COMPANY RESEARCH AND ANALYSIS REPORT

MonotaRO Co., Ltd.

3064

Tokyo Stock Exchange First Section

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Index

Summary

Major increases in sales and profits in 2Q FY12/19, as forecast. Investigating methods to utilize data to discover customers with high lifetime value. Announced a concept for the future to expand distribution (until 2022)

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 18 million items for a customer base of 3,735,000 accounts (as of June 30, 2019) and sells about 555,000 items with same-day shipment (including roughly 428,000 items for which the Company has its own inventories).

1. 2Q FY12/19 non-consolidated results

The Company sustained robust growth in non-consolidated sales and earnings through 2Q FY12/19 with ¥60,564mn in sales (up 21.8% YoY), ¥7,911mn in operating income (up 13.7%), ¥7,907mn in ordinary income (up 14.3%), and ¥5,490mn in net income (up 15.2%).

Net sales increased significantly YoY due to the steady implementation of various marketing measures. For new customer acquisition, on the main axes of listing advertisements and working on search engine optimization (SEO), the various measures were successful, including the continuous broadcasting of TV commercials and the broadening of the product scope (to more than 18 million products), and the number of accounts acquired grew. In the 2Q, 372,000 new accounts were acquired (a record high), for a cumulative total of 3,735,000 accounts. For existing customers, the Company actively developed measures, including email, postal direct mail, daily special sales, and the publication and distribution of catalogs. In the purchase management system business (business with large corporations), the number of large corporations it conducted business with was 708 corporations (up 195 corporations YoY). Net sales increased to ¥9.2bn (up 53%), maintaining the high rate of increase for sales. The gross profit margin declined 1.4 percentage points (PP) YoY due to the increase in the delivery cost rate and the effects of changes to the product mix. Conversely, the SG&A expenses ratio fell 0.4 of a PP due to the decline in the ratio of advertising expenses to net sales from the scale effects of the TV commercials and catalog production, etc. As a result, operating income increased 13.7% YoY and the operating income margin declined 0.9 of a PP. Overall, progress was made in line with the initial forecasts.

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 is basically unchanged from the Company's initial forecasts as it expects strong growth in sales and earnings to continue. If it can achieve these targets, the Company will realize 18 consecutive periods of sales growth and 10 of earnings growth.

As its business strategy, the Company continues to work to "expand the customer base," "grow sales to existing customers," and "promote business with large corporations." To "expand the customer base," it is progressing measures including further utilizing marketing data, broadening the product scope, and strengthening listing advertisements and SEO, etc. As a new measure, it is investigating the effective allocation of customer-acquisition costs based on the lifetime value of customers. Specifically, the approach is to derive trends from the past purchasing history data held by the Company and to prioritize the discovery of users with high future potential. To "grow sales to existing customers," it intends to implement promotions tailored to customer attributes and to further reduce lead times by optimizing distribution. To "promote business with large corporations," it is aiming to achieve the forecasts by increasing numbers in the corporate sales group and opening a new sales base in the Chubu region (in Nagoya in the fall of 2019) in addition to the two bases in Tokyo and Hyogo. The progress made up to 2Q for the full fiscal year net sales forecast was 46.2% (47.2% in the same period in the previous fiscal year), while for operating income it was 45.9% (48.7%). Therefore, this progress, while not quite at the level of the previous fiscal year, was at the level of a typical year. In the Company's business model, sales and profits increase more in the 2H than in the 1H. With that in mind, it is considered unlikely that it will not achieve the full fiscal year forecasts, as long as there are no major disturbances in the external environment in the 2H.

