%	7.3%	33.1%	• 0.6pp YoY increase

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

Looking at monthly results, the Company is sustaining at least 20% YoY sales growth, even with seasonal fluctuations and promotion-related variations.

Monthly sales



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

In overseas business, while sales at the Korean subsidiary missed forecast, the operating loss was smaller than expected and this business should reach single-month profitability during FY12/17. Consulting business in the US and Europe is generating royalty income roughly in line with forecast owing to sales growth in that business.

Business outlook

On track to reaching FY12/17 forecast with healthy sales progress through 2Q of 49.6%, anticipating progress in lowering the logistics-related cost ratio from the latter half of 2H FY12/17 from Kasama DC operations

● FY12/17 consolidated outlook

The Company maintained period-start forecast for FY12/17 consolidated results at ¥84,239mn in sales (up 21.0% YoY), ¥11,596mn in operating income (up 22.2%), ¥11,607mn in ordinary income (up 22.0%), and ¥7,934mn in net income attributable to owners of the parent (up 24.6%) and thus expects to sustain robust sales and earnings growth. Reaching these targets would consecutive increases to 16 fiscal years for sales and eight fiscal years for profits. Sales tend to be larger in 2H as a seasonal pattern because of sales build-up from customers acquired in 1H. Progress rates through 2Q were sales at 49.6% (vs. 47.8% in the previous year), operating income at 48.0% (vs. 47.5%), ordinary income at 48.4% (vs. 47.4%), and net income attributable to owners of the parent at 50.0% (vs. 46.8%), making more progress than at this point in FY12/16. The Company added 254,000 new accounts through 2Q FY12/17, an all-time high for a half year. These accounts are likely to drive sales growth in 2H. Furthermore, the logistics cost ratio is likely to move lower in the second half of 2H because of the opening of the Kasama DC utilization rate following the smooth launch.

These trends indicate that the Company has sufficient leeway to attain full-year forecast and is likely to exceed its targets. Also, the Company changed its policy for revision of consolidated results from FY12/17. It will disclose revisions when deviation from forecast exceeds ±5% of consolidated sales and ±10% of consolidated earnings.

Consolidated operating results targets

(¥mn)

	FY12/16		FY12/17			
	Results	vs. sales	Targets	vs. sales	YoY change	Q2 progress rate
Net sales	69,647	100.0%	84,239	100.0%	21.0%	49.6%
Gross profit	21,895	31.4%	26,182	31.1%	19.6%	-
SG&A expenses	12,401	17.8%	14,585	17.3%	17.6%	-
Operating income	9,493	13.6%	11,596	13.8%	22.2%	48.0%
Ordinary income	9,514	13.7%	11,607	13.8%	22.0%	48.4%
Net income attributable to owners of the parent	6,368	9.1%	7,934	9.4%	24.6%	50.0%

Source: Prepared by FISCO from the Company's materials

Topics

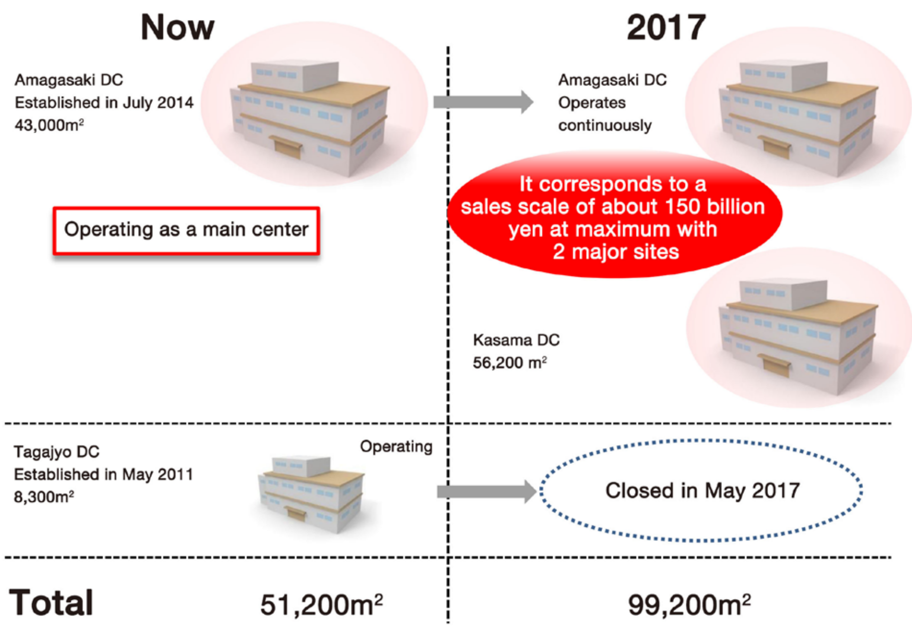
Started operation of the industry top class-sized Kasama DC outfitted with auto-guided vehicle robots in April

We review the plan, basic information, aims, results thus far, and prospects for the Company's new industry top class-sized logistics site (Kasama DC) completed in February 2017 and launched for operation in April.

1. Kasama DC operations plan

Logistic operations prior to the Kasama DC consisted of the Amagasaki DC (located in Hyogo Prefecture; 43,000m^2) as the main center with coverage of a broad area and the Tagajyo DC (located in Miyagi Prefecture; 8,300m^2) as a sub-center. These two sites provided 51,200m^2. Following opening of the Kasama DC (located in Ibaraki Prefecture; 56,200 m^2), the Company continues to operate the Amagasaki DC and closed the Tagajyo DC (in May 2017), giving it a combined 99,200m^2 and thus doubling capacity. These facilities are enabling the Company to expand inventory capacity from about 300,000 items, when it only had the Amagasaki DC, to 500,000 items with the two sites and have established logistics capabilities that can support up to ¥150bn in sales.

2017 Logistics center operations plan



Source:

2. Basic information regarding Kasama DC

Name: Kasama distribution center (Kasama DC)
Location: 1877-3 Tairamachi, Kasama City, Ibaraki Prefecture
Structure: Reinforced concrete, single-story building
Floor space: Approx. 56,200m²
Shipment capacity: Up to about 40,000 shipments per day
Inventory capacity: Possible to increase inventory capacity to a total of 500,000 items assuming parallel operation with Amagasaki DC
Main facilities: Racrew auto-guided vehicle robots, automated packaging and sealing machines
Employees: Roughly 200 expected in 2017; likely to increase thereafter as utilization expands

3. Kasama DC launch goal 1: Expansion of inventory capacity

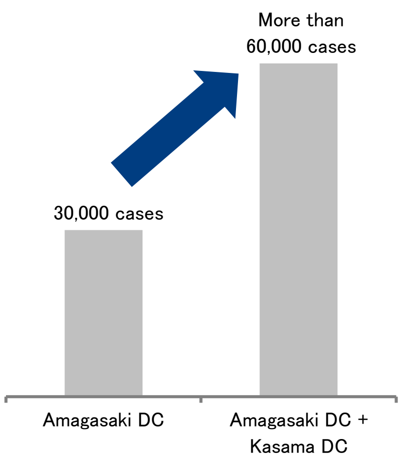
Expansion of inventory capacity is likely to play an important role in the Company's growth. Delivery timing of MRO products is directly linked to operations at businesses using the Company's services, and this means that delivery speed and reliability are vital to customer satisfaction. The Company hence aims to cover more products in its inventory and be capable of shipping them on the same day as receiving orders. It will shift from operations with about 300,000 inventory items at the Amagasaki DC to cover almost the entire country to having sites in eastern and western Japan with a total of roughly 500,000 inventory items. Another goal is further shortening of lead time. The Company hopes to realize a beneficial cycle in which improved convenience from larger inventories expands the customer base and sales.

The Kasama DC had 120,000 inventory items at the end of June 2017 and is targeting 200,000 items at the end of December 2017.

4. Kasama DC launch goal 2: Reinforcement of shipping capacity

The Company needs to reinforce shipping capacity in order to accommodate ¥150bn in sales. Better productivity is a key point. At the Kasama DC, the Company deployed auto-guided vehicle robots to support efficient picking of a wide range of products and thereby hopes to raise on-site work efficiency. This format significantly shortens walking time, which previously accounted for a large portion of picking operations, by having robots bring shelves to workers. The site's 154 self-direct delivery robots are currently traveling 1,300km daily, though this result is still at an early stage. Operation of the Company's new picking method is proceeding smoothly.