3. Announced a concept for the future to expand distribution (until 2022)

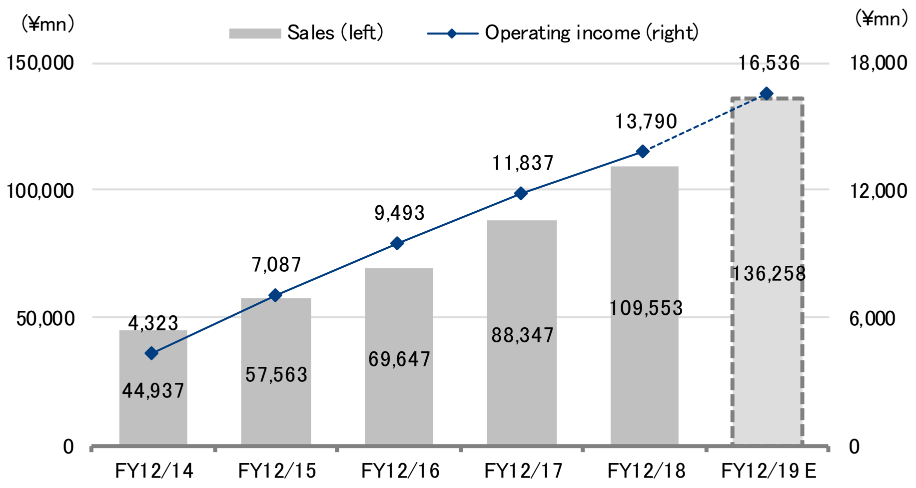
One of the Company's strengths is its quick and timely delivery of low-volume, high-mix, long-tail products*, and the quantity and quality of the distribution function is an important strategic theme. For the Company, which has continued to achieve annual growth in excess of 20%, roughly calculated, sales (distribution volume) double every 4 years, so it must constantly expand its distribution capability. Up until now, it has built a structure with two major centers in the East and West; the Amagasaki Distribution Center (DC), which became operational in 2014, and the Kasama DC, which became operational in 2017. Aiming for further expansion of business scale, it has announced a concept for the future to expand distribution from 2019 to 2022. In FY2019, it completed phase 2 of the construction work to expand the Kasama DC's facilities in April, which doubled the throughput of this DC. In addition to the use of auto-guided vehicle robots, utilizing the application of projection mapping technologies onto the picking station has reduced the burden on operators and improved work accuracy. In FY2020, the operations of the new orders management systems will become fully fledged. Alongside this, the Company is considering expanding its use to the delivery network, such as introducing timely direct deliveries (in the event that efficiency is confirmed). In FY2021, the newly established Ibaraki Chuo Satellite Center (SC) (Ibaraki Town, Higashi Ibaraki District, Ibaraki Prefecture) will become operational. This center is located 10 minutes by car from the Kasama DC, and it will mainly function as the Kasama DC's backyard to store products unloaded from the overseas containers arriving from the Hitachinaka Port. It is scheduled to have a shipping function, centered on high-demand products, such as PB products. The plan for FY2022 is to open the Inagawa DC (Inagawa Town, Kawabe District, Hyogo Prefecture) as a state-of-the-art DC in the Kansai area. The total floor space is expected to be around 130,000m2, which would be approximately triple that of the Amagasaki DC (total floor space: 44,000m2). Once the Ibaraki Chuo SC and Inagawa DC are established, the Company will be able to respond to a sales scale as high as ¥300bn. Currently, distribution-related costs are 6.0% (2Q FY12/19). While controlling the ratio of distribution costs, the Company will take on the challenge of achieving both a reduction in delivery lead time and an increase in distribution capacity.

* 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.

Key Points

- Sales and profits increased significantly in 2Q FY12/19, as forecast. New customer acquisitions were strong, while business with large corporations also grew by more than 50%.
- For FY12/19, the initial forecasts, of high growth for both sales and profits, have been left unchanged. Investigating methods of utilizing data to discover customers with high lifetime value.
- Announced a concept for the future to expand distribution (until 2022)

Trends in net sales and operating income



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

Results trends

Company recorded significant increases in sales and profits for 2Q FY12/19 as it planned
New customers acquisitions were strong, while business with large corporations also grew by more than 50%

● **Review of 2Q FY12/19 results (non-consolidated)**

The Company sustained robust growth in non-consolidated sales and earnings through 2Q FY12/19 with ¥60,564mn in sales (up 21.8% YoY), ¥7,911mn in operating income (up 13.7%), ¥7,907mn in ordinary income (up 14.3%), and ¥5,490mn in net income (up 15.2%). Both sales and profits sustained growth momentum.

Net sales increased significantly YoY due to the steady implementation of various marketing measures. For new customer acquisition, on the main axes of listing advertisements and SEO measures, which enable one's own site to appear at the top of search-engine results, the various measures were successful, including the continuous broadcasting of TV commercials and the broadening of the product scope (to more than 18 million products). Therefore, the number of accounts acquired grew. In the 2Q, 372,000 new accounts were acquired (a record high), for a cumulative total of 3,735,000 accounts. On the back of this increase, traffic via smartphones was outstanding. For existing customers, the Company actively developed measures including email, postal direct mail, daily special sales, and the publication and distribution of catalogs. In the purchase management system business (business with large corporations), the number of large corporations that conducted business with the Company was 708 corporations (up 195 corporations YoY) for net sales of ¥9.2bn (up 53%). The Company maintained a high rate of increase for sales.

Gross margin dropped 1.4 pp YoY. The main reasons of this were a 0.3 pp increase in the delivery cost ratio and a 0.2 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 (NB) 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 0.4 pp YoY. The ratio of advertising expenses to net sales fell 0.4 of a PP YoY, with the main factor being that, due to the higher sales, scale effects were realized for TV commercials and catalog production.