Reinforcement of shipping capacity



Source: Prepared by FISCO from press release

Source: Reprinted from the Company's results briefing materials

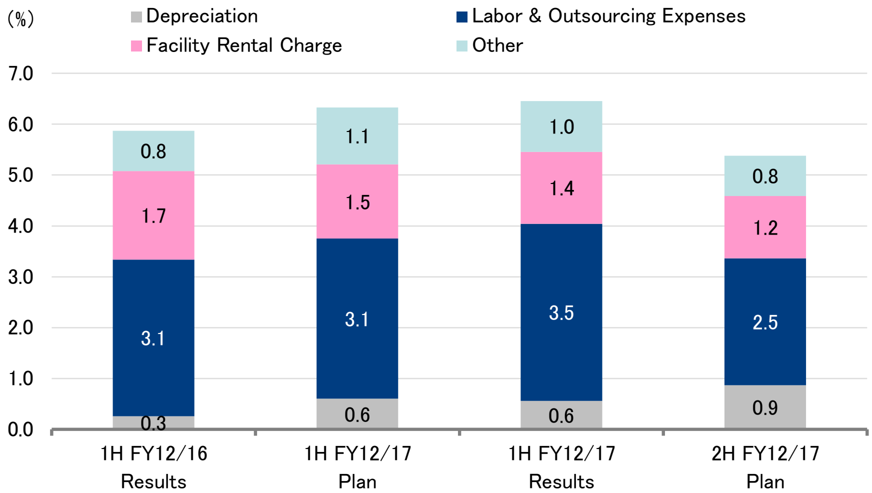
5. Logistics-related cost results and plan

The Company's ratio of logistics-related costs to sales was 5.9% in 1H and 2H FY12/16, with personnel costs and outsourcing expenses accounting for at least half (3.1%).

While 1H FY12/17 forecast already projected a 6.3% (+0.4pp YoY) ratio due to cost overlap and one-time expenses related to the Kasama DC launch (April), Tagajyo DC closure (May), and other changes, the actual result was 6.5%, a further 0.2pp higher. Kasama DC shipments were roughly on track with the plan, but outsourcing costs climbed because the Amagasaki DC enlisted additional dispatched personnel to accommodate higher sales (shipment deal increase) and shipment volume than expected.

The logistics cost ratio is likely to trend lower as Kasama DC operations stabilize and its shipment ratio increases. The Company hopes to adjust the shipment balance between the two DCs and boost the Kasama DC shipment ratio to over half of total shipments by period-end. It expects full utilization of the productivity improvement effect to lower the ratio of logistics-related costs to less than the 2H FY12/16 level (5.9%).

Logistics-related cost (vs. sales) (non-consolidated)



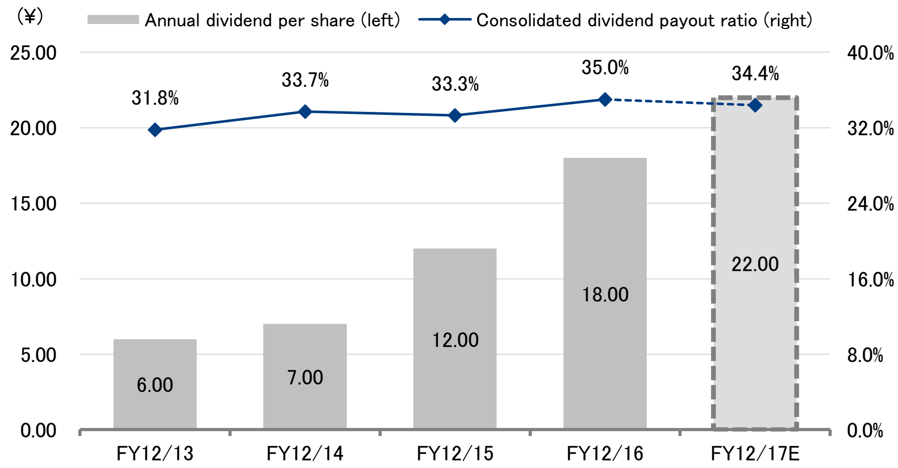
Source: Prepared by FISCO from the Company's materials

Shareholder return policy

¥11 dividend in 1H, planning ¥22 for the full year (34.4% dividend payout ratio)

The Company's policy on dividends is to pay a stable dividend in accordance with its operating results. The Company sharply raised the FY12/16 dividend to ¥18 (up ¥6 YoY) at ¥9 in 1H and ¥9 in 2H. For FY12/17 the Company is projecting another dividend increase to ¥22 per share, comprising a 1H dividend of ¥11 (paid) and a 2H dividend of ¥11 (forecast), due to a target increase in profit for the year. The dividend payout ratio has been maintained at the 30% level over the past four years, and is projected to maintain the same level for FY12/17 at 34.4%. The Company offers shareholder benefits in the form of private brand product gifts for each shareholder holding 100 or more shares for at least 6 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; these are tax-exclusive values).

Dividends and consolidated dividend payout ratio



Source: Prepared by FISCO from the Company's financial results
Note: The Company conducted 2-for-1 stock splits in FY12/13 and FY12/15, which have been reflected retroactively.

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