As a result of the above, operating income increased 13.7% YoY and the operating income margin declined 0.9 of a PP. Overall, progress was made in line with the initial forecasts.

Non-consolidated income summary for 2Q FY2/19

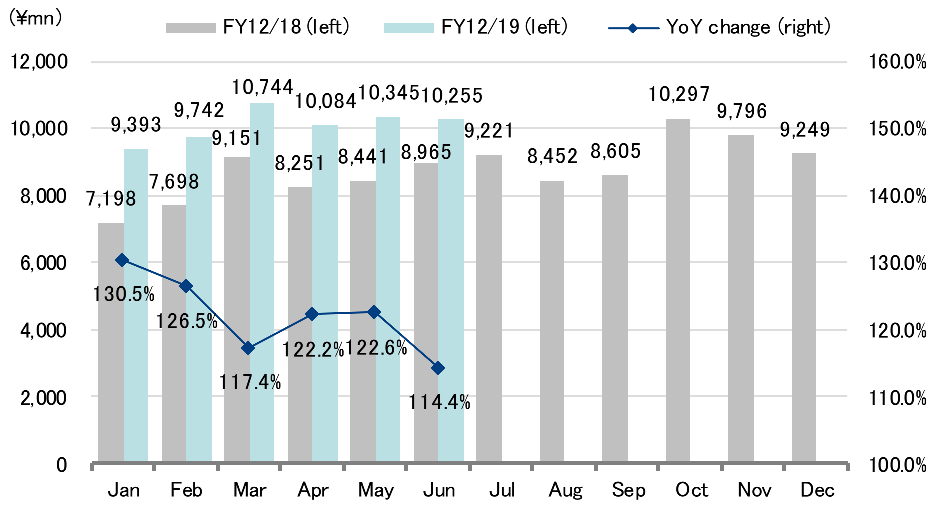
(¥mn)

	2Q FY12/18		2Q FY12/19			Change factors
	Results	vs. sales	Results	vs sales	YoY	
Sales	49,707	100.0%	60,564	100.0%	21.8%	• Increased new accounts (up 372,000 accounts) through various successful measures, including enhancing keyword search and product listing advertisements, strengthening SEO, new TV commercials, and broadening the scope of products handled • In the purchase management system business (business with large corporations), sales rose (up 53% YoY) due to the increases in the numbers of corporations and users
Gross profit	14,964	30.1%	17,391	28.7%	16.2%	• Gross margin dropped 1.4 pp YoY • Delivery cost ratio increased (down 0.3 pp) due to price increase, etc. • Change in product mix (decline in the gross profit margin due to the expansion of products and the increase in the NB products sales ratio) and increase in the number of large corporation (down 0.2pt) • Impact of a decrease in overseas royalties
SG&A expenses	8,007	16.1%	9,480	15.7%	18.4%	• SG&A expense ratio declined 0.4 pp YoY • Decrease in the ratio of advertising expenses to net sales due to the higher sales (down 0.4pt, decline in the TV commercials expenses ratio and improved catalog production efficiency)
Operating income	6,956	14.0%	7,911	13.1%	13.7%	• Net sales ratio dropped 0.9 pp YoY
Ordinary income	6,919	13.9%	7,907	13.1%	14.3%	• Net sales ratio dropped 0.8 pp YoY
Net income	4,765	9.6%	5,490	9.1%	15.2%	• The percentage of sales decreased 0.5pt YoY, the tax rate declined.

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

Looking at the trends in the Company's monthly results, we see that although there were some variations by month from January to June 2019, ranging from 114% to 130% YoY, every month was higher than the same month in the previous fiscal year and stable growth is continuing. Incidentally, the number of business days in 2Q was down by 4 YoY to 117 days (121 business days in the same period in the previous fiscal year). Breaking this down, there was one fewer day in March, two in May, and one in June, and this naturally affected the monthly sales.

Monthly sales



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

Business outlook

For FY12/19, the initial forecasts, of high growth for both sales and profits, have been left unchanged
Investigating methods utilizing data to discover customers with high lifetime value

● 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 is basically unchanged from the Company's initial forecasts as it expects strong growth in sales and earnings to continue. If it can achieve these targets, the Company will realize 18 consecutive periods of sales growth and 10 of earnings growth.

As its business strategy, the Company continues to work to “expand the customer base,” “grow sales to existing customers,” “and promote business with large corporations.” To “expand the customer base,” it is progressing measures including further utilizing marketing data, broadening the scope of products handled, and strengthening listing advertisements and SEO, etc. As a new measure, it is investigating the effective allocation of customer-acquisition costs based on the lifetime value of customers. Specifically, the approach is to derive trends from the past purchasing history data held by the Company and to prioritize the discovery of users with high future potential. To “grow sales to existing customers,” it intends to implement promotions tailored to customer attributes and further reduce lead times by optimizing distribution. To “promote business with large corporations,” it has set the high target of net sales of ¥19.5bn (up 44% YoY) for FY12/19. It is aiming to achieve the target by increasing the numbers of staffs in the corporate sales group and opening a sales base in the Chubu region (in Nagoya in the fall of 2019) in addition to the two bases in Tokyo and Hyogo.

The progress made up to 2Q for the full fiscal year net sales forecast was 46.2% (47.2% in the same period in the previous fiscal year), while for operating income it was 45.9% (48.7%), for ordinary income it was 46.0% (48.5%), and for net income attributable to owners of the parent it was 45.3% (48.4%). Therefore, this progress, while not quite at the level of the previous fiscal year, was at the level of a typical year. The Company’s business model has the advantage that as customer numbers accumulate and their purchase histories grow longer, the purchase amount increases. Therefore, sales and profits increase more in the 2H than in the 1H. With that in mind, it is considered unlikely that it will not achieve the full fiscal year forecasts, as long as there are no major disturbances in the external environment in the 2H. Incidentally, in this July, the monthly sales growth rate was strong at 125.3%.

Consolidated targets

(¥mn)

	FY12/18		FY12/19			
	Results	vs. net sales	Forecast	vs. net sales	YoY	2Q progress rates
Sales	109,553	100.0%	136,258	100.0%	24.4%	46.2%
Gross profit	32,027	29.2%	39,065	28.7%	22.0%	45.7%
SG&A expenses	18,236	16.6%	22,529	16.5%	23.5%	45.6%
Operating income	13,790	12.6%	16,536	12.1%	19.9%	45.9%
Ordinary income	13,788	12.6%	16,530	12.1%	19.9%	46.0%
Net income attributable to owners of the parent	9,515	8.7%	11,715	8.6%	23.1%	45.3%

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

Topics

Announced a plan to expand distribution (until 2022)

● **The Ibaraki Chuo Satellite Center (SC) is scheduled to start operation in 2021 and the Inagawa DC in 2022**

One of the Company's strengths is its quick and timely delivery of low-volume, high-mix, long-tail products, and the quantity and quality of the distribution function is an important strategic theme. For the Company, which has continued to achieve annual growth in excess of 20%, roughly calculated, sales (distribution volume) double every 4 years, so it must constantly expand its distribution capability. Up until now, it has built a structure with two major centers in the East and West; the Amagasaki Distribution Center (DC), which became operational in 2014, and the Kasama DC, which became operational in 2017. Aiming for further expansion of business scale, it has announced a concept for the future to expand distribution from 2019 to 2022.

Plans to implement measures to expand delivery capabilities

Fiscal year	Measures to expand delivery capabilities
2019	■ Completed phase 2 of the construction work to expand the Kasama DC's facilities (operational from April 2019) ■ Closely investigating the shipping capabilities of the Amagasaki DC and Kasama DC • Assessing actual shipping capabilities • Extending operating hours, etc.
2020	■ Expanding the utilization of the distribution network on the fully-fledged operations of the orders management systems • Introducing timely, direct deliveries for cases where efficiency is confirmed, etc. (The orders management system is being installed in 2019 and will start operations in 2020)
2021	■ Start of operations of the Ibaraki Chuo Satellite Center (SC) • Addition of shipping functions for imported products and high-demand products
2022	■ Start of operations at the Inagawa DC
To be determined	■ Establishing the next DC in the Kanto area (currently being investigated)

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

In FY2019, it completed phase 2 of the construction work to expand the Kasama DC's facilities in April, which doubled the throughput of this DC. In addition to the use of auto-guided vehicle robots, utilizing the application of projection mapping technologies onto the picking station has reduced the burden on operators and improved work accuracy. Within the year, it plans to closely examine the shipping capabilities of the Amagasaki DC and the Kasama DC, including to explore the possibility to extend their operating hours. In FY2021, the operations of the new orders management systems will become fully fledged. Alongside this, the Company considers expanding its use of the delivery network, such as introducing timely direct deliveries (in the event that efficiency is confirmed). It has developed the orders management system in-house so far, this new system will be introduced by utilizing it for existing packages (slightly customized), in consideration of factors such as maintainability.

In FY2021, the newly established Ibaraki Chuo Satellite Center (SC, Ibaraki Town, Higashi Ibaraki District, Ibaraki Prefecture) will become operational. This center is located 10 minutes by car from the Kasama DC, and it will mainly function as the Kasama DC's backyard to store products unloaded from the overseas containers arriving from the Hitachinaka Port. It is scheduled to have a shipping function, centered on PB products and high-demand products. The site has already been secured and the Company is currently investigating the investment amount and rental fees for the buildings and equipment. The plan for FY2022 is to open the Inagawa DC (Inagawa Town, Kawabe District, Hyogo Prefecture) as a state-of-the-art DC in the Kansai area. The total floor space is expected to be around 130,000m2, which would be approximately triple that of the Amagasaki DC (total floor space: 44,000m2). The floor space used will be gradually expanded alongside the increase in shipments. Renting is planned. The next DC in the Kanto area is currently being investigated. Currently, distribution-related costs are around 6.0% (FY12/19 2Q, stand-alone basis). While controlling the ratio of distribution costs, the Company will take on the challenge of achieving both a reduction in delivery lead time and an increase in distribution capacity.

The new DC plan

Name (tentative)		Ibaraki Chuo SC	Inagawa DC
Address		Ibaraki-machi, Higashi Ibaraki-gun, Ibaraki Pref.	Inagawa-cho, Kawabe-gun, Hyogo Pref.
Floor size		About 47,000m^2 (Under examining)	About 130,000m^2 (Expand floor size gradually)
Start Operation		Early 2021	Early to mid 2022
Delivery Capacity		About 30,000-50,000 lines / day	About 150,000 lines / day (Start with about 100,000 lines / day)
Inventory Capacity		20,000-30,000 SKU, high demand products (Main function is back yard)	500,000 SKU
Invest・Rental Amount	Land	About 1.3 billion JPY	Rent: About 17.1 billion JPY (Dec. 2021 – Nov. 2031 Total Rent in ten-year-contract term)
	Building	About 6.0 billion JPY (Under examining)	
	Equipment		Under examining
Remark		Main function is back yard for Kasama DC. Having also function of shipping high-demand products. Storing imported products landed at Hitachinaka Port.	Renting 3 floors of 4 in first year. Renting another floor as shipping level goes up.
Picture			

Source: The Company's financial materials

Shareholder return policy

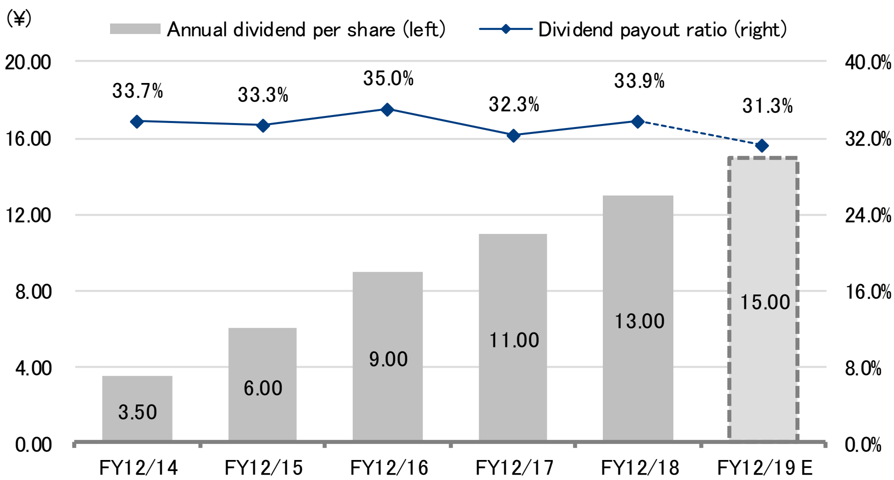
Forecasting a ¥15 dividend in FY12/19 (up ¥2 YoY), 31.8% dividend payout ratio
Expecting a high growth rate for the Company's profits at a fast pace

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 FY12/14 (a dividend of ¥3.5 per share, a ¥0.5 increase) and maintained a dividend payout ratio of 30% or higher.

At the end of 2Q FY12/19, the Company paid a dividend of ¥7.5. Combined with the period-end dividend of ¥7.5, the forecast for the full-fiscal year dividend is ¥15 (up ¥2 YoY). The forecast dividend payout ratio is 31.8%. As the Company's profits growth rate is high, we can expect the dividend to increase at a rapid pace.

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 (excluding tax)).

Dividends and dividend payout ratio



Note: The Company conducted 2-for-1 stock splits in FY12/15. We retroactively adjusted dividend values for the share split.
Source: Prepared by FISCO from the Company's financial results

